

No. 02-2915

IN THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

CLARICE A. STAHL, et al.,

Plaintiffs-Appellants,

v.

UNITED STATES DEPARTMENT OF AGRICULTURE,

Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NORTH DAKOTA

REPLY BRIEF OF THE PLAINTIFFS/APPELLANTS

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ARGUMENT

I. INTRODUCTION.

Appellee's Brief fails to accurately set forth Plaintiffs' claims. Therefore, a short and plain summary of these claims follows.

The complaint presents an action for declaratory judgment regarding the meaning of a "poorly drafted and confusing" contract¹ - the Shared Appreciation Agreement (hereafter "SAA") Add. A22-23 - between farmers and the Farmers Home Administration ("FmHA" or "USDA"). The contracts were required of any farmer whose debts were written down under the Agriculture Credit Act of 1987 ("ACA"). Plaintiffs' claims are predicated on the contract, associated regulations, and on the fact that over time, USDA has applied two different meanings to the same contract. The first meaning was the meaning used by USDA and the farmers when the contracts were signed starting in 1989. The second meaning is the meaning used by USDA years later during the collection process. Plaintiffs claim that after the contracts were signed, USDA unilaterally changed its administration of the contracts and when the expiration date of the agreements approached, USDA began to collect amounts that are not due at all or that are incorrectly calculated.

The first two claims for relief rest upon whether any amount is due if the farmer does not sell property or cease farming during the ten-year term of the

¹ This was a finding of the court. Add. A9.

agreement. They are primarily based on the contract language and 7 C.F.R. Section 1965.3, stating a farmer's payment obligations are to be determined by loan documents.

The third claim rests upon what maximum amount may be collected, if any payment becomes due. It involves analysis of a term in the contract - the "amount of account equity" - which Plaintiffs contend is the most that can be collected. This claim is primarily based on interpretation of the SAA and its companion document - the Noncash Credit for Farmer Program Loans When Establishing a Recapture Receivable ("Exhibit B") Add. A33-34 - as well as references to Exhibit B in regulations and forms.

The fourth and fifth claims state that USDA has deprived Plaintiffs of due process rights without a fair hearing by changing its administration and interpretation of the contracts and not abiding by the terms of the contract that were the basis of the bargain between the parties.

II. 7 U.S.C. § 2001 DOES NOT PRECLUDE PLAINTIFFS' INTERPRETATIONS OF THE SAA'S.

The court's first error was ruling that the controlling statute forbade any interpretation of the contract that did not provide for collection of up to the full amount written down at the expiration of the SAA if the property appreciated during the term of the agreement. The court found that Plaintiffs' factual claims and interpretations of the SAA's "fly in the face of what the Court construes as the

clear Congressional intent of the ACA generally and the SAA system in particular.” Order, 18-19; Add. A5. USDA concurs. *See* Appellee’s Brief at 21 (USDA’s current interpretation of the SAA is mandated by statute and any other interpretation would violate the federal statutes or regulations).

The court’s conclusions are premised on a fundamental misunderstanding of the applicable law. Congress expressly allowed USDA discretion to provide that the SAA’s expire at the end of ten years and that no amount of debt written off is due if the farmer did not sell the property or cease farming during the ten-year term. Further, Congress expressly allowed USDA discretion to provide that the maximum amount collectible may be less than the full amount of debt written down.

The cardinal rule in construing a statute is that it must be read as a whole since the meaning of statutory language, plain or not, depends on context. King v. St. Vincent’s Hospital, 502 U.S. 215, 221 (1991). Although the court correctly stated the principle that government contracts must be construed “against the backdrop of the legislative scheme that authorized them,” it did not correctly apply this principle. Order, p. 5; Add. A5. The court considered only *one section* - 7 U.S.C. § 2001(e) - of the ACA in isolation.

Section 2001(e) cannot be properly construed without reference to the Congressional purposes for adopting the ACA and other provisions of the ACA

that provided USDA with the authority to write down debt. When the ACA was adopted, the extent of farm distress was almost unimaginable.² Title VI governed FmHA and was included to address the “huge losses in borrower bankruptcies and liquidations” FmHA was experiencing. S.Rep. No. 100-230. It provided a panoply of farm relief options. A major new remedy for farmers – debt write-down – was provided by Section 615 of the ACA. The Congressional intent for debt restructuring was that “debt restructuring will stop the unnecessary displacement of family farmers and generate earnings for FmHA. It will prevent FmHA from forcing farm families off their land where that will cost the government more than allowing them to farm that land.” H.R. Rep. No. 100-295 at 62.

