Agricultural Law Update

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INSIDE

IN FUTURE ISSUES

- Class action not available to prior foreclosures
- State laws on ownership of U.S. land by aliens and corporations
- FmHA misrepresentation
- Barn outside curtilage of farmhouse

No laws, however stringent, can make the idle industrious, the thriftless provident, or the drunken sober.

-- Samuel Smiles

Recoupment in FmHA foreclosure actions

Defendants in Farmers Home Administration (FmHA) foreclosure actions should investigate the availability of equitable recoupment as a waiver of sovereign immunity allowing counterclaims that offset the FmHA's claims.

Recoupment does not rely on a specific statutory waiver, but is found in equitable concepts and the government's entering the court to bring its suit. *United States v. Shaw*, 390 U.S. 495, 60 S.Ct. 659, 84 L.Ed. 888 (1940); *United States v. United States Fidelity and Guaranty Co.*, 390 U.S. 506, 60 S.Ct. 653, 84 L.Ed. 894 (1940).

It is not a *carte blanche* (in which any possible counterclaim can be pled, allowing an offset up to the government's claim), but is restricted to claims arising from the same transaction or occurrence sued on. *See, United States v. Taylor*, 342 F. Supp. 715, 716-17 (D. Kan. 1972).

This restriction has been implemented through the use of a two-prong test. Not only must a defendant allege a claim which is founded in the same transaction or occurrence as the government's action, but it cannot seek relief of a kind or quantity different from (or greater to) that pled in the complaint. *Frederick v. United States*, 386 F.2d 481, 488 (5th Cir. 1967).

The "same transaction or occurrence" prong of the test is basically the same as that for compulsory counterclaims, and courts often cite the following from a Wright and Miller test as their guideline:

1) Are the issues of fact and law raised by the claim and counterclaim largely the same?

2) Would res judicata bar a subsequent suit on defendant's claim absent the compulsory counterclaim rule?

3) Will substantially the same evidence support or refute plaintiff's claim as well as defendant's counterclaim?

4) Is there any logical relation between the claim and the counterclaim?

6 C. Wright and A. Miller, *Federal Practice and Procedure*, Section 1410 (1971). *See also* Wright and Miller, Section 1427 (counterclaims against United States) and Section 3654 (sovereign immunity).

(continued on next page)

Federal court holds NEPA does not apply to pesticide registrations

The United States Court of Appeals for the Ninth Circuit has concluded that Congress did not intend for the Environmental Protection Agency (EPA) to comply with the National Environmental Policy Act of 1969 (NEPA) when it registers pesticides under the Federal Insecticide, Fungicide and Rodenticide Act (FIFRA). *Merrell v. Thomas*, 807 F.2d 776 (9th Cir. 1986).

The plaintiff Merrell sought injunctive relief to set aside the registration of seven herbicides issued by the EPA. Merrell was upset when county workers sprayed the herbicides along the road leading to his wife's farm. He telephoned the EPA to demand that it immediately suspend the pesticide registrations. Two weeks later, he filed this lawsuit.

The plaintiff alleged that the EPA was required to comply with the NEPA before it could register the pesticides, and that their registrations should be held invalid because the EPA failed to either prepare an environmental impact statement or to explain why an environmental impact statement was not necessary under 42 U.S.C. Section 4332(2)(c).

The federal court responded that applying the NEPA to the FIFRA's registration process would "sabotage the delicate machinery that Congress designed to register new pesticides." *Id.* at 779.

Specifically, the court concluded that recent amendments to the FIFRA were designed to increase agriculture's influence on registration decisions. Under 7 U.S.C. Section 136d(b), the Administrator must prepare an "agricultural impact statement" before issuing notice of intent to cancel or limit the registration of a pesticide.

(continued on next page)

RECOUPMENT IN FmHA FORECLOSURE ACTIONS/CONTINUED FROM PAGE 1

While the entire Wright and Miller test is often recited, courts seem to rely on the "logical relation" test to reach an actual decision. *Columbia Plaza Corp. v. Security National Bank*, 525 F.2d 620, 625 (D.C. Cir. 1975); *Great Lakes Rubber Corp. v. Herbert Cooper Co.*, 286 F.2d 631, 634 (3rd Cir. 1961); *Diamond v. Terminal Ry. Ala. State Docks*, 421 F.2d 228, 236 (5th Cir. 1970); *Kissell Co. v. Farley*, 417 F.2d 1180, 1183 (7th Cir. 1969).

This requirement has been used to narrow applicable claims, disallowing recoupment claims based on breach of contract and unjust enrichment, when the government sued to recover fraudulent payments. *United States v. Isenberg*, 110 F.R.D. 387, 393-95 (D. Conn. 1986).

Recoupment, however, has been allowed in a suit against a Small Business Administration loan guarantor when the counterclaim was based on conversion. *United States v. Irby*, 618 F.2d 352, 356-57 (5th Cir. 1980).

The "same relief" requirement has been used not only to preclude affirmative judgments arising from the acts asserted for recoupment (*see, Federal Deposit Insurance Corp. v. Lattimore Land Corp.*, 656 F.2d 139, 143 (5th Cir. 1981)), but has also been used to preclude recoupment on theories other than that sued upon by the government.

This is predictable when the FmHA has brought a replevin action, and has not sought monetary damages. *United States v. Ameco Electronic Corp.*, 224 F. Supp. 783, 786 (E.D. N.Y. 1963)), but it has been used to exclude a tort claim in an action to collect notes in default even though the court appears to have treated the claims as part of the "same transaction." *Federal Deposit Insurance Corp. v. Shinnick*, 635 F. Supp. 983, 985 (D. Minn. 1986).

