// Agricultural Law Update

VOLUME 3, NUMBER 7, WHOLE NUMBER 31 — APRIL 1986

Official publication of the American Agricultural Law Association

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The law can never make us as secure as we are when we do not need it.

— *Alexander M. Bickel*

Coleman court issues two new orders

On March 3, 1986, two new orders were issued in *Coleman v. Block*, #A1-83-47 (D.N.D. 1986), the national class action initiated in 1983 against the Farmers Home Administration (FmHA) for failure to implement its deferral authority under 7 U.S.C. § 1981a.

The first of the March orders amends the permanent injunction in *Coleman v. Block*, 580 F.Supp 194 (D.N.D. 1984), by adding a paragraph that enjoins the FmHA from refusing to release its lien on normal income security to provide an allowance for "necessary" and unplanned family living and farm operating expenses.

The injunction is effective unless the FmHA provides borrowers with notice that they have a right to a hearing within 20 days to contest the refusal and to establish eligibility for a loan deferral. The notice must also provide the borrower with a statement giving reasons for the refusal, factors that determine eligibility for a loan deferral, as well as the identity of the official who will be presiding at the hearing.

The permanent injunction mandated procedural due process when the FmHA terminated releases for living and operating expenses set out in the Farm and Home Plan.

Plaintiffs argued that the amendment was necessary to protect borrowers who did not have a current Farm and Home Plan, or who faced unexpected expenses from being forced into voluntary liquidation without due process or substantive consideration for deferral relief.

Judge Van Sickle held that FmHA borrowers have a strong expectation that releases for necessary family living and farm operating expenses will be made, "whether or not a current Farm and Home Plan exists," and that this interest is protected by the due process clause of the 5th Amendment. This interest, said Judge Van Sickle, "arises from the special protections afforded farm income as a form of wages, as well as from FmHA regulations."

The court also held that when actual income falls short of the income figure projected by the plan, the document cannot constitute a borrower's agreement to the FmHA's refusal to release proceeds for necessary living and operating expenses.

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Being "at risk" for purposes of special use valuation

A pair of decisions by the Seventh Circuit Court of Appeals has cast additional light on the "qualified use" test for purposes of special use valuation. That test requires that the decedent or member of the decedent's family (in the pre-death period, for purposes of eligibility) have an equity interest in the farm operation.

In general, it has been believed that cash rent leases to non-family members failed to meet the test, which must be met at the time of death, as well as for three or more of the last five years before death.

The test could be met by a cash rent lease to a member of the decedent's family as tenant, or by a crop share or livestock share lease to a tenant who is not a member of the decedent's family.

A similar test has been imposed on *each qualified heir* in the post-death recapture period, except for a two-year recapture period immediately after death. Because each qualified heir must meet the test, it has been believed that cash rent leases — even to members of the qualified heir's family — would violate the rule and trigger the recapture of special use valuation benefits.

In *Schuneman v. United States*, 783 F.2d 694 (7th Cir. 1986), the court addressed the question whether the decedent was sufficiently "at risk" with an adjustable cash rent lease as a matter of pre-death eligibility.

The lease provided for a set cash rent amount, but if the tenant's gross income (under the lease) were to fall below the amount that could be generated by 70 bushels per acre of corn at $2.25 per bushel, the rental amount would be adjusted downward 20%.

The court held that the decedent's income was "substantially dependent upon production," with the estate qualifying for special use valuation. The qualified use test was met with the adjustable rent provision, giving the decedent an equity interest in the farm operation.

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COLEMAN COURT'S NEW ORDERS

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The court declined to analyze the FmHA's new deferral regulations issued Nov. 1, 1985, 50 Fed. Reg. 45740 (1985), in light of this new extension of the permanent injunction, saying "the instant motion will be decided without regard to those [new] regulations." The order, however, grants important new rights, and should prompt amendments.

The second of the March orders responds to plaintiffs' direct challenge to the November regulations. Judge Van Sickle declined to issue a preliminary injunction to halt their implementation. The renewal of the *Coleman* lawsuit, however, seemed to prompt a substantial administrative response.

Once the supplemental complaint was filed, the FmHA altered its plans to send its "Notice of Intent to Take Adverse Action" (the first step in the foreclosure process) to all borrowers delinquent $100 or more as of Dec. 31, 1985. Instead, the agency will only send these notices to borrowers who have made no payments for three years, or who are in non-monetary default. All other delinquent borrowers will receive a letter — which will not threaten foreclosure — but invite an application for servicing relief.

The FmHA also responded to plaintiffs' challenge to the use of a new FmHA form, 1962-1, "Agreement for the Use of Proceeds/Release of Chattel Security." This form is to be completed annually by the borrower and his county supervisor, and will show the planned use of farm income to be released, as well as how, when and to whom the borrower will sell. The regulations take a dim view of dispositions in violation of the form. For more on the use of this form, see the In Depth article on FmHA conversion actions in this issue.

