CASE LAW UPDATE

Farmers Were Not "Farmers" for Purposes of Conservation Easement Charitable Deduction

Rutkoski v. Comissioner, 149 T.C. 6 (August 7, 2017).

THE PARTIES: Mark Rutkoske and Felix Rutkoske are brothers who engaged in a farming operation through various business entities on land leased by Browning Creek, LLC, a limited liability company, also owned by the brothers. The Commissioner of Internal Revenue is the head of the Internal Revenue Service, an agency within the United States Department of Treasury.

THE FACTS: In 2009, the brothers, through Browning Creek, LLC (hereafter "Company"), conveyed a conservation easement restricting the development of a 355-acre tract of land to Eastern Shore Land Conservancy, Inc. (the "Charity"). The Charity purchased the conservation easement below the land's fair market value, which resulted in a non-cash charitable contribution of $1,504,960. That same day, the brothers sold their remaining interest in the property. As a result of these transactions, each brother earned approximately $800,000 in gross income. To offset their potential tax burden, the brothers each claimed a noncash charitable deduction in the amount of $667,520 for their share of the Company's contribution of the conservation easement.

THE DISPUTE: The Commissioner challenged the brothers' charitable deduction, arguing that it should have been limited to 50% of their contribution base. Generally, charitable deductions from gross income are capped at fifty percent of a taxpayer's contribution base. A taxpayer's contribution base is defined as that person's adjusted gross income, calculated without regard to any net operating loss carryback, less the value of other charitable contributions for the year. A

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special exception exists for "qualified farmers or ranchers," which allows those qualified individuals to deduct up to 100% of the value of certain charitable contributions, such as conservation easements, from their adjusted gross income.

LEGAL ISSUES: In carving out a special charitable deduction for conservation easements under IRC § 170(b)(1)(E), Congress limited the deduction to "qualified farmers and ranchers" whose gross income from the "trade or business of farming" is more than fifty percent of their gross income. At trial, the Commissioner asserted that the brothers were not "qualified farmers" entitled to deduct 100% of the donation because the majority of their income that year came from the sale of real estate. The brothers argued that the sale of a farm asset constitutes income from the business of farming.

CONCLUSIONS: The court held that the brothers were not qualified farmers under Section 170 of the Internal Revenue Code and that they were not entitled to a full deduction of the contribution. According to the court, neither the sale of real property nor the sale of development rights results in income from a farming activity. The fact that the brothers invested most of the proceeds in their farming operation did not matter. As a practical matter, farmers looking to donate a charitable conservation easement may lose out on the associated tax benefits if they sell a portion of their property in the same year. The brothers were also disqualified from deducting the full value of the charitable contribution because the brothers made the donation through their company, which was engaged in the business of leasing real estate and not farming.

Pink Slime Defamation Lawsuit Settlement Exceeds $177 Million

Beef Prod., Inc. v. Am. Broad. Companies. Inc., No. 12-292 (S.D. Cir. Ct. 2017).

THE PARTIES: Beef Products Incorporated ("BPI") is a South Dakota corporation engaged in the production and sale of lean, finely textured beef. ABC, Inc. ("ABC") is a commercial broadcasting television network headquartered in New York and owned by The Walt Disney Company.

THE FACTS: In 2012, ABC ran a multi-part month-long exposé on BPI and its process for producing lean, finely textured beef. Lean, finely textured beef is commonly added to ground beef to reduce the overall fat content. The product is made by separating the fat from trimmings left after beef cattle are butchered and then applying ammonia gas to kill bacteria. ABC claimed that seventy percent of supermarket beef contained the product, broadcasted unappetizing images of the product, and referred to the product throughout its coverage as "pink slime." Following ABC's exposé, BPI closed three of its four factories and laid off approximately 750 employees. According to BPI, sales dropped from five million pounds per week to less than 2 million pounds per week. BPI filed lawsuits in state and federal court against ABC, alleging product disparagement and defamation. The trial began on June 5, 2017, and was scheduled to last a full two months before the parties reach a settlement.

