

FCSA Rejects Rabobank and AgStar Offers

By Dr. Neil E. Harl

Late last month the board of directors of Farm Credit Services of America (FCSA), Omaha, NE, turned down the offer made in July by Rabobank to buy FCSA from its 51,000 stockholders. The initial offer of \$600 million had been upped to \$750 million before the rejection.

The FCSA board also rejected the offer by AgStar Financial Services, another member of the Farm Credit System (FCS) with operations in Minnesota and Wisconsin. FCSA directors said that rejecting both offers “was in the best interest of our stockholders.”

FCSA's submission of the buyout details to FCA, the federal regulator of the FCS, was initially set for Sept. 7. The delay was a signal that the deal was in trouble.

Criticisms of the Buyout

Criticism of the buyout commenced almost immediately after announcement of the proposed deal. A group of mostly former FCSA directors was organized by mid-August in opposition to it. Other units of the FCS and the Farm Credit Council were vocal critics of the buyout.

At a hearing in late September by the House Agricultural Committee's subcommittee on Credit and Rural Development, Rep. Tim Holden (D-PA), ranking minority member of the committee, said the sale could cause a chain reaction by other units of the FCS that could lead to the downfall of the entire System.

Arguments in Support of the Buyout

Much of the support for the takeover of FCSA came from the FCSA executives who argued that the deal would free the Omaha-based farm loan cooperative from the FCS's restrictions on lending, including rules preventing FCS units from offering home loans in communities with populations over 2,500.

Rabobank cited its commitments to agricultural lending worldwide as a plus and pointed out that the Rabobank operations would provide additional financial products internationally to farm borrowers in the four-state area — Iowa, Nebraska, South Dakota and Wyoming.

Other Factors

One criticism was that the purchase price was too low. Some had pointed out that, to the extent the purchase price was on the low side, it raised a question of possible breach of fiduciary duty on the part of the FCSA board. Boards of directors are obligated to seek the best deal for their stockholders or run the risk of legal action by stockholders upset with the deal. An independent consultant to one of the groups organized to oppose the sale pegged the value of

FCSA at \$1.775 billion. That put the value well above the revised offer of \$750 million.

The size of the “exit” fee, the levy for leaving the FCS, was initially estimated at “more than \$800 million.” It was revised upward to just under \$900 million shortly before the deal fell through. That fee is based on the amount in excess of 6 percent of FCSA's capital. The amount involved would have been paid by FCSA, not Rabobank, and would have been paid to the FCS's insurance fund which would have reduced the cost of borrowing by FCS borrowers in other states for several years to come.

With more than 70 percent of FCSA's retained earnings coming from the Federal Land Bank (FLB), and with the FLB earnings exempt from income tax since its formation in 1916, our estimate was that income tax liability from payment of the exit fee and tax liability triggered on the takeover of the bank from its stockholders would likely have triggered as much as \$500 million in tax liability.

Others, principally from commercial banks, were concerned about whether the lending offices of FCSA would become full-service banks and would lend on a level playing field with commercial banks. Other commercial banks (and the American Bankers Association) lauded the deal for moving to eliminate the privileged position of FCSA with its access to funds as a government-sponsored entity. That allows borrowing by the FCS at roughly 50 basis points over U.S. Treasury borrowing.

So What Happens Now?

Some are arguing that the deal should have been approved and other potential buyers will be pursuing FCSA or other units of the FCS. Others aren't so sure. Yet others say the deal points out, vividly, why the restrictions on FCS lending should be lifted. Many point out that the deal has focused much unwanted attention on the privileged position of the FCS and don't see Congress moving in the direction of easing the limits on lending.

The ball is now in Congress's court. That's the body in a position to change the rules within which the FCS operates. Thus, one scenario places the issue before Congress next year with a likely focus on (1) whether the FCS should continue (many point out that the System was designed to provide a dependable source of farmer-controlled lending at favorable interest rates); (2) if it continues, whether its privileged position should likewise continue; and (3) what limitations should be imposed to limit the anti-competitive effect of its privileged position.

Some hope the controversy will recede by the time the 109th Congress convenes in January 2005, but few believe that it will. In all likelihood, the scrutiny of the FCS will continue for months to come. ♦