To place Section 2001(e) in context, it is necessary to review other parts of Title VI. Section 615(a) of the ACA, codified at 7 U.S.C. § 2001(a), states:

- (a) IN GENERAL. – The Secretary shall modify delinquent farmer program loans made or insured under this title ... to the maximum intent possible –
 - (1) to avoid losses to the Secretary on such loans, with priority consideration being placed on writing-down the loan principal and interest (subject to subsections (d) and (e) and debt set-aside (subject to subsection (e), whenever these procedures would facilitate keeping the borrower on the farm or ranch, or otherwise through the

²*See generally*, Summary of Preliminary Regulatory Analysis published with the proposed regulations to implement the ACA, 53 Fed.Reg. 18,392-393 (May 23, 1988).

use of primary loan service programs as provided in this section; and
(2) to ensure that borrowers are able to continue farming or ranching operations.

7 U.S.C. § 2001(b) sets forth four eligibility requirements, including the requirement that “the loan, if restructured, must result in a net recovery to the Federal Government, during the term of the loan as restructured, that would be more than or equal to the net recovery to the Federal Government from an involuntary liquidation or foreclosure on the property securing the loan.”

Finally, Congress gave direction in Section 615(a) (7 U.S.C. § 2001(d)) that priority was to be given to write-down of debt:

(d) PRINCIPAL AND INTEREST WRITE-DOWN.

(1) In General –

(A) Priority Consideration. – In selecting the restructuring alternatives to be used in the case of a borrower who has requested restructuring under this section, the Secretary shall give priority consideration to the use of principal and interest write-down

Reading the provisions of Section 2001(e) against the backdrop of the other provisions of the law contained in Section 615(a) of the ACA, several points are obvious.

First, the Secretary’s duty to avoid losses did not mean that the Secretary’s duty was to maximize earnings by the Secretary. Losses to FmHA were to be avoided by not liquidating or foreclosing and by writing off debt as a “priority consideration.”

Second, subsection (e) of Section 2001 governing SAA's was "subject to" the priority consideration that debt be written off to avoid losses.

Third, Congress authorized SAA's in two completely different settings: first, to recapture appreciation when the term of a debt set-aside expired or the debt set-aside was paid in full, and second, to recapture appreciation when a farmer who received debt write down sold the property or ceased farming "during" the term of the agreement. The fact that Congress authorized recapture of shared appreciation for debt set-asides explains in part why the statute lists "termination of the agreement" and "payment of the loans" as triggers for recapture of appreciation in 7 U.S.C. § 2001(e).

Fourth, SAA's were entirely optional with USDA. *See* 7 U.S.C. § 2001(e)(a): "As a condition of restructuring a loan . . . , the borrower of the loan may be required to enter into a shared appreciation agreement" (Emphasis added.) Courts are bound to afford statutes a practical common sense reading. O'Connell v. Shalala, 79 F.3d 1970, 176 (1st Cir. 1996). If the agency did not have to require payment of appreciation at all, it was a reasonable exercise of the agency's authority to require payment of only a portion of that written down debt and to require payment of appreciation only under certain conditions. The grant of a greater power (the power to not require any recapture of appreciation) necessarily includes the lesser power (the power to cap the amount of recapture or to require

recapture only when certain triggering events occur). This common sense maxim that a legislative grant of a greater power includes the lesser power has been broadly applied by the courts in a variety of settings and should be applied here. *See Asbury Hospital v. Cass County, ND*, 326 U.S. 207, 211-212 (1945); *People of the State of New York & Public Service Commission v. Federal Communications Commission*, 267 F.3d 91, 107 (2nd Cir. 2001); *Olivares v. Marshall*, 58 F.3d 109, 111 (9th Cir. 1995) (power to waive all fees includes lesser power to set partial fees); *Shelby County Health Care Corp. v. American Federal of State, County and Municipal Employees*, 967 F.2d 1091, 1096-97 (6th Cir. 1992) (power to terminate includes lesser power to apply lesser sanctions).

