Agricultural Law Update

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The life of the law has not been logic; it has been experience.

— *Oliver Wendell Holmes Jr.*

Dairy diversion program challenged

In an unpublished District Court case (James Neal Shelton, et al. v. U.S. Department of Agriculture, et al.), federal Judge Halbert Woodward, in Lubbock, Texas, in April 1986 ordered the U.S. Department of Agriculture (USDA) to write new regulations for implementation of the dairy buy-out program.

The suit brought by, among others, the National Cattlemen's Association, was settled May 9, 1986, by stipulation. The 10-point agreement provides that the USDA contact the dairy program participants and request monthly reports of past, present, as well as future slaughtering plans and exports of dairy beef; that certain modifications be made of some of the dairy contracts to delay disposal dates; that projected dairy beef exports and slaughter dates and amounts be generally published; that the U.S. government make sufficient non-displacement purchases of beef to strengthen the beef market; that exports of dairy cattle be facilitated through some short-term credit to Mexico, use of agricultural attaches, and the publishing of lists of exporters.

Preliminary indications are that the government is complying with the 10-point agreement. Plaintiffs joined in a motion to vacate the preliminary injunction and to dismiss their complaint with prejudice. The motion was granted on May 19, 1986, and the agreement became operative. Venue is set in Lubbock, Texas for any later enforcement suits.

— *Patricia A. Conover*

Fractional share stallion syndication: Not a security

In *Kefalas v. Bonnie Brae Farms Inc.*, 630 F.Supp. 6 (E.D. Ky. 1985), the purchaser of a fractional share in a stallion syndication sued the syndicator of the horse under federal and state securities laws. The purchaser claimed that the fractional shares were "investment contracts" covered by the securities laws and that violations of the securities laws also constituted a violation of the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. § 1961 et seq.

On motion for summary judgment brought by the defendant syndicator, the District Court ruled that fractional shares in a stallion syndication are not securities. The judge then granted summary judgment for the defendant.

Fractional share stallion syndications are a common business and legal relationship in the horse industry. Through this method of syndication, the owner of a valuable stallion divides the ownership of the stallion into 40 (the number most often used) undivided interests. Each purchaser of a fractional interest thereby becomes a tenant-in-common owner of the stallion, and gains the right to breed one mare to the stallion during each breeding season.

The right to breed a mare is called a "nomination" and the fractional share owner can either use the nomination, or sell it in accordance with the syndicate terms. The offspring of the mare belongs to the mare owner, who is then solely responsible for the training, racing, or selling of the foal.

In most instances, once the stallion has been syndicated, the original owner remains involved with the stallion and the syndication as the syndicate manager. It is the syndicate manager who provides care and boarding to the stallion, and supervises the health and breeding of the mares brought to the stallion.

The syndicate manager provides these services for a fee which is above and beyond the price already paid for the fractional shares. Hence, a syndication involves not only the sale of the stallion in fractional shares, but also involves a management contract between the syndicator and the share owners.

While fractional share stallion syndications have been used for years, they have been especially popular since the Securities Exchange Commission (SEC) issued a No Action Letter on a similarly described fractional share stallion syndication to Gainesway Farms on Aug. 18, 1977.

(continued on next page)

FRACTIONAL SHARE STALLION SYNDICATION

CONTINUED FROM PAGE 1

Differences between the syndication approved in Gainesway Farms' No Action Letter and the syndication involved in *Kefalas* are that the purchaser in this lawsuit owned no mares, yet alleged that he had been told he would profit through the actions of the syndicator creating a market for the sale of nominations to mare owners.

Even assuming these allegations to be true, the Court ruled that the *Howey* test for an investment contract had not been met. Specifically, the Court first ruled that no common enterprise existed between the various purchasers of the fractional shares. Each purchaser would make a profit or take a loss independently of all other purchasers of the syndicate shares. The Court indicated that "horizontal" commonality was required by the *Howey* test.

Second, the Court ruled that the expected profits were not to be derived from the "entrepreneurial or managerial efforts of others" than the purchasers themselves. The Court held that the purchasers would either use or consume the fractional share themselves, or they would make the decision to sell the nomination to other breeders.

In either instance, the purchasers would make a profit or take a loss through their own efforts. Once the Court had ruled that the fractional shares were not "investment contracts" under the federal and identical state definitions, the RICO claim also collapsed because it was founded upon a determination of securities fraud.

In reaching its decision, the Court did not discuss the line of cases beginning with *S.E.C. v. Glen Turner Enterprises Inc.*, 474 F.2d 476 (9th Cir.) *cert. denied* 414 U.S. 821 (1973), which posits a vertical commonality between the promoter and the purchaser as the test for common enterprise. Moreover, the Court did not clearly distinguish between the sale of the fractional shares in the stallion and the management contract.

The sale of the ownership in the stallion is likely not a security, while at the same time, the management contract (with accompanying promises and terms) could be a security. Indeed, this distinction between the sale contract and the management contract is the classic situation of *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293 (1946), arising from sale of interests in orange groves in the citrus industry.

Due to the factual situation before the Court in *Kefalas*, the decision is not precedent with respect to whether the sale of interests in a general partnership syndication or in a breeding right syndication is the sale of securities under federal or state laws. These issues are to be faced another day.