THE DISPUTE: BPI brought suit against ABC for defamation and product disparagement and sought damages in the amount of $1.9 billion. Under South Dakota's Agricultural Food Products Disparagement Act, ABC could have been liable for treble damages—almost $6 billion.

LEGAL ISSUES: BPI accused ABC of knowingly publishing false and misleading information that caused consumers to believe lean, finely textured beef is unsafe and that the product was not actually meat. ABC argued that it reported the facts accurately, that it presented the views of people knowledgeable about the product, and that it was not liable for any damages to BPI.

CONCLUSION: In late June, after three weeks of trial but before presenting its defense, ABC entered into a settlement agreement with BPI. The details of the settlement are private, but Disney, the parent company of ABC, Inc., reported a $177 million settlement on its quarterly filings with the U.S. Securities and Exchange Commission. The settlement is believed to exceed $177 million, with the remainder of the funds coming from insurance. BPI subsequently created a $10 million fund for the benefit of former employees who lost their jobs when BPI closed three of its four production facilities.

Utah's Law Against Agricultural Operation Interference Declared Unconstitutional

Animal Legal Defense Fund v. Herbert ,13-cv-00679 (D. Utah, July 21, 2017).

THE PARTIES: The parties to this case included Plaintiffs Amy Meyer, an animal rights activist, Animal Legal Defense Fund (ALDF), and People for the Ethical Treatment of Animals (PETA), against Defendants Gary Hooper in his official capacity as Governor of Utah and Sean Reyes in his official capacity as Attorney General of Utah.

THE FACTS: In the early 1990s, animal rights advocates increasingly began conducting "undercover investigations" to expose alleged animal abuse at various agricultural facilities across the United States. These "investigations" often involve activists improperly gaining access to private farms and making audio or video recordings or taking photographs of farmers and facilities without permission. A number of States, including Kansas, Montana and North Dakota, responded to these initial covert investigations by enacting laws that criminalized entering an animal facility and filming the same without consent.

On February 8, 2013, Amy Meyer became the first person to be charged under Utah's agricultural operation interference law (hereinafter the "Act"), which was signed into law on March 20, 2012. Meyer also appears to be the only person in the country to ever be charged pursuant to any such laws. Meyer was arrested while filming what appeared to be a bulldozer moving a sick cow at a slaughterhouse in Draper City, Utah. The State of Utah brought charges against Meyer pursuant to the Act, but ultimately dismissed its case against her without prejudice.

THE DISPUTE: The primary dispute between the parties was whether the Act was constitutional. The Plaintiffs argued that the Act was unconstitutional because it was an impermissible restriction on free speech in violation of the First Amendment of the United States Constitution. The Plaintiffs raised a Fourteenth Amendment challenge to the Act as well, but the Court declined to address that argument raised by Plaintiffs.

The State of Utah argued that the Act was constitutional primarily because it was tailored to achieve four discrete government interests. The State argued that those four interests were: (1) the protection of animals from diseases brought into facilities by workers; (2) the protection of animals from injury resulting from unqualified or inattentive workers; (3) the protection of workers from exposure to zoonotic diseases; and (4) the protection of workers from injury resulting from unqualified or inattentive workers.

LEGAL ISSUES: After the Court determined that the Plaintiffs had standing to bring this case, the primary issues addressed by the court were whether (1) Plaintiffs' actions were protected by the First Amendment, and (2) if Plaintiffs' actions were protected by the First Amendment, what level of judicial "scrutiny" must be applied to the Act.

CONCLUSIONS: The United States District Court for the District of Utah declared the Act an unconstitutional violation of the First Amendment. The Act's provisions prohibited (1) obtaining access to an agricultural operation under false pretenses (hereinafter the "Lying Provision"),(2) bugging an agricultural operation,(3) filming an agricultural operation after applying for a position with the intent to film, and (4) filming an agricultural operation while trespassing (hereinafter the "Recording Provisions").