Fifth, at the time USDA drafted the SAA form, USDA was aware of Congress' intent that USDA must fashion agreements that would deter the use of Chapter 12 bankruptcies;³ that Congress' "primary consideration" was that the program be administered to prevent borrowers from quitting and putting their property on the market, further depressing already depressed land values; and that Congress' bottom line for recovery was the net recovery value. Faced with these competing considerations, USDA's choice to draft a SAA that expired rather than matured at the end of ten years (thereby supporting the purpose of keeping land off

³ *See* Amended Complaint, Par. 18. Chapter 12 does not allow a creditor to revalue property or capture appreciation after the creditor is given a secured claim worth an agreed value of the property. *See generally*, *Harmon v. U.S.*, 101 F.3d 574 (8th Cir. 1996). The maximum length of a Chapter 12 is five years. *Id.*

a depressed farm real estate market) and that required repayment only if the farmer sold the property or stopped farming during the term (thereby recapturing part of the appreciation if the goal of keeping the farmer on the land were not met) were reasonable and were not *ultra vires*.

Sixth, the optional authority to recapture appreciation in 7 U.S.C. § 2001(e), is also subject to the broad authority provided to the Secretary by Congress to compromise, adjust, reduce or charge off debts provided in 7 U.S.C. § 1981(b)(4). Both statutes must be read together to provide that the Secretary had broad authority to set the terms of the SAA.

But, even if Section 2001(e) is viewed in isolation, it is internally contradictory and capable of different interpretations, several of which would reasonably support Plaintiffs' claims. "Recapture" is not a defined term in Section 2001(e). The statute uses the word interchangeably as a verb ("to be recaptured"), as a noun describing a trigger ("the recapture occurs"), and as a noun indicating payment ("recapture shall take place"). Section 2001(e)(3) specifies that the "amount of appreciation to be recaptured by the Secretary shall be 75 percent of the appreciation in the value of such real security property if the recapture occurs within 4 years of the restructuring, and 50 percent if the recapture occurs during the remainder of the term of the agreement." The use of the word "if" in

conjunction with the limiting phrases “within” and “during” implies that recapture may not occur unless it occurs before the end of the term of the agreement.

On the other hand, Section 2001(e)(4) specifies that “Recapture shall take place at the end of the term of the agreement, or sooner – (A) on the conveyance of the real security property; (B) on the repayment of the loans; or (C) if the borrower ceases farming operations.” Yet, Section 2001(e)(3) providing that 50 percent of the appreciation is to be recaptured “if the recapture occurs during the remainder of the term” does not refer to any percentage of recapture of appreciation at the end of the term. An interpretation reconciling these apparent inconsistencies is that debt set-asides and the shared appreciation on such debt set-asides are repayable at the end of the term of the debt set-aside agreement or upon payment of the loans, whereas shared appreciation on debt written down would be recaptured on conveyance of the property or when the farmer ceases farming operations.

Moreover, a key provision of the ACA was that the SAA’s term could not exceed ten years. Congress did not say that the SAA had to come due or mature within 10 years. Although the court and USDA contend that Section 2001(e)(4) “Time of Recapture” provides four triggers for payment becoming due -- the expiration date, conveyance of property, payment of debts, and cessation of farming – Congress listed explicitly only the last three as separate items. Reading the provisions of Section 2001(e) together, a reasonable interpretation allows

payment of any recaptured amount to be made no later than the expiration date, if the property is conveyed, the loans repaid, or the farmer ceased farming. This, as discussed below, is the interpretation adopted in the SAA's.

III. NORMAL PRINCIPLES OF CONTRACT INTERPRETATION APPLY.

It is well accepted that in interpreting federal contracts, normal principles of contract law apply. Mobil Oil Exploration & Producing Southeast, Inc. v. United States, 530 U.S. 604, 607 (2000) (“When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals.”) *See also* discussion in Appellants’ Brief at 33-35.

In an analogous situation the Court of Appeals for the District of Columbia Circuit held that the statute made clear the agreements were to be “contracts, not departmental regulations,” and therefore they were “subject to interpretation under the neutral principals of contract law, not the deferential principles of regulatory interpretation.” Mesa Air Group, Inc. v. Department of Transportation, 87 F.3d 498 (D.C. Cir. 1996).

