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Agricultural Law Update

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Solicitation of articles: All AALA members are invited to submit articles to the Update. Please include copies of decisions and legislation with the article. To avoid duplication of effort, please notify the Editor of your proposed article.

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Deferred payment contracts and alternative minimum tax relief

On January 28, 1997, the Internal Revenue Service [Service] announced in Notice 97-13 that "it intends to make it easier for farmers who receive deferred crop payments to change their accounting method for alternative minimum tax [AMT] purposes." The Notice allows farmers "to change to a permissible method of accounting" for reporting the income, effective for 1997 returns (due in 1998). For 1996 returns, income from deferred payment contracts may be treated as in prior years even if an "impermissible" method of accounting is used. The Notice also provides audit protection from previous years' returns to those who have not received an audit letter on the issue before January 28.

The Notice marks the latest development in the continuing saga that began when the Service ruled in TAM 9640003 (Dec. 21, 1995) that a cash-method farmer must include in income for AMT purposes the fair market value of a deferred payment crop sale in the year of sale. In December, Treasury Secretary Rubin backed the Service's position, but said that he would support legislation changing the law. Because the TAM was not released until October of 1996, and it appeared likely that Congress would overturn the TAM, the Service was under extreme congressional pressure to not apply the TAM to 1996 returns. However, the Service still maintains that the position taken in TAM 9640003 is correct, but now acknowledges that the TAM amounts to a substantial change in the Service's position on this issue.

The Service also stated in the Notice that farmers who want to change their method of accounting for income received from some deferred payments sales contracts to compute their AMT for the 1997 tax year will need to attach a Form 3115 to the 1997 return due in 1998. The normal user fee will be waived. Farmers taking advantage of the automatic change procedure will be protected from IRS audits on this issue for previous years, unless they were under audit or involved in litigation on the issue before January 28, 1997.

It is expected that Congress will pass legislation designed to reverse the impact of TAM 9640003. Iowa Senator Charles Grassley introduced S. 181 on January 22, which had over fifty co-sponsors as of January 28. Grassley's bill specifically provides that installment sales by family farmers not be treated as a preference item for purposes of the AMT. Representative George Nethercutt (R-Wash) introduced a companion bill on January 9 with seventy-seven original co-sponsors in the U.S. House.

Notice 97-13 will appear in the Internal Revenue Bulletin dated February 10, 1997.

—*Roger McEowen, Cooperative Extension Service, Kansas State University, Manhattan, KS*

Lien stripping allowed in Chapter 12

The Eighth Circuit recently ruled that Chapter 12 of the Bankruptcy Code permits a debtor to "strip down" an undersecured creditor's lien to the value of the collateral. *Harmon v. U.S.*, 101 F.3d 574 (8th Cir. 1996). Although the court noted that this was "a question of first impression in the Courts of Appeals," many may have not considered that this right was in question. As one farm bankruptcy treatise reported, "The ability to reduce secured debt to the value of the property securing the debt and to pay that reduced debt over an extended period of time is the hallmark of chapter 12 and the basis for the vast majority of chapter 12 plans." Randy Rogers & Lawrence P. King, Collier Farm Bankruptcy Guide, 4-103 (1994). Nevertheless, ever since the Supreme Court decision in *Dewsnup v. Timm*, 502 U.S. 410, 112 S. Ct. 773, 116 L. Ed. 2d 903 (1992), this right, referred to as "lien stripping," has been somewhat unclear.

Dewsnup was a Chapter 7 liquidation case in which the debtor sought to "strip down" an undersecured creditor's lien to the value of the collateral. The debtor's argument was based on § 506(d) of the Bankruptcy Code, which appears to void liens to the extent that they exceed the value of the collateral. 11 U.S.C. § 506(d). ("To the

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extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void...."). The Supreme Court concluded, however, that "allowed secured claim" in § 506(d) does not mean a claim that is allowed and fully secured, but rather a "claim [that] is secured by a lien and has been fully allowed." *Dewsnup*, 502 U.S. at 417, 112 S. Ct. at 778. As the Eighth Circuit Court in *Harmon* described it, under *Dewsnup*, "if a claim is secured in the non-bankruptcy sense, without regard to § 506(a)'s bifurcation of claims into secured and unsecured claims, and it is allowed in the bankruptcy case, it cannot be voided or stripped down by § 506(d)." *Harmon*, 101 F.3d at 580. On this basis, after *Dewsnup*, debtors were no longer entitled to "strip down" liens to the value of the collateral in a Chapter 7 bankruptcy. *Dewsnup* expressed no opinion as to the meaning of "allowed secured claim" in other sections of the Code, nor did it rule on "lien stripping" in other bankruptcy chapters. *Dewsnup* at 417 n. 3, 112 S. Ct. at 778 n. 3.