The Court determined that the Lying Provision and the Recording Provisions all regulated "speech" protected by the First Amendment. Because of this, the Court applied what is called "strict scrutiny" to the Act to review whether or not the Act was constitutional. Strict scrutiny means that the State had the burden of showing that the Act's restrictions furthered "a compelling interest" and that the restrictions were "narrowly tailored to achieve that interest."In the end, the Court determined that the Act was unconstitutional because it was not "narrowly tailored" to achieve any of the four government interests set forth above.

In September 2017, the State of Utah declined to appeal the District Court's ruling holding that the Act was unconstitutional.This may embolden challenges to similar laws in other states, as well as signal to states that may be otherwise inclined to enact such laws in the future that such laws may not withstand legal challenges.

Syngenta Corn Litigation Settlement

In re Syngenta AG MIR 162 Corn Litigation, 14-md-02591 (D. Kan.)*; In re Syngenta Litigation,* 27-cv-15-3785 (D. Minn.).

THE PARTIES: The parties to this case include thousands of United States corn farmers, among others, and Syngenta, a Swiss agribusiness company, and the third largest seed company in the world.

THE FACTS: Syngenta created the GMO Agrisure Viptera MIR162 (MIR162) seed. In November 2013, China detected MIR 162 in corn shipments from the United States. China had not yet approved MIR 162 and rejected shipments of corn from the United States and canceled certain contracts because of the presence of the unapproved MIR 162 trait.

Corn prices in the United States – and corn farmers' revenues – plummeted drastically. Various plaintiffs, including corn farmers and producers, grain elevators, ethanol producers, Cargill and ADM all brought lawsuits against Syngenta on a number of legal theories and in several different U.S. courts. The first of these lawsuits to reach trial was in the United States District Court for the District of Kansas. The second was in the United States District Court for the District of Minnesota.

LEGAL ISSUES: The primary legal issues in this case were (1) whether Syngenta's actions made it liable to plaintiffs for the plaintiffs' damages and (2) if Syngenta was liable, what were the plaintiffs' damages resulting from Syngenta's introduction of the MIR162 seed into the Unites States corn supply prior to its approval in China. Syngenta argued that good weather and bumper crops depressed corn prices, not the loss of the Chinese export market.

CONCLUSIONS: In June, a jury awarded Kansas farmers $217.7 million in damages against Syngenta. Syngenta decided to appeal this award, and additional trials were scheduled. However, during the middle of a multi-week trial in Hennepin County, Minnesota, Syngenta agreed to settle claims brought by United States farmers on account of Syngenta's allegedly premature introduction of MIR 162.

The details of the settlement have not been released, and the settlement must be approved by the Court. A Syngenta representative stated that the settlement amount would be made public once approved by the Court. In addition, this settlement does not affect the claims that Cargill and ADM brought against Syngenta. Thus, this litigation will continue and shall be addressed in future DIRT articles.