Where a recoupment claim based on breach of contract has been proper, courts have allowed lost profits as an element of the claim. *United States v. Gregory Park, Section II, Inc.*, 373 F. Supp. 317, 350-51 (D. N.J. 1974); *United States v. Thompson*, 150 F. Supp. 674, 678 (N.D.W.V. 1957).

Since breach of contract claims are allowed by the Tucker Act, and from the facts this Act grants jurisdiction to District Courts for claims up to $10,000, some courts have allowed counterclaims under the Tucker Act to be pled in conjunction with the recoupment claim, thus allowing affirmative judgments in the District Court up to $10,000. *United States v. Timber Access Ind.*, 54 F.R.D. 36, 38 (D. Ore. 1971).

A defendant has even been allowed to "split" a Tucker Act claim and litigate the first $10,000 in the foreclosure/recoupment action, and pursue the remainder in the Court of Claims. 54 F.R.D. at 38-39.

One of the great values of recoupment is its avoidance of exhaustion requirements, mandating demand to, and denial from, the appropriate agency before a claim can be litigated. *Northridge Bank v. Community Eye Care Center*, 655 F.2d 832, 835-36 (7th Cir. 1981) (28 U.S.C. Section 2675(a) exempts compulsory counterclaims); *United States v. Frank*, 207 F. Supp. 216, 221 (S.D. N.Y. 1962) (28 U.S.C. Section 2406 prior disallowance requirement does not apply to recoupment claims).

Some authority exists for the avoidance of statutes of limitation as well. *Bull v. United States*, 295 U.S. 247, 262 (1935); *See also United States v. Waterman S.S. Corp.*, 471 F. Supp. 87 (D.D.C. 1979); *United States v. Southern Pacific Co.*, 210 F. Supp. 760 (N.D. Cal. 1962); 3 J. Moore, *Federal Practice*, para. 13.11 (1985).

Defendants should use recoupment in conjunction with Federal Tort Claim Act and Tucker Act claims when appropriate. The surest recoupment claims in a foreclosure action would sound in breach of contract, but quasi-contract and tort claims might be possible as well. The application between (and even within the same) circuit(s) is not consistent. Given this inconsistency, a good faith argument for a tort-based recoupment claim may be possible in a foreclosure action.

If the FmHA loan documents incorporate regulations, many of the duties to supervise ongoing operations, to notify loan recipients of changes in regulations and program features, or to advise farm clients in their management decisions arguably become contractual. The failure to perform these duties adequately could form a breach of contract claim.

A District Court's Tucker Act jurisdiction covers claims of $10,000 or less, but a favorable judgment on the foreclosure/recoupment/counterclaim action might allow a settlement that avoids Court of Claims litigation. But most importantly, recoupment may "write down" the amount of a loan, allowing some farm debtors to keep their farms.

— Gene Olson

NEPA FAILS TO APPLY TO PESTICIDE REGISTRATIONS/CONTINUED FROM PAGE 1

The court concluded that this explicit balancing of environmental and agricultural impacts is a compromise adopted by Congress which should not be judicially overturned by requiring the EPA to comply with the NEPA before registering pesticides.

The court also noted that the FIFRA registration procedures provide for public notice and participation in ways that differ materially from those under the NEPA. For example, the court stated that the FIFRA's registration procedures do provide for public comment on registration standards.

Although this input is more limited than that which would be provided in preparing a site-specific environmental impact statement, the court held that public participation at this level is nevertheless meaningful.

The plaintiff complained that these FIFRA procedures do not enable him to participate in a registration decision *before* it is made. The court responded by saying that the plaintiff could still petition for cancellation or suspension of a pesticide under existing FIFRA provisions.

The court conceded that the FIFRA vests considerable discretion in the Administrator concerning any decision to deny, cancel or suspend a pesticide registration, but it concluded that interested parties can still influence the Administrator's decisions through petitions.

— David A. Myers

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Federal Register in brief

The following is a selection of proposed rules, interim rules, and notices that have been published in the *Federal Register* in the last few weeks:

1. U.S. Department of Agriculture (USDA); Privacy Act; System of Records; Notice of Revision of Privacy Act System of Records. 52 Fed. Reg. 6,030. Relates to information maintained by the Federal Crop Insurance Corp. Effective date: March 30, 1987.

2. USDA; Office of International Cooperation and Development; Indirect Costs Rates for Cooperative International Agricultural Development Programs; Proposed Rule. 52 Fed. Reg. 6,803. Comments due by May 1, 1987.

3. Amendment to Certification of Central Filing System; Arkansas. 52 Fed. Reg. 6,040. Dated Feb. 23, 1987.

4. Amendment to Certification of Central Filing System; Utah. 52 Fed. Reg. 8,491. March 13, 1987.

5. Immigration and Naturalization Service (INS); Cooperative Agreement; Designated Entities Authorized to Receive Legalization and Special Agricultural Worker Applications for Temporary Residence on Behalf of the Attorney General; Availability of Funds for Fiscal Year 1987, 1988 and 1989. 52 Fed. Reg. 6,230. Dated Feb. 26, 1987.

6. Farmers Home Administration (FmHA); Implementation of Internal Revenue Service (IRS) Offset; Interim Rule; 52 Fed. Reg. 6,319. Effective date: March 3, 1987.

7. Commodity Futures Trading Commission (CFTC); Conduct of Members and Employees of the CFTC; Conflict of Interest; Proposed Rule. 52 Fed. Reg. 6,588. Comments due by April 20, 1987.