Armed with the *Dewsnup* opinion, Farm Service Agency [FSA], the secured creditor in the Harmons' Chapter 12 bankruptcy case, challenged the Harmons' ability to use "lien stripping" in Chapter 12. In 1988, the Harmons obtained confirmation of a plan that provided that the value of FSA's secured claim was $51,200. The property that secured this claim was worth $165,000, but it was subject to a contract for deed obligation of $113,800 that preceded FSA in priority. The FSA debt totaled $425,817. Under the plan, FSA was to receive the present value of its secured claim over a period of thirty years, and the Harmons agreed to devote their disposable income during the three-year-plan term to the unsecured claims. In 1992, the Harmons agreed to pay FSA $75,000 in disposable income payments in order to settle an objection to discharge, and in 1994, the discharge was granted. Payments on the FSA-secured claim were made as scheduled. In the meantime, Mr. Harmon died, and Mrs. Harmon sought to sell the property. She intended to pay off the remaining secured debt to FSA with the sale proceeds. The FSA notified her that they would require payment of the entire FSA balance of the loan, including the unsecured claim, before they would release the mortgage. The property was eventually sold, with the proceeds placed in escrow. Mrs. Harmon brought a declaratory judgment action, and on cross motions for summary judgment, the district court granted judgment for Harmon, concluding that the FSA's lien was extinguished by the payment in full of the secured claim and the required payments on the unsecured claim. *Harmon v. United States*, 184 B.R. 352, 354-55 (D.S.D. 1995). The district court rejected Harmon's contention that the actions of the government were abusive, arbitrary, capricious, and malicious. *Id.* at 355. Harmon applied for attorney fees pursuant to the Equal Access to Justice Act [EAJA], 28 U.S.C. § 2412(d), but the district court denied the application, concluding that the government's position was substantially justified. The government appealed to the Eighth Circuit, and Harmon cross-appealed the findings that the government did not act arbitrarily and that the government's position was substantially justified. *Harmon*, 101 F.3d at 577.

The government raised four principal arguments on appeal: (1) because section 506(d) applies in Chapter 12, the *Dewsnup* holding that disallowed "lien stripping" should be extended to Chapter 12 cases; (2) the discharge provisions in §§ 524(a) and 1228(a) do not affect the debtor's in rem liability; (3) section 1225(a)(5) requires that secured creditors retain their liens; and (4) regardless, the Harmons' Plan did not purpose to strip down the

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AALA Editor .... Linda Grim McCormick
Rt. 2, Box 292A, 2816 C.R. 163
Alvin, TX 77511
Phone/FAX (281) 388-0155
E-mail: hcxb52a@prodigy.com

Contributing Editors Susan A. Schneider, Hastings, MN; Roger McEowen, Cooperative Extension Service, Kansas State University, Manhattan, Kansas; Donald B. Pedersen, University of Arkansas, Fayetteville, AR; Linda Grim McCormick, Alvin, TX.

For AALA membership information, contact William P. Babione, Office of the Executive Director, Robert A. Leflar Law Center, University of Arkansas, Fayetteville, AR 72701

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Iowa **Farmegg** *case overturned*

In late 1996, the Iowa Supreme Court overturned a twenty-five-year-old Iowa Supreme Court case in construing the outer limits of Iowa's agricultural exemption from county zoning. In the 1971 case, *Farmegg Products, Inc. v. Humboldt County*, 190 N.W.2d 454 (Iowa 1971), a proposed facility for raising 40,000 chickens in confinement every twenty-two weeks to be located on a four-acre tract was held not to constitute an agricultural purpose. As a result, the proposed facility was subject to county zoning regulations. In the 1971 case, the court determined that the legal issue was whether the activity in question was carried on as part of an overall agricultural operation or whether it was separately organized as an independent productive activity. In a 1995 case, the Iowa Supreme Court held that the proposed construction of a hog confinement facility was associated with an existing farming operation and was exempt from county zoning (*see*, *Thompson v. Hancock County*, 539 N.W.2d 181 (Iowa 1995)).

In the 1996 case, *Kuehl v. Cass County*, 555 N.W.2d 686 (Iowa 1996), two hog producers formed a joint venture for the purpose of building and operating a hog confinement operation for the contract production of hogs with a Pennsylvania company. They proposed to build one confinement building to house 2,000 hogs and anticipated building a second structure of equal size for the same purpose on a five-acre site. The local zoning administrator determined that the proposed facility was not a permissible use under the county zoning ordinance unless the hog farmers obtained a special exception from the board of adjustment. The board of adjustment upheld the applicability of the zoning regulations. The district court affirmed that decision on the basis that the proposed facility was separate from any forming operation otherwise carried on by the hog farmers. The Iowa Supreme Court rejected the view that to be exempt as an agricultural use, a facility must be used in conjunction with a traditional agricultural use otherwise in existence. Instead, the court held that the hog farmers had established that their proposed facilities would be primarily adapted for use for agricultural purposes. Therefore, the proposed facility was exempt from Iowa county zoning regulations.

—Roger McEowen, Cooperative Extension Service, Kansas State University, Manhattan, Kansas

Statute of limitations defense applied to FSA loans

For some time, it has been recognized that the former Farmers Home Administration [FmHA], now the Farm Service Agency [FSA], has a relatively large number of long-delinquent loans in its loan portfolio. *See, e.g.*, U.S. General Accounting Office, *High Risk Series: Farm Loan Programs*, GAO/HR-95-9, Feb. 1995. The Conference Committee that agreed upon the terms of the Federal Agriculture Improvement and Reform Act of 1996 [FAIRA] acknowledged this problem, noting that "the agency continues to have thousands of delinquent borrowers who owe billions of dollars on their delinquent loans." 142 Cong. Rec. H2716-03 (Mar. 25, 1996; 1996 WL 131098 (supporting the use of collection agencies, tit. IV, § 632). As a result of this concern, FAIRA included numerous provisions designed to hasten the resolution of these delinquent loans and enhance agency collection efforts. Since passage of FAIRA, the FSA has initiated collection actions such as liquidation and foreclosure on many delinquent loans.