At the January hearing, plaintiffs presented testimony of farmers and farm management experts, indicating that borrowers would have difficulty complying with such a rigid planning process for the release of income. The FmHA responded on Feb. 7, 1986 by issuing Administrative Notice No. 1336 to all local FmHA offices, which explains the use of Form 1962-1 in much softer terms. It directs county supervisors, for example, to explain to borrowers that Form 1962-1 "is intended to describe the borrower's operation, and not place restrictions on the operation."

The issuance of this administrative notice was a crucial factor in Judge Van Sickle's decision to deny the preliminary injunction. However, the court did hold that borrowers who disputed the amounts allocated to living and operating expenses on Form 1962-1 could not be denied an appeal hearing, as the regulations provided. The FmHA recognized this appeal right in Administrative Notice No. 1355 (March 6, 1986) where it is also provided:

> "While any appeal is pending, FmHA *must* make releases for family living and farm operating expenses which are basic, crucial, or indispensable. In addition, FmHA *may* make releases for other items on which the borrower and the county supervisor agree."

The plaintiff class made other challenges to the new regulations, including the repeal of any priority in the release of income for family living and farm operating expenses, which Judge Van Sickle declined to address with a preliminary injunction.

However, a memo to the *Coleman* class from their attorneys, James Massey and Lynn Hayes, states that "some parts of the order will be appealed, and there will be a full trial on many of the issues."

— *Annette Higby*

SPECIAL USE VALUATION

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The same court, in *Martin v. Commissioner*, 783 F.2d 81 (7th Cir. 1986), heard an appeal from the Tax Court as to whether cash rent leasing of land under a special use valuation election triggered recapture of special use valuation benefits.

A state court had approved the cash rent lease over the objections of two of the heirs, who had feared that recapture would result. The Seventh Circuit held that the cash rent lease transformed the qualified heirs into passive investors, with the result that the qualified use test was not met. Accordingly, special use valuation benefits were properly recaptured.

The court acknowledged that the statute was not abundantly clear on the point, but the committee reports and regulations supported the Internal Revenue Service argument that Congress did not intend to permit special use valuation benefits to be enjoyed by mere passive investors who did not participate in the risks of production.

— *Neil E. Harl*

Suit against PCA survives res judicata claim

In *Johansen v. Production Credit Association*, 378 N.W.2d 59 (Minn. App. 1985), appellant won a procedural reprieve in his litigation against the Production Credit Association (PCA). Johansen had originally proceeded on a pro se basis in federal court.

The action arose from the PCA's refusal to extend further credit to Johansen after having promised him that cooperation with PCA security demands would assure future financing.

Johansen charged the PCA with various violations of the United States Code. The federal court summarily dismissed his pro se complaint.

Subsequently, Johansen brought suit in state court, claiming false and misleading representation, negligence and fraud. The trial court dismissed all of these claims on the grounds of res judicata and because the Farm Credit Act did not create a private cause of action.

However, the Minnesota Court of Appeals reversed the trial court, and held that Johansen's federal statutory causes of action did not render res judicata the common law causes of action that he had asserted in the state court.

The court also ruled that although the Farm Credit Act does not create a private cause of action, that does not preclude a plaintiff from bringing successful common law actions in state court.

— *Gerald Torres*

Agricultural Law Update

VOL. 3, NO. 7, WHOLE NO. 31 APRIL 1986

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Agricultural Law Update is edited for those with a professional interest in agricultural law including attorneys, farm managers, agricultural lenders and agricultural land owners. Subscription: $75.00 in U.S., Canada and Mexico; $100.00 to all other countries. Back copies, when available, are $9.00 each for U.S., Canada and Mexico. All other countries add $6.00. All U.S. funds. Payment must accompany order.

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Installment payment options for public utility right-of-ways

Effective after Aug. 31, 1984, a new payment option became available in Indiana when a public utility makes certain easement acquisition offers in excess of $5,000. Ind. Code Ann. § 32-11-3-4 (Burns 1980 and 1985 Supp.).

The owner of land zoned or used for agriculture may elect to accept either a lump sum payment or annual payments with interest for a period not to exceed 20 years.

A landowner must make the election at the time of: 1) Accepting the public utility's offer to purchase an easement; 2) Accepting the appraiser's award; or 3) Being awarded damages by a judgment. Examples 2 and 3 occur in condemnation suits.

The new law provides that at such time that the servient estate is no longer zoned or used for agricultural purposes, the utility shall pay to the landowner the entire remaining balance.

The right to elect annual installment payments for a right-of-way (easement) might help to reduce the landowner's income tax liability. However, the general rule is that when a condemning authority acquires an easement, it is not considered as a disposition of real property, and the tax basis of the affected property must be reduced by the amount received.

To the extent there is basis to be reduced, no taxable income would result in the year of the payment (in one year or over a series of years when installment payments might be received).

If the payment(s) exceed the available basis, there would be taxable income, and the spreading of payments over several years could then help reduce income tax liability. Typically, these payments would be long-term capital gain subject to the 60% deduction.

