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Top Ten Agricultural Law Developments of 2004

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- by Roger McEowen

1. **Multi-billion dollar verdict rendered in cattle case.**
   On February 17, 2004, a federal jury in Alabama returned a $1.28 billion verdict against Tyson Fresh Meats, Inc. (Tyson) in a nation-wide class-action lawsuit alleging that Tyson manipulated the price for fed cattle that it purchased through the use of long-term contracts (known as captive supply cattle) in violation of the Packers and Stockyards Act (PSA). The PSA prohibits meat packers from engaging in any unfair, unjustly discriminatory or deceptive practice, or engaging in any course of business or doing any act for the purpose or with the effect of manipulating or controlling prices or creating a monopoly in the acquisition of, buying, selling, or dealing in, any article, or of restraining commerce. The plaintiff class of cattlemen claimed that Tyson's store of livestock (via captive supply) allowed Tyson to avoid reliance on auction-price purchases in the open market for most of its supply. Tyson then uses that leverage, the claim is, to depress the market prices for independent producers on the cash and forward markets in violation of the PSA. The trial court jury unanimously found that

   1) there was a single national market for fed cattle;
   2) Tyson's use of captive supply had an anticompetitive effect on the cash market for fed cattle;
   3) Tyson had no legitimate business reason or competitive justification for using captive supply;
   4) Tyson's use of captive supply proximately caused the cash market price for fed cattle to be lower than it otherwise would have been; and
   5) Tyson's use of captive supply injured each member of the class. The jury then found that Tyson's use of captive supplies from February 1, 1994, through October 31, 2002, damaged the cash market for fed cattle in the amount of $1,281,690,000.

   In March, Tyson filed a motion for Judgment as a Matter of Law or for a New Trial, and on April 23, the trial court judge granted Tyson's motion, thereby invalidating the jury verdict. While the trial court judge did not disturb any of the jury's findings, particularly the finding that Tyson's use of captive supply cattle manipulated the cash market price for fed cattle, the judge ruled that Tyson was entitled to use captive supplies to “meet competition” and assure themselves of a reliable supply of cattle. The cattlemen appealed.

   On December 17, oral arguments in the case were heard by the United States Court of Appeals for the Eleventh Circuit. During oral arguments, Tyson's counsel admitted that if the PSA prohibits the use of captive supplies, then the “meeting competition” defense was inapplicable. Tyson's counsel was also questioned as to Tyson's claim that the company could not control when captive cattle were delivered, but yet maintained that the use of captive supplies was necessary to achieve a consistent supply of cattle. Tyson's counsel also admitted that the jury was free to believe the cattlemen's expert economist and disbelieve Tyson's expert. In the end, however, the primary appellate issue is the appropriate legal standard for evaluating a claim of price manipulation under the PSA. The trial court judge adopted a Sherman Act “rule of reason” standard, thereby allowing Tyson to defend its actions by showing a legitimate business justification for using captive supplies (such as the assuring a reliable supply of cattle). The question is whether the Sherman Act's rule of reason is applicable under the PSA. An opinion is expected in 2005 by the appellate court. *Pickett. v. Tyson Fresh Meats, Inc.,* 315 F. Supp. 2d 1172 (M.D. Ala. 2004).

2. **Developments in GMO patent infringement cases.**
The patenting of seed technology has led to cases in which farmers have been sued for misappropriation of the technology. Generally, courts have held that the process by which the patented seed arrives on a farmer's land (whether by pollen drift or from passing grain trucks, for example) is irrelevant. But two cases decided in 2004 may indicate that the courts are re-evaluating the legal issues associated with the drift of genetically modified seed technology. On May 21, the Canadian Supreme Court rendered its opinion in *Monsanto Canada, Inc. v. Schmeiser.* Monsanto sued a Canadian canola farmer for the "theft" of the company's Roundup Ready canola technology when the traits showed up in Schmeiser's fields.