Because some of the loans at issue have been delinquent for many years, a number of borrowers have attempted to invoke a statute of limitations defense to the FSA's collection efforts. This defense is usually based on the federal statute that provides in part that "[a]ll actions for money damages brought by the government, or an agency of the government, founded upon a contract are barred unless the complaint is filed within six years from the date upon which the cause of action accrues." 28 U.S.C.§ 2415(a).

Two recent cases address the use of this defense in the context of an FSA effort to collect a long overdue debt. In both cases, but on different grounds, the court held that the statute of limitations defense was inapplicable.

One restriction on the use of the statute of limitations provision is found in subsection (c) of § 2415. This subsection provides that the limitation does not apply to actions brought to "establish the title to, or right of possession of, real or personal property." 28 U.S.C. § 2415(c). This restriction was at issue in the recent case of *U.S. v. Omdahl*, No. 95-35753, 1997 WL 9283 (9th Cir. Jan. 13, 1997).

In *Omdahl*, the borrowers/defendants first became indebted to the FmHA in 1982. At that time, they executed two promissory notes in the amounts of $66,270.00 and $28,730.00, to be paid annually over twenty-one years. As security for the notes, they mortgaged three parcels of land. The Omdahls soon experienced difficulty in their farming operation and were unable to make the January 1985 payment. They made no subsequent payments on the indebtedness, and in 1989, they were considered for debt restructuring. The FmHA made a computer error in valuing the restructuring offer to the Omdahls, thus complicating the restructuring process and raising a number of other issues not related to the statute of limitations defense. Eventually, however, the offer of restructuring was turned down by the Omdahls. In 1992, the FmHA accelerated the loan, and in 1994, a foreclosure action was commenced. The FmHA sought recovery only against the property and did not seek a deficiency judgment. The district court gave its Judgment and Decree of Mortgage Foreclosure, finding that the Omdahls owed $95,350.00 on the principal and $137,328.97 in interest.

On appeal to the Ninth Circuit, the court first noted that the federal government generally has immunity from limitations periods for actions brought in its sovereign capacity pursuant to federal statute. *Omdahl*, at *1 (citing *United States v. California*, 507 U.S. 746, 757-58, 113 S. Ct. 1784, 1790-91, 123 L. Ed. 2d 528 (1993). This immunity is implied in all federal enactments unless expressly waived. *Id.* (citing *Board of Comm'rs v. United States*, 308 U.S. 343, 351, 60 S. Ct. 285, 288, 84 L. Ed. 313 (1939). However, the Omdahls argued that Congress expressly waived governmental immunity for foreclosure actions when it enacted 28 U.S.C. § 2415(a), which waives governmental immunity from limitations periods for contract actions brought by the federal government.

The court acknowledged that the United States is time-barred by § 2415(a) from bringing any action for money damages on a contract theory. However, in the *Omdahl* case, the court found that the United States was not claiming money damages, but merely sought to foreclose on a property interest. The court quoted § 2415(c) and held that a mortgage foreclosure action fell within this exception to the limitation. It constituted "an action to establish the title to, or right of possession of, real ... property." *Id.* at *2 (citing 28 U.S.C. § 2415(c); *United States v. Dos Cabezas Corp.*, 995 F.2d 1486, 1489-90 (9th Cir.1993)). The court further noted that this decision reaffirmed its previous

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Dakota farmers get feed assistance for snow-stranded cattle

On January 16, 1997, the USDA activated an emergency feed grain donation program, the Disaster Relief Assistance Program (DRAP), to help get feed to thousands of livestock stranded by blizzards in North and South Dakota. In a USDA announcement, Agriculture Secretary Glickman stated that "[t]he problems are that ranchers can't get feed to cattle isolated on the range and in some places, feed simply isn't available. We are immediately activating an emergency feed grain donation program to help alleviate these problems." USDA Announcement Release No. 0010.97, USDA Home Page on the World Wide Web at http://www.usda.gov.

Under the DRAP, the USDA will make available feed grains from its disaster reserve or use funds from the sale of grain in the reserve to help buy livestock feed to be shipped into the disaster areas. Alternatively, it is authorized to give the funds to producers to buy feed locally when it is available. Funds can also be used for transporting grain and removing snow to feed cattle. The estimated cost of feeding all 100,000 animals for fifteen days is about $1.4 million. Because of the severity of the problem, USDA announced that it would bear the entire cost of meeting this short-term emergency. For longer range assistance, producers will have to provide seventy percent of the cost of feed acquired under the program. *Id.*

The USDA estimates that South Dakota is the biggest livestock-producing state in the storm area, with about 80,000 head at immediate risk because producers cannot get to the animals or get to their feed supplies. In North Dakota, it is estimated that about 20,000 animals are in the same immediate difficulty. There, however, producers anticipate exhausting available supplies of hay for approximately 1,900,000 head of cattle in the near future. Cattle stranded away from feed sources are expected to be a problem for the next several months. In South Dakota, the USDA estimates that about one fourth of the state's four million head of cattle will be without feed unless supplies can be shipped in from out of state. *Id.*

An interim rule initiating the use of the DRAP was published on January 22, 1997 at 62 Fed. Reg. 3195 (1997) (to be codified at 7 C.F.R. § 1439.402). The effective date of this rule is back-dated to January 10, 1997. This rule amended the current DRAP regulations at 7 C.F.R. pt. 1439, and as described in the *Federal Register* Notice dated October 29, 1996 and published at 61 Fed. Reg. 55,783 (1996).