8. CFTC; Revision of Federal Speculative Limits; Proposed Rule. 52 Fed. Reg. 6,812. Comments due by June 3, 1987.

9. IRS; Tax Treatment of Partnership Items; Temporary Regulations. 52 Fed. Reg. 6,779. The regulations apply to partnership taxable years beginning after Sept. 3, 1982.

10. IRS; Income Tax; Certain Elections Under the Tax Reform Act of 1986; Corrections. 52 Fed. Reg. 8,405. March 17, 1987.

11. Federal Grain Inspection Service (FGIS); Grain Handling Practices; Proposed Rule. 52 Fed. Reg. 7,880. Reopens for additional comment the proposed rule entitled Official U.S. Standards for Grain found at 51 Fed. Reg. 35,224 and 51 Fed. Reg. 41,971. Comments due by April 13, 1987.

12. FGIS; Insect Infestation in Grain; Proposed Rule. 52 Fed. Reg. 8,455. Comments due by April 17, 1987.

13. Agricultural Stabilization and Conservation Service (ASCS); Grain Warehouses; Transfer of Stored Grain; Final Rule. 52 Fed. Reg. 8,056. Effective date: March 16, 1987.

— Linda Grim McCormick

Conversion to Chapter 12

The conflict between the Conference Report and Section 302(c)(1) of the Bankruptcy Judges, United States Trustees and Family Farmer Bankruptcy Act of 1986 on the question of conversion to Chapter 12 of pending cases is still being litigated, but at a less furious pace.

Several Westlaw searches over the past two months have revealed a number of cases. The following cases are among those that have followed the statutory language denying conversion. *In re Rossman*, No. NK86-00385 (Bankr. W.D. Mich., March 17, 1987) (available March 30, 1987 on WESTLAW); *In re Hughes*, 70 Bankr. 66 (Bankr. W.D. Va. 1987); *In re Glazier*, 69 Bankr. 666 (Bankr. W.D. Okla. 1987); *In re Barkley*, 69 Bankr. 552 (Bankr. C.D. Ill. 1987); *In re Spears*, 69 Bankr. 511 (Bankr. S.D. Iowa 1987); *In re Petty*, 69 Bankr. 412 (Bankr. N.D. Ala. 1987); *In re Albertson*, 68 Bankr. 1017 (Bankr. W.D. Mo. 1987); *In re Groth*, 69 Bankr. 90 (Bankr. D. Minn. 1987); *In re Council*, 70 Bankr. 20 (Bankr. W.D. Tenn. 1987); *In re B.A.V.*, 69 Bankr. 411 (Bankr. D. Colo. 1986); *In re Tomlin Farms*, 68 Bankr. 41 (Bankr. D. N.D. 1986).

Three cases based on the Conference Report have allowed pending cases to convert to Chapter 12. *In re Mason*, No. 86-21110 (Bankr. W.D. N.Y. Feb. 17, 1987) (available March 9, 1987 on WESTLAW); *In re Big Dry Angus Ranch Inc.*, 68 Bankr. 695 (Bankr. D. Mont. 1987); *In re Erickson Partnership*, 68 Bankr. 819 (Bankr. D. S.D. 1987).

As can be seen, the courts are tending to follow the statutory language.

Of interest is an Ohio case, *In re Woloschak Farms*, No. B87-00079-Y (Bankr. N.D. Ohio, Feb. 26, 1987) (available March 15, 1987 on WESTLAW). This case involved a confirmed farmer plan in which the farmer was delinquent on plan payments.

When the creditors sought to enforce an earlier order allowing the creditors to repossess the collateral when the farmer defaulted a second time, the farmer filed a motion to convert to Chapter 12.

In the alternative, the farmer asked the court to dismiss his Chapter 11 case. Meanwhile, the farmer filed a Chapter 12 petition. The court allowed dismissal and then ruled that with the Chapter 11 case dismissed, the farmer was free to file a Chapter 12 petition even though the statute did not allow conversion. The court does not discuss why it allowed dismissal.

This issue is bound to be litigated in most states, so more cases are yet to come.

— Janet A. Flaccus

AG LAW CONFERENCE CALENDAR

Forest Taxation.
May 20-22, 1987, Westin Peachtree Plaza, Atlanta, GA.

Topics include: property and related taxes, federal and state death taxes, and the new income tax law.

Sponsored by the Society of American Foresters and the Forest Products Research Group. For more information, call: 608/231-1361.

Agricultural Finance: How Lawyers Can Help Lenders and Borrowers.
April 30-May 1, 1987, The Westin, Chicago, IL.
May 28-29, 1987, The Westin, Denver, CO.

Topics include: shared appreciation mortgages, law practice involving government programs, commodity supply and demand, and Chapter 12.

Sponsored by the American Bar Association Sections on Corporation, Banking and Business Law, General Practice, Real Property, Probate and Trust Law, and the Illinois Farm Legal Assistance Foundation.

For more information, call: 312/988-6200.

New Horse Syndication Strategies Under the Tax Reform Act of 1986.
May 18-19, 1987, the University of Tulsa Business Administration Hall, Room 213, Tulsa, OK.

Topics include: the impact of the new "passive activity" rules, structuring the syndicate for today's market, and securities law considerations.

Sponsored by the University of Tulsa College of Law Division of Continuing Education. For more information, call: 918/592-6000, Ext. 2210 or Ext. 3088.

Pacific and Western Mountains Bankruptcy Law Institutes.
May 20-22, 1987, Hyatt Regency Hotel, San Francisco, CA.
June 29-July 2, 1987, Jackson Hole Lodge, Jackson Hole, WY.