— *Drew L. Kershen*

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AALA Editorial Liaison: Donald B. Pedersen, University of Arkansas

Editor: Nancy Harris, Century Communications Inc

Contributing Editors: Terence J. Centner, University of Georgia; Patricia A. Conover, University of Georgia; Annette Higby, University of South Dakota; Drew L. Kershen, University of Oklahoma; Mary Helen Mitchell, Pioneer Hi Bred International; Donald B. Pedersen, University of Arkansas

State Reporters: John C. Becker, Pennsylvania; Patricia A. Conover, Alabama; Drew L. Kershen, Oklahoma; Gerald Torres, Minnesota.

For AALA membership information, contact Terence J. Centner, University of Georgia, 315 Conner Hall, Athens, GA 30602.

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Letters and editorial contributions are welcome and should be directed to Don Pedersen, director of the Graduate Agricultural Law Program, University of Arkansas, Waterman Hall, Fayetteville, AR 72701

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Federally licensed warehousemen can now transfer grain

When space shortages arise, a federally licensed grain warehouseman may now transfer stored grain to another warehouse for continued storage, according to Milton Hertz, acting administrator of the U.S. Department of Agriculture's (USDA) Agricultural Stabilization and Conservation Service (ASCS).

Transfers of grain, for which receipts had been issued by a warehouse, were previously prohibited by the U.S. Warehouse Act of 1916, as amended.

The 1916 law was amended on March 20, 1986, and grain transfers are now legal. The warehouse where the grain was first deposited and receipted will continue to be responsible to the owner for redelivery of quantity, kind, quality and grade of grain deposited. Warehousemen can move the grain to another warehouse, provided it is neither government-owned nor under loan to the Commodity Credit Corp. (CCC), according to Hertz.

Government-owned grain or grain under CCC loan remains under the terms of the Uniform Grain Storage Agreement (UGSA). To transfer grain under the UGSA, the warehouseman is still subject to the UGSA, and must fulfill the following requirements:

- For government-owned grain, the warehouseman must obtain written permission from the ASCS's Kansas City Commodity Office.
- For grain under CCC loan, the warehouseman must get written permission from the producers of the grain, and must advise the ASCS county office (in writing) of the amount of loan grain to be transferred, as well as the names of the producers involved.

Warehousemen with questions on the amendment can contact: Rolland Hendricks, chief, Warehouse License and Contract License Division, KCCO, ASCS, 8930 Ward Parkway, Kansas City, MO 64141; 816/926-6444.

The Secretary of Agriculture issued new regulations generated by the March 20, 1986 amendment, which were published in the May 9, 1986 Federal Register. 51 Fed. Reg. 17306 (1986). The regulations will be considered interim-final; however, interested parties can submit written comments. Comments must be received on or before July 8, 1986 for consideration.

Send comments to: Paul King, director, Warehouse Division, USDA, ASCS, Room 5968-S, P.O. Box 2415, Washington, D.C. 20013. Comments will be available for public inspection in Room 5968-S of the USDA's South Building during business hours.

— *USDA News Release*

Federally licensed warehouses

The Agricultural Stabilization and Conservation Service (ASCS) has published a list of warehouses licensed under the U.S. Warehouse Act, 7 U.S.C. § 241 et seq., as of Dec. 31, 1985, and a list of cancellations and/or terminations that occurred during calendar year 1985.

Copies of either list may be obtained from Mrs. Judy Fry, Warehouse Division, Warehouse Licensing Branch, U.S. Department of Agriculture, P.O. Box 2415, Room 5968, South Agriculture Bldg., Washington D.C. 20013; 202/447-3822. See 51 Fed. Reg. 7970 (1986).

— *Donald B. Pedersen*

STATE ROUNDUP

ALABAMA. *Governor Sues Department of Agriculture*. Gov. George C. Wallace filed suit April 29, 1986 in Circuit Court of Macon County, naming as defendants Richard Lying (sic), secretary of the U.S. Department of Agriculture; Kenneth Auberger, acting chairman of the Farm Credit Board; A, B and C, fictitious defendants whose identities are currently unknown, but who may be responsible for implementing the lending policies of the United States with respect to farm and agricultural related government loans.

Relying on an equal protection argument and alleging that the U.S. government has given more favorable treatment to foreign debtor nations than to United States farmers, the complaint seeks declaratory judgment and an injunction against the Farmers Home Administration from taking any adverse action toward Alabama farmers.

Citing Alabama usury laws, the complaint seeks an injunction against defendant Farm Credit from charging 12.5% on rural home loans, and 12.25% on farm loans.

— *Patricia A. Conover*

MINNESOTA. *Farm Products Rule Repealed*. In the 1986 Regular Session, Chapter 322, the legislature responded to the federal preemption of U.C.C. § 9-307(1) by repealing provisions adopted in 1985 that established a registration system for security interest in farm products. Effective March 15, 1986, buyers of farm products take free of security interests.

— *Gerald Torres*

MINNESOTA. *Omnibus Agriculture Act of 1986*.

Mandatory Mediation. Article 1 of Chapter 398 provides that any creditor seeking to enforce a security interest in agricultural collateral securing a debt of $5,000 or more must first submit to mediation. In cases where the debt is $5,000 or more, mediation must also precede efforts to attach, execute, levy or seize.