—Susan Schneider, Hastings, MN

Federal farm products rule—developments

By Donald B. Pedersen

It is now eleven years since the enactment of the federal farm products rule—and ten years since that legislation became effective.[1] The only amendments to date came in the 1996 Farm Bill, and as yet significant reported cases are few and of recent vintage. The 1996 legislation is brief and gives limited recognition to the age of electronic data interchange [ED] in the context of certified central notice systems [CNS's] for effective financing statements [EFS's]. The cases are a mixed bag —some helpful, others disturbing harbingers of costly litigation.

Statutory developments

Until the recent changes, an EFS in a CNS state was required to be a paper original or reproduced copy signed both by the secured party and the debtor. Now, in a state where the UCC allows electronic filing of financing statements, the EFS and amendments thereto can be electronically filed. Signatures of the debtor and the secured party are then not required.[2] Countermeasures such as requiring the filing office to generate and date stamp a paper copy of the EFS and send same to the secured party are discretionary with the state.[3]

Until the recent changes, the portions of master lists to be distributed had to be in "written or printed form" —on paper. Requests could, however, be honored from registrants who wanted the information on tape, disc, or fiche. Now the regulations allow a state to honor requests from registrants who want the information via EDI.[4]

The feasibility of an entirely paperless CNS system is very real—gathering, organizing, and disseminating information electronically is not only possible, but probably the most cost efficient and reliable method. Because information filed electronically could be almost instantaneously available to registered buyers, it offers the prospect of eliminating the time gap between the filing of an EFS and the information appearing on a received master list—a troublesome features of CNS's that some states have tried to deal with by allowing parallel use of direct notice. A registered buyer who buys during the gap period would otherwise take free of the security interest. Colorado, for example, provides by statute that:

> [a] written notice under section 1324(e)(1) of the Federal 'Food Security Act of 1985' sent after the central filing system...is certified and operational shall be valid only during the interval between the date on which the notice is 'received' by the buyer, ... and ten days after the date on which the next ensuing master list on which the security interest could be reflected is mailed...to registered buyers....[5]

Because the full application of EDI technology could mean immediate access to CNS-filed data, unregistered status could turn out to be as workable as registered status.[6]

Litigation—direct notice states

The essence of the federal farm products rule is that buyers in the ordinary course of business of farm products from sellers engaged in farming operations take free of security interests created by such sellers. This in effect reverses the rule of U.C.C. § 9-307(1), which said that such buyers took subject to—a rule that had many buyers paying twice after being successfully sued. Of course, under current federal law, secured parties are not left with security interests unenforceable against all buyers of farm products collateral. In direct notice states, they can protect themselves by seeing that potential buyers annually receive written notice of the security interest.

It is the adequacy of such written notices that is the focus of *First National Bank v. Miami County Cooperative Assoc.*, the most significant and at the same time most troublesome case to come from a direct notice state.[7] The federal statute at 7 U.S.C. § 1631(e)(1)(A)(1994) requires that the direct notice:

—be organized according to farm products;

—contain the names and ad-dresses of the secured party and the debtor;

—contain the Social Security number of the debtor (taxpayer ID number if not an individual;

—describe the farm products, including the amount of such products where applicable;

—state the crop year;

—give the county or parish, and a reasonable description of the property;

—state any payment obligation imposed on buyer (such as "cut a two party check") to obtain waiver or release of the security interest.

In *First National*, the bank used a popular preprinted form that identifies the information required by the statute and provides ample space to insert it. The least specific of the notices evaluated in the litigation did include the required names and addresses, the debtor's social security number, a statement that the notice covers all of the farm products if no amounts are stated, directions to cut a two-party check, and a reference to "grain," "grain and/or beans," or "grain/beans." Missing were the crop year, name of the county, description of the property where the crops were to be grown, and specific identification of farm products covered.

The Supreme Court of Kansas, in affirming that the notices were adequate to protect the bank, first concluded that a rule of substantial compliance with the federal statute should govern, not a rule of strict construction. The federal statute is silent on this, although a rule of substantial compliance is provided for the EFS's used in CNS's. The court gives favorable attention to the arguments for a substantial compliance rule advanced by Kershen and Hardin.[8] This portion of the court's opinion is persuasive and is likely to be followed in most, though notnecessarily all states.[9]

What is unsettling about the *First National* decision is the holding that notices that out and out ignore several elements of the federal statute can be in substantial compliance with it. It is one thing to deal with minor errors or an isolated omission and to conclude that they are not misleading, but quite another to simply pass off as legally irrelevant the exclusion of various pieces of information that the Congress must have thought important to help buyers organize their files and to quickly assess their status vis-à-vis secured parties.[10] Unhappiness with the requirements of the federal statute ought to be taken up with Congress, it might be thought. In direct notice states, the apparent intent of Congress is to place the burden to affirmatively supply information on secured parties, rather than an affirmative duty on buyers to request missing information. The Kansas court, by setting a low threshold for substantial compliance, invites litigation elsewhere as it is likely that courts in other states might not be so forgiving.