Topics include: Agricultural issues, lender liability, tax issues in Chapter 11 cases, and recent developments.

Conducted by Institutes on Bankruptcy Law. For more information, call: 703/684-0510.

Security interests in payments from government farm programs

by Susan A. Schneider, Lynn A. Hayes and Phillip L. Kunkel

There are several forms of personal property in which agricultural lenders often take a security interest as collateral for an agricultural loan. Traditionally, lenders take a security interest in crops, livestock and livestock products. Often, however, farmers also have a property interest in several different types of government payments, particularly those paid by the U.S. Agricultural Stabilization and Conservation Service (ASCS).

Often, creditors overlook such assets, or simply fail to properly complete the security documents necessary to take a valid lien in these payments. As a result, these payments may be an important potential source of cash that may be used for operating expenses when additional credit is not available, or used to reorganize a farming operation through bankruptcy.

This article discusses the various types of government programs and security interests in the payments received under them. Most of the cases included in this article are from bankruptcy courts, since the enforcement of security interests are often decided in the bankruptcy context.

These decisions, however, may also be used in litigation outside of bankruptcy court. The procedure that the Farmers Home Administration (FmHA) may use to take ASCS payments (even without a valid security agreement) is also discussed.

I. Government Payments

A. Deficiency Payments

Deficiency payments, which are based upon the difference between the national average market price of a commodity and the "target" price for that commodity, may be substantial. Several courts have held that deficiency payments are "proceeds" of crops.

Thus, a secured creditor who has a valid lien on crops may also have a valid lien on deficiency payments. *In re Nivens*, 22 Bankr. 287 (N.D. Tex. 1982); *In re Judkins*, 41 Bankr. 369 (M.D. Tenn. 1984); *In re Munger*, 495 F.2d 511 (9th Cir. 1974). *See, also, In re Patsantaras Land and Livestock Co.*, 60 Bankr. 24 (Colo. 1986); *In re Kruger*, 68 Bankr. 43 (C.D. Ill. 1986).

It must be noted, however, that the deficiency program regulations restrict the assignment of those payments.

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B. Storage Payments

In addition to receiving deficiency payments, a farmer may be entitled to storage payments when a commodity is placed in the long-term grain reserve program. Such payments are considered rent for the use of the grain storage facilities. No such payments are available when a commodity is placed in the short-term price support loan program.

Some courts have held that these commodity storage payments are "general intangibles," as defined by the Uniform Commercial Code (UCC). *In re Connelly*, 41 Bankr. 217 (Minn. 1984); *in accord, In re Boyd Elevator Inc.*, 63 Bankr. 689 (N.D. Tex. 1986).

Thus, a creditor who has taken a security interest in "general intangibles" may have a valid lien on the storage payments.

Some states, however, have laws restricting assignments of rent. *See, for example*, Minn. Stat. Section 559.17. In states with such restrictions, arguably the storage payments that are considered rent may not be subject to a security interest claimed under Article 9 of the UCC. *In re Standard Conveyor*, 773 F.2d 198 (8th Cir. 1985).

C. Payment-in-Kind Benefits (1983)

In 1983, the Payment-In-Kind (PIK) program was established. Under this program, the farmer received surplus commodities in exchange for not producing that commodity. The courts have reached conflicting results in determining what is required to obtain a lien on PIK benefits.

One line of cases holds that the PIK payments are "general intangibles" under the UCC. *In re Sunberg*, 729 F.2d 561 (8th Cir. 1984). *In accord, In re Schmaling*, 783 F.2d 680 (7th Cir. 1986); *In re Kruse*, 35 Bankr. 958 (Kan. 1983); *In re Mattick*, 45 Bankr. 615 (Minn. 1985); *In re Schmidt*, 38 U.C.C. Rep. Serv. 589 (N.D. 1984); *In re Fowler*, 41 Bankr. 962 (N.D. Iowa 1984). *See, also, United Virginia Bank v. Slab Fork Coal Co.*, 784 F.2d 1188 (4th Cir. 1986).

Thus, a valid security agreement that includes "general intangibles" would create a lien on the PIK payments. A security interest in "crops" is not sufficient to reach PIK entitlements under such a view. *In re Kruse*, 35 Bankr. 958 (Kan. 1983); *In re Schmaling*, 783 F.2d 680 (7th Cir. 1986); *In re Binning*, 45 Bankr. 9 (S.D. Ohio 1984); *In re Frasch*, 53 Bankr. 89 (S.D. 1985); *Knosby v. First Iowa State Bank*, 390 N.W.2d 605 (Iowa Ct. App. 1986).

In contrast, a recent Kansas case holds that PIK entitlements are *not* "general intangibles," but rather, "contract rights" that are included in the UCC definition of "accounts." *In re Lions Farms Inc.*, 42 U.C.C. Rep. Serv. 302 (Kan. 1985).

This Kansas case held that, due to the requirements of the PIK program to use good conservation techniques, to plant a ground cover, and to refrain from grazing, the contract rights were in the nature of payments for "services rendered."

A third line of cases has held that PIK entitlements represent "rents, issues and profits" of real estate, and thus, are subject to a FmHA mortgage. *In re Lee*, 35 Bankr. 663 (Bankr. N.D. Ohio 1983); *In re Preiser*, 33 Bankr. 65 (Bankr. Colo. 1983); *In re Cupp*, 38 Bankr. 953 (N.D. Ohio 1984). It is difficult to reconcile such cases in any state that has adopted the "lien theory" of a real estate mortgage.