Mediation is also required prior to cancellation of a contract for deed or foreclosure of a mortgage. The requirement, however, does not apply when the debtor owns or leases less than 60 acres with less than $20,000 in gross sales of agricultural products in the preceding year.

Mediation provisions became effective on March 22, 1986, and the Act requires mediation notices for actions that "begin" on or after that date. Litigation is pending which should resolve confusion that has arisen concerning retroactivity of the mediation process.

Creditor's remedies are suspended until 90 days after initiation of mediation or a mediation agreement is reached. U.S. agency creditors have their remedies suspended for 180 days.

Mediators are to be appointed by the Director of the Agricultural Extension Service. Detailed time lines for mediation are spelled out in the legislation. When creditors do not participate in good faith during the initial mediation effort, there will be a second round of court-supervised mediation which may last an additional 60 days.

Creditors who do not demonstrate good faith in the court-supervised mediation may have their remedies delayed for an additional 180 days.

Agricultural Homestead. Article 2 of Chapter 398 requires that a notice of homestead rights be served in all mortgage foreclosures, even in instances where there may not be a homestead. The new statutory notice sets out rights of debtors to designate part of debtor's real estate as homestead property, to have that portion sold separately, and to separately redeem it.

Legal Assistance Program. Article 3 of Chapter 398 established a family farm legal assistance program, and funds it at $650,000.

Statutory Redemption. Article 12 of Chapter 398 clarifies the rights of the planting crop owner when the owner's statutory redemption period following mortgage foreclosure ends prior to harvest.

Landlords' Lien. Article 15 of Chapter 398 establishes a landlord lien and describes its priority position over other liens in the agricultural products or proceeds which are produced on the landlord's property during the lease period.

Homestead Acreage. Article 16 of Chapter 398 increases from 80 to 160 the acreage available for homestead exemption in rural land in cases of personal or deficiency judgments.

Deficiency Judgments. Article 19 of Chapter 398 limits deficiency judgments in foreclosure sales involving agricultural property. Instead of measuring the deficiency by subtracting the foreclosure sale price from the amount owed, the deficiency will be determined by subtracting the fair market value of the property from the amount owed.

— *Gerald Torres*

OKLAHOMA. *Deferrment Law*. In May 1986, Oklahoma adopted a law prohibiting the Federal Land Bank of Wichita and any local Federal Land Bank Association from initiating foreclosure action in the state courts of Oklahoma for a period of one year from the date of enactment unless the Capital Corporation of the Farm Credit System determines that the loan or loans held by the borrower are ineligible for restructuring assistance. Okla. Stat. Ann. tit. 62 §§ 492-493.

— *Drew L. Kershen*

OKLAHOMA. *Task Force on the Rural Crisis*. The Oklahoma Bar Association has appointed a Task Force on the Rural Crisis, whose membership is composed of attorneys that represent both borrowers and lenders.

The Task Force has decided to address three issues: Continuing legal education for attorneys representing the various parties; Development of a mediation dispute resolution program for farmers and bankers; and Creation of legal assistance programs for farmers.

The efforts of the Task Force have included the following: A seminar on agricultural finance held in Enid and Muskogee, Oklahoma in early May; Generation of a list of attorneys willing to take referrals from the Oklahoma Conference of Churches' AG-LINK HOTLINE (80 attorneys were on the list by late May); and A proposal on agricultural finance mediation (in conjunction with the Oklahoma State Department of Agriculture) for submission to the Oklahoma Supreme Court for its approval under the Court's new rules relating to mandatory mediation dispute resolution.

— *Drew L. Kershen*

PENNSYLVANIA. *Partial OSHA Preemption of Pennsylvania Right-to-Know Act*. *Manufacturers' Association of Tri-County v. Knepper*, 623 F.Supp. 1066 (D.C. Pa. 1985), is the first decision on issues raised by certain manufacturers and non-manufacturers to Pennsylvania's Worker and Community Right-to-Know Act, Penn. Stat. Ann., tit. 35, Sec. 7301 et seq. and the Occupational Safety and Health Act's (OSHA) Hazard Communication Standard, 29 C.F.R. §§ 1910.1200 et seq.

New Jersey State Chamber of Commerce v. Hughey, 774 F.2d 587 (3rd Cir. 1985), is important precedent for this decision.

Plaintiffs argued the Pennsylvania statute is preempted by the OSHA and its Hazard Communication Standard without regard to whether the employer is within Standard Industrial Classification (SIC) Codes 20-39. Defendants, while acknowledging that certain provisions of the Pennsylvania Right-to-Know Act are preempted, nevertheless maintain that the remainder of the Pennsylvania Act should be enforced, and that the preempted sections of the Act can be severed.

For reasons fully set forth in the opinion, the court concluded that the Pennsylvania Right-to-Know Act is entirely preempted by federal law to the extent that it requires employers in the manufacturing sector to identify and disclose information concerning workplace hazards.

The Right-to-Know Act is not preempted as it applies to all employers in the non-

(continued on next page)

STATE ROUNDUP
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manufacturing sector, nor as it requires all employers to disclose information relating to environmental hazards, except for the labeling requirement in the manufacturing sector. This means that to the extent that the Pennsylvania Right-to-Know Act applies to agricultural enterprises, preemption has not occurred.