As a practical matter, secured parties should be advised to send direct notice forms that include all of the information required by the federal statute. The information should not be difficult for lenders to assemble—the name of the county and the description of the farm will be in the existing security agreement if growing crops are involved. And, most lenders will know the particular crops raised by their debtor, and thus farm products could readily be described more specifically, for example, as rye, wheat, soybeans, and lima beans. As with EFS's, an argument can be made that the intent is that farm

Donald B. Pedersen is Professor of Law at the University of Arkansas, Fayetteville, AR.

products be specified in direct notices rather than being described generically, so that the individual buyer, like the Secretary of State, can easily keep organized, accessible records. Lenders who are thorough will stand a better chance of being found to be in substantial compliance if minor errors or omissions creep into their direct notices. Buyers and commission merchants faced with notices that omit information required by the federal statute would be well advised to check with both the debtor and the secured party to confirm instructions for cutting a two-party check or remitting directly to the secured party. If the farmer-debtor and the secured party are at odds, payment into court may be advisable.

Another direct notice case, *Ashburn Bank v. Farr*,[11] is a straightforward affirmation of certain basics of the federal statute: preemption of the farm products rule of U.C.C. § 9-307(1) and recognition that the federal definition of buyer in the ordinary course is not the same as the definition in the UCC. In *Ashburn Bank*, a feedlot operator who contracted to feed and fatten the cattle of others and who periodically purchased cattle to raise, fatten, and resell was not a cattle dealer or broker. Rather, he was engaged in farming operations, and the cattle that he sold were farm products. Thus, not having received direct notice from the secured party bank, the rancher who bought in this case took free of the security interest created by the feedlot operator even though the rancher, a buyer in the ordinary course, might have had actual knowledge of it.

Yet another direct notice case, *Jenkins v. Missouri Farmers Ass'n, Inc.*, illustrates the irrevelance of the farm products rule to statutory farm landlord liens.[12] To protect rent, the farm landlord relied on the Missouri statutory farm landlord lien on crops and also an Article 9 security interest in the crops. Creating such an election of remedies is implicitly sanctioned in this case.[13]

In *Jenkins* the landlord sought to protect its security interest by giving direct notice to MFA, the potential buyer, but the notice lacked the required social security number of the debtor. While the landlord sought to rely upon the landlord's lien, the buyer apparently asserted that said lien is a security interest under the federal farm products rule and was lost because proper direct notice had not been received by MFA. The court correctly held that the federal farm products rule applies to consensual security interests created by the seller. The landlord's statutory lien came into existence by operation of law and is not governed by the federal farm products rule. Thus, the competition between this lien and MFA's security interest is still resolved under state law *and* outside the UCC.[14] Because the landlord's lien statute does not have a priorities section, the priority—to the landlord in this case—was determined by Missouri case law, here from 1901.

Litigation—central notice states

The decision in *First Bank v. Eastern Livestock Co.* concerns the fate of an unregistered buyer under a CNS.[15] Such a buyer takes subject to the security interest of the seller of farm products if an adequate EFS has been filed prior to the sale even though the information is not yet included on a distributed master list. There is no gap issue, as in the case of a registered buyer. In this case, there was a question as to whether the security interest had attached at all. If there had been no attachment, issues under the federal farm products rule would have become moot. The court in *First Bank* assumed the existence of an attached security interest--a state law issue, and thus reached the issue of the adequacy of the EFS--a federal law issue.

The EFS in *First Bank* stated that cattle then owned or thereafter acquired were "kept on real estate owned by Bobby Caston and located on HWY 569" in Amite County. One month after the EFS was filed, the debtor lost his lease and none of the cattle were ever kept at the indicated location. No effort was made to amend the EFS "within three months to reflect material changes." The court found that in a notice-oriented system an ambiguity that is not misleading will not render the EFS insufficient—and, that is the court's result here. However, the court suggests that the requirements for descriptions in security agreements might be stricter than those applicable to financing statements —relying on at least one case (from 1974) involving a UCC 1 financing statement. But, recall that there is no requirement that a security agreement or a UCC 1 financing statement include a reasonable description of the real property where livestock are to be kept. That requirement is federal and unique to the EFS.

The facts of the *First Bank* case suggest additional issues that are not raised. For example, the court asks whether "the financing statement was sufficient to perfect a security interest in the cattle purchased by Easton." Since this statement comes in the context of a discussion of the EFS it makes little sense. Perfection is still accomplished with a UCC 1 and local filing in Mississippi. Order of perfection is critical in resolving a conflict between competing secured parties. The filing of an EFS does not perfect a security interest in Article 9 terms.[16] Rather the EFS filing has an impact on competing claims of the secured party and the buyer of the farm products collateral. Indeed, it is generally thought that one who holds an attached security interest (secured party) and who has properly filed an adequate EFS will prevail over a buyer of the farm products (security interest survives sale) even though the security interest was never perfected (UCC 1 not filed).[17] This assumes either a registered buyer who buys after the gap period or an unregistered buyer who buys at any time after the EFS is filed.

Another issue that lurks in *First Bank* is the design of the Mississippi statute as such. It authorizes the creation of a CNS for EFS's and gives rule-making authority to the state department of agriculture. Then the statute indicates that a secured party can choose not to file an EFS, but nevertheless protect itself with potential buyers by sending direct notices as in Kansas and the other direct notice states. So, a buyer in Mississippi could have some secured parties doing one thing and others another. The question, unlitigated as yet, is whether Congress in federalizing the farm products rule intended a dual system. Or, did the Congress intend that states make a choice—certified central filing system *or* direct notice? Because Congress seemed intent on cleaning up one mess in 1985, it is difficult to believe that it intended another. Yet, what Mississippi has done will probably—though not certainly—be sustained if challenged, as will the more limited dual systems illustrated by the Colorado statute quoted above. After a decade of dual activity in some states, courts are unlikely to wreak havoc by fashioning some remedy—i.e., the certified central filing system in Mississippi has never been effective. Further, courts are likely to see the gap problem in central filing states as a sufficient reason to allow direct notice to coexist with the EFS system. Legislative history and rules of statutory construction have a way of being read to meet the perceived needs of the day. Of course, advocates of dual systems must not overlook the influential article by Kershen and Hardin wherein the authors make a compelling argument that the two systems are mutually exclusive.[18]