If a perpetual easement is acquired, and all the beneficial use of property is released (such as for a railroad, or for plots taken up by power line towers), the condemnation is treated as a disposition of property, and gain or loss (proceeds less basis) must be recognized on that portion of the property.

Usually, there is a very small amount of land taken for power line easements on farmland, and a reduction in value of the remaining land is a major rationale for a payment. Depending on the size of the payment and the basis of the remaining land, there may be little taxable income.

Perhaps this new statute should be amended to give landowners an option for installments where several acres are taken by a public utility or other condemning authority and taxable income is likely to be realized.

When acreages are disposed of under the threat of condemnation, "likekind" property may be acquired in order to avoid recognizing income on the taxable gain. An election to take installment payments would give the property owner another useful option. — *Gerald A. Harrison*

Equity in converted property necessary for finding of non-dischargeability

Where collateral allegedly has been converted, a common response by the secured party in a farm bankruptcy case is to object to the dischargeability of the secured claim under 11 U.S.C. § 523(a)(6), or to the discharge of the debtor under 11 U.S.C. § 727(a)(2)(A). In either case, the creditor must show that the debtor engaged in a willful and malicious act.

In *In Re Ellefson,* 54 B.R. 16 (Bankr. W.D. Wis. 1985), the debtors sold collateralized cattle without obtaining the prior consent of the secured party. According to the court, however, because the debtors had no "equity" in the cattle (they were mortgaged for more than their fair market value), they did not transfer any of "their" property.

In other words, because the cattle were mortgaged in excess of their value, none of the proceeds of the sale would have been available to satisfy the claims of unsecured creditors. Thus, there was no basis for a general denial of discharge under 11 U.S.C. § 727(a)(2)(A).

The court also noted that the evidence did not clearly establish that debtors had disposed of any of the cattle, except pursuant to the culling provision in the security agreement. Therefore, there was insufficient evidence to support a finding of conversion that would justify discharge of the secured party's claim pursuant to 11 U.S.C. § 523(a)(6).

— *Phillip L. Kunkel*

Federal Crop Insurance Corp. issues new appeal procedure

The Federal Crop Insurance Corp. (FCIC) has promulgated a final rule to provide administrative procedures under which any person or organization may request and obtain review and appeal of determinations made by the FCIC. 51 Fed. Reg. 5147 (1986) (to be codified at 7 C.F.R. pt. 400).

The regulations are applicable to any request for review filed after the effective date of Feb. 12, 1986. The new procedures also apply to requests filed prior to the effective date — to the extent that the new procedures do not adversely affect any party in such proceedings.

— *Donald B. Pedersen*

Ag Law Conference Calendar

Agricultural Finance: How Lawyers Can Help Lenders and Borrowers.
May 8-9, 1986, St. Louis.

For registration information, contact the American Bar Association, Division for Professional Education, 750 N. Lake Shore Drive, Chicago, IL 60611; 312/988-6200.

Problems and Opportunities During Hard Times in the Minerals Industry.
May 1-2, 1986, Denver, CO.

For more information, call the Rocky Mountain Mineral Law Foundation, 303/492-6545.

Representing the Agricultural Client.
April 18, 1986, Rochester, NY.
May 2, 1986, Syracuse, NY.

Topics include: Agricultural workouts and bankruptcies; Farm business and estate planning in times of economic uncertainty.

For more information, contact the Continuing Legal Education Department, NYSBA, 1 Elk St., Albany, NY 12207; 518/463-3724 or 518/463-3725.

Agricultural Finance: Representing Borrowers and Lenders in Rural Oklahoma.
May 9, 1986, Muskogee, OK.
May 16, 1986, Enid, OK.

For information, contact Susan G. Naifeh, Oklahoma Bar Association CLE, P.O. Box 53036, Oklahoma City, OK 73152; 405/524-2365.

Pacific Bankruptcy Law Institute.
May 21-23, 1986, San Francisco, CA.

Program covers agricultural bankruptcies and other topics.

For more information, contact the Institutes on Bankruptcy Law, CCR Publishing Co., P.O. Box 1905, Alexandria, VA 22313-1905; 703/684-0510.

Western Mountains Bankruptcy Law Institute.
June 27-30, 1986, Jackson Hole, WY.
Same program and contact as Pacific Bankruptcy Law Institute.

FmHA conversion actions: The Farm and Home Plan defense

by Annette Higby

Three recently decided conversion cases brought by the Farmers Home Administration (FmHA) against FmHA borrowers or their agent sellers, who disposed of farm products under an FmHA lien, raise many issues worthy of discussion. One defense raised by these defendants, however, deserves special scrutiny.

The defense was that the sale of collateral, characterized by the FmHA as a conversion, was contemplated by the Farm and Home Plan and that the proceeds of the sale were properly applied to farm operating and family living expenses, also contemplated by the plan. The sale, therefore, was an authorized disposition of secured property. The judicial responses to this argument were as numerous as the cases.

The Farm and Home Plan (FmHA Form 431-2) is both a loan application document and a management assistance tool. It includes a financial statement, an inventory of planned production and sales of crops and livestock, and identifies key farm, home and financial management practices.