Schmeiser did not have a license to grow Roundup Ready canola, and claimed that the GMO canola was present in his fields either by cross-pollination from neighboring fields, blowing from passing grain trucks, or both. Schmeiser saved some of the resulting GMO canola and replanted it. While the Court ruled that plants are not patentable (in accordance with an earlier opinion of the Court holding that "higher life forms" are not patentable), the Court held that Monsanto's patent applied to the genes and cells of the plants and was, therefore, valid. The dissent (the opinion was 5-4) would have held that the cultivation of plants containing the patented gene and cell did not constitute infringement, and that to conclude otherwise would confer patent protection on the resulting plants - an unpatentable higher life form. Consequently, Schmeiser was found to have infringed the patent. However, the Court held that Monsanto was not entitled to damages because Schmeiser earned no profit from the technology - he never sprayed his crop with Roundup to reduce weeds.*Monsanto Canada, Inc. v. Schmeiser,* [2004] S.C.C. 34.

Earlier, in late April, the United States Court of Appeals for the Federal Circuit invalidated a patent on a self-reproducing antidepressant drug because previous clinical trials constituted a prior use that had placed the compound in the public domain. A concurring opinion reasoned that the patent was invalid not because of prior use of the subject matter, but because the subject matter was not patentable since it could reproduce itself in nature. The concurring judge compared the seeding and conversion process of the compound at issue to the spread of patented, biotech seed traits via cross-pollination, and concluded: "[T]he implication - that the patent owner would be entitled to collect royalties from every farmer whose cornfields contained even a few patented…stalks… - cannot possibly be correct." *Smithkline Beecham Corp. v. Apotex,* 365 F.3d 1306 (Fed. Cir. 2004).

While the Canadian Supreme Court opinion is not binding on U.S. courts, it will not go unnoticed. Likewise, the two cases provide a framework for the development of future cases and legislation supporting an equitable enforcement of patent laws respecting both the rights of patentees and the rights of innocent infringers.

3. **WTO finds that U.S. cotton subsidies violate international trade rules.**
On April 26, an interim panel of the World Trade Organization (WTO) issued a report finding that U.S. cotton subsidies violate international trade agreements and price developing countries out of markets. The WTO Agreement on Agriculture (AoA) requires that domestic subsidies that encourage production are not to exceed 1992 per-country levels. In 1992, cotton payments totaled $1.62 billion. However, cotton payments were pegged at $2.3 billion in 1999, $1.57 billion in

2000, and $2.06 billion in 2001. As a result the panel concluded that decoupled payments to U.S. cotton farmers (pursuant to the 1996 Farm Bill and continuing under the 2002 Farm Bill) provide an incentive for overproduction and distort trade by pricing developing nations' goods out of markets. The challenge was brought primarily by Brazilian cotton farmers, who also pointed out that the U.S. share of the global cotton market had increased during the same time frame. Challenged are direct payments to U.S. cotton farmers, as well as payments made under emergency supplemental appropriation bills. Involved are producer flexibility payments, market loss assistance payments and counter-cyclical payments.

The U.S. claims that direct payments are decoupled and are not trade distorting because they are not linked to current production and are, therefore, not "subsidies." Thus, the U.S. position is that direct payments to cotton producers should not be counted when compared to the 1992 levels because the payments are not encouraging production for the year in which the payments are made. However, from 1998 though 2001, U.S. cotton production increased almost 50 percent, and the U.S. share of world cotton exports increased from 24 percent in 1996 to 37 percent in 2001 (anticipated to be 42 percent in 2004). In 2002, cotton was exported from the U.S. at 61 percent below the cost of production. Under the Agreement on Subsidies and Countervailing Measures, agricultural subsidies are deemed to be harmful to international trade if the subsidizing member increases its share of the world market when compared to its average share over the prior 3-year period.

The interim panel's ruling was later affirmed by a panel of trade experts. On October 18, the U.S. formally appealed the ruling to the appeals body of the WTO. The appeals body has until Jan. 18, 2005, to produce a final ruling in the matter.

The WTO ruling provides an opportunity for the U.S. Congress to debate seriously the future of agricultural policy. The core issue is whether the policy that emerges will support independent family farmers or continue the subsidization of multinational agribusiness cartels in world markets. In theory, the WTO dispute could lead to a dramatic reduction in U.S. agricultural subsidies.