The court also concluded that the Pennsylvania Act does not impose an undue burden on interstate commerce, and therefore, does not violate the Commerce Clause of the U.S. Constitution. Further, the court concluded that the Act does not work a taking of trade secret information without just compensation.

The case has been appealed to the Third Circuit, and the outcome of that appeal will be reported herein. Of course, if the OSHA should amend its Hazard Communication Standard and extend it to agriculture, it is likely that federal preemption would occur as to that portion of the non-manufacturing sector.

An extensive discussion of right-to-know standards and statutes as they impact agriculture appears at 3 *Agricultural Law Update* 4 (December 1985).

— *John C. Becker*

Jewell v. Bank of America: Ag lender appeals $22 million verdict

In an agricultural credit case that has received national attention, a California trial court judge, Hon. Laurence K. Sawyer, has upheld a massive jury verdict against the Bank of America — leaving an award of $17 million in general damages intact — but reducing an award of punitive damages from $22 million to $5 million. *Irene O'Connell Kruse, plaintiff, v. George M. Jewell, et al., defendants; George R. Jewell, cross-complainant, v. Bank of America et al., cross-defendants,* No. 112439 (Superior Ct. of the State of Calif., Co. of Sonoma) (order denying judgment notwithstanding verdict and conditional order granting new trial, Sept. 20, 1985).

The jury was out eight days before returning its verdict. The Bank of America has appealed, and cross-complainants and plaintiff have filed notices of cross-appeal.

The litigation began in 1981, when Ms. Kruse sued the Jewells over the failure of the James E. O'Connell Co., an apple processing plant located in the Sebastopol Valley, which served a group of independent farmers.

Another plant, located in the same valley, the Sebastopol Cooperative Cannery, was formed as a cooperative, with members signing five-year marketing agreements.

In 1976, Jewell and the Bank of America entered into an agreement whereby the bank loaned money to Jewell so that he, in turn, could make loans to the O'Connell Co.

Subsequently, the Bank of America cut off Jewell line of credit, and Jewell filed under Chapter 11 of the Bankruptcy Code. The Jewell cross-complaint against the Bank of America charged that the bank dominated as lender to both the Jewell-O'Connell operation and the cooperative.

The cross-complaint in this complex litigation alleged the breach of a fiduciary relationship between the Bank of America and the Jewells. Various allegations of fraud, negligence, conversion and bad faith were also included.

Among the most serious of the allegations was the suggestion that the Bank of America cut off the Jewell-O'Connell line of credit so as to force the O'Connell Co. out of business, thus compelling independent growers to divert their business to the cooperative.

It was alleged that the Bank of America wanted to shore up the slacking business of the Sebastopol Cooperative Cannery, given some $18 million in loans to this cooperative (loans far in excess of those to Jewell). Interestingly enough, the cooperative has now also failed.

The Bank of America argued that its decision to cut off credit to Jewell was a reasonable banking decision made in good faith under circumstances in which it had no obligation to continue to loan to or extend loans to Jewell.

In his order of Sept. 20, 1985, Judge Sawyer stated (in part):

> In the handling of these financial transactions, the Bank may have exhibited a conscious disregard for the rights of the parties, but there is also ample evidence that some Bank officials, especially at the local level, continue to support the business activities of the parties and advance money through hard economic times. For example, even though the defendant may have deceived the parties with respect to the making of a long-term loan, the evidence also shows that Mr. Sullivan [Bank of America] did continue to assist Mr. Jewell directly and the plaintiff indirectly with their financial problems and did make some effort to arrange for a long-term loan prior to the time of his early retirement. Likewise, the conduct of Mr. Bunch [Bank of America] in obtaining deeds of trust from Mr. Jewell appeared to be motivated in part by his desire to work out the financial difficulties of the parties before the time that the original complaint was filed. The Court is also of the opinion that the evidence is not sufficient to show that the wrongful conduct of the defendant was motivated by a corporate plan or scheme to put the parties out of business. Finally, the evidence shows that, in addition to the wrongful conduct of the defendant, other circumstances contributed to the losses incurred by the parties. For example, poor business judgment on the part of the plaintiff and the cross-complainant and adverse economic times were factors involved in the business losses suffered by those parties.

The appeal is one to watch as the implications for agricultural lenders and their borrowers are of considerable significance. If the reduced award of punitive damages stands, it will still be the largest in California history, exceeding the $3.5 million award against the Ford Motor Co. in one of the cases involving the Pinto automobile model. There are reports that several similar farm-related cases are pending in California.

— *Donald B. Pedersen*

AG LAW CONFERENCE CALENDAR

Summer Institute in Agricultural Law.
Agricultural Credit: U.C.C. Article 9, June 16-19; Agriculture and the Environment, June 23-26; Cooperative Taxation, June 30-July 3; Government Regulation of Agriculture: The 1985 Farm Bill, July 7-10; Biotechnology and Agriculture, July 14-17; Litigation and Agricultural Lending, July 21-24.

Contact Drake University Law School, Des Moines, IA; 515/271-2947.