Farmers & Merchants State Bank v. Teveldal provides lessons in the scope of the federal farm products law.[19] The bank loaned money and filed a financing statement to perfect a security interest in beef cattle, dairy cattle, and hogs. Later, Teveldal, a hog feed merchant, called the secretary of state and was told that the bank had only beef and dairy cattle as collateral. This may have happened because the financing statement also served as the EFS, and regulations in South Dakota called for inclusion of farm prod-

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ucts code numbers for EFS purposes. The bank had omittedthe code number for hogs. Teveldal subsequently filed a financing statement listing hogs. The court held that the bank had committed but a minor error and that its financing statement was adequate to accomplish perfection in hogs and achieve priority over Teveldal. Keep in mind that the issue of the adequacy of the document for purposes of perfection is wholly a matter of state law. If the same document had been evaluated for purposes of its adequacy as an EFS, the omission could also have been treated as minor and not misleading—but this result is not a foregone conclusion because federal law applies, as it does in a case involving the sufficiency of the contents of a direct notice.

The court also was required to determine if Teveldal was a buyer protected by the federal farm products rule. The court properly determined that Teveldal was a seller and supplier of hog feed and a competing secured party with the bank. One who takes a security interest in hogs is not a buyer of hogs for purposes of the federal statute. Had Teveldal been a buyer, the issue of the adequacy of the EFS filed by the bank would have been raised.

Is U.C.C. § 9-306(2) preempted?

In *Mercantile Bank of Springfield v. Joplin Regional Stockyards, Inc.*, the secured party bank gave an adequate direct notice, but the buyer stockyard failed to list the bank as a joint payee on the check as the notice directed.[20] To avoid liability for conversion, the buyer argued that the secured party had waived its security interest in a course of dealing—by allowing debtor to sell some livestock and keep the proceeds for farm operating expenses. The threshold issue is whether U.C.C. § 9-306(2) continues to have application in cases where the federal farm products rule is in play. By rejecting preemption, this court opened the door to an examination of the pattern of past sales by the debtor and the acquiescence of the secured party as the proceeds were applied to debtor's operating expenses. The court found waiver of the security interest. However, this case decided in a district court on a summary judgment motion hardly settles the preemption issue.[21]

Fortunately, a rash of waiver cases is unlikely. In at least three states, U.C.C. § 9-306(2) is changed to provide that security interests in farm products cannot be waived by course of dealing or trade usage.[22] For other states, consider these factors. First, given the explicit payment instructions in direct notices, farm product buyer errors in remitting proceeds should be rare. And, registered buyers who receive master lists in CNS states are likely to request and follow payment instructions. Second, some courts can be expected to hold that the equitable doctrine of waiver ought not be available to a buyer who by direct notice has actual knowledge of payment instructions or notice to inquire via a distributed master list. Unregistered buyers with constructive knowledge have been barred from claiming waiver.[23] Third, because direct notices with payment instructions will be sent annually, it might be argued that secured parties will thereby manifest an intent that they do not sanction direct payments to the debtor—even if this has been recent practice. If this argument prevails, any relevant course of dealing would have to occur after receipt by the buyer of the most recent annual notice and before the sale. The burden of proving a course of dealing in such a short time frame is likely to discourage most buyers.[24] Finally, courts in some jurisdictions may well find federal preemption of § 9-306(2).

Conclusion

Many issues remain to be resolved under the federal farm products rule. Sophisticated parties such as lenders, commission merchants, and buyers ought not to be cut too much slack. Cases would be best resolved to discourage litigation and to encourage compliance with the federal statute.

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[1] 7 U.S.C. § 1631 (1994)(as amended). For the basics of the federal farm products rule see Donald B. Pedersen and Keith G. Meyer. *Agricultural Law In a Nutshell* 189-191 (West 1995).

[2] Pub. L. No. 104-127, 101 Stat. 1107, § 662. amending § 1324(c)(4) of the FSA of 1985.

[3] GIPSA Interim Rule, 61 Fed. Reg. 54727 (1996)(to be codified at 7 C.F.R. §§ 205.202, .209)(eff. Oct. 22, 1996).

[4] Id. (to be codified at 7 C.F.R. § 205.105).

[5] Colo. Rev. Stat. § 4-9-307(1)(b)(II).

[6] Drew L. Kershen and J. Thomas Hardin, *Section 1631: Developments in Farm Products*, 8 Agric. L. Update 5 (1990).

[7] 257 Kan. 989, 897 P.2d 144 (1995).

[8] Drew L. Kershen and J. Thomas Hardin, *Congress Takes Exception to the Farm Products Exception of the UCC: Centralized and Presale Notification Systems—Part II*, 36 Kan. L. Rev. 383, 411-12 (1988).

[9] Another view is possible—direct notice is not notice filing. but a specific statutory formula affording sophisticated parties a method to preserve security interests in farm products by giving specific instructions to buyers—who are entitled to ignore incomplete notices from secured parties as well as actual notice from any other source.