4. **Rabobank's attempted takeover of a Farm Credit System lender .**

On July 30, Rabobank, a Dutch banking conglomerate that is the fifteenth largest banking institution in the world, announced that it had agreed to purchase Farm Credit Services of America (FCSAmerica) for $600 million – at the time FCSAmerica represented 6.5 percent of the Farm Credit System's total assets and 6.9 percent of System's combined capital. That same day, AgStar Financial Services, a Farm Credit Sytsem (FCS) association headquartered in Minnesota, confirmed that it had made a formal merger offer to the FCSAmerica Board of Directors to merge the two FCS lenders. FCSAmerica later began the regulatory process for terminating its status as a System institution by submitting to the Farm Credit Administration, its board of director's resolution to terminate its System status and then merge the association into a subsidiary of Rabobank. The proposed acquisition of a unit of the FCS by a private (albeit foreign) lender was unique, and raised significant tax and legal issues as well as the concern of whether the Congress ever intended that current stockholders of a unit of the FCS should be permitted to benefit from a sale of the entity to a non-System buyer.

On October 20, 2004, FCSAmerica announced that its board voted to terminate its agreement with Rabobank and remain a System institution. FCSAmerica also announced that it had rejected the merger offer from AgStar. Throughout the late summer and early fall of 2004 it became clear that the FCSAmerica board had not fully analyzed the legal, tax and policy ramifications of the proposal or anticipated the widespread opposition to the deal among family farmers.

From a policy perspective, it is highly unlikely that the Congress ever intended that an FCS unit could be sold to a private entity. Also, the Congress has given the FCS a privileged position in agricultural lending that has contributed to the value of FCSAmerica. This "agency status" allows the FCS to access funds from the money markets at a slightly higher cost than the U.S. Treasury can borrow in the same markets. Had the deal gone through, the four remaining districts would most certainly have taken note that they could become targets from other large lenders looking to enhance their position in agricultural lending. Consequently, the buyout could have initiated the demise of the FCS. Likewise, Rabobank would likely have been more attuned to serving relatively larger borrowers because of their share of the purchase price. However, small and mid-size borrowers in the four states at issue (IA, NE, SD and WY) would likely have seen the picture differently, at least until a new holder of the FCS charter had established a truly competitive presence (and that could have taken several years). The buyout would also have contributed to a dramatic increase in the input-supply side of agriculture, raising further questions about competition in agricultural lending. Also, questions would have abounded concerning Rabobank's willingness to work with borrowers in financial distress compared to local lenders or a lender whose mandate is to assist farm borrowers.

5. **Agricultural check-offs.** 2004 was another busy year in the courts concerning agricultural check-offs. On February 24, the United States Court of Appeals for the Third Circuit held the Dairy check-off (mandatory 15 cent/hundredweight of milk sold) unconstitutional on First Amendment free-speech grounds. The court determined that the Dairy Act that authorizes the check-off constituted private speech and was, therefore, subject to scrutiny under the First Amendment. The court noted that the Secretary of Agriculture, under the Dairy Act, acted only in a supervisory role and that the government described the dairy check-off as a non-governmental program financed and directed by dairy farmers. Thus, the check-off was private speech. On the free-speech issue, the court noted that the Dairy Act is a stand-alone law that was not passed as part of a scheme of greater economic regulation of the dairy industry. Dairy producers, the court noted, are not bound together and required by law to market their products according to cooperative rules for purposes other than advertising or speech. Thus, compelled funding of generic advertising is a violation of the free-speech rights of those who object to the promotion of milk as a generic product. *Cochran v. Veneman*, 359 F.3d 263 (3d Cir. 2004), *rev'g* , 252 F. Supp. 2d 126 (M.D. Pa. 2003).

   On May 24, the U.S. Supreme Court (upon request by the U.S. Solicitor General) granted certiorari on a limited basis in a case from the United States Court of Appeals for the Eighth Circuit involving the constitutionality of the beef check-off. The case involves plaintiffs who were livestock producers subject to an assessment of one dollar per head of cattle to be used by the USDA and the Cattlemen's Beef Board for promotion of the beef industry, as provided by the Beef Promotion and Research Act (7 U.S.C. §2901 et seq.). The plaintiffs challenged the law as an unconstitutional violation of the First Amendment. The plaintiffs objected to the assessment because it paid for advertising beef products, such as steak, which is not the product (live cattle) that the plaintiffs sold. The trial court held that (based on prior U.S. Supreme Court precedent) the assessment violated the First Amendment. The Eighth Circuit affirmed, and also ruled that the beef check-off did not constitute government speech. Oral arguments were heard in the Supreme Court on December 8. *Livestock Marketing Association v. United States Department of Agriculture*, 355 F.3d 711 (8th Cir. 2003), *cert. granted sub. nom., Veneman v. Livestock Marketing Assoc*., 124 S. Ct. 2389 (2004).