1986 Annual Meeting: American Agricultural Law Association.
Oct. 23-24, 1986, Worthington Hotel, Fort Worth, TX.

Sessions on the Current State of Agriculture, Agricultural Policy, Role of the Bar, the Farmers Home Administration, the Farm Credit System, Innovative Financing, Creditor Responsibilities, Educational Directions, Farm Bankruptcies, The 1985 Farm Bill, Agricultural Labor, Tax "Reform" and U.C.C. § 9-307(1).

Watch for details.

Alternative minimum tax relief for farmers

Section 13208 of the Omnibus Budget Reconciliation Act of 1986, 100 Stat. 321, April 7, 1986, reduced the alternative minimum tax bite resulting from farmland foreclosures or sales or exchanges of farmland under the threat of foreclosure. The amendment applies to real property transactions made after Dec. 31, 1981.

In order to qualify for the special relief, the taxpayer and the transaction must meet certain conditions. The taxpayer must be a "farmer," i.e., 50% or more of the annual gross income of the taxpayer for the past three years must be attributable to the trade or business of farming. The taxpayer must be insolvent at the time of the transaction; i.e., there is an excess of liabilities over fair market value of assets.

The transaction must involve farmland and may include a transfer in cancellation of indebtedness or a sale or exchange under the threat of foreclosure. Farmland is any land used or held for use in the trade or business of farming.

It is important to note that the new provision is concerned with the alternative minimum tax, which can result when an insolvent farmer has capital gains in a "farm insolvency transaction." It does not apply to cancellation of indebtedness income as such, since that would be *ordinary* income — not capital gains.

Section 13208 refers to a *transfer* in cancellation of indebtedness. Such a transfer could result in both cancellation of indebtedness income (ordinary) and capital gains. This new provision would be concerned only with the latter, and provides for exclusion of long-term capital gains (in excess of losses) from the sale of farmland, but only to the extent of the taxpayer's insolvency before the transfer. I.R.C. §§ 108 and 1017 would be relevant to the former.

Finally, it is to be noted that Congress failed to create a "window" to allow the filing of amended returns to report liquidations that occurred in 1982. The Internal Revenue Service takes the position that the statute of limitations for filing amended returns has run for farmers who liquidated land in 1982.

Proposed regislation (H.R. 4617 and S. 2350), if enacted, would allow taxpayers an opportunity to amend their 1982 tax returns to take advantage of § 13208.

— *Patricia A. Conover*

USDA institutes radiation prevention measures for meat imports

In the wake of the Soviet nuclear accident at Chernobyl, the U.S. Department of Agriculture (USDA) will monitor meat and poultry imports from affected countries for radiation at U.S. ports of entry, according to Donald L. Houston, administrator of the USDA's Food Safety and Inspection Service.

In addition, the USDA has notified nations that export meat and poultry products to the United States that they must institute controls to prevent radiation contamination in products destined for the United States if high ground levels of radiation are detected in their country.

"At the present time, there appears to be no danger to meat and poultry imports from radiation contamination from the Chernobyl accident," said Houston.

"We are, however, taking the precautionary measure of requiring countries exporting meat and poultry to the United States to test ground contamination levels. If those levels exceed 0.13 microcuries (a measure of radiation) per square meter, we will require the countries to institute a control program to assure that the amount of radiation in the meat is below U.S. protective action levels," Houston explained.

As a check to assure compliance, the USDA will monitor incoming shipments at points of entry. If the monitoring indicates any radiation contamination, the product will be held while additional laboratory tests are performed to confirm the radiation level.

Houston said USDA employees regularly review foreign inspection systems to insure adherence to U.S. import standards. In affected countries, these reviews will include checks on compliance with radiation guidelines.

The USDA is responsible for ensuring that all meat sold in commerce is safe, wholesome and accurately labeled.

— *USDA News Release*

Unconscionable clauses in seed contracts

The Sixth Circuit Court of Appeals has upheld a district court decision that, under Michigan law, disclaimers and limitations of remedies in seed contracts sometimes may be unconscionable. *Martin v. Joseph Harris Co. Inc.*, 767 F.2d 296 (6th Cir., 1985).

In August 1972, certain Michigan commercial farmers (plaintiffs) placed orders for cabbage seed with defendant, Joseph Harris Co. (Harris Seed). As had been the case in earlier transactions, the order form supplied by Harris Seed included a clause disclaiming the implied warranty of merchantability and limiting the buyers' remedies to the purchase price of the seed.

A similar clause was used by Harris Seed's competitors. The plaintiffs did not read the clause, and defendant's salesperson did not point it out to them or explain its purpose.

Three to four months after plaintiffs had placed their orders, they received Harris Seed's 1973 catalog. The catalog contained a notification that Harris Seed was discontinuing the practice of "hot water" treating cabbage seed. The treatment had been successful in controlling a seed borne disease known as black leg, which causes affected cabbage plants to rot before maturing.

Plaintiffs planted their cabbage crop in April and May of 1973. In July 1973, Harris Seed notified plaintiffs that the seed they had purchased was infected with black leg. Despite plaintiffs' attempts to control the effects of the disease, a large portion of their cabbage crop was destroyed.

Due to a rise in the market price of cabbage, however, plaintiffs made a profit equal to or higher than in previous normal cabbage crop years.