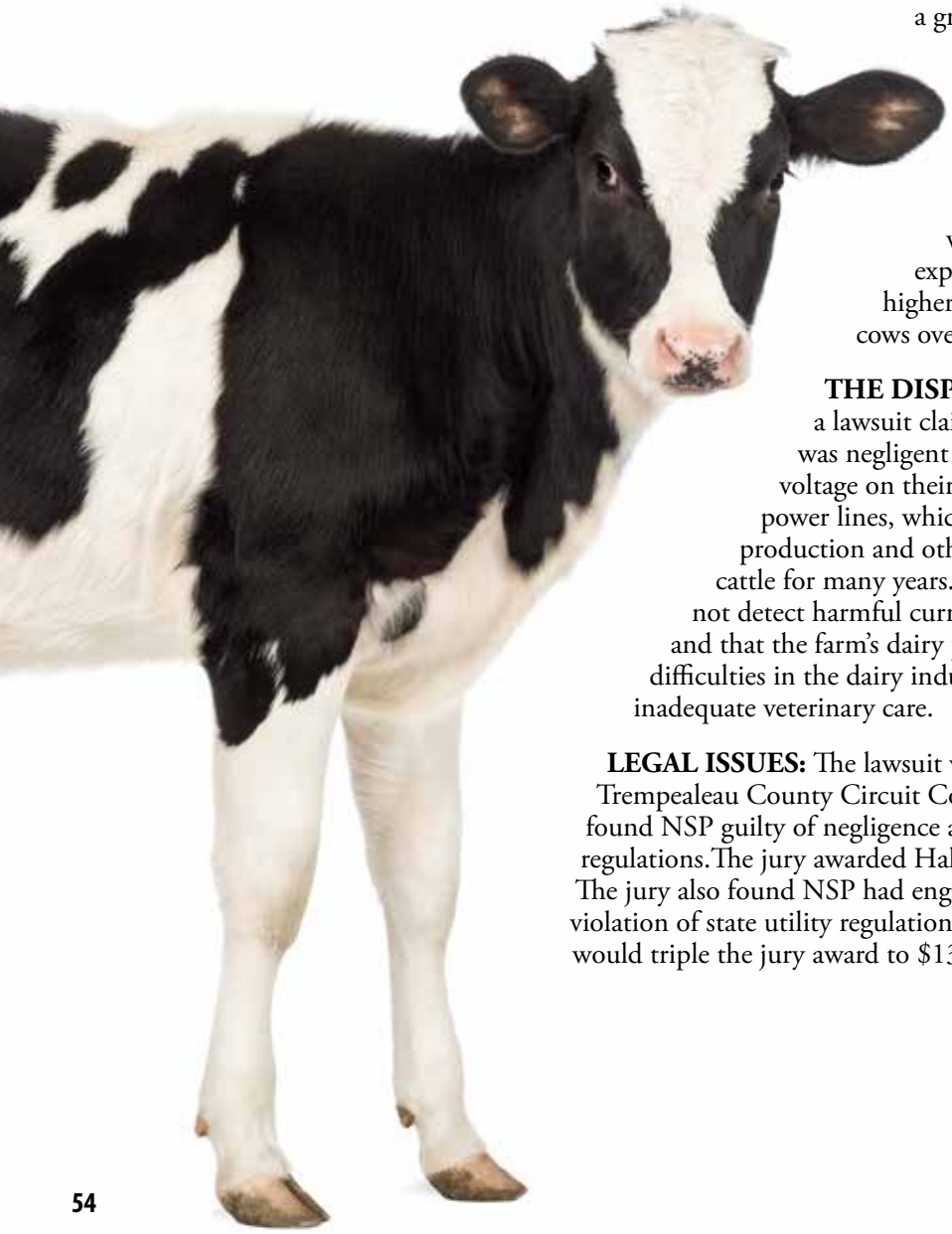
Dairy Farmer Wins Jury Award Against Xcel Energy in Stray Voltage Case

Paul Halderson, Lyn M. Halderson and Arctic View Farms, LLC, v. Northern States Power Company d/b/a Xcel Energy Services, Inc., et al, Cir. Ct. File No. 2012CV74, Circuit Court for Trempealeau County, Wisconsin (2017).

THE PARTIES: Spouses Paul Halderson and Lyn M. Halderson own Arctic Farms, LLC (collectively "Halderson"), and collectively own and operate a dairy farm in Galesville, Wisconsin. Northern States Power Company d/b/a Xcel Energy Services, Inc. ("NSP") provided electrical services to the dairy farm owned by Halderson.

THE FACTS: For over a decade, Halderson's herd of nearly 1,000 dairy cows struggled with illness and decreased milk production. It was asserted that in 1996 NSP discovered but failed to report excessive voltage in one of Halderson's barns, and Halderson repeatedly requested that NSP check its electrical services in the years thereafter. An independent consultant hired by Halderson in 2011 identified and reported high levels of electricity coming from NSP's distribution system.

Current that leaks from neutral wire into the earth is referred to as stray voltage. Animals can receive small shocks when they come into contact with a grounded object, such as a watering trough. Research from the USDA has found that stray voltage can cause cows to avoid eating, become stressed, and produce less milk. After identification and correction of the stray voltage, Halderson's dairy herd experienced increased production, higher reproduction rates, and healthier cows overall.