It serves as an annual plan for the distribution of farm income for the payment of annual operating expenses, family living expenses, as well as payment of debt owed to the FmHA and other creditors. If a borrower's Farm and Home Plan does not project enough income to meet all of these expenses, a loan will not be approved.

In the event of an unapproved disposition of security property, the FmHA may decide to bring a civil action in tort against the borrower for acts inconsistent with the FmHA's security interest, or to request prosecution pursuant to the following criminal statute:

> Whoever, with intent to defraud, knowingly conceals, removes, disposes of, or converts to his own use or to that of another, any property mortgaged or pledged to, or held by, the Farm Credit Administration... [or] the Secretary of Agriculture acting through the FmHA.. shall be fined not more than $5,000 or imprisoned not more than five years, or both. 18 U.S.C. § 658.

The Farm and Home Plan defense has been used in both criminal and civil actions.

United States v. Garth, 773 F.2d 1469 (5th Cir. 1985), was an unsuccessful attempt to use the Farm and Home Plan defense to overturn a conviction of criminal conversion. Wayne Garth had received emergency and operating loans totaling $1,650,640 from the FmHA in 1979. Garth granted a security interest in his "crops, then and thereafter planted, and all livestock, owned and thereafter acquired."

Late in 1980, Garth sold his seed milo crop to a company in which he was a partner without reporting the sale, and without accounting for the proceeds. In 1981, Garth's son and partner sold 121 head of cattle without reporting or accounting to the FmHA. Garth's son also sold wheat and deposited the proceeds in his father's account, with none of the proceeds being turned over to the FmHA.

Garth signed a written admission of conversion prior to his indictment. The jury found him guilty, and he appealed to the 5th Circuit. Garth's first point of error, however, was that because he was a member of the plaintiff class in *Coleman v. Block*, 580 F.Supp. 194 (D.N.D 1984), the government was barred from prosecuting him.

. *Coleman*, a national class action brought by FmHA borrowers in 1983, is effective in 44 states. It held that an FmHA borrower is entitled to notice and an informal hearing prior to foreclosure or termination of family living and farm operating expenses set out in the Farm and Home Plan. Borrowers must also be given notice and an opportunity to apply for deferral of loan payments under 7 U.S.C. § 1981a. For details of the latest *Coleman* orders, see the lead article in this issue.

The court in *Garth* conceded that the defendant was a member of the *Coleman* class, but held that his membership failed to provide any protection against criminal prosecution for conversion. The court said that the only restriction the *Coleman* court placed on the government in cases of criminal conversion was the requirement that the borrower be afforded an opportunity to apply for deferral relief.

Garth next argued that the FmHA had consented to his conduct by allowing FmHA borrowers to sell crops and livestock and report it after that fact. The record, said the court, merely supported a finding that the FmHA expected the debtor to report the proceeds of the sale within a few days of the sale Garth never reported any of the sales.

Garth then argued that even though he failed to report the disposition, he used the proceeds for necessary farm operating expenses. Garth, however, failed to establish that the proceeds were used solely for farm operating expenses. Even if he had established that such an application of proceeds had been authorized, the court said, this would not, as a matter of law, relieve Garth of criminal liability.

The court said that "estoppel should be applied against the government with utmost caution and restraint," and further that the facts constituting the basis of an estoppel claim may go to the question of intent to defraud, in which case the question is one for the trier of fact. The court upheld Garth's conviction, finding ample evidence to support it.

The Farm and Home Plan defense has been successful in at least one action for criminal conversion brought by the FmHA. The case is *United States v. Menne*, No. 85-12CR(1) (D. Mo. E.D. 1985).

Bernard Menne had made periodic sales of feeder pigs in which the FmHA held a security interest without first obtaining a release, and without formally reporting the sales to the FmHA. Of the $18,000 in proceeds, $17,000 went for feed and other farm expenses, while the remaining $1,000 was used for family living expenses. None of the proceeds were applied to his FmHA debt.

Menne pointed out that all of the paid expenses, as well as the sales, were contemplated by his Farm and Home Plan. He also argued that even though he never formally reported each sale, the FmHA was aware that he periodically sold feeder pigs as they became ready for market. The FmHA never objected to this practice or these specific sales until several years after the fact.

The jury took two hours to return a verdict of not guilty.

Garth and *Menne* are clearly distinguishable on their facts. Garth was unable to establish that the proceeds were applied to necessary farm operating expenses, while the sales to his own partnership and those made by his son provided evidence of intent to conceal. The limited record available in *Menne*, however, provides slim support for the Farm and Home Plan defense in the face of *Garth*.

The Farm and Home Plan defense has also been utilized in civil actions for conversion. In *United States v. New Holland Sales*, 603 F.Supp 1379 (E.D. Penn. 1985), defendant livestock commission brokers were found liable for the conversion of cattle in which the FmHA held a security interest. The 236 cattle served as collateral for the two FmHA loans received by Mark and Cheryl Noll.