[10] The casual treatment of the failure in the direct notice to specifically identify the farm products by type is particularly disturbing. Professors White and Summers make clear the requirements for an adequate direct notice. James J. White and Robert S. Summers, *Uniform Commercial Code section 24-14* (p. 886)(4th ed. 1995).

[11] 206 Ga. App. 517, 426 S.E.2d 63 (Ga. App. 1992). Another direct notice case, *Jenkins v. Missouri Farmers Ass'n, Inc.*, 851 S.W.2d 542 (Mo. App. W.D. 1993), illustrates the irrelevance of the farm products rule to statutory farm landlord liens.

[12] 851 S.W.2d 542 (Mo. App. W.D. 1993).

[13] *See also Mousel v. Daringer*, 190 Neb. 77, 206 N.W.2d 579 (1973).

[14] U.C.C. § 9-310 does not apply to nonpossessory statutory liens, and in any event there also is a threshold requirement that the lienholder have furnished "services or materials."

[15] 837 F. Supp. 792 (S.D. Miss. 1993). The same analysis applies to an unregistered commission merchant.

[16] A state can have a combined UCC-1 and EFS if central filing is required by the UCC-1. Yet, it is still the state law that sets the requirements for the content of the document for purposes of perfection and the federal law for purposes of the farm products rule. Predictably. it has been held that the federal statute does not preempt U.C.C. § 9-103(1)(d)(i), the four month rule governing reperfection of collateral moved to another state. *In re Julien Co.*, 141 B.R. 384 (Bkrtcy W.D Tenn 1992).

[17] White & Summers, *supra* note 10 at § 24-14 (p. 887); Kershen and Hardin, *supra* note 8, *Part I*, 36 Kan. L. Rev. 1, 48-51 (1987).

[18] 36 Kan. L. Rev at 405-409.

[19] 524 N.W.2d 874 (S.D. 1994)

[20] 870 F. Supp. 278 (W.D. Mo. 1994).

[21] *See, e.g.*, Sanford, *The Reborn Farm Products Exception Under the Food Security Act of 1985*, 20 U.C.C.L.J. 3, 10 (1987)(argument for preemption)

[22] Arkansas, Nebraska, New Mexico. 3A Uniform Laws Ann. § 9-306 (West 1992 & 1996 Supp.).

[23] *First Bank v. Eastern Livestock Co.* 886 F. Supp 1328, 1332 (S.D Miss 1995)

[24] See *C & H Farm Service Co. of Iowa v. Farmers Sav. Bank*, 449 N.W.2d 866 (Iowa, 1989).

Federal Register *in brief*

The following is a selection of matters that were published in the *Federal Register* from 12/13/96-1/23/97.

1. CCC; NRCS; Wildlife Habitat Incentive Program; proposed rule. 61 Fed. Reg. 65485.

2. CCC; FCIC; Implementation of the noninsured crop disaster assistance program provisions of FAIRA 96; final rule; effective date 12/31/96. 61 Fed. Reg. 69004.

3. CCC; Disaster Reserve Assistance Program; emergency livestock feed assistance; interim rule; effective date 1/10/97; comments due 2/21/97. 62 Fed. Reg. 3195.

4. USDA; Outreach and technical assistance to socially disadvantaged farmers and ranchers; final rule; effective date 1/8/97. 62 Fed. Reg. 1031.

5. PSA; Filing of a petition for rulemaking; packer livestock procurement practices; notice of receipt of petition for rulemaking; comments due 4/14/97. 62 Fed. Reg. 1845.

6. Department of the Interior; NEPA revised implementing procedures; notice of final revised procedures for the Fish and Wildlife Service; effective date 1/16/97. 62 Fed. Reg. 2375.

—*Linda Grim McCormick, Alvin, TX*

STATUTE OF LIMITATIONS/*Cont. from page 3*
holding that the United States is not time barred from foreclosing on a mortgage even though it would be barred from bringing an action for money damages by § 2415(a). *Id.* (citing *United States v. Thornburg*, 82 F.3d 886, 894 (9th Cir.1996)).

Other courts that have addressed this issue have agreed with the *Omdahl* interpretation allowing foreclosure actions to be brought after the federal six-year statute of limitations. *See, e.g., Davidson V. F.D.I.C.*, 44 F.3d 246 (5th Cir. 1995); *U.S. v. Alvarado*, 5 F.3d 1425 (11th Cir. 1993); *U.S. v. Ward,* 985 F.2d 500 (10th Cir. 1993).

Another exception to the statute of limitations in § 2415(a), however, may also be particularly important in the context of FSA loans. This exception provides "[t]hat in the event of later partial payment or written acknowledgment of debt, the right of action shall be deemed to accrue again at the time of each such payment or acknowledgment." *Id.* This exception raises the issue of what constitutes a "written acknowledgment of debt." This was the precise question presented to the United States District Court for the District of Maine in the recent decision of *U.S. v. J.R. Lapointe & Sons, Inc.*, No. 96-121-B, 1996 WL 762507 (D. Me. Dec. 30, 1996).

The *Lapointe* opinion states that the case arose as a result of a foreclosure action brought by the United States as a result of a default in the loan obligations of the defendant. *Lapointe*, *1. The government conceded that the initial default, and thus, its claim, occurred over six years prior to the initiation of the foreclosure action. The parties stipulated to this as well as to all other issues of fact, leaving "the one remaining dispute is whether the government's suit is barred by the applicable statute of limitations." *Id.*

According to the parties' stipulation of facts, the defendants applied to the FmHA for debt settlement in October 1993. The specific question argued by the parties and addressed by the court was whether this application constituted an acknowledgment of debt under the statute sufficient to restart the statute of limitations on the government's contract claim against the defendants. *Id.* There is no discussion of the exception to the limitation at § 2415(c) concerning title to property/foreclosure actions.