USDA attempts to prevent use of the normal principles of contract construction by stating that construing the contract as Plaintiffs do would violate the authorizing statute. Having shown Plaintiffs’ interpretations are not precluded by the statute, attention must return to normal principles of contract construction.

A cardinal principle of contract construction is that a document should be read to give effect to all its provisions and to render them consistent with each other. Restatement (Second) of Contracts §§ 202(5), 203(a) and Comment b.

In this case, the court simply disregarded inconsistencies in the contract and provisions that did not support USDA's current interpretation. Among the provisions ignored were the identical language in both repayment schedules ("either the expiration date of this Agreement or") and the "Amount of Account Equity, and the absence of a method to calculate an amount due on the expiration of the agreement.

It is equally well accepted that in construing a contract found to be ambiguous, the "general maxim that a contract should be construed most strongly against the drafter" applies. United States v. Seckinger, 397 U.S. 203, 210 (1970). In Seckinger, the United States Supreme Court applied the *contra proferentem* doctrine to a form contract that was promulgated as a regulation and published in the Code of Federal Regulations. 397 U.S. at 209 n.13. The court's observation that Rule 12(b)(6) standards "arguably apply somewhat differently here, however, as the Court is confronted with a legal challenge to an agency's interpretations of its own regulations" is in direct opposition to the approach taken by the United States Supreme Court. *See*, Order at p. 4; Add. A4

In Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 61 (1995),

the United States Supreme Court stated the rationale for this rule:

"Where one party chooses the terms of a contract, he is likely to provide more carefully for the protection of his own interests than for those of the other party. He is also more likely than the other party to have reason to know of uncertainties of meaning. Indeed, he may leave meaning deliberately obscure, intending to decide at a later date what meaning to assert. In cases of doubt, therefore, so long as other factors are not decisive, there is substantial reason for preferring the meaning of the other party." Restatement (Second) of Contracts § 206, Comment a (1979).

The court in Mesa Air found it did not need to apply the *contra proferentem* doctrine under the facts of that case to the contract terms drafted by the government, but would have if "other factors" had not been decisive in mandating the same result of finding against the government's drafting. 87 F.3d at 506.

This Court has held that the *contra proferentem* doctrine applies to ambiguous contracts drafted by USDA, particularly where they are "contracts of adhesion" such as the SAA here. A.W.G. Farms v. FCIC, 757 F.2d 720, 726 (8th Cir. 1985).

Rather than applying this doctrine, the court construed all ambiguities in USDA's favor.

USDA claims that these principles of construction of ambiguous contracts do not apply here because the ambiguities are "patent" and a duty exists to seek

clarification. Appellants' Brief at 19. However, the duty to inquire does not arise if an ambiguity is latent or falls into a "grey area." See Fort Vancouver v. U.S., 860 F.2d 409, 413-414 (Fed. Cir. 1988).

When the contracts were presented to the farmers, they looked to the formula for calculating the "amount due" and saw that the amount of payment would be measured by the difference between the value of the property at the time of restructuring and the value when they sold it or ceased farming. Further, even though USDA used the word "due date" or "matures" on all of their other loans, the word "expires" was used in the SAA. The farmers also saw that 50 percent of appreciation could be recaptured "if such event occurs after four years but before the expiration date of the agreement." Reading the terms of the agreement, no ambiguity was apparent. It was not until USDA contacted the farmers shortly before the expiration date to say the agreements had "matured" and an amount would be due on the expiration date that an ambiguity became apparent. Under these circumstances, any ambiguity was latent or in the grey area.

Even if part of the ambiguity were patent, the farmers sought clarification of the terms from the county supervisors who uniformly explained that they would owe nothing under the SAA unless they paid the loans, sold their land, or ceased farming during the ten-year term. See Affidavits of Plaintiffs, Docket Nos. 6 and 9. Under these circumstances, USDA still bears the onus of the ambiguity. See

Hunt Construction Group, Inc. v. United States, 281 F.3d 1369, 1375 (Fed.Cir. 2002) (when a bid is ambiguous, an inquiry by one bidder places a duty on the government to clarify the bid to all bidders; the onus of the ambiguity still rests with the government).