A fourth group of cases finds PIK entitlements to be "proceeds" of non-existent crops. *Osteroos v. Norwest Bank Minot*, 604 F. Supp. 848 (D.N.D. 1984); *Production Credit Association of Fairmont v. Martin County National Bank*, 384 N.W.2d 529 (Minn. Ct. App. 1986). As such, these entitlements would be subject to a creditor's valid security interest in crop proceeds.

D. Payment in Commodities

The Commodity Credit Corp. (CCC) has begun to issue "CCC Commodity Certificates." Such certificates bear a dollar amount and expiration date. The certificates may be exchanged for the inventory of the CCC, or exchanged for cash. In addition, a farmer may transfer the certificates to any person in exchange for cash, commodities, or any property of value.

A farmer can only transfer the full amount of the certificate, however. The transfer is effective only after the farmer endorses the back of the certificate. The CCC will not accept any certificate bearing any endorsement to "bearer," or any other non-restrictive endorsement.

While the certificates are transferable, a program participant may not assign the right to receive a commodity certificate. The applicable federal regulation provides as follows:

> Notwithstanding any provision of this chapter, a payment made under this part may not be the subject of an assignment, except as determined and announced by the CCC.

7C.F.R. Section 770.6, 51 Fed. Reg. 21,835 (June 16, 1986).

In addition, the federal regulations provide that such certificates are *not* subject to security interests or liens arising under state law. 7 C.F.R. Section 770.4(b)(2).

E. Dairy Termination Program

The Dairy Termination Program (DTP) was

designed to reduce the production of milk. Milk producers were eligible to submit bids in order to dispose of their herds in one of three contract disposal periods.

If a bid was accepted by the CCC, the dairy farmer was required to dispose of the herd and to withdraw from dairy production. Production cannot be resumed for a period of five years. The CCC provides payments to the farmer during this period.

The money the farmer receives for the sale for export or slaughter of the dairy herd is subject to a creditor's security interest in livestock and livestock proceeds. If there is a difference between the slaughter value of dairy cows and the market value of producing dairy cows, such a creditor may be entitled to collect that difference. *See, e.g., In re Grunzke*, Bankr. 3-86-435, Civil 4-86-791 (D. Minn. Jan. 6, 1987).

With regard to the DTP payments, the courts have taken at least two different approaches. A Wisconsin court held that the right to such payments was a "general intangible" under the UCC. *In re Weyland*, 63 Bankr. 854 (E.D. Wis. 1986).

As a result, a lender who held a security interest in the livestock and milk (but not in general intangibles") would not be entitled to the DTP payments.

In a recent Minnesota bankruptcy case, however, the court held that the DTP payments are for neither the cattle nor the proceeds from offspring of the cattle. Moreover, the court rejected the argument that these payments are "general intangibles."

Instead, the court held that the payments are to compensate the farmer for lost future income. Therefore, the bank did not have an interest in the DTP payments when the farmer entered the DTP after filing his bankruptcy petition. *In re Grunzke*, Bankr. 3-86-435, Civil 4-86-791 (D. Minn. Jan. 6, 1987).

F. Conservation Reserve Program

The Food Security Act of 1985 includes a major new program designed to enhance conservation efforts, as well as to reduce the production of surplus agricultural commodities. The Conservation Reserve Program (CRP) allows owners of highly erodible land to remove such land from production for 10 to 15 years.

Landowners or operators who desire to participate in the CRP must agree to implement a plan (approved by the local conservation district) to place highly erodible cropland into grasses, trees, or other acceptable covers.

They must further agree not to harvest, graze or make other commercial use of the forage from the land for the duration of the contract — unless specifically authorized by the CCC.

In exchange for the farm operator's agreement to take eligible land out of crop production, the CCC will provide three forms of assistance: 1) annual rental payments made either in cash or with in-kind commodities or commodity certificates; 2) 50% of the cost of establishing vegetative cover; and 3) conservation technical assistance.

Because the CRP payments are referred to as rent in the federal regulations, the payments may be subject to mortgages (such as those used by the FmHA), which cover "rents, issues and profits" of real estate.

In states that have laws restricting assignment of rents, however, there may be an argument that the CRP payments are not subject to such liens. *See, e.g.*, Minn. Stat. Section 559.17.

II. Timing of Government Entitlements

Often, when a farmer files for bankruptcy, his or her contract with the CCC has not been fully performed. In such cases, an issue will arise as to whether the government payments are property of the bankruptcy estate at the time of the commencement of the case.

In a Texas case, the court held that deficiency payments were not part of the bankruptcy estate (but were post-petition entitlements) since the determination of entitlement to such payment occurs only at or near harvest time. *In re Hill*, 19 Bankr. 375 (N.D. Tex. 1982).

Only after the market price is established can one determine whether a deficiency between that price and the target price occurs.

Similarly, in a Chapter 7 bankruptcy case, the court held that a debtor's entitlement to benefits from the Milk Diversion Program (MDP) had not been sufficiently established at the time of the commencement of the case, so as to render such payments property of the estate. *In re Lamb*, 47 Bankr. 79 (Vt. 1985).

Some courts disagree with this approach, however. *In re Matthieson*, 63 Bankr. 56 (Minn. 1986); *In re Weyland*, 63 Bankr. 854 (E.D. Wis. 1986).

III. Federal Regulatory and Statutory Restrictions on Liens

In a Minnesota bankruptcy case, the court considered whether a secured creditor's interest in proceeds and products of livestock created a security interest in MDP entitlements. *In re Bechtold*, 54 Bankr. 318 (Minn. 1985).

The debtors settled a dispute with the Chapter 7 trustee as to the trustee's claims to the check, but the court was required to rule on the issue regarding the lender's interest.