The district court held that under Michigan law, the disclaimer of implied warranty of merchantability and limitation of remedies clause was unconscionable. The issues of negligence and breach of implied warranty were tried to a jury, which found for the defendant. The court, however, granted plaintiffs' motion, and entered judgment n.o.v. for the plaintiffs on the implied warranty issue.

In affirming, the Sixth Circuit gave considerable weight to the district court's view that under Michigan law, warranty disclaimers that complied with U.C.C. § 2-316 were limited by U.C.C. § 2-302.

The court noted that U.C.C. § 2-302 provides that "any clause" of a contract may be found unconscionable and that U.C.C. § 2-316 does not expressly state that disclaimers meeting its requirements are immune from general policing provisions such as U.C.C. § 2-302.

Citing *Allen v. Michigan Bell Telephone*, 18 Mich.App. 632, 171 N.W.2d 689 (1969),

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UNCONSCIONABLE SEED CLAUSES

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the Sixth Circuit stated that two inquiries must be made in resolving the unconscionability issue in a case such as this: 1) What are the relative bargaining powers of the parties, their relative economic strengths, the alternate sources of supply; and 2) Are the challenged terms substantively reasonable?

Applying the *Allen* test to the facts at hand, the Sixth Circuit noted that Harris Seed is a large, national producer and distributor of seed, and that plaintiffs are relatively small, independent farmers.

Furthermore, the farmers were limited in their alternate sources of supply, as all seed distributors placed similar disclaimers and limitation of remedies clauses in their contracts. The court also considered the fact that Harris Seed's salesperson did not point out to plaintiffs, who were uncounseled laymen, that the clauses in question altered significant statutory rights.

It was also important that the presence of black leg in the cabbage seed was a latent defect which was in the power of Harris Seed to control. The Court stated:

> If Harris Seed were permitted to rely on the disclaimer and limitation clause to avoid liability under the facts of this case, the farmers who had no notice of, ability to detect, or control over the presence of the black leg could lose their livelihood. On the other hand, Harris Seed, which had the knowledge, expertise and means to prevent the disease, would only lose a few hundred dollars. *Id.* at 301-2.

Harris Seed argued that there was no breach of implied warranty of merchantability because plaintiffs had suffered no economic harm due to the fact they were able to sell their reduced cabbage crop at a higher than normal market price.

The Sixth Circuit agreed with the district court's finding that the defendant's sale of the diseased seed to these two plaintiffs did not cause the higher market price. The court also found that some diseased seed had been sold by other seed distributors and, therefore, the higher market price was not caused by defendant's breach alone.

Thus, the proper measure of damages as applied by the district court was the difference in value between the cabbage crops actually raised by plaintiffs and the crops that would have resulted had the seed not been diseased.

The Sixth Circuit also held that the Federal Seed Act and the Michigan Seed Law did not set forth the full extent of Harris Seed's obligation of merchantability and that, therefore, the seed was subject to the warranty provisions of the Uniform Commercial Code (UCC).

Finally, the Sixth Circuit ruled that since Harris Seed had failed to prove that the disease could have been caused by anything other than the defective seed, the district court had not erred when it granted plaintiffs' motion for judgment n.o.v.

— *Mary Helen Mitchell*

FmHA ordered to pay "refund"

In *Payne v. Block*, 622 F.Supp. 904 (D.C. Colo. 1985), the Farmers Home Administration (FmHA) was ordered to "refund" planned family living and farm operating expenses which the court held were seized in violation of the borrowers' due process rights.

Larry and Carolyn Payne operated a dairy farm. In connection with their FmHA loan, they assigned $4,906 of their monthly milk income directly to the FmHA. The remainder of the milk proceeds were used for family living and farm operating expenses.

In the summer of 1983, the Paynes suffered crop damage from a severe hail storm, forcing them to purchase feed which they would otherwise have produced themselves. Further difficulties during the winter of 1983-84 resulted in reduced milk output, and the Paynes became delinquent in their payments to the FmHA.

The Paynes' milk income declined, leaving insufficient income (after the FmHA deduction) to allow them to pay budgeted operating and living expenses as set out in their Farm and Home Plan. The Paynes requested that the FmHA release a portion of their milk assignment to allow them to meet these expenses. Their request, however, was denied by letter.

Shortly thereafter, the Paynes were sent a "pretermination notice," informing them that the FmHA intended to accelerate their debts and foreclose on their real estate. The notice gave the Paynes an opportunity to request servicing relief, including a deferral of loan payments. Their request for this relief was denied by letter.

The Paynes brought suit for declaratory and injunctive relief, compensation for wrongfully withheld funds and punitive damages.

In response to plaintiffs' motion for partial summary judgment, the court held that the Paynes were members of the national class of FmHA borrowers in *Coleman v. Block*, 580 F.Supp. 194 (D.N.D. 1984).

Coleman mandated that FmHA borrowers be afforded procedural due process (including notice and an informal hearing) and substantive consideration for deferral or other servicing relief prior to foreclosure or termination of releases for family living and farm operating expenses.

The court in *Payne* refused to distinguish *Coleman* on the basis of the milk assignment, holding that the existence of the income assignment did not modify the FmHA's obligation to give first priority in the release of income to living and operating expenses.

The court ordered the FmHA to release sufficient funds for living and operating expenses until the Paynes were provided "reasonable notice and a prior hearing on the issue of termination," and until given the right to apply for (under appropriate regulations) a deferral of loan payments.

The court held further that the prior seizures of funds were in violation of plaintiffs' rights to due process of law, and ordered that "such amounts as have been so seized...must be refunded to plaintiffs."

— *Annette Higby*

FCIC: Timely acreage reports essential

A farming couple who suffered total crop loss of their 1983 corn, soybean and peanut crops were held to be without crop insurance coverage in *Ward v. Federal Crop Insurance Corp.*, 627 F.Supp. 1545 (E.D.N.C. 1986).

The Wards were eligible for Federal Crop Insurance Corp. (FCIC) crop insurance coverage for 1983, received policies early in that year, and confirmation notices in the spring. The Wards, however, failed to file timely acreage reports by July 15, 1983 (as required by the contracts). According to the contracts, the FCIC may then elect to determine that the insured acreage is "zero."

The court found the contract clause to state a condition precedent to insurance coverage. Relying on *FCIC v. Merrill*, 332 U.S. 380 (1947), the court noted that "neither ignorance of nor hardship to the Wards, nor their misplaced reliance upon the acts of an agent of FCIC, can vitiate the requirements that the Wards comply with the condition precedent to the effectuation of insurance coverage in this case."

The court also noted that the fact that the Wards had submitted acreage data to the Agricultural Stabilization and Conservation Service (ASCS) prior to the FCIC filing deadline did not constitute compliance as the ASCS is not an agent of or component part of the FCIC.

— *Donald B. Pedersen*

Grain warehouse failure: Farmers vs. CCC

The recent decision in *Preston v. United States*, 776 F.2d 754 (7th Cir. 1985), grew out of the failure in the early 1970s of a grain warehouse located in Evansville, Wis. The fact pattern is classic. Farmers dealt with the warehouse both as bailors under grain storage contracts and as sellers under price-later contracts.

Under the price-later contracts, the warehouse would purchase grain delivered by farmers pursuant to an agreement to pay the market price once that price had been set at a future date. The warehouse also served as a storage facility for the Commodity Credit Corp. (CCC), which owned grain acquired when farmers forfeited under CCC price support loans.

On Nov. 30, 1972, the warehouse (as bailee) should have held 474,601.48 bushels of farmer-owned and CCC-owned stored grain. Actually, only 438,406.84 bushels were on hand in the commingled mass. The CCC, upon discovering the shortage, issued two load-out orders, and took physical delivery of 293,446.12 bushels of grain — the total number of bushels that the CCC had in storage.

Following this delivery, the warehouse filed for bankruptcy. Given the farmer/bailor claims of 181,125.36 bushels, the CCC was found to have overdrawn its prorata share of the commingled mass by 22,380.72 bushels.

Relying upon a conversion theory and the Federal Tort Claims Act, 28 U.S.C. § 2674, plaintiff farmers obtained a judgment against the CCC for $79,675.36 in damages ($3.56 per bushel), such judgment being affirmed by the Seventh Circuit in *Preston*. Plaintiffs' recovery represented only the value of the stored grain converted by the CCC, and did not include "loss of use" or interest, given the strictures at 28 U.S.C. § 2674.

In an interesting effort to prove an even greater level of conversion by the CCC, plaintiffs argued that the actual claims against the commingled mass exceeded 474,601.48 bushels. The defunct warehouse itself had acquired title to grain sold and delivered by farmers under price-later contracts. Title had passed on delivery, even though farmers had never been paid.

Given the shortage and the inability of the warehouse to fully honor the bailment claims of farmers and the CCC, however, the court properly held that the warehouse had no claim against the commingled mass based on some number of bushels of company-owned grain.

"If the warehouse is responsible through its fault or negligence for the loss, then it, as a bailee for the goods, will not be entitled to share prorata in the goods remaining following the loss." *Id.* at 759.

This case suggests an avenue of recovery against a fellow bailor who, with actual knowledge, draws more than his prorata share from a warehouse experiencing a shortage, even where that fellow bailor is the CCC.

Of course, in this case, had the CCC withdrawn a lesser amount so that enough remained in the commingled mass to give farmers their full prorata shares, the conversion case would have been headed off by crediting the number of bushels the CCC had withdrawn after acquiring actual knowledge of the shortage at the warehouse against its rightful prorata share. See *United States v. Luther*, 225 F.2d 499 (10th Cir. 1955).

Shorted bailors (to the extent that in a failed warehouse their prorata share of grain on hand does not cover their actual bailment claims) can pursue other remedies not discussed in *Preston*. A claim as an unsecured creditor can be filed in the warehouse bankruptcy (with the benefit of the limited $2,000 fifth priority since the Grain Warehouse Amendments of 1984).

Other avenues of relief may include a claim against the warehouse bond or private surety deposit (In 1985, Wisconsin reduced minimum bond requirement for state licensed warehouses from 40% to 20% of the current market value of grain stored in the warehouse); conversion suits against the warehouse manager and directors; claims against a state indemnity fund if one now exists; claims against private insurance in the rare cases where such coverage has been purchased by the farmer; or a suit against a principal if the warehouse turns out to be the agent of some larger grain company or other institution.