The defendants argued that under Rule 408 of the Federal Rules of Evidence, offers of settlement are not admissible to prove or negate liability. Applying this to their application for settlement, they argued that evidence regarding this "offer" should not be admissible to prove their liability for the debt. The court noted, however, that Rule 408 allows for exceptions. *Id.*, *2. In particular, it allows for the admission of evidence to prove something other than the underlying liability. *Id.* (citing 23 Charles A. Wright and Kenneth W. Graham, Jr., Federal Practice and Procedure § 5310 (1980). For example, the court noted that "compromise evidence can be admitted to prove the bias or prejudice of a witness, to negate a contention of undue delay, to prove agency, ownership, or control, or to support a claim alleging that an illegal act occurred during the course of settlement negotiations." *Id.* (citing Fed. R. Evid. 408; *Lloyd v. Thomas*, 195 F.2d 486, 491 (7th Cir.1952)).

The court then analyzed some of the cases that have ruled on the meaning of the "acknowledgment of a debt" under § 2415(a) and the admissibility of debt under Rule 408. The court noted that the First Circuit held that listing a debt as a liability on an estate return was admissible as an acknowledgment of the debt and was sufficient to restart the statute of limitations under § 2415(a). *Id.* (citing *Federal Deposit Insurance Corporation v. Cardon*, 723 F.2d 132, 137 (1st Cir. 1983)). The court also noted that the Fourth Circuit held that listing a debt on financial statements provided to the Small Business Administration served as an acknowledgment of the debt "sufficient to start anew the running of the limitations period as stated in § 2415(a)." *Id.* (citing *United States v. Culver*, 958 F.2d 39, 41 (4th Cir. 1991).

The precedent that was most persuasive to the court was *Midstates Resources Corp. v. Farmer Aerial Spraying Service, Inc.*, 914 F. Supp. 1424 (N.D. Tex. 1996). *Lapointe*, *3. In *Midstates Resources Corp.*, the controversy was whether a settlement letter from one of the parties was sufficient to restart the otherwise expired limitations periods on the contract claims in question. After discussing § 2415(a), the district court determined that the settlement letter was an acknowledgment sufficient to restart the running of the limitations period. The letter was a request to the Federal Deposit Insurance Corporation that the agency begin settlement negotiations concerning the defendants' debts. The court held "that the letter restarted all relevant limitations periods running, and consequently, the suit is not time barred." *Id.* (quoting *Midstates Resources Corp.*, 914 F.Supp. at 1427).

Relying on these cases, and in particular on the reasoning in *Midstates Resources Corp.*, the court held that the defendants' application for settlement constituted an "acknowledgment of a debt" that was admissible under an exception to Rule 408. *Id.*

Thus, the "title to property" and the "acknowledgment of debt" exceptions to 28 U.S.C.§ 2415, as interpreted by the courts, may create an insurmountable barrier to many FSA borrowers seeking to rely on the statute of limitations as a defense to actions against them for long overdue debts. Nevertheless, because of the unusually long period of time the agency has taken to act on some of these delinquencies, this defense should always be considered.

—Susan A. Schneider, Hastings, MN

LIEN STRIPPING/*Cont. from page 2*
FSA's lien. *Id.* at 581.

Addressing the first argument, the court noted that *Dewsnup* does not hold that section 506(d) prohibits lien-stripping in Chapter 7—it holds only that section 506(d) does not itself provide the authority for a debtor to strip down liens. *Id.* (citing *Dewsnup*, 502 U.S. at 417, 112 S. Ct. at 778). In Chapter 12, the court found other provisions that provide this authority, specifically § 1222(b)(2), which permits a plan to "modify the rights of holders of secured claims;" and § 1227(c), which vests property in the debtor "free and clear of any claim or interest of any creditor provided for by the plan." *Id.* at 584 (citing 11 U.S.C. §§ 1222(b)(2), 1227(c)). Similarly, while the government argued that the discharge provisions in § 524(a) and § 1228(a) do not affect the debtor's in rem liability, the court disagreed that this marked the end of the analysis. "Again," the court stated, "the question is whether any other provision of Chapter 12 permits it." *Id.* at 582. The court found that §§ 1222, 1225, and 1227 contemplated the modification of liens and the revesting of property free and clear of debtors in the debtor. *Id.*

The court also rejected the government's argument that § 1225(a)(5) requires that secured creditors must retain their original pre-bankruptcy lien in its full amount. Rather, the court interpreted this section as providing that "the creditor must retain the pre-bankruptcy lien only insofar as it secures repayment of the secured claim and not insofar as it secures the portion of the debt that has become, by operation of §506(a), an unsecured claim." *Id.* at 583.

Finally, the court reviewed the Harmons' confirmed plan, which provided that after the debtors made the last payment on the secured claim, "the [FSA] shall release any claim it may have." The court stated that, "[t]his language is inconsistent with the government's argument that the Plan allowed the FSA to retain its lien, and we thus conclude that the lien was stripped down to the value of the FSA's secured claim." *Id.* at 584.

On the issues raised by the Harmons in their cross-appeal, the court also affirmed the lower court. It found that the district court did not abuse its discretion in finding that the government's position was substantially justified. *Id.* at 586-7.

—Susan A. Schneider, Hastings, MN

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