This case is significant because the court held that even if the security agreement did not cover the MDP payments, the lender's security interest "would not attach to the payment as a matter of federal law." *Id.* at 321.

The court relied on a provision in the contract between the debtor and the CCC, which provided that any assignment of payments was subject to the provisions of 7 C.F.R. Part 709. The court cited 7 C.F.R. Section 709.3(a), which provides as follows:

> A payment which may be made to a producer under any program to which this part is applicable may be assigned only as security for cash or advances to finance making a crop, handling or marketing an agricultural commodity, or performing a conservation practice for the current crop year. No assignment may be made to secure or pay any preexisting indebtedness of any nature whatsoever.

Therefore, the court concluded that the regulations envisioned a program in which the MDP payments would be free of claims in order to provide cash that could be used to finance a new crop. *See*, 16 U.S.C. Sec. 590h(g); *J. Catton Farms Inc. v. First National Bank of Chicago*, 779 F.2d 1242 (7th Cir. 1985); *In re Bearce*, Bky. No. 86-40019 (Kan. Aug. 13, 1986); *Barlow v. Collins*, 397 U.S. 159.

In a recent Florida bankruptcy case, the court (relying on the *Bechtold* case and this federal regulation) held that a creditor's security interest did not attach to the MDP payments because the creditor had not advanced operating credit. *In the Matter of Azalea Farms Inc.*, 68 Bankr. 32 (M.D. Fla. 1986).

It is important to note that this reasoning applies to any program that incorporates this (or any other) restrictive regulation. As such, it is vital to check the regulations for each program to determine what assignment restrictions — if any — apply.

Complicating the analysis further (in contrast to *Bechtold*), at least two Colorado courts have rejected restrictive regulations and applied state law. *In re Mahleres*, 53 Bankr. 86 (Colo. 1985); *In re Patsantaras Land and Livestock Co.*, 60 Bankr. 24 (Colo. 1986). It would appear that this begs the question of federal preemption, an issue beyond the scope of this article.

IV. Waivers and Releases

In at least two cases, creditors have argued that the lien waiver (required by 7 C.F.R. Section 1421.10) of a secured creditor is, in fact, a subordination agreement. In both cases, the argument has failed. *In re Bar C Cross Farms and Ranches Inc.*, 48 Bankr.

(continued on next page)

CONTINUED FROM PAGE 5

976 (D. Colo. 1985); *Iowa Trust and Savings Bank v. USDA*, 42 U.C.C. Rep. Serv. 1471 (N.D. Iowa 1986). *See, also, In re Connelly, supra*, 41 Bankr. 217 (Minn. 1984).

In order to maintain a secured position in an "overage," it will, therefore, be necessary for the secured creditor to obtain a *new* security agreement after the crops are placed in the price support loan program.

V. FmHA Offset of Government Payments

The FmHA has recently issued regulations that will allow it to take payments owed by government agencies (such as the ASCS) to FmHA Farm Program borrowers who are behind in their scheduled loan payments. 7 C.F.R. Section 1951.101, *et. seq.*, 51 Fed. Reg. 42,820-23 (Nov. 26, 1986).

The FmHA will use these regulations to take ASCS payments, even if it does not have a security agreement or an assignment covering the payments.

Before the FmHA can use these new offset regulations, the FmHA borrower's account must have been accelerated. 7 C.F.R. Section 1951.05, 51 Fed. Reg. 42,821 (Nov. 26, 1986).

For the account to be accelerated, the FmHA must have sent a Notice of Acceleration stating that the entire amount of the debt is due and payable. The acceleration notice tells the borrower that he or she has 30 days in which to pay the entire debt — or the FmHA will start liquidation and foreclosure.

The FmHA cannot accelerate a Farm Program borrower's account until it has given the borrower a notice that it intends to foreclose and liquidate, or an opportunity to apply for a deferral. In addition, any appeal process must be completed before the FmHA can accelerate a borrower's account. *See, Coleman v. Block*, 580 F. Supp. 194 (D.N.D. 1984). *See, also, Farmers' Legal Action Report*, Vol. 2, No. 1, Nov./Dec. 1986).

The FmHA may not use these offset regulations:

1. If it is not practical (for example, the cost to the government of collecting by offset might exceed the amount of the delinquency);
2. If making the payments directly would substantially interfere with or defeat the purpose of the federal agency from which the payments are to be taken;
3. If there are legal obstacles to collecting the debt (for example, if the borrower is under the jurisdiction of a bankruptcy court, or if the statute of limitations on collecting the debt has expired, the debt cannot be collected by offset); or
4. If, according to state law, accepting a payment after acceleration has the effect of reinstating the account.

7 C.F.R. Section 1951.105, 51 Fed. Reg. 42,821 (Nov. 26, 1986).

Before the FmHA takes payments from the ASCS (or another government agency) under these offset regulations, it must send the farmer a notice that it intends to offset. The farmer may respond to this notice by asking to review his or her own FmHA records, agreeing to pay the amount due to the FmHA, and/or requesting a review of the FmHA's decision to take the offset. 7 C.F.R. Sec. 1951.105, 51 Fed. Reg. 42,821-22 (Nov. 26, 1986).

These offset regulations may make it impossible for FmHA borrowers whose loans have been accelerated to rely on deficiency or other ASCS or CCC payments for operating and living expenses. It may also prevent the use of these otherwise unencumbered payments in a bankruptcy reorganization plan unless the bankruptcy petition is filed before these payments are offset.

VI. Conclusion

Because of the complex issues involved with security interests in the various government payment programs, each such claimed interest must be carefully analyzed as to: 1) the character of the property; 2) its classification under the UCC; 3) relevant case law; and 4) the contract, statute, and regulations that create the underlying property right.