Annette Higby is a third-year student in the University of South Dakota's School of Law, where she serves as a researcg assistant for Professor John H. Davidson. She is a co-author of the original and revised editions of FmHA Farm Loan Handbook (center for Rural Affairs).

The Nolls granted a security in "all livestock, crops, farm and other equipment described, together with all property of a like nature acquired thereafter." The FmHA form security agreement contained a clause requiring the FmHA's written consent prior to the sale of collateral.

The Nolls sold cattle throughout 1981, with defendants acting as commission brokers. Of the $232,922 in proceeds, the Nolls made five payments to the FmHA totaling $155,000. The remaining proceeds were used to pay normal, routine farm expenses.

In August 1981, the Nolls informed their county supervisor that they would not be able to pay off their entire loan. At this meeting, the county supervisor noted on an FmHA form entitled "Record of the Disposition of Security Property" (which listed the debtors' sales) that the sales and the use of the proceeds were not approved. The Nolls filed for bankruptcy and the government instituted a civil conversion action against the livestock brokers.

The brokers argued that the sales had been authorized, and pointed to the Farm and Home Plan, which contemplated periodic sales through these same defendants. The document also called for the application of the estimated proceeds to farm operating expenses, family living expenses and repayment of the debt to the FmHA. The only thing that was not contemplated was that the proceeds would be insufficient to meet all expenses.

Most state uniform commercial codes presumably would support the defendants' argument. U.C.C. § 9-306(2) provides that a security interest continues in collateral notwithstanding sale "unless the disposition was authorized by the secured party in the security agreement or **otherwise**" (emphasis supplied). The court instead applied FmHA regulations governing the release of FmHA liens.

FmHA regulations in place at the time distinguished between basic and normal income security. Basic security includes all equipment, foundation herds, or other livestock which serve as the "basis" for the farming operation The authorized uses for proceeds from the sale of basic security are quite specific, and do not include payment of family living and farm operating expenses.

On the other hand, proceeds from the sale of normal income security, or all other security (including crops and livestock sold in the normal course of operating the farm) can be used to pay necessary farm and home expenses. In fact, under the regulations in place when this case arose, these payments were given priority over FmHA debt repayment. 7 C.F.R. § 1962.17(c)(1) (1985).

The court characterized the Nolls' sale of livestock as a sale of basic security, and held the application of those proceeds to the planned family living and farm operating expenses to be an improper disposition, incapable of authorization under FmHA regulations. The livestock in question, 400- to 500-pound steers, had been purchased by the Nolls and fattened for sale. Characterizing these cattle as basic security rather than normal income security is a mistake of fact and law. The issue is now pending in the 3rd Circuit Court of Appeals.

As these cases illustrate, the Farm and Home Plan defense has yielded mixed results. While FmHA borrowers have won substantial reforms in the area of deferral rights and protection from unwarranted terminations of income stream, the government seems to have come out ahead in conversion cases.

Courts have strained to support the government's characterization of routine and contemplated farm sales (which produce an uncontemplated shortage of proceeds) as acts of conversion. This is best illustrated by the dubious characterization of the sale of fat cattle as the sale of basic security in *United States v. Holland Sales, supra*. Courts have also been too quick to dismiss the relevance of *Coleman v. Block* to these kinds of cases.

Coleman v. Block provided more protection for FmHA borrowers accused of conversion than the *Garth* court suggests. First of all, it must be understood that the *Coleman* court's direct remarks concerning conversion were addressed in the limited context of class definition. The government attempted to limit the plaintiff class by urging exclusion of borrowers found guilty of conversion by admission or judicial determination.

Because conversion was a default which represented an independent basis for foreclosure, the government's argument went, these borrowers were not entitled to deferral relief.

The *Coleman* court noted the "untrammeled discretion" of the FmHA field staff in presenting a claim of conversion for criminal prosecution, and concluded that the fact of criminal prosecution (or even a determination of guilt) should not limit a borrower's opportunity to apply for deferral relief. See also, *United States v. Hamrick*, 731 F.2d 69 (4th Cir. 1983); *Chandler v. Block*, 589 F.Supp. 876 (W.D. Mo. 1983); *United States v. Serveas*, 608 F.Supp. 775 (D.C. Mo. 1985).

The *Coleman* decision is more important for what it said about the distribution of available farm income and the nature of the FmHA's security interest in proceeds from the sale of normal income security.

The *Coleman* court recognized that an FmHA borrower, as the weaker party, had no option but to grant a security interest in all supplies, equipment and produce of the farm, described by Judge Van Sickle as all the fruits of the farmer's labor. And, despite the statutory directive to the Secretary of Agriculture to take such security as is "appropriate" 7 U.S.C. §§ 1925, 1927(c), 1946, 1964(d), the FmHA form security instruments are all-encompassing, assuring a security interest in all after acquired property and a virtual dominion over the farmer's income stream.