USDA claims that Plaintiffs cannot rely on the advice and explanations of the county supervisors because it was not in their scope of authority, citing F.C.I.C. v. Merrill, 332 U.S. 380 (1947) (Appellee’s Brief at 19-20). However, the scope of a county supervisor’s authority is a disputed issue of fact. FmHA county supervisors received training from the national office. *See* 7 C.F.R. § 1951.1917. Further, oversight was conducted of their implementation and if inaccurate advice was provided, it should have been caught and promptly corrected, but it was not. 7 C.F.R. § 1951.1918. This Court has held that “[o]ne may have to turn ‘square corners’ when dealing with a governmental entity, but this does not mean the government may operate so recklessly so as to put parties dealing with it entirely at its mercy.” A.W.G. Farms v. F.C.I.C., 757 F.2d at 729.

Contrary to common sense, USDA argues that the paragraphs that set the payment schedule are more specific than the paragraph that defines the “amount due” and that they trump the amount due calculations. This argument has no merit because the timing or scheduling of payments is a general provision relating to *when* payment may occur but does not define the “amount ” of that payment. As a

specific term, the paragraph on calculation of the amount due controls the general terms that specify when payment is due. *See Corso v. Creighton Univ.*, 731 F.2d 529, 533 (8th Cir. 1984).

The court and USDA place great reliance on the “either/or” language in the 50 percent appreciation payment schedule in order to override the paragraph defining the “amount due.” Their reliance on this “either/or” provision, however, ignores the identical “either/or” language in the 75 percent payment schedule. The operative language (“either the expiration date of this agreement or ...”) is identical in the two subsections of the schedule of payments. Thus, the interpretation adopted by the court necessarily means that a farmer could owe either 75 percent or 50 percent of appreciation at the “expiration of the agreement” at the agency’s whim. Courts should not construe contracts to reach obviously absurd results. This is especially true when such a construction is used to override a specific provision that says that FmHA will calculate the amount due by an entirely different method.

The court (Order at 7; Add. A7) and USDA (Appellee’s Brief at 21) place great reliance on “instructions” on the SAA’s to override the specific SAA’s provision on calculation of amount due. However, these were not presented to the farmer as “instructions” at all, but were presented as a “summary” of options that might become available. Under general principles of contract interpretation, an

inaccurate summary presented by one party cannot override the actual terms of the contract that is signed at a later time. Moreover, a borrower's obligations are governed by the loan documents, not by summaries of loan documents. 7 C.F.R. § 1965.3.

IV. THE AMOUNT OF ACCOUNT EQUITY ON THE SAA PROVIDES A CAP ON THE AMOUNT COLLECTIBLE.

USDA contends that Exhibit B and the equity recapture account amount calculated on Exhibit B form were only an internal accounting mechanism and did not substantively affect Plaintiffs' rights under the SAA. Based on this characterization, USDA argues it was "entirely proper" for it to discontinue use of Exhibit B through an Administrative Announcement (AN No. 1934) without formally repealing the regulations which required its use.

Whether Exhibit B was solely an internal accounting mechanism is a disputed question of material fact which would preclude granting USDA summary judgment on the current state of the record. The Exhibit B form was required to be completed by the county supervisor at the same time the county supervisor completed the SAA. 7 C.F.R. § 909(j). Add. A26. The Exhibit B form was to be attached to the SAA⁴ and a copy of the Exhibit B form was to be attached to the promissory note and a copy given to the borrower. Add. A24. Documents that are

⁴ "In consideration for this noncash credit an equity receivable account will be established in accordance with the attached ... Shared Appreciation Agreement ... signed by the borrower." (Emphasis added). Add. A24.

part of the same transaction and attached to each other must be construed together. Personal Security & Safety Systems Inc. v. Motorola, Inc., 297 F.3d 388, 393 (5th Cir. 2002) (“When several documents represent one agreement, all must be construed together in an attempt to discern the intent of the parties, reconciling apparently conflicting provisions and attempting to give effect to all of them, if possible.”) *See also*, Restatement of Contracts (Second) § 202(2).

