Failure to Execute a Written Lease Leads to a Lawsuit; and Improper Use of SBA Loan Funds

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Overview

One of the most important things that a farmer or rancher can do is to put lease agreements in writing. The problems that can arise with an oral lease are to innumerable to list or even think of. The first case below is an example. The second case involves a farm couple that were struggling financially and were trying to utilize Chapter 12 bankruptcy and SBA COVID relief funds. But the rules must be followed closely, as the Nebraska bankruptcy court's decision illustrates.

Problems with oral farming agreements and misuse of SBA loan funds – these are the topics of today's post.

Document Filed with FSA Not a Valid Lease

Coniglio v. Woods, No. 06-22-00021-CV, 2022 Tex. App. LEXIS 8926 (Tex. Ct. App. Dec. 7, 2022)

Involved in this case was land in Texas that the landowner's son managed for his father who lived in Florida. The landowner needed the hay cut on 107 acres of the over 5,100-acre farm and agreed orally that the plaintiff, a neighboring landowner, could cut the hay when necessary. The hay was cut on an annual basis. So that he could receive government farm program payments on the land, the plaintiff filed wrote up a "memorialization of a lease agreement" and filed it with the local USDA Farm Service Agency (FSA). The agreement stated as follows: "This is to inform you that Michael J. Woods operates my farm [farm number specified], (approximately 107 acres) agriculturally for hay. This lease agreement began in 2015 and will continue thru December 31, 2020." The document was dated September 28, 2016, and was signed by the plaintiff. The landowner's son also signed the agreement at the plaintiff's request, but later testified that he didn't believe the document to constitute a written lease. After three years of cutting the hay, the landowner wanted to lease the hay ground for solar development and the plaintiff was told by the landowner and son that the hay no longer needed to be cut and there would be no hay profits to share.

The plaintiff sued for breach of a farm lease agreement – purportedly a lease for a five-year term. The plaintiff also claimed that the father and son tortiously interfered with contract for future years, were unjustly enriched by the breach and had also violated the Texas Deceptive Trade Practices Act (DPTA). The trial court ruled in favor of the plaintiff on the basis that the form submitted to the USDA was sufficient to show the existence of a lease agreement, and entered a judgment for the plaintiff and against the father and son, jointly and severally, for $163,434.68 for breach of the "lease." The trial

court also awarded triple that amount ($490,304.94) for violation of the DPTA. The trial court also awarded court costs and attorney fees. The total award was $601,815.62,

On appeal, the defendant claimed that the document filed with the FSA did not satisfy the writing requirement of the statute of frauds. The father testified that he wasn't aware of any lease agreement and the son testified the arrangement was simply one to have the plaintiff cut the hay when needed and the parties would split the hay. The son testified that he signed the agreement simply so that the plaintiff could receive the farm subsidies associated with the hay ground. The appellate court agreed, noting that the document didn't contain the essential terms of the lease. It didn't denote the names of the parties, didn't describe the property, didn't note the rental rate, and didn't list any conditions or any consideration. Accordingly, the appellate court determined that no valid lease existed and reversed the trial court's judgment.

Debtors Barred From Further Use of COVID Relief Funds

In re Klein, No. BK 22-40804, 2022 Bankr. LEXIS 3451 (Bankr. D. Neb. Dec. 7, 2022)

This is the debtors' third Chapter 12 case since 2019. Two banks as creditors filed motions to dismiss, asserting the debtors were not eligible for Chapter 12 bankruptcy because they were not "family farmers" at the time of filing Chapter 12. The debtors claimed that they did meet the definition of a "family farmer" because they were engaged in farming with 15 cows, 5 calves, a one-half interest in a bull, and cash to operate. However, the debtors did not know where their cows were or if any of them were pregnant. They also failed to confirm a plan in their previous Chapter 12 cases, did not own any land or equipment and were on the brink of surrendering their livestock. Their only source of income was Social Security. The debtors obtained a $500,000 COVID hardship loan from the SBA in October of 2021 based on their representation that they were engaged in the business of farming, operating under a confirmed Chapter 12 plan. When they applied for the loan, the debtors agreed the loan money would only be used as working capital and there was no "substantial adverse change" in their financial condition. The debtors failed to schedule the loan and the debtors claimed they had an approved plan of reorganization for their bankruptcy claim, which they did not. When the debtors received the loan, they paid their attorneys for work on their prior bankruptcy cases, paid themselves for farm work, paid for their own groceries, and paid their daughters as contractors. Within four months of the loan disbursement the debtors had used $275,594.41 of the loan. The SBA sought a preliminary injunction against the debtors to ensure they could not use the remainder of the loan that SBA alleged was obtained by fraud. The bankruptcy court granted the preliminary injunction against the debtors to protect the remainder of the SBA loan. The court found that without the injunction the SBA would suffer irreparable harm if the loan proceeds were spent, and that the SBA would suffer greater harm if an injunction wasn't entered than if the debtors' access to was limited. The court also determined that the SBA was likely to succeed on its claim to except the debt from discharge and that public policy favored ensuring that the loan process was not abused and that the loan funds were properly used.

Observation

In *Coniglio*, the lack of a formal written document memorializing the relationship between the parties and the duties and expectations of both, created a problem that resulted in litigation – litigation that could have been avoided. Based on the facts as stated by the court, the arrangement appeared to be one of a custom cutter. That would be the result if the plaintiff supplied the machinery to cut the hay. In that event, the plaintiff would have simply been an independent contractor and not a tenant. The other possibility is that the plaintiff was a cropper that was compensated with a share of the crop. To be a cropper, the plaintiff would have used the landowner's (or son's) equipment. In that instance, the plaintiff would not have any legally enforceable interest in the crop, but would have a contract right to compensation for the provision of his in-kind labor. A cropper is an employee that is hired to produce a crop. A cropper has no interest in the real estate is not a tenant operating under a lease agreement. A cropper is, in essence, an employee. *See, e.g., Henney v. Lambert, 237 Iowa 146, 21 N.W.2d 301 (1946).* The court didn't get into these distinctions, but that would be the analysis. In any event, the writing, by itself, was insufficient to constitute a lease.

Conclusion

The court opinions indicate the problems that can arise when farming agreements aren't reduced to writing and how financial distress can lead to the snowballing of additional legal issues.

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