   While the beef check-off case will be the first time that the U.S. Supreme Court has addressed the free speech issue in the context of an agricultural check-off, two Circuit Courts of Appeal have dealt with the matter. The U.S Court of Appeals for the Third Circuit, in *United States v. Frame,* *885 F.2d 119 (3d Cir. 1989),* while upholding the beef check-off as constitutional (the rationale of the court on this point is no longer valid due to a later U.S. Supreme Court opinion), rejected the USDA's argument that the beef check-off was government speech. As noted above, the Eighth Circuit has also held that the beef check-off does not constitute government speech.

For a check-off to constitute government speech, the government must exercise sufficient control over the content of the check-off to be deemed ultimately responsible for the message, the source of the check-off assessments must come from a large, non-discrete group, and the central purpose of the check-off must be identified as the government's. The beef check-off likely clears only the first hurdle. The source of funding for the beef check-off comes from a discrete identifiable source (cattle producers) rather than a large, non-discrete group, and the check-off has as its central purpose that of being a "self-help" program designed to improve markets for beef. That central purpose has been articulated clearly by the Congress in the legislative history of the Act, and readily admitted to publicly by the current president of the National Cattlemen's Beef Association.

6. **Key eminent domain case reaches the Supreme Court.**
In recent years, a significant question has arisen as to whether the government's eminent domain power can be exercised either by or on behalf of private parties to take private homes, land and businesses for commercial development. The argument is that the resulting "economic development" increases jobs and tax revenue in the area and that this satisfies the Fifth Amendment's "public use" requirement. In late September, the U.S. Supreme Court agreed to hear a case from Connecticut on the issue. In *Kelo v. City of New London, 268 Conn. 1, 843 A.2d 500 (2004), cert. granted, 125 S. Ct. 27 (2004),* the City transferred its eminent domain power to a private company who then exercised it to take several homes that were in the path of their plans for the development of private businesses. The company argued that the taking was for a "public purpose" because the businesses would increase tax revenue from the subject area. The Connecticut Supreme Court agreed. In 2003, the Arizona Supreme Court reached an opposite conclusion, and in 2004 the Michigan Supreme court, in *County of Wayne v. Hathcock, 684 N.W.2d 765 (Mich. 2004),* ruled that the exercise of the eminent domain power is proper only if (1) the private entities involved are public utilities that operate highways, railroads, canals, power lines, gas pipelines, and other instrumentalities of commerce; (2) the property remains under the supervision or control of a governmental entity; or (3) the public concern is accomplished by the condemnation itself (i.e., blighted housing has become a threat to public health and safety).

It goes without saying that the U.S. Supreme Court's opinion in the Connecticut case is of primary significance to private landowners (urban as well as rural) throughout the United States . An opinion is expected by then end of June, 2005.

7. **Second federal court holds that CERCLA reporting requirements apply to agricultural confinement operations.**
With respect to releases of "hazardous" substances, the federal Comprehensive Environmental Response Compensation & Liability Act (CERCLA) provides that any person in charge of a "facility" from which a hazardous substance has been released in a reportable quantity must immediately notify the National Response Center (a comparable state-level requirement also applies under the Emergency Planning and Community Right to Know Act). Releases that exceed 100 pounds per day must be reported. A key question of major importance to agriculture is whether large-scale livestock/poultry confinement operations constitute a single "facility," or whether each confinement structure on a farm is a separate facility. In 2003, a federal district court in Kentucky held that a vertically integrated firm was on "operator" of the farms at issue pursuant to production contracts with the farm owners, and that each farm was a single "facility"