USDA argues that the Exhibit B form can only be understood by looking at the form’s history but then proceeds to ignore that history. Appellee’s Brief at 25-26. The history of the Exhibit B form evidences its effect on the substantive rights of the borrowers. The interim final regulations published for comment in the Federal Register at 53 Fed. Reg. 35,638 *et. seq.* (Sept. 14, 1988), differed in significant ways from the initial proposed rules drafted by USDA to implement the ACA published at 53 Fed. Reg. 18,392 *et. seq.* (May 23, 1988).

The SAA published in the proposed rules did not contain a space for the “Amount of Account Equity.” 53 Fed. Reg. 18,471-472. Likewise, the Exhibit B form did not contain an “equity recapture account amount.” *Id.* at 18,471. It was only when the Exhibit B form was changed and published in the Federal Register as part of the interim rules, along with comprehensive instructions for calculating the equity recapture account amount, that the “Amount of Account Equity” was added to the SAA. 53 Fed. Reg. at 35,746-747.

The Appellee, ignores this history and speaks only of USDA's improper discontinuance of Exhibit B through AN No. 1934. Appellee's Brief at 25-26. USDA justifies its use of AN No. 1934 to discontinue use of a form required by the applicable regulations because it "had no substantive effect" and was "simply a general statement of policy or rule of agency procedure" citing to ANR Pipeline v. FERC, 205 F.3d 403 (D.C. Cir. 2000). ANR Pipeline does contain the quote attributed to it by USDA: "A policy statement does not become a regulation simply because an agency chooses to publish it in the Code of Federal Regulations." However, that case does not apply to the circumstances here. The statement published at 18 C.F.R. § 2.65 involved in ANR Pipeline began: "It will be the general policy of the Commission" The court concluded it was a policy statement and not a regulation based both on its specific language stating it was a policy statement and on the fact that it was promulgated without notice and comment. 205 F.3d at 407. Neither circumstance exists here. Rather Northern States Power Co. v. REA, 248 F.Supp. 616 (D.C. Minn. 1965) *rev'd* on other grounds, 373 F.2d 686 (8th Cir. 1967) discussed on pages 41 and 46 of Appellants' Brief controls here.

USDA further points out that the term "equity recapture account amount" does not appear in the statute. Appellee's Brief at 12. It is disingenuous of USDA to now claim that the term "equity recapture account amount" -- a term it coined

for use in regulations it promulgated -- is meaningless and inconsistent with the statute because that term is not mentioned in the statute!

In a similar vein, USDA now refers to this amount as a “rather oddly defined quantity.” Appellee’s Brief at 25. USDA has ignored the evidence in the Affidavits submitted by Plaintiffs in support of their Motion for a Preliminary Injunction that county supervisors completing the SAA’s used this “oddly defined quantity” as the amount of account equity on the SAA. USDA also ignores the fact that its Inspector General used this “oddly defined quantity” as the potential amount of recapture collectible under the SAA’s in his 1992 audit of the SAA program. *See* Appellants’ Brief at 13; Add. A31-35.

The equity recapture account amount, rather than being an “oddly defined quantity,” was well thought out and very appropriate as a cap on the amount to be recaptured under the SAA’s. It was to be the lesser of the difference between the loan balance of the debt before restructuring and the net recovery value⁵ (write-down amount) or the difference between the market value of the property and the net recovery value. The two numbers reflect two key concepts: write down and equity. The amount written down is the amount of the loan balances that the

⁵ The “net recovery value” is the amount that USDA would have recovered through foreclosure. See item 8 of the instructions for preparation: “Enter the value of the loan as if FmHA were to go through liquidation procedures.” In the ACA, Congress provided very explicit instructions as to how “net recovery value” was to be calculated. *See* 7 U.S.C. § 2001(c).

government deemed uncollectible based on the value of the collateral after expense of liquidation. The difference between the market value and the net recovery value is the amount of equity that a farmer would have after the loan was written down. This difference - based on the USDA's estimated foreclosure costs - was a key factor because it reflected a potential windfall to the farmer if the farmer sold the property within 10 years after it was restructured because such a sale would be at market value, rather than at the government's net recovery value. Using this, farmers' equity as the maximum to be recaptured for the taxpayers if the farmer sold the farm or ceased farming is a reasonable cap authorized by the statute.