The FmHA releases its lien on proceeds from the sale of normal income security to allow a debtor to make payments in accordance with his Farm and Home Plan. Prior to the *Coleman* injunction, when the FmHA unilaterally decided to liquidate, this release for farm and household expenses was terminated, and, in effect, cut off the farmer's income stream. Borrowers in this position frequently resorted to "voluntary" liquidation, unaware of the availability of deferral relief or their appeal rights.

The *Coleman* court likened the farmer's interest in the proceeds from the sale of normal income security to that of a worker's interest in his wages (citing *Sniadach v. Family Finance Corp.*, 395 U.S. 337 (1969)), and held that this interest in the amounts set aside in the Farm and Home Plan for family living and farm operating expenses were important enough to warrant an informal hearing prior to termination.

The *Coleman* court has since mandated similar due process protections when the FmHA refuses to release proceeds for "necessary" living and operating expenses, even if there is no current Farm and Home Plan, or the expense is unexpected and unplanned. See a report on this latest order on page 1 of this issue.

The *Coleman* court also held that, despite the agency's position as a secured creditor, the FmHA had a two-fold duty — to assist farmers in need and to protect the agency's investment. In some circumstances, resorting to commercial law and procedure were not quite appropriate to meet the agency's "charitable obligation."

Coleman established the importance of

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FmHA CONVERSION ACTIONS

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the Farm and Home Plan as documentation of both parties' expectations as to the distribution of available farm income. More recently, it has been established that borrowers have a strong expectation, protected by the due process clause, that releases for necessary living and operating expenses will be made, even if the expense is unplanned.

Coleman has also established that the FmHA's rights as a secured creditor should be exercised in a manner not incompatible with its social welfare goals. When a borrower applies proceeds from planned sales of normal income security to planned or necessary expenses, but is unable to meet his FmHA repayment schedule, the appropriate response of a social welfare agency is to consider deferral relief or other servicing options, rather than institute a conversion action. In fact, *Coleman* suggests that a refusal to subsequently approve such an application would trigger procedural due process, and substantive consideration for deferral relief.

While space does not permit a detailed discussion of the position of the broker in these cases, a few general remarks are in order. Where the sale involves post-approval, simple notice of a security interest is of little value. The existence of an FmHA security interest in "all the fruits of a farmer's labor" is more than likely. The question is whether the sale will be authorized after the fact.

Where approval or disapproval rest upon subjective criteria — and in the Nolls' case, disapproval appeared to rest on the simple fact of a delinquency — the broker is no longer a mere agent of the farmer. He becomes a guarantor of his indebtedness.

Surely Congress never intended that when a borrower was unable to meet his repayment schedule, the FmHA could force the farmer into bankruptcy, leaving the broker holding the bag. Congress expected the FmHA to defer payments of principal and interest when a borrower was temporarily unable to continue making payments due to circumstances beyond his control. 7 U.S.C. § 1981a.

The "untrammeled discretion" of the FmHA field staff, the certainty of a lien on "all the fruits of a farmer's labor," as well as the inconsistent policing of the security agreement and other loan documents make it much too easy for the FmHA to convert a simple delinquency into a case for conversion.

While *Coleman* mandates that borrowers accused of conversion be afforded an opportunity to apply for deferral relief, the FmHA's regulations still treat conversion as a separate and distinct basis for foreclosure. See 50 Fed. Reg. 45740 (1985) (to be codified at 7 C.F.R. § 1962.4(g)(3)).

Conversion cases and deferral cases run on two very different procedural tracks. Compare *id.* at §§ 1962.18, 1962.49 with §§ 1924.72, 1951.44. In addition, in order to grant a deferral, the FmHA field staff must determine that a borrower has "properly maintained and accounted for security." *Id.* at § 1951.44(c)(6). These provisions could operate as a Catch-22, denying borrowers the substantive consideration for deferral relief to which they are entitled.

The FmHA has taken several other steps that purportedly respond to the dictates of *Coleman*. The agency's new regulations eliminate any priority in the application of proceeds to family living and farm operating expenses. Congress responded with § 1315 of the Food Security Act of 1985, directing the FmHA to release enough income to meet "essential" family living and farm operating expenses until a loan was actually accelerated.

The new regulations also dispense with any formal distinction between normal income security and basic security, and introduce a new form — FmHA Form 1962-1, "Agreement for the Use of Proceeds/Release of Chattel Security."

Form 1962-1 is to be completed annually, and must show the planned use of income to be received from livestock and crops held for sale, as well as how, when and to whom the borrower will sell. *Id.* at §§ 1924.57(b)(2), 1962.17(b).

County supervisors are authorized to approve dispositions when proceeds are used for the purposes and amounts set forth in the form. Dispositions not in accordance with the form must be approved in advance. *Id.* at § 1962.17(b)(5). Dispositions in violation of the form will be handled as a conversion. *Id.* at § 1962.18. The use of this form was recently challenged by the *Coleman* class. For the outcome, see the article on page 1 of this issue.

Completion of Form 1962-1 can be a unilateral process. If the borrower and county supervisor cannot reach an agreement on the planned uses of proceeds, the district director will make the final decision. The district director's decision is not appealable. *Id.* at § 1924.57(b)(3).

In these cases, Form 1962-1 can hardly be called an "agreement," and if the farmer's interest in these proceeds are analogous to a worker's interest in his wages, catagorizing the district director's decision as unappealable is indefensible.

From a public policy standpoint, the FmHA has yet to achieve a fair balance between its position as a secured creditor and its responsibilities as a social welfare agency. The new regulations maintain the virtual dominion over a farmer's income stream, remove any priority for family living and farm operating expenses, and attempt to disguise the very real distinction between normal income security and basic security.

The boundaries of an FmHA borrower's legal rights are found in a quickly changing and, at times, ambiguous body of law.

If you have handled FmHA conversion cases, please share your experiences with the readers of *Agricultural Law Update.*

Involuntary liquidation of farmer upheld in Chapter 11

In an unpublished decision, the Fourth Circuit Court of Appeals ruled that: "The Code protects farmers against involuntary bankruptcy proceedings, but the farmer who enters Chapter 11 voluntarily is subject to the same substantive law as other debtors.

Once the farmer has entered Chapter 11 voluntarily, there should be no complaint that the provisions protecting creditors' rights are applied on equal footing with those provisions that provide relief to debtors. Thus, creditors should be allowed to submit their own reorganization plans once the farmer has exhausted 11 U.S.C. Sec. 1121's exclusive filing period.

If a creditor's plan satisfies the requirements set forth in 11 U.S.C. Sec. 1129, it should be confirmed over the farmer's objections, notwithstanding the fact that it may propose the liquidation of the farmer's assets. The Code recognizes that liquidation is an appropriate form of reorganization. See 11 U.S.C. §§ 1123(a)(5)(d)(b)(4), 1129(a)(11), and, absent an indication of congressional intent to the contrary," the Court declined to imply a farmer's exemption from Chapter 11 liquidation plans.

In re J.F. Toner & Son Inc., No. 34-2389 (4th Cir. June 4, 1985). Accord *In re Button Hook Cattle Co.*, 747 F.2d 483 (8th Cir. 1984); *In re Jasik*, 727 F.2d 1379, *reh'g. denied*, 731 F.2d 888 (5th Cir. 1984); and *In re Tinsley*, 36 Bankr. 807 (Bankr. W.D. Ky. 1984). *Toner* criticized the ruling in *In re Lang*, 39 Bankr. 483 (Bankr. D. Kan. 1984) (agreeing with argument identical to that made by farmer bankrupt in *Toner*). *Cf. In re Blanton Smith Corp.*, 7 Bankr. 410, 414 (Bankr. M.D. Tenn. 1980) (noting in dicta that farmer may not be forced to liquidate under either Chapter 7 or 11).

— *L. Leon Geyer*

STATE ROUNDUP

COLORADO. *A Choice of Water or Land.* Ide sued Miller, seeking to reform a contract for purchase of a farm. The contract for sale specified that there was a well on the property with a 350-gallon permanent capacity. It turned out that the well would only produce 115 gallons per minute.

The Colorado Court of Appeals held that the provision (with respect to the well capacity) was a condition, and thus, upon its breach, the buyers had only the options of either rescinding the contract and getting their money back, or waiving the defect and accepting the farm at the contract price.

The Court's rationale for the holding was that the capacity of the well was a condition to be met before the buyers became obligated to perform. Since well capacity was a matter of great concern to the buyers, the provision went "to the root of the contract" as a condition.

The Court noted that if the provision was one that merely affected the contract rather than going to the root, it would have been a covenant, the violation of which could be compensated for in money damages. *Ide v. Joe Miller & Co.*, 703 P.2d 590 (Colo. App. 1984).

— *Bruce McMillen*

MONTANA. *Adjudication of Federal Reserved Water Rights in State Court.* Responding to the state law questions left open by the U.S. Supreme Court in *Arizona v. San Carlos Apache Tribe of Arizona*, 463 U.S. 545 (1983), the Montana Supreme Court held that the state adjudication process, on its face, is adequate to adjudicate federal and Indian reserved water rights.

The Court also ruled that Montana's constitutional disclaimer of all lands owned or held by any Indian tribe in Montana does not constitute a bar to state court jurisdiction in a general adjudication of water rights.

The result of the decision is that along with federal reserved water rights, farmers and ranchers with state created water rights will have their rights adjudicated in a single, comprehensive adjudication in state court. *State ex rel. Greely v. Confederated Salish and Kootenai Tribes*, 712 P.2d 754 (Mont. 1985).

— *Donald B. MacIntyre*

SOUTH DAKOTA. *Contract for Deed Forfeiture Tempered.* The South Dakota Supreme Court has considered the validity of yet another forfeiture provision in a contract for deed, adding gloss to the rule of *Prentice v. Classen*, 355 N.W.2d 352 (S.D. 1984) (determining the validity of a liquidated damage clause in a foreclosure action requires balancing the buyer's equity against the seller's detriment).