Injunction allows Farmland Dairies to enter New York milk market

A federal district court has issued a major antitrust ruling in enjoining the Commissioner of the New York State Department of Agriculture and Markets from unconstitutionally applying New York law to deny Farmland Dairies access to four counties of the New York milk market. *Farmland Dairies v. Commissioner of the New York State Department of Agriculture*, 650 F. Supp. 939 (E.D.N.Y. 1987).

Farmland Dairies had applied for an extension of its license concerning milk distribution in New York state to include additional counties.

After a number of delays and public hearings, the Commissioner found that Farmland Dairies' entry into additional counties would "tend to a destructive competition in markets already adequately served and would not be in the public interest." In applying New York law to this finding, the Commissioner denied Farmland Dairies' application.

Farmland Dairies challenged the application of New York law, claiming that the denial of the license was in violation of the commerce clause of the federal Constitution. Farmland Dairies sought equitable and declaratory relief against the Commissioner in his official capacity, as well as individually.

Prior to determination in this action, the Commissioner resigned.

The district court found that the application of state law to deny a license to Farmland Dairies was discriminatory, and was based on economic protectionism. Absent a properly grounded legitimate health or safety concern, such action was violative of the commerce clause.

Farmland Dairies also sought damages against the former Commissioner individually. The district court concluded that Farmland Dairies' complaint stated sufficient allegations of ultra vires conduct by the former Commissioner to defeat the Commissioner's motion for summary judgment.

— *Terence J. Centner*

State Agricultural Board not liable for cooperative's losses

The Supreme Court of Kansas has affirmed summary judgment against an agricultural cooperative in an action by the cooperative for losses sustained as a result of an incompleted transaction for the sale of milo. *Farmers Cooperative Association v. State Board of Agriculture*, 729 P.2d 1190 (Kan. 1986).

The cooperative sought to impose liability on the defendants based upon alleged misrepresentation and concealment of information relative to a prospective sale of milo. A primary contention of the cooperative's claim was that the defendants had concealed a material fact which was a major cause of the cooperative's losses.

The losses arose when the cooperative purchased vast amounts of milo at approximately $1 above the market price.

The Kansas Supreme Court found that the defendants had not breached any legal duty to the cooperative that led to the alleged damages. Rather, the cooperative was responsible for its decision to engage in the business activities from which it incurred the losses.

— *Terence J. Centner*

STATE ROUNDUP

LORIDA. *MRTA Does Not Apply to Flo..da Sovereign Lands.* In the consolidated cases of *Coastal Petroleum Co. v. American Cyanamid Co., Board of Trustees of the Internal Improvement Trust Fund of the State of Florida ("Board of Trustees") v. American Cyanamid Co.* and *Board of Trustees v. Mobil Oil Co.*, 492 So.2d 339 (Fla. 1986), the Florida Supreme Court held that the Florida Marketable Record Title Act (MRTA), Fla. Stat. Ch. 712, did not divest the State of title to sovereignty lands below the ordinary high-water mark of navigable rivers when it conveyed swamps or overflowed lands.

The Court operated on the presumption that Florida received title to all lands beneath navigable bodies (up to the ordinary high-water line) as sovereignty lands, held in the public trust, when it became a state in 1845. The salient issue in the instant case concerned non-navigable swamp and overflowed lands that the federal government held until Congress conveyed these lands to Florida in 1856.

While the sovereignty lands remained vested in the Legislature for the public trust, the swamps and overflowed lands were vested in the Board of Trustees for the Internal Improvement Fund of Florida — subject to conveyance under the MRTA.

The respondents in *Coastal Petroleum* gued that the MRTA extinguished the State's title to navigable stream beds within swamps and overflowed lands that the Board of Trustees had previously conveyed.

The prior case of *Odom v. Deltona Corp.*, 341 So.2d 977, 989 (Fla. 1976), in which the Florida Supreme Court stated that the Board of Trustees' rights to beds underlying navigable waters previously conveyed are extinguished under the MRTA, was held to be in error.

The Court in *Coastal Petroleum* held that prior conveyances to private parties did not convey sovereignty lands when the State conveyed swamps and overflowed lands. "We are persuaded that had the legislature intended to revoke the public trust doctrine by making MRTA applicable to sovereignty lands, it would have, by special reference to sovereignty lands, given some indication that it recognized the epochal nature of such revocation." 492 So.2d at 344.

Therefore, the Board of Trustees' failure to explicitly exempt sovereignty lands from conveyances of swamp and overflowed lands did not convey beds of navigable waters to private parties. *Id.* at 343.

The *Coastal Petroleum* holding presents a serious problem for Florida agricultural 'andholders who have previously relied on ater from navigable streams within swamps and submerged lands that they possess.

Rather than drawing from their own private water supply, such agricultural entities must now operate within the reasonable use riparian permit system directed by the State Department of Environmental Regulation and regional Water Management Districts.

— Sid Ansbacher

TEXAS. *Farm Equipment Exemption Denied.* In the case of *In re Rodgers*, Bankr. No. 586-20211-7 (N.D. Tex. Nov. 12, 1986), the court held that farm equipment subject to a valid consensual lien is non-exempt personal property under Texas law and therefore, is not exempt under the exemption provisions of the Bankruptcy Code.

In *Rodgers*, Texas American Bank held an unchallenged, non-judicial, non-purchase money, non-possessory lien. The debtors filed a Chapter 7 bankruptcy proceeding and claimed the farm equipment subject to the bank's lien as exempt from the bankruptcy estate.