Even though the court reviewed Exhibit B and its instructions including examples for calculating the equity recapture account amount, the court admitted it did not understand the function of the equity recapture account amount. Order, pp. 14-16, 21; Add. A14-16, A21. Nonetheless, the court agreed with USDA that the equity recapture account amount was an unimportant, irrelevant calculation that could be eliminated without affecting any rights of the borrowers.

USDA further disparages Plaintiffs' interpretation of the "Amount of Account Equity" as being the same as the "equity recapture account amount," by pointing out that the Exhibit B form did not specifically state that amount was the maximum amount that could be recovered under an SAA and in fact did not say anything about the purpose or function of the "equity recapture account amount."

Appellee's Brief at 24-25. However, the purpose and function of the equity recapture account amount is adequately explained in the text of the regulation at 7 C.F.R. § 1951.914(a)(1), (a)(2), (c)(2), (c)(4), and (c)(5). USDA also has offered no rationale for why it placed the Amount of Account Equity on the SAA. At the minimum these failures by USDA create an ambiguity in the SAA, an ambiguity which must be construed against the drafter. USDA's failure to draft clear documents should not be used to make the regulations USDA promulgates meaningless.

Finally, to the degree the summary of the SAA given to farmers compels an interpretation that the SAA's cannot permit any interpretation that would allow Plaintiffs' first and second causes of action, it necessarily requires reinstatement of Plaintiffs' third cause of action. Three times in that three sentence summary it states that the agreement (or FmHA) will ask you to repay "part of" the debt written down. App. 67-68. Nowhere in the summary does it indicate that USDA can ask for the full amount written down. USDA cannot pick and chose how it applies the identical language to Plaintiffs' different causes of action.

V. PLAINTIFFS' CONSTITUTIONAL CLAIMS WERE IMPROPERLY DISMISSED.

USDA claims that Plaintiffs' constitutional claims are barred as a matter of law because "there is an established remedial procedure available to farmers who disagree with the Department of Agriculture's interpretation of the SAA's," citing

7 U.S.C. § 6996. However, USDA ignores 7 U.S.C. § 6992(d) providing that matters of general applicability – such as the agency’s interpretation of the SAA - cannot be administratively appealed. USDA’s appeal regulations are to the same effect. *See* 7 C.F.R. §§ 11.3(b), 780.2(c).

VI. THE COURT DID NOT FOLLOW THE REQUIREMENTS OF RULE 12(b)(6) IN DISMISSING PLAINTIFFS’ CAUSES OF ACTION.

USDA argues that that the court did not violate Rule 12(b)(6), that even if Rule 12(b)(6) was not followed Plaintiffs waived the right to object, and that any errors were harmless.

A. No Waiver Occurred.

USDA states that because the matters outside the pleadings were attached to Defendants’ memorandum in support of the Rule 12(b)(6) motion, Plaintiffs were “on notice” that the matter would be converted to a summary judgment and since they did not object, they have waived any argument that conversion was improper. Appellee’s Brief at 36-39. This is not the case. The documents in question were attached to a multi-purpose brief. It was submitted in reply to the Motion for a Preliminary Injunction and in support of two motions to dismiss – one made under Rule 12(b)(1) and the other under Rule 12(b)(6). *See* Appellee’s Separate Appendix 1-40. The memorandum was considered first with respect to the preliminary injunction which was denied on August 21, 2001. On August 28, 2001 --- *before their replies to the motions to dismiss were due* --- Plaintiffs filed a

motion that requested permission to conduct discovery in order to develop evidence essential to their claims. Plaintiffs' brief specifically identified the original interpretation and administration of the SAA's as a "contested issue of material fact." App. 145. USDA's claim that Plaintiffs in any way waived their rights must be rejected based on a review of the transcript of the September 21, 2001, hearing on the motion, *See* App. 152-169, and the court's order (App. 170-171). During the hearing, the court stated: "It's not my inclination, Miss Vogel, to consider any factual materials in considering a motion to dismiss. It's my understanding the motion to dismiss tests only the legal sufficiency of the complaint." App. 157. Counsel for USDA also objected to discovery, saying "it is a motion to dismiss which rests on the legal sufficiency of the pleadