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What government is the best? That which teaches us to govern ourselves.

— Goethe

Cooperative securities and director liability

Difficult financial times have led some cooperatives to attempt to raise additional funds through various financial devices or programs, including the sale of demand notes.

Farmers Co-op of Arkansas and Oklahoma Inc., initiated a demand note program in 1980, whereby the cooperative sold unregistered demand notes to more than 1,600 members (raising more than $10 million), labeling the program as a "Co-op Investment Program."

In a significant judicial ruling, a federal district court has found that the sale by the cooperative of unregistered demand notes violated the Arkansas Securities Act. *Robertson v. White*, 635 F.Supp. 851 (W.D. Ark. 1986).

The court interpreted Arkansas law as imposing an absolute duty on officers and directors to register securities prior to sale, or ascertain that they are exempt from registration so that officials breaching this duty are jointly and severally liable to the purchasers. Ark. Stat. Ann. Sec. 67-1256.

Furthermore, cooperative directors or officers cannot rebut the negligent non-registration of securities by alleging reliance on the advice of counsel, as the registration requirement is basically a "strict liability" provision.

The *Robertson* case raises some important issues for consideration by cooperatives. First, has the cooperative initiated any financing program that may constitute the sale of a security? If so, has the cooperative registered its securities under applicable state and federal laws, or does the cooperative qualify for exemption or exception from the registration provisions?

Of course, cooperatives operating in more than one state generally will be bound by more than one blue-sky law, and will, therefore, need to ascertain compliance under each state's statutes.

(continued on next page)

Farm Credit Administration publishes final rules on borrowers' rights

On Oct. 28, 1986, the Farm Credit Administration (FCA) published final rules implementing the borrower rights provisions of the Farm Credit Act Amendments of 1985. 51 Fed. Reg. 39,486-39,504 (1986). In general, the Farm Credit Act Amendments of 1985 mandated the creation or extension of borrower rights in four areas:

1. The disclosure of information relating to interest rates on loans (12 U.S.C. § 2199 (a);
2. The establishment of credit review committees by the board of each system institution (12 U.S.C. § 2202);
3. The development of forbearance policies by system institutions (12 U.S.C. § 2199(b)); and
4. The provision of access to certain loan documents by borrowers (12 U.S.C. § 2200).

The proposed rules were published on May 8, 1986. 51 Fed. Reg. 17,035-17,049 (1986). As is reflected in the FCA's 14-page summary of the comments that it received on the proposed rules that precedes the text of the final rules, the rules generated considerable controversy.

A greater controversy (and one certain to result in litigation), however, is developing over the FCA's position that the new borrower rights will not be given to system borrowers who were subject to "collection actions" commenced before Nov. 28, 1986, the effective date of the final rules. 51 Fed. Reg. 39,497 (1986).

The expected challenges to the exclusion of certain borrowers from the benefits of the borrower rights provisions of the 1985 amendments most likely will be premised on allegations that the decision to exclude those borrowers did not comply procedurally with the Administrative Procedure Act, 5 U.S.C. § 553, and was arbitrary, capricious, or otherwise contrary to law. *See generally*, 5 U.S.C. § 706.

(continued on next page)

Second, the imposition of liability on cooperative directors and the general manager in *Robertson* raises a question of the desirability of bylaw indemnity provisions or liability insurance for officers and directors. Many cooperatives already provide for the indemnification of directors and officers in instances where the officials deviate from a prudent-man "duty of care."

Robertson, however, suggests that a cooperative may also want to indemnify directors in situations where negligent acts result in liability under strict responsibility laws. This latter coverage need not include indemnity for all director or officer negligence, but could be limited to acts that may result in liability under strict responsibility laws.

Finally, *Robertson* raises the policy issue of the desired scope of state securities laws' application to cooperative financing programs. The Arkansas statute contained a qualified exemption for certain cooperative securities, but the cooperative in *Robertson* had failed to qualify for the exception.

It has been argued that under the principles of cooperation, cooperative members do not need the protection offered by securities laws, and therefore, cooperative financing programs should not be subject to the registration provisions of the securities acts.

As noted in *Robertson* court, however, the "very evil the blue-sky laws were designed to deter [is] the broadscale public solicitation of large amounts of unsecured capital by the cooperative for deployment in a speculative venture." (*Id.* at 863-64).

Robertson suggests that there may be instances in which cooperative members need the protection of the securities laws.

— *Terence J. Centner*

FCA FINAL RULES ON BORROWERS' RIGHTS
CONTINUED FROM PAGE 1

The procedural challenge arises from the failure of the proposed rules to make reference to the exclusion of any current System borrowers. Also, no record was developed to support the decision of the FCA to exclude borrowers facing collection actions.

The substantive challenge centers on the fact that the borrower rights provisions of the 1985 amendments became effective Jan. 22, 1986. Pub. L. No. 99-205, § 401, 99 Stat. 1678, 1709 (1985). The legislation specifically provided that it was "... the sense of Congress that the pressing needs of the Farm Credit System and the United States agricultural industry require the implementation of this Act as soon as practicable..." *Id.*, § 403, 99 Stat. at 1710.

Hence, it may be argued that Congress intended that the borrower rights provisions be available to all current borrowers of the Farm Credit System as of the amendments' effective date.

Apart from the exclusion of a group of borrowers, the final rules are noteworthy for their affording borrowers seeking forbearance the right to appeal a denial to the institution's credit review committee. 51 Fed. Reg. 39,502-03 (1986) (to be codified at 12 C.F.R. § 614.4513).

The proposed rules had excluded appeals to the credit review committees by borrowers seeking forbearance on an existing loan. 51 Fed. Reg. 17,047 (1986). In addition, the definition of forbearance was expanded in the final rules to include "a reduction in the amount or rate of principal or interest" due on a loan. 51 Fed. Reg. 39,502 (1986) (to be codified at 12 C.F.R. § 614.4513(b)).

— *Christopher R. Kelley*

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Wild horse damage not "taking"

The case of *Mountain States Legal Foundation v. Hodel*, 799 F.2d 1423 (10th Cir. 1986), *reversing*, 740 F.2d 792, was brought on behalf of the members of a grazing association whose members ranch in southwestern Wyoming. The land in question is known as the "checkerboard" because of the pattern in which public and private lands are mixed.

The plaintiffs claim that the Secretary of the Interior has statutory responsibility for managing wild horses and burros on public lands, and that the horses have been going on the private lands of plaintiffs, where they consume large amounts of forage and contribute to deterioration of surface.

Plaintiffs claim a Fifth Amendment "taking." The court phrased the issue in the case as "whether the Secretary's failure to manage the wild horse herds in accordance with the requirements of the Wild Free-Roaming Horses and Burros Act...gives rise to a claim for a taking of the Association's property under the Fifth Amendment."

The court, in holding for the United States, pointed out that wild horses and burros are wild animals and are managed by governments in the same manner as other wild animals. Wild horses are not federal instrumentalities invading private land, as plaintiffs asserted. Damage to private property by protected wildlife does not constitute a taking.

— *John H. Davidson Jr.*

State redemption rights and the FmHA

In the case of *United States v. Elverud*, 640 F. Supp. 692 (D.N.D. 1986), Farmers Home Administration (FmHA) borrowers, whose loans were foreclosed, sought the benefit of North Dakota's one-year redemption period (N.D. Cent. Code Section 28-24-01 (Supp. 1985)).

The district court held that federal law governs, and that the North Dakota law should not apply. Instead, the court established an equitable period of redemption based upon the particular facts of the case. It was noted that this approach allows the court to tailor the redemption period to the likelihood of the borrower's eventual ability to redeem the property.

The parties have reached an agreement that the case will not be appealed.

— *John H. Davidson Jr.*

MSPA family business exemption

The family business exemption in the Migrant and Seasonal Agricultural Worker Protection Act (MSPA), 29 U.S.C. § 1803(a)(1), exempts the following groups of persons from the MSPA's requirements:

> Family business exemption. - Any individual who engages in a farm labor contracting activity on behalf of a farm...which is owned or operated exclusively by such individual or an immediate family member of such individual, if such activities are performed only for such operation and exclusively by such individual or an immediate family member...

29 U.S.C. § 1802(6) defines a "farm labor contracting activity" as the act of "recruiting, soliciting, hiring, employing, furnishing, or transporting any migrant or seasonal agricultural worker." (It is to be noted that this definition is in the disjunctive).

MSPA regulations define immediate family to include only spouse, children, parents, brothers and sisters. 29 C.F.R. § 500.20(o).

The decision in *Martinez v. Berlekamp Farms Inc.*, 635 F.Supp. 1191 (N.D. Ohio 1986), holds that the defendants' admitted use of independent, third party crew leaders in their farm operations disqualifies them from the MSPA family business exemption.

Not surprisingly, the court firmly rejected an argument that the MSPA is designed only to regulate the activities of farm labor contractors, and not those of farmers who use migrant and seasonal workers.

Of much more potential consequence is the decision in *Bueno v. Mattner*, 633 F.Supp. 1446 (W.D. Mich. 1986). In this case, a farmer was denied the family business exemption, even though there had never been explicit authorization given to non-family members to perform farm labor contracting activities. There was a tacit understanding, however, that the farmer would hire new workers brought to the farm by repeat help.

Accordingly, those non-family members who solicited, furnished, or transported migrant and seasonal agricultural workers were held to be doing so on behalf of the farmer, and were in violation of the stricture in the family business exemption.

The decision in *Bueno* could have far reaching implications if it is a common practice for farm employers to encourage members of their work force to bring new workers. There is no requirement that such employees be paid money or other valuable consideration to be found to be engaging in farm labor contractor activities under the MSPA.

— *Donald B. Pedersen*

Veterinarians: The standard of skill and care

In a recent United States Court of Appeals case arising in Louisiana, *Ladnier v. Norwood*, 781 F.2d 490 (5th Cir. 1986), the court considered three issues of importance to veterinarians. These were the standard of skill and care for the practitioner, the standard for the specialist, and the applicability of medical malpractice law to veterinary medical malpractice.

In affirming a district court decision that the veterinarian was not negligent in administering a drug to a horse or in failing to inform the plaintiff about the possibility of a bad reaction, the court of appeals found (with respect to these three issues) that a "locality rule" still applies to general veterinary practitioners, that the skill of an equine practitioner will be compared to that of other equine specialists, and that some (but not all) of the decisions and statutes affecting the medical profession may be carried over to help determine issues arising in veterinary medicine.

A Louisiana statute, La. Rev. Stat. Ann. Sec. 9:2794(A) (West Supp. 1985), establishes a locality rule for physicians and dentists and a general rule for medical specialists. A statutory provision on the standard of skill and care is not usual, and the Louisiana statute runs counter to what now appears to be the standard applied by most courts.

For example, in *Kerbow v. Bell*, 259 P.2d 317, 319 (Okla. 1953), the court said: "A person professing and undertaking to treat animals is bound to use in performing the duties of his employment such reasonable skill, diligence, and attention as may ordinarily be expected of careful, skillful, and trustworthy persons in his profession."

And in *Avey v. St. Francis Hospital and School of Nursing*, 442 P.2d 1013, 1022 (Kan. 1968), a medical malpractice case, the court said: "The need for emphasis on locality no longer exists...We believe the knowledge of similar conditions is the essential element rather than geographic proximity."

The court in *Ladnier*, while it felt comfortable in applying to veterinarians the Louisiana statutory provision defining the degree of knowledge and skill for physicians or dentists, expressed doubt that Louisiana's Uniform Consent Law, La. Rev. Stat. Ann. Sec. 40:1299.40 (West 1977), should be applied by analogy to veterinarians.

This expression of doubt is dicta, however, since the court found that the possibility of a bad reaction was so minimal that the veterinarian breached no duty in failing to warn.

— *H. W. Hannah*

Federal Register in brief

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

1. FmHA: Controlled Substances Production Control. 51 Fed. Reg. 40,783. Final Rule. The FmHA amends its regulations to prohibit assistance to applicants/borrowers who have been convicted of planting, cultivating, growing, producing, harvesting, or storing a controlled substance after Dec. 23, 1985. Comments must be submitted by Dec. 10, 1986. Effective date: Nov. 10, 1986.
2. Animals Destroyed Because of Brucellosis. 51 Fed. Reg. 41,108. Proposed Rule. Written comments due by Dec. 15, 1986.
3. Disaster Assistance; Withdrawal of Proposed Revisions. 51 Fed. Reg. 41,132. FEMA withdraws proposed rules revising disaster assistance regulations (51 Fed. Reg. 13,332).
4. Disaster Payment Program for 1986 Crops. 51 Fed. Reg. 41,757. Interim Rule. Effective date: Nov. 17, 1986. Comments due by Dec. 4, 1986.
5. Federal Crop Insurance Corp.; General Administrative Regulations — Appeal Procedure. 51 Fed. Reg. 41,800. Proposed Rule. Written comments due by Jan. 20, 1987.
6. Farm Credit Administration; Miscellaneous Technical Changes. 51 Fed. Reg. 41,932. Final Rule. Effective date: Nov. 20, 1985.
7. Viruses, Serums, Toxins, and Analogous Products; Experimental Products and Exempted Products. 51 Fed. Reg. 41,975. Proposed Rule. Comments due by Jan. 5, 1987.
8. Tuberculosis in Cattle; State Designations. 51 Fed. Reg. 42,081. Interim Rule. Effective date: Nov. 21, 1986. Comments accepted until Jan. 20, 1987.
9. Rules of Practice Governing Proceedings Under the Packers and Stockyards Act; Rules Applicable to Reparation Proceedings. 51 Fed. Reg. 42,082. Final Rule. Effective date: Dec. 22, 1986.
10. Farm Credit Administration; Disclosure to Shareholders; Accounting and Reporting Requirements. 51 Fed. Reg. 42,084. Final Rule. Effective date: Nov. 21, 1986.

— *Linda Grim McCormick*

Some observations on lender liability and representing the farmer/borrower

by Christopher R. Kelley

Introduction

"A legal doctrine now being forged in courts across the country is sending chills down many a banker's spine." With those words, the publication *United States Banker* introduced its readers to lender liability in the cover story of its May 1986 issue.

Characterizing lender liability as a "threat" that "is real and growing," the article warned of banks being "targeted" for lawsuits that strike at "lending — the bedrock of banking." Swartz, *Lender Liability*, U.S. Banker, May 1986, at 10.

Although some would contend that the introduction of lender liability to the readers of *United States Banker* tended toward the hyperbolic, lender liability indisputably is receiving greater attention by lawyers and bankers. Articles on the subject recently have appeared in publications ranging from law journals to trade journals. Flick & Replansky, *Liability of Banks to Their Borrowers: Pitfalls and Protections*, 1986 Banking L.J. 220; Cappello, *Banking Malpractice?*, Case & Comment, Sept.-Oct. 1986, at 3; Victor, *Lender-Liability Doctrine Gives Creditors Clout*, Nat'l. L.J., Sept. 1, 1986, at 1; Pelzer, *Farmers vs. Lenders*, Agri Finance, Jan. 1986, at 60; Cochero and Clark, *Lenders, Better Watch Your Backs*, A.B.A. Banking Journal, Nov. 1986, at 31; Wright, *Creditor Fiduciary Contractual and Statutory Responsibilities in Farm Lending*, 1986 A.A.L.A. Seventh Annual Meeting Proc. (citing additional articles). Because of the current financial distress of farmers, lender liability is becoming an increasingly significant aspect of agricultural law.

In essence, lender liability is the accountability of a lender for its lending practices and conduct. At the current stage of its development, it is a concept that encompasses a variety of theories upon which liability may be asserted or predicated.

The more common theories are constructive and actual fraud, duress, breach of the covenant or the implied duty of good faith, breach of fiduciary duty, interference with contractual relationships, interference with business relations, negligence, and indemnity under a joint venture or partnership theory.

The reception that lender liability has received in the courts (at least at the appellate level) has been mixed. Thus far, the landmark victories for borrowers include *State National Bank v. Farah Manufacturing Co.*, 678 S.W.2d 661 (Tex. Ct. App. 1984) (lender held liable for fraud, duress, and interference with business relations for implying that loan would be called if certain management changes were not made); *K.M.C. Co. Inc. v. Irving Trust Co.*, No. 3-82-36, slip. op. (E.D. Tenn. 1983), *aff'd*, 757 F.2d 752 (6th Cir. 1985) (lender held liable for refusing to make loan advances based on implied duty of good faith imposed by Uniform Commercial Code); *A. Gay Jenson Farms Co. v. Cargill Inc.*, 309 N.W.2d 285 (Minn. 1981) (lender's assumption of control over borrower's business resulted in liability as a principal for the debts of the borrower); and *Alaska State Bank v. Fairco*, 674 P.2d 288 (Alaska 1983) (liability for improper acceleration of note predicated on breach of obligation of good faith and fair dealing).

Borrowers have suffered defeats, however, the most notable of which was *Centerre Bank of Kansas City, N.A. v. Distributors Inc.*, 705 S W.2d 42 (Mo. Ct. App. 1985) (declining to impose an implied duty of good faith on a lender seeking payment on a demand note).

Nevertheless, with jury awards to the borrower reaching $22 million for punitive damages as recently occurred in *Jewell v. Bank of America*, No. 112439 (Superior Ct. of the State of Calif., Co. of Sonoma) (trial court reduced the award of punitive damages to $5 million, but left the award of $17 million general damages intact, with case now on appeal), borrowers are now aware that juries will hold lenders accountable where the circumstances warrant.

Rather than re-tracing the increasingly well-worn path of reviewing each of the landmark and other decisions, this article will focus on several of the practical problems and tasks of litigating a lender liability action on behalf of a farmer. As any attorney who has represented a plaintiff in such litigation will tell you, the course of lender liability litigation presents some unique difficulties.

In large part, the difficulties are attributable to the relative novelty of lender liability, the concomitant problems arising from the need to base the theories of recovery on traditional common law doctrines that developed in other contexts, as well as the tendency of lenders to resist with unparalleled tenacity.

The Two Phases of the Farmer-Lender Relationship

The threshold task in lender liability litigation is determining whether a cause of action exists. For one reason or another, lawyers representing farmers often do not obtain sufficient facts from their clients to properly assess the existence of a lender liability action. All too often, once the lawyer learns that the client has signed a promissory note and has not paid it on demand or at its maturity, the inquiry stops.

The error in stopping the inquiry after a review of the farmer's compliance with the terms of the promissory note is that in virtually every agricultural lender-borrower relationship, that note is not the "real" agreement between the parties.

Both lawyers and judges have the tendency to assume — without question — that the promissory note necessarily reflects the substance of the obligations between the lender and the farmer. Overcoming that assumption is essential — not only to evaluating your client's situation — but also to prevailing on a lender liability claim.

The typical farmer/borrower has only one or two major creditors for his land and operating indebtedness. Looking back over the typical relationship between a farmer and his major lender, two phases can usually be seen. Both have significance in the context of lender liability.

The First Phase

The first phase is usually the longer one, encompassing all of the years before the relationship between the farmer and the lender soured. During that time, a number of legally significant things may have occurred. First, all of the elements of a fiduciary relationship may have arisen.

As a general rule, a fiduciary relationship does not arise solely from the lender-borrower relationship. *E.g., Kurth v. Van Horn*, 380 N.W.2d 693, 696 (Iowa 1986); and *Thigpen v. Locke*, 363 S.W.2d 247, 253 (Tex. 1962). Accordingly, the existence of a fiduciary relationship will depend upon the facts and circumstances of each case. The indicia of a fiduciary relationship include the following:

> the acting of one person for another: the having and the exercising of influence over one person by another; the reposing of confidence by one person in another; the dominance of one person by another; the inequality of the parties; and the dependence of one person upon another

Id. (citing *First Bank of Wakeeney v. Moden*, 681 P.2d 11, 13 (Kan 1984) (per curiam) and 36A C.J.S. *Fiduciary*, at 386-87 (1961)).

An examination of the relationship between a farmer and one of his major lenders will commonly reveal that the farmer has dealt with that lender exclusively for a long period of time. Often, that farmer initially chose that lender (or was solicited by the lender) to do business with it on the basis that

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the lender "understood" agriculture. It is not uncommon for commercial lenders to acquire and foster relatively specialized reputations, such as being a good "cattle bank."

Of course, some lenders (such as production credit associations) have made their "understanding" of agriculture the virtually exclusive theme of their marketing efforts.

The lender's "understanding" of agriculture usually meant two things. First, before the current crisis, it was more common for lenders' references to the cyclical nature of a farmer's fortunes to take the form of a promise or pledge to stick with the farmer through "thick and thin."

In today's farm crisis, it is easy to forget that banks once competed for the opportunity to extend loans to farmers. A lender's assurance to the farmer that the bank would be with him for a long term was one way to gain and maintain the farmer's business.

Second, a lender's understanding of agriculture also typically meant that the lender had loan officers and other staff who were knowledgeable about farming. The lender was not only a source of capital, but also of advice and direction on matters ranging from marketing strategies to land purchases. Many farmers looked to their banks as the primary source of advice and direction on the financial aspects of their operations.

At this point in the farmer's relationship with his lender, most, if not all, of the indicia of a fiduciary relationship will be present. After years of borrowing exclusively from one lender, alternative lines of credit are generally unavailable, particularly if the farmer is now in financial distress.

Because the farmer's operation remains capital intensive, the farmer is absolutely dependent on the lender to continue in business. Partially because of that dependence and partially because of the confidence the farmer may have in the financial acumen of the lender, the lender is in a position to exercise (and usually does exercise) considerable influence over the farmer and his operations.

In addition to the formation of a fiduciary relationship, the first phase of a farmer's relationship with his lender may have given rise to other legally significant occurrences. For example, the informality that tended to characterize the dealings between farmers and lenders in better times may have resulted in a course of conduct between the parties that was favorable to the farmer, but inconsistent with the existing written obligations.

Because of the farmer's justifiable reliance on the continuation of that course of conduct, it may now be inequitable to enforce the written obligations that conflict with the farmer's expectations. Also, the advice that was given by lenders during those years may have contributed to the financial distress the farmer is now encountering.

In many cases, it was the lender who advised and encouraged farmers to borrow for expansion in the late 1970s and early 1980s. During that time, some lenders paid their employees bonuses based on the loan volume they initiated. When farmers were prospering, it also was not uncommon for lenders to put a borrower's debts that should have been in long-term debt into short-term debt obligations. Such practices may have substantially contributed to a farmer's current difficulties.

The Second Phase

The point of demarcation between the first and second phases of a farmer's relationship with his lender is typically marked by the lender's assessment that the farmer is in serious financial distress. In the second stage, the lender's attitude typically changes from concessionary to demanding. A common pattern during this stage is for the lender to condition future loans on the restructuring of the farmer's operations.

Often, the consultation with the farmer on the required changes will be minimal or nonexistent. Some lenders will simply decide that they know how to farm better than the farmer, and will impose requirements for changes without regard to the farmer's opinion of them or his ability to accomplish them successfully. At this point, the farmer has little choice but to make the changes because he has not established any other lines of credit, and he needs the forbearance and future advances of the lender making the demands.

The lender may also condition future advances on the acquisition of new security. This may be done even after they have made the undisclosed decision to liquidate the farmer shortly after the additional security is acquired and the advance made. Lenders have been known to make one more loan simply to impose conditions or to require new collateral so that the lender's position will be enhanced before it forces the farmer's liquidation.

For example, in pending litigation, it has been alleged that after requiring the farmer to sign a blank security agreement, the lender then completed it by adding unauthorized items of collateral.

As suggested by the foregoing example, the lender's activities in the second phase may form the basis for fraud and duress claims without reference to occurrences in the first phase. Duress, or business coercion, occurs "when a threatening party acts oppressively to further his own economic interests." *State National Bank v. Farah Manufacturing Co.*, 678 S.W.2d 661, 685 (Tex. Ct. App. 1984) (the court's opinion contains an informative discussion of the tort of duress); *see generally*, Restatement (Second) of Contracts § 176 (1981).

Most of these claims are easily recognizable if the facts are known. When apparently less egregious conduct occurring in the second stage is viewed from the perspective of the farmer's entire history with the lender (particularly where a fiduciary relationship has developed), that conduct gains a new significance, however.

Farmer Vs. Lender

When the lender seeks a judgment on the note (together with foreclosure or replevin or both), the complaint will invariably contain a simple recitation of the facts of the farmer's signing of the note, the lender's advancement of the loan, and the farmer's failure to repay it. A copy of the promissory note will be attached to the complaint.

Discovery will usually reveal that the note was prepared by a commercial publisher of promissory notes, and purchased by the lender for use in virtually all of the bank's loans. The only terms of the note supplied by the lender for each transaction are the amount of principal, the rate of interest, and the time of payment.

Neither the loan officer nor the farmer will have discussed any other terms (other than those supplied), and usually will not have read any of the terms other than those. Of course, the note will make no reference to any of the words, acts or conduct that arose in and serve to characterize the two stages of the relationship between the farmer and the lender. Nevertheless, the lender and his/her attorney will behave henceforth as if nothing else but the note mattered.

At that point, it becomes incumbent upon the farmer's attorney to educate the court that there is more to the farmer's relationship with his lender than his failure to pay his indebtedness. If the facts are sufficient to support a counterclaim against the lender, it is usually advisable to plead it in greater detail than one would for a claim arising out of a more familiar event such as an intersection collision between automobiles.

Because defenses or claims premised on constructive fraud, breach of fiduciary duty, breach of implied duty of good faith, and estoppel necessarily are based on relatively extensive facts, a pleading setting forth those facts in specific detail is still consistent with notice pleading.

In some cases, the history of a farmer's relationship with his lender may extend for the

(continued on next page)

20 or more years that the farmer has been farming. In addition, the last years of that relationship may involve a complex series of events.

Therefore, as an organizational aid, it is often helpful to prepare a chart or schematic outline, matching the elements of each cause of action with the various relevant events in that history. The diagram will help to refresh recollections each time work is done on the case, and it could be developed into a visual aid for the court and jury.

Although discovery in lender liability litigation will not vary extensively in scope from other factually complex litigation, the attorney representing the farmer should bear in mind the importance of developing the facts of the first phase of the relationship between the farmer and the lender.

For example, where the lender has cultivated an image of being a bank that "understands" agriculture, discovery should include obtaining copies of print and film advertisements and the lender's instructions to its public relations agency relating to the image that it desired to foster. Similarly, information on the loan officers' backgrounds in agriculture could provide information relating both to their proclivity to give advice, as well as their competency to do so.

In a recent deposition in pending litigation, a loan officer for a commercial bank testified that his advice-giving function was the equivalent to that of a county extension agent's (except that the recipients of his advice had no choice but to follow his instructions).

Discovery should also include a review of the lender's policy and procedures manuals. Often, those policies and procedures are outdated, and will not have been followed in the particular farmer's case.

When documents are reviewed, it is again important to view them in the context of the historical relationship of the lender and the farmer. For example, in pending litigation, it was discovered that, for the past several years, the lender had required the farmer to prepare detailed cash flow projection sheets. The sheets showed all anticipated income and expenses for each month in the forthcoming year, including the monthly distribution of loan proceeds.

The lender approved each projection, and expected the farmer to conduct his operations in accordance with the projections. The farmer complied, but when the lender refused to advance the loan proceeds as scheduled, the farmer suffered significant losses in production. Because of the context in which those sheets were prepared, approved and implemented, the farmer is arguing that the lender, in effect, agreed to advance the loan proceeds as scheduled and that the lender's failure to do so was a breach of contract.

Establishing damages may require the assistance of an expert, and that work should begin early. The farmer's attorney should also consider videotaping a "day in the life" of the farm to illustrate its nature and operations to the jury. Some attorneys have found that videotaping the foreclosure or liquidation sale is an excellent way of conveying the farmer's loss to the jury.

Needless to say, each lender liability lawsuit will present unique problems and possibilities. The important thing is for the farmer's attorney to not be misled by the simplicity of the lender's focus on the promissory note.

The attorney and, ultimately, the courts must recognize and take into account the entire history of the farmer's relationship with his lender.

FmHA interim rules narrow homestead protection

The Farmers Home Administration (FmHA) Farmer Program Dwelling Retention Program, authorized in the 1985 Farm Bill, has been implemented by interim regulations. 51 Fed. Reg. 9174 (1986) (to be codified at 7 C.F.R. various pts).

Certain FmHA inventory property acquired as a result of foreclosure, voluntary conveyance, or conveyance by a trustee in bankruptcy, may be considered for dwelling retention if it is borrower-occupied. Borrowers who have lost their farms to the FmHA, but who continue to occupy them while in FmHA inventory, are to be advised by letter of their rights under the program. Such borrowers may apply to lease and acquire an option to purchase the previously owned personal residence.

The application period is Dec. 22, 1985 to the close of business on Dec. 22, 1988. An applicant must provide evidence of:

1) Gross annual farm or ranch sales of at least $40,000 in at least two calendar years between Jan. 1, 1981 and Dec. 31, 1985;

2) At least 60% of gross annual income of farmer and spouse from the farming or ranching operation during at least two years of the five-year period;

3) Possession and occupation of the dwelling and engagement in farming or ranching operations on adjoining or other controlled land during the five-year period;

4) Sufficient projected income to pay rent and maintain the property;

5) No other suitable housing; and

6) Exhaustion of all remedies for restructuring the farmer program loan and either release from personal liability, debt settlement, or discharge in bankruptcy.

The lease will cover the dwelling and not more than five acres of land unless additional land is needed for specified purposes. The rental will be based upon equivalent rents for similar residential properties in the area.

During the lease term, the lessee may exercise an option to purchase in writing. The market value of the homestead property, as improved, will be determined by independent appraisal within six months after the borrower responds to the program. This figure becomes the option price. Terms include no down payment, monthly installment payments up to 35 years, and interest rates to be announced from time to time.

In addition, questions have been raised as to whether FmHA borrowers who were foreclosed upon or voluntarily liquidated prior to Dec. 27, 1985 (the 1985 Farm Bill effective date) are eligible.

The spirit and letter of the statute requires that such persons be allowed to apply, so long as they have continued in possession of the dwelling. Language to be codified at 7 C.F.R. § 1955.18(h) requires that the notice of the program (Exhibit G) is to be sent when "real property with a dwelling is acquired as a result of foreclosure by FmHA, voluntary conveyance, or conveyance by a trustee in bankruptcy." The fact that there is no reference to past acquisitions should not be read to suggest that the program applies only to borrowers who have suffered such adverse actions after Dec. 22, 1985.

Two aspects of the interim rules could substantially narrow the availability of the program.

First, the interim rules deny eligibility to borrowers whose farms were acquired by the FmHA as a result of foreclosure by a creditor other than the FmHA. The rules do not recognize or reflect the authority possessed by the FmHA, when it desires a foreclosure, to prompt prior lienholders to foreclose. 7 C.F.R. § 1955.15(d) (1) (1986).

The FmHA takes the position that only when it forecloses or joins in a foreclosure will the acquired property be eligible. FmHA An. No. 1389 (1955), April 8, 1986).

Second, the interim rules require the borrower to have been discharged from liability on his FmHA debt or to have discharged the debt in bankruptcy. That requirement effectively gives the FmHA the absolute, unfettered discretion to control eligibility.

The FmHA can simply decline to release the borrower from liability. Then, the only recourse for the borrower is to obtain a discharge in bankruptcy. In many states, however, the homestead exemption available in bankruptcy is not sufficient to fully protect the homestead.

Arguably, these two restrictions disregard the intent of Congress. There is ample legislative history reflecting a desire that the homestead protection provisions be broadly applied. See 131 Cong. Rec. S15710-11 (daily ed. Nov. 18, 1985).

— *Christopher R. Kelley*

STATE ROUNDUP

ARKANSAS. *Punitive Damages Proper Where Lessor Destroys Insured Crops.* In the case of *Brown v. Chapman Farms Inc.*, 289 Ark. 88, 709 S.W.2d 404 (1986), Chapman Farms Inc. leased land from Brown for the 1983 crop year, with the term ending after the fall harvest. The lease provided that Brown would have the right to plant wheat after Chapman had harvested his crop.

In June and July of 1983, Chapman Farms Inc. planted 630 acres of soybeans on the leased land, and insured the crop with the Federal Crop Insurance Corp. (FCIC). Under the terms of the insurance, Chapman Farms Inc. was assured of collecting up to 26 bushels of beans per acre.

By late October, it became obvious that the harvest would not equal the insured amount, and that the FCIC would pay the difference between the actual amount harvested and the insured amount.

In late October, Brown told Chapman that the beans were not worth the cost of harvesting and that he wanted to disk the tenant's crop in order to begin planting wheat. Chapman replied that it would first be necessary to obtain FCIC written consent in order for the insurance benefits to be collectible.

Without obtaining such consent, however, Brown proceeded to disk 187 acres of the beans. Consequently, the FCIC refused to pay Chapman the insurance benefits. Chapman filed suit, alleging that Brown had trespassed and intentionally destroyed his soybeans. The jury found for Chapman and awarded both actual and punitive damages.

Affirming the jury's award of punitive damages, the Supreme Court of Arkansas rejected Brown's arguments that punitive damages were improper. Brown claimed that his actions were not malicious, and that he acted under the honest belief that the FCIC would pay the benefits.

The Court found that malice may be inferred from Brown's intentional violation of Chapman's rights to the beans and his conscious indifference to the consequences of destroying them. Moreover, the Court looked to testimony that Brown knew that Chapman would be damaged — at least to the extent of the projected harvest.

Thus, the Court found that there was substantial evidence from which the jury could find that Brown knew that Chapman would be damaged by his actions, and was simply indifferent to those consequences.

— *Kimberly W. Tucker*

IOWA. *Bank Interferes With Farmer's Lease.* In the case of *Peterson v. First National Bank of Iowa*, 392 N.W.2d 158 (1986), the appeals court reversed the district court's grant of a new trial and reinstated the jury verdict in favor of the Petersons on their claims of intentional interference with existing and prospective contracts and breach of oral contract, as well as the verdict for the bank on its counterclaim on several promissory notes.