for the reporting rule. In late 2004, the United States Court of Appeals for the Tenth Circuit held that the statutory definition of "facility" unambiguously included any site or area where a hazardous substance has been disposed of. The case involved the defendant's operation of two hog farms in western Oklahoma comprised of eight confinement buildings housing 25,000 hogs that utilized a common waste management system. The plaintiff claimed that the defendant knew of the ammonia emissions from the hog operations and failed to report them as required under CERCLA. CERCLA classifies ammonia as a hazardous substance, but the defendant claimed that that hog farms consisted of numerous "facilities" such as lagoons, barns, and land application areas, and that each barn, lagoon, and land application area was a separate "facility" for CERCLA reporting purposes. As such, the defendant argued, no single "facility" exceeded the reporting requirements under CERCLA. *Sierra Club, Inc. v. Tyson Foods, Inc.,* 299 F. Supp. 2d 693 (W.D. Ky. 2003); *Sierra Club v. Seaboard Farms, Inc.,*387 F.3d 1167 (10th Cir. 2004).

The rulings make it more likely that large-scale confinement operations will be subject to the reporting requirements of CERCLA.

8. **Federal Court issues key ruling on the enforceability of liquidated damages clause in seed technology agreement.**
On April 9, the United States Court of Appeals for the Federal Circuit reversed a trial court's ruling on the enforceability of Monsanto's liquidated damages clause contained in a technology agreement signed by a Mississippi soybean farmer. Monsanto owns a patent for genetically modified soybeans, and the farmer signed the technology agreement in connection with the license of the patented seeds.

The trial court held that the farmer breached the technology agreement when he replanted soybeans saved from his prior year's crop. On appeal, the court affirmed the trial court's ruling that the farmer had violated Monsanto's patent by replanting the patented seed. The federal court also affirmed the trial court's ruling that Monsanto was not in violation of antitrust law by tying second-generation seeds to the patented seeds. The court held that Monsanto's replanting restrictions were proper because the patent applied to all generations of the soybeans. However, the appellate court reversed the trial court on the enforceability of the liquidated damages clause in the technology agreement that required the farmer to pay 120 times the $6.50/bag technology fee. The farmer admitted that he saved 1,500 bushels of seed from his 1998 crop (enough to plant about 1,500 acres) and replanted it in 1999, then saved 3,075 bags of soybeans from his 1999 crop and replanted those the next year. The court held that the 120 multiplier was "not a reasonable estimate of the harm that would be anticipated to flow from breach of the prohibition prohibiting replanting seed." Monsanto argued that the damages calculation was warranted to allow the company to recover costs and pay for future research. The company has filed over 70 lawsuits against farmers in recent years over the issue. Monsanto Co. v. McFarling, 363 F.3d 1336 (Fed. Cir. 2004).

9. **American Jobs Creation Act of 2004.**
On October 22, President Bush signed into law the American Jobs Creation Act of 2004 (AJCA). The new tax law contains several provisions of importance to agricultural producers. The key agricultural provisions include:

a. The Act extends from two years to four years (for tax years after 2002 in areas designated as eligible for assistance by the federal government) the period of reinvestment of the proceeds from sale of livestock held for draft, dairy, or breeding purposes because of weather-related conditions. The treasury secretary is given authority to extend, on a regional basis, the period for replacement if the weather-related conditions continue for more than 3 years. Generally, the excess livestock sold because of weather-related conditions must be replaced with livestock held for the same purpose as the animals disposed of. However, if it is not feasible to reinvest the proceeds in property similar or related in use, the proceeds can be reinvested in other property used for farming purposes (except for real estate). But, once the two-year replacement period is exceeded (if the longer period applies), the replacement property must be livestock that is similar or related in service or use to the animals disposed of.

b. The Act provides that, in computing alternative minimum tax, the regular tax liability for farmers and fishermen is determined without regard to income averaging. Thus, a farmer receives the full benefit of income averaging. The Act also extends income averaging to fishermen. The provision is effective for taxable years beginning after 2003.

c. Under the Act, expense method depreciation is continued through 2007 at the level of $100,000 (inflation adjusted). The figure is $102,000 for 2004, $105,000 for 2005. However, the Act limits expense-method depreciation for sport utility vehicles (SUVs) to $25,000 for property placed in service after October 22, 2004. Under the definition of “sport utility vehicle,” cargo vans would largely not be included, but SUVs driven for personal or business purposes would be included.