The bankruptcy court held for the farmer/debtor. The district court, relying on *Allen v. Hale County State Bank*, 725 F.2d 290 (5th Cir. 1984), reversed, denied the exemption, and held that the bank could assert its rights under the lien.

The law on this question may be unsettled despite *Rodgers*. *See In re Thompson*, 59 Bankr. 690 (Bankr. W.D. Tex. 1986). *See also, In re Hall*, 752 F.2d 582 (11th Cir. 1985) (a household goods exemption case).

— H. DeWayne Hale

OKLAHOMA. *Exemption Statute and Lien Avoidance.* The question posed to the bankruptcy court in Oklahoma was whether the state statute which affected a limitation on the exemption of encumbered property for purposes of lien avoidance under section 522(f) of the Bankruptcy Code was constitutional.

The statute read: "In no event shall any property under paragraph 5 or 6 of subsection A of this section [concerning the exemption of agricultural equipment], the total value of which exceeds $5,000, of any person residing in this state be deemed exempt or otherwise exempt under the laws of this state for purposes of the lien avoidance powers provided to debtors under subsection (f) of section 522 of the Bankruptcy Reform Act of 1978..." Okla. Stat. tit. 31, section 1.C. (Supp. 1986).

The court in *In re Pelter*, 64 Bankr. 492 (Bankr. W.D. Okla. 1986), held that it was not constitutional and declared the statute suspended prospectively.

The state statute limiting debtors' exemption rights only came into play when a debtor sought to avoid liens on exempt property in bankruptcy. For exemption purposes, farm debtors could exempt farm implements of unlimited value.

Thus, the court found that the Oklahoma statute was not an exemption statute, but rather, a "statute designed to frustrate the Congressional purposes of Section 522(f) and limit the exclusive power of the bankruptcy courts to avoid liens." *Id.* at 492.

The case is on appeal.

— Patricia A. Conover

KANSAS. *Prosecution of Bankrupt Enjoined.* In *In re Nittler*, No. 86-0019 (Bankr. Kan. 1986), the debtor obtained a loan from a bank by representing as his own 134 head of someone else's cattle. Later, the debtor sold the cattle in which the bank held a security interest.

In 1984, the debtor filed Chapter 13 bankruptcy. Although the bank exercised its set-off rights, a portion of the debt remained unsecured. The bank opposed the debtor's Chapter 13 plan pursuant to which the remaining debt would be effectively discharged.

In 1986, at the bank's request, the county attorney filed a criminal complaint, charging the debtor with theft by deception under Kan. Stat. Ann. section 21-3701, as well as unlawful disposal of collateral without the creditor's written consent under Kan. Stat. Ann. section 21-3734.

Relying on 11 U.S.C. Section 105(a), the court held that a permanent injunction of the criminal proceedings was appropriate because the real motive for the prosecution was the collection of a prepetition debt. Such a prosecution would unduly interfere with the administration of the debtor's estate and the purposes of the Bankruptcy Code.

It should be noted that the county attorney stated that it was the policy of his office not to prosecute this type of crime unless the victim requested prosecution to seek restitution.

In a later appeal by the bank of the subsequent confirmation of the debtor's Chapter 13 plan, the district court in *In re Nittler*, 67 Bankr. 217 (Bankr. D. Kan. 1986), held that the bankruptcy court failed to make sufficient inquiry as to whether the plan was proposed in good faith. (The plan called for no payment to unsecured creditors — including the bank).

The court held this factor to be but one among others warranting a re-examination of the good faith issue. The case was accordingly remanded.

— Alice Devine

PENNSYLVANIA. *Life Tenant's Right to Oil and Gas.* If a life estate is created on land that is subject to an oil and gas lease, the life tenant may operate the lease.

If the lease expires, the life tenant may enter into subsequent leases, without the consent of the remainderman, if it can be determined that the party creating the life estate intended the life tenant to have that authority. *Cronan v. Castle Gas Co. Inc.*, 512 A.2d 1 (Pa. Super. 1986).

— John C. Becker

agricultural law update
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AMERICAN AGRICULTURAL LAW ASSOCIATION NEWS

AALA SECRETARY-TREASURER'S POSITION. The Board of Directors of the American Agricultural Law Association (AALA) is seeking applications for the position of secretary-treasurer for the 1988 membership year. This officer is appointed by the Board and handles all routine secretary-treasurer functions. Some of these duties include: handling all membership applications, receiving all dues payments, writing AALA correspondence, preparing financial reports and budget for the Board and auditor, keeping minutes of Board meetings, managing the election of new officers, and serving as Chairman of the Finance Committee.

It is anticipated the position will require eight to 10 hours of work each week. More detailed information can be obtained from Terence J. Centner, 1986-87 secretary-treasurer, Athens, GA; 404/542-0756. Letters of application for this position should be submitted by Oct. 1, 1987 to James B. Dean, AALA President, 600 S. Cherry St., Suite 640, Denver, CO 80222.

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 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 June 30, 1987, and communicated to Drew L. Kershen, Chair, Awards Committee, School of Law, University of Oklahoma, 300 S. Timberdell Road, Norman, OK 73069; 405/325-4702.

FOURTH ANNUAL STUDENT WRITING COMPETITION. The AALA is sponsoring its fourth 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 June 30, 1987. For complete competition rules, contact Drew L. Kershen, Chair, Awards Committee, School of Law, University of Oklahoma, 300 S. Timberdell Road, Norman, OK 73069; 405/325-4702.

CONVENTION REMINDER. The 1987 AALA Convention will be held Oct. 15-16, 1987 at the Omni-Shoreham Hotel in Washington, D.C.