The Petersons farmed rental properties in 1982, and were heavily indebted to the First National Bank. When rental payments were due in November 1982, the Petersons decided to obtain a Commodity Credit Corp. (CCC) loan, using harvested 1982 crops as collateral. It was disputed that promises were made by a bank officer on several occasions to loan the rent money to the Petersons in exchange for the CCC proceeds.

Keel Peterson tendered a check for the fall rent to his landlord, telling him that it could be cashed as soon as the proceeds were received from the CCC. On Dec. 6, 1982, the bank refused to cover the check to the landlord. The Petersons' lease with that landlord was then terminated in February for failure to pay.

On cross-appeal, the bank claimed the trial court committed an error of law by giving inadequate instructions on the issue of intentional interference with prospective contractual relations. The instructions given, however, were requested by the bank.

Since the bank did not object to its instructions until its motion for a new trial, it waived any error. Therefore, the lower court's order of a new trial on this issue was reversed.

The bank preserved error, however, on several other issues. One issue was whether there had been tortious interference by the bank with the existing contract (the lease between Keel Peterson and the landlord) since Peterson had already breached the terms of the lease by failing to pay rent on time in November.

The court found that even though the contract was breached, it existed until it was terminated by the landlord in February, and Peterson's breach was no justification for the bank's alleged interference in December.

Another issue concerned the breach of contract by the bank to loan the Petersons the rent money. The bank claimed that the Petersons' promise to pay existing debts from the CCC proceeds could not constitute consideration for the bank's promise to loan the money.

The court agreed that this was an accurate statement of contract law, but pointed out that in this case, since none of the Petersons' notes were yet past due, applying the CCC proceeds to the debts without obligation to do so four months early could have been valid consideration.

Issues related to emotional distress, the defense of justification, and lost profit damages were also not found to warrant reversal. As to the last issue — whether the Petersons were entitled to lost profits — a key determination was whether they made reasonable efforts to get alternate financing.

The court held that even though the Petersons went to only one other bank to seek financing, given their debt load and the fact that they did visit the only other bank with which they had had prior financial experience, the attempt to secure alternate financing could be considered satisfactory — thus allowing lost profit damages.

— *Neil Hamilton*

MARYLAND. *Local Pesticide Regulation.* The U.S. District Court of Maryland in *Maryland Pest Control Association v. Montgomery County, Md.*, Civ.A.No. JFM-86-1688, ruled that state law preempts county law on pesticide use.

Two Maryland counties had passed ordinances requiring the posting of warning signs whenever lawns, golf courses, rights-of-way, etc. were treated with pesticides, and the providing to customers a detailed list of all chemicals used. The court held that the Federal Insecticide, Fungicide and Rodenticide Act gives regulatory authority to the state — not to its political subdivisions.

The counties had argued that their ordinances do not regulate pesticide use, but are instead, merely consumer information laws. Earlier, the Maryland House of Delegates had refused to pass bills to nullify the county laws or establish a uniform state law. The two counties have indicated that they will appeal the decision. — *Michael C. White*

MISSISSIPPI. *Ad Valorem Tax Preference.* An additional class of property has been created and granted preferential ad valorem tax status in Mississippi.

Owner-occupied, single-family residential property will be assessed at 10% of true value under a constitutional amendment referendum narrowly passed by the voters and upheld by the courts. Other residential, agricultural, commercial and personal property will continue to be assessed at 15%, with automobiles and utilities at 30%.

The State Attorney General has ruled that this 10% assessment does not apply to all homestead property, but only to that in residential use. This excludes any property currently appraised at use-value in commercial agriculture or forestry use. This change is in effect for the 1986 tax year. (H. Con. Res. No. 41 (1986); Amendment to Section 112, Miss. Const. of 1890). — *James H. Simpson*

VIRGINIA. *Virginia Farm Product Exception Repealed.* Effective Dec. 23, 1986, Virginia eliminates the farm products exception to U.C.C. Sec. 9-307(1). Va. Code Section 8.9-307(1).

Criminal Penalty. A new code section provides that failure to pay the lender secured by farm products within 10 days of the sale of farm products shall be prima facie evidence of larceny unless the evidence of the indebtedness provides otherwise. Va. Code Section 18.2-115.

Larceny of goods greater than $200 is punishable by one to 20 years in the penitentiary, or jail for up to 12 months and/or a fine not to exceed $1,000. — *L. Leon Geyer*

Address Correction Requested

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6201 Howard Street
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AMERICAN AGRICULTURAL LAW ASSOCIATION NEWS

STATE REPORTERS. Every issue of *Agricultural Law Update* includes a column entitled State Roundup, in which agricultural law developments at the state level are reported by members of the American Agricultural Law Association (AALA) who serve as state reporters.

If you know of developments in your jurisdiction, including unreported cases that might be appropriate for the State Roundup, contact your state reporter or send the material to Linda Grim McCormick, editorial liaison, for forwarding to the state reporter. If no state reporter is listed for your jurisdiction, please consider volunteering to fill the vacancy.

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With this listing, we are pleased to announce the appointment of Gene Olsen, Alice Devine and David Anderson as state reporters for Connecticut, Kansas and Michigan, respectively.