THE DISPUTE: In 2012, Halderson filed a lawsuit claiming, in relevant part, that NSP was negligent in its failure to prevent stray voltage on their property by improperly grounding power lines, which directly caused decreased milk production and other injuries to their herd of dairy cattle for many years. In response, NSP claimed it did not detect harmful currents where the cows were located and that the farm's dairy production issues were a result of difficulties in the dairy industry such as bad feed, disease and inadequate veterinary care.

LEGAL ISSUES: The lawsuit went to trial in July of 2017 in Trempealeau County Circuit Court, and on August 1, 2017, a jury found NSP guilty of negligence and failure to comply with state regulations.The jury awarded Halderson $4,500,000 in damages. The jury also found NSP had engaged in a willful, wanton or reckless violation of state utility regulations, which, if awarded by the Court, would triple the jury award to $13,500,000.

CONCLUSIONS: There is not yet a decision by the Circuit Court as to whether it will award treble damages. NSP currently has pending a motion for a new trial. It also has the ability to appeal the verdict to the Wisconsin Court of Appeals.

Stray voltage cases are familiar to those involved in agriculture. Farmers in Minnesota have also recently seen a large award in a stray voltage case, perhaps indicating a current willingness of juries to make such awards.

Damages Awarded for Breach of Manure Easement Agreement

Thompson v. JTTR Environ, L.L.C., No. 16-1610, 2017 WL 3065159 (Iowa Ct. App. July 19, 2017).

THE PARTIES: Tommy Thompson ("Thompson") is an owner of farmland in Iowa. JJTR Environ, L.L.C. ("JJTR") is an owner of a hog facility adjoining Thompson's property.

THE FACTS: In the spring of 2012, Thompson purchased approximately 146 acres of farmland (the "Property") from Ricke and Marian Langel. The Langels retained a 10.25 acre parcel upon which a hog farrowing facility was located. A condition to closing was that Thompson and the Langels would enter into a Manure Easement Agreement (the "Agreement"), which they did.The Agreement granted Langels and all future owners of the hog facility a permanent easement and the right to apply manure generated by the hog facility onto the Property. Under the Agreement, Thompson is allowed as much manure as needed to cover the Property.

In August of 2012, the hog farrowing facility was sold to JTTR, who converted it into a hog finishing facility, which was placed into production in the spring of 2013. In the fall of 2013 Thompson requested enough manure to apply on the entirety of his Property consistent with the Agreement. Due to the corn/soybean crop rotation on the Property, JTTR demanded that either manure from its facility be applied every other year or that only 73 acres of manure would be provided annually from its facility. Thompson accepted 73 acres of manure in the fall of 2013 and received no manure thereafter.

THE DISPUTE: In May of 2014 Thompson filed suit against JTTR for its breach of the Agreement. A bench trial was held, and in August of 2016, the district court returned a verdict in favor of Thompson, awarding damages in the amount of $70,433.93, plus $15,451.81 in attorneys' fees. JTTR appealed the verdict.

LEGAL ISSUES: JTTR first argued that it had not breached the Agreement because the easement only created a burden for Thompson to accept the manure. The District Court held that the Agreement explicitly imposed a burden upon JTTR to place manure on the Property annually and that such express terms of the Agreement were controlling. JTTR next argued that its manure was more valuable as being part of a finishing facility rather than the Langels' prior farrowing facility and, accordingly, it was subject to a greater burden than was originally intended by the Agreement. This argument was not found to be credible by the Iowa Court of Appeals, after not being considered by the District Court. Finally, JTTR argued the Agreement imposed a duty upon Thompson to rotate his crops, therefore entitling him to manure only every other year, which the District Court also rejected based on the clear and unambiguous language of the Agreement.

CONCLUSIONS: The Iowa Court of Appeals affirmed the District Court's rulings with regard to the legal analysis of the Agreement, but did reduce the amount of Thompson's award by $26,523.93 because Thompson failed to prove that he incurred damage in a year that he would not have applied manure in any event.

This ruling enforces the fact that words matter. Courts will first and foremost look to the express language of any agreement when interpreting the intent of such agreement in a contract dispute.