While *Preston* does not explore the status of farmers who delivered under price-later contracts and were never paid, it is clear that they stand as unsecured creditors of the warehouse. Other than an unsecured claim in the warehouse bankruptcy (with the benefit of the limited $2,000 fifth priority pursuant to the Grain Warehouse Amendments of 1984), these farmers have little recourse unless they happen to uncover evidence of an undisclosed principal as in *A. Gay Jenson Farms Co. v. Cargill Inc.*, 309 N.W.2d 285 (Minn. 1981), or are in a jurisdiction that has now enacted an indemnity fund scheme that extends to unpaid sellers of grain, as well as to shorted bailors.

— Donald B. Pedersen

Patent controversies: Harvesting equipment

The continued adoption of new technology in agriculture has been accompanied by the use of patent law to encourage and assist inventors. Two recent federal decisions concerning patents for agricultural harvesting equipment highlight problems which may be encountered by agricultural clients developing, adopting, modifying or selling patentable technology.

The first case involved an infringement action against a farm supply store for selling unpatented replacement disks for the patented header of a tomato harvester. *Porter v. Farmer Supply Service Inc.*, 617 F.Supp. 1175 (D. Del. 1985).

The claim alleged that the unpatented disks sold by the farm supply store directly and contributorily infringed upon a patent. The court found that the omission of any one element of the combination claim of patent for the entire header precluded a finding of direct infringement for the sale (by themselves) of the unpatented component disks.

The rights of a holder of a combination patent extend only to the sale and manufacture of articles that contain every element of the claim, and not to independent elements by themselves. The claim of contributory infringement against the farm supply store could be maintained if use of the unpatented disks by purchasers directly infringed upon the patent.

The court found that the disks were being used by the owners of the harvesters to replace a worn, unpatented part. This constituted a repair, which meant that there was no direct infringement by harvester owners to support the allegation of contributory infringement. Therefore, the farm supply store was entitled to summary judgment.

The second case, *Harrington Manufacturing Co. v. Powell Manufacturing Co.*, 623 F.Supp. 872 (E.D. N.C. 1985), concerned the validity of a patent by an overzealous inventor.

One of three joint-inventors had shared their invention of a mechanical tobacco harvester with an agricultural editor of a newspaper more than one year prior to filing for a patent. Pursuant to the public use rule of 35 U.S.C. § 102(b), this public disclosure of the harvester defeated their right to a patent.

Although inventors may demonstrate their inventions in experimental use without compromising their right to a patent, public use of the invention more than one year prior to filing for a patent is not permitted.

— Terence J. Centner

Address Correction Requested

Agricultural Law Update

5520-G Touhy Avenue
Skokie, IL 60077

AMERICAN AGRICULTURAL LAW ASSOCIATION NEWS

1987 OBERLY AWARD NOMINATIONS. Nominations are sought for the 1987 Oberly Award for bibliographic excellence in the agricultural or related sciences. To be eligible, a bibliography must have been published in 1985 or 1986, and an author, editor or compiler must be a U.S. citizen.

Bibliographies will be judged on usefulness, scope, accuracy, format, explanatory features and indexing methods. The Oberly Award Committee will consider bibliographies on any aspect of agriculture and related sciences. Thus, a bibliography on the broad field of agricultural law, or a narrow topic, such as estate planning for farmers, would be considered.

The award is administered by the Science and Technology Section of the Association of College and Research Libraries. It will be presented at the annual meeting of the American Library Association in 1987. Nominations in the form of a letter and, if possible, a copy of the bibliography should be sent by Jan. 1, 1987 to: John P. Abbott, chair, Oberly Award Committee, Box 8001, North Carolina State University, Raleigh, NC 27695-8001.

POSITION AVAILABLE. Members of the American Agricultural Law Association (AALA) interested in applying for appointment as editorial liaison to *Agricultural Law Update* (effective October 1986 issue) should contact: Neil D. Hamilton, Drake University School of Law, Des Moines, IA 50311; 515/271-2824.

STATE REPORTERS. *Agricultural Law Update* is pleased to announce that Daniel M. Roper is taking over as state reporter for Georgia, replacing Terence J. Centner. Sidney F. Ansbacher has agreed to fill the Delaware vacancy.

1986 ANNUAL MEETING. Mark your calendar now for the 1986 meeting of the AALA, to be held at the Worthington Hotel in Fort Worth, Texas, October 23-24. Join your peers for two days of information and discussion.

"IN DEPTH" ARTICLES. In order to bring you a number of articles of medium length, we omitted the "In Depth" article from this issue. "In Depth" pieces, however, will resume with the July 1986 issue.

During the next several months, you can anticipate "In Depth" articles on pesticide litigation, veterinary jurisprudence, cooperative tax netting and tracing issues, the H-2 Foreign Agricultural Worker Program, the Freedom of Information Act as administered by the U.S. Department of Agriculture, pleading and practice in cases against the Farmers Home Administration, the use of foreign sales corporations by cooperatives, agriculture/wetlands conflicts, and much more.

Articles on farm credit crisis issues and legal aspects of the 1985 Farm Bill will continue to appear. If you are interested in writing an "In Depth" article for *Agricultural Law Update* (roughly 3,000 words), contact Donald B. Pedersen, professor of law and director of the Graduate Agricultural Law Program, University of Arkansas School of Law, Fayetteville, AR 72701; 501/575-6109.