d. The Act denies tax-free exchange status to a principal residence acquired in a like-kind exchange within the prior five-year period beginning with the date of property acquisition. The provision is designed to counter situations where

    1) the property is exchanged for residential real property, tax-free, under the like-kind exchange rules;
    2) the property is converted to personal use; and
    3) a tax-free sale is arranged under the existing rule for tax-free sale of a principal residence.

e. The legislation repeals the 2000 ETI Act effective for transactions after 2004, subject to transitional rules for 2005 and 2006, and binding contract in effect on Sept. 17, 2003. The phase-out rule provides taxpayers with 80 percent of their otherwise applicable ETI benefits for transactions during 2005 and 60 percent of their otherwise applicable ETI benefits for transactions during 2006. The legislation replaces the ETI Act with a deduction ultimately equal to nine percent of the lesser of the “qualified production activities income” of the taxpayer for the taxable year or taxable income for the year. The transition percentage is three percent for 2005 and 2006 and six percent for years 2007-2009. The deduction cannot exceed 50 percent of the W-2 wages of the employer for the taxable year. The term “qualified production activities income” equals the taxpayer's domestic production gross receipts over the sum of the cost of goods sold, other expenses allocable to such receipts and a ratable portion of other expenses and losses not directly allocable to such receipts. A key part of the provision is the definition of “domestic production gross receipts” which includes gross receipts derived from “any lease, rental, license, sale, exchange or other disposition of qualifying production property which was manufactured, produced, grown, or extracted by the taxpayer in whole or in significant part within the United States.”

f. The law eliminates reduced rates of excise tax for most alcohol-blended fuels and imposes the full rate of excise tax on most alcohol-blended fuels. In place of reduced rates, the legislation creates two new excise tax credits – the alcohol fuel mixture credit and the biodiesel mixture credit. The sum of these credits may be taken against the tax imposed on taxable fuels. Also, the legislation extends the present-law alcohol fuels income tax credit through 2010.

g. The Act imposes limits on donated property, such as used automobiles, boats and airplanes, with a claimed value in excess of $500 by requiring contemporaneous substantiation of value and providing that sale of the vehicle by the donee (without improvements or significant intervening use) limits the charitable deduction to the gross proceeds received from the sale. The provision is effective for contributions made after 2004.

10. **IRS acknowledges that commodity certificate gain is taxable, but refuses to order information reporting.** In a March 18 news release, the IRS issued a reminder to farmers concerning the income tax treatment of subsidies received in the form of marketing assistance benefits by means of commodity certificates. While the IRS noted that commodity certificate gain is taxable, it refused to require the USDA to issue a Form 1099G to report the gain to the IRS and the taxpayer for commodity certificate gains. The problem was brought to light by an article published in the May 12, 2003, issue of Tax Notes by professors Neil Harl and Roger McEowen that pointed out a serious inconsistency in how government farm payments are handled by the USDA and the IRS. As discussed in the article, federal farm subsidies are paid in three forms:

    1) direct payments;
    2) counter-cyclical payments; and
    3) marketing assistance benefits.

    All three are to be reported as ordinary income. The problem is with marketing assistance benefits, which are paid under four mutually exclusive methods of payment. Payments under three of the methods are reported to the IRS and the taxpayer by the USDA. The fourth method (the use of commodity certificates to pay a CCC loan), which is used almost exclusively by large cotton and rice producers (because the payment is not subject to the per person payment cap), is not reported even though the benefit is virtually indistinguishable from the other three.

    In the news release, the IRS restated the above and conceded that the commodity certificate gain is taxable. However, the IRS refused to require the USDA to issue a Form 1099G to report the gain to the IRS and the taxpayer. So, while acknowledging the commodity certificate gain is taxable, but pointing out that no information reporting is required, the IRS has probably increased the incidence of non-reporting. Certainly, the Congress has no choice but to statutorily order information reporting for all government farm program payments - including commodity certificate gains. In the news release, the IRS also noted that a farmer who reports CCC loans as income, and thus has an income tax basis in the commodity, accounts for the market gain by reducing the basis of the commodity. That position was staked out by the IRS in a 1987 Revenue Ruling. IRS News Release, IR 2004-83, Mar. 18, 2004.