In reviewing the trial court's approach, the court said it was proper to include costs and attorney's fees expended by the sellers to recover the property. It was, however, improper to exclude interest payments made by the buyers.

After balancing the seller's detriment of $148,300 (rent equivalent less taxes, costs and fees, and a 12.5% loss in land values) against buyer's $135,000 in principal payments, $25,935 in interest payments, and his $23,900 in improvements, including seeding some of the land to winter wheat, the buyers emerged with a $36,535 equity in the property.

The buyers could either pay the balance due on the contract, or receive their $36,535 equity in the property and lose all other rights to it. *Dow v. Noble*, 380 N.W.2d 359 (S.D. 1986).

— *Annette Higby*

CFTC approves improved trade timing rules

In perhaps the most controversial action of its 11-year existence, the Commodity Futures Trading Commission (CFTC) recently amended its regulations to require a one-minute timing standard for the recording of trade execution times on the floors of the nation's commodity exchanges. See 51 Fed. Reg. 2684 (Jan. 21, 1986).

The purpose of these new regulations is to provide substantial improvement in the ability of the exchanges and the CFTC to deter, detect and prosecute trading abuses.

As reported in the February 1985 issue of *Agricultural Law Update*, current regulations require only that brokers and traders record the 30-minute time period, or "bracket," in which trades occur. In many instances, the imprecision of this 30-minute standard leaves both the exchanges (which have self-regulatory responsibilities under the Commodity Exchange Act) as well as the CFTC unable to either prove or disprove whether trading abuses occurred.

The amended regulations require the exchanges to move from the current 30-minute requirement to a one-minute standard by Oct. 1, 1986. In addition, the amended regulations require the exchanges to integrate and use this improved timing data into their affirmative trading surveillance programs by Jan. 1, 1987.

Although it originally proposed that the time of trade execution be recorded mechanically or electronically, following an extensive review of the comments received on the proposed rules and the various trading systems on each exchange, the CFTC determined to leave as open as possible the methods by which this improved time is captured.

Thus, the amended regulations do not specify any methods for capturing the time, but permit the time simply to be written down, to be recorded by the exchange, to be recorded using a technological device, to be captured by using times on customer order tickets (which are currently required to have the minute time-stamped prior to and after a trade is executed), or by any other method, as long as the one-minute standard is met.

Five commodity exchanges currently have systems which either meet the standard or easily could be adapted. Other exchanges are expected to adopt a variety of systems.

— *Thomas M. McGivern*

Violence in the countryside

The South Dakota Supreme Court has affirmed the jury conviction of Byron Dale for obstructing law enforcement officers and resisting legal process.

The Timber Lake Production Credit Association had obtained an order compelling the receiver of Dale's ranch to take immediate possession of property and livestock. Dale made repeated threats of violence, bloodshed and death in the several days prior to seizure and his arrest.

The high court held that the offense of obstruction under S.D.C.L. 22-11-6, did not require a technical or physical assault upon the officer or that violent or physical resistance be exerted.

However, Judge Henderson noted that the state trooper, specially trained in defensive tactics, should not have used a ketchup bottle to subdue Dale, striking him on the forehead and inflicting gashes on his face. *State of South Dakota v. Byron Dale*, # 14804-a-GWW (Dec. 12, 1985, Supreme Court of South Dakota).

— *Annette Higby*

Address Correction Requested

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AMERICAN AGRICULTURAL LAW ASSOCIATION NEWS

STATE ROUNDUP. *Agricultural Law Update* welcomes Gregory Romano as state reporter for New Jersey. All members of the American Agricultural Law Association (AALA) are invited to submit news items for inclusion in the State Roundup. Contact your state reporter, or any other member of the staff of *Agricultural Law Update*.

AALA DISTINGUISHED SERVICE AWARD. The AALA invites nominations for the Distinguished Service Award. The award is designed to recognize distinguished contributions to agricultural law in practice, research, teaching, extension, administration or business.

Any AALA member may nominate another member for selection by submitting the name to the chair of the Awards Committee. Any member making a nomination should submit biographical information of no more than four pages (in quintuplicate) in support of the nominee. The nominee must be a current member of the AALA, and must have been a member thereof for at least the preceding three years. Nominations for this year must be made by May 1, and communicated to: Patrick K. Costello, chair, AALA Awards Committee, P.O. Box 1, Lakefield, MN 56150; 507/662-6621.

THIRD ANNUAL STUDENT WRITING COMPETITION. The AALA is also sponsoring its third annual Student Writing Competition. This year, the AALA will award two cash prizes in the amounts of $500 and $250.

The competition is open to all undergraduate, graduate or law students currently enrolled at any of the nation's colleges or law schools. The winning paper must demonstrate original thought on a question of current interest in agricultural law. Articles will be judged for perceptive analysis of the issues, thorough research, originality, timeliness, and writing clarity and style. Papers must be submitted by May 1, 1986. For complete competition rules, contact: Patrick K. Costello, chair, AALA Awards Committee, P.O. Box 1, Lakefield, MN 56150; 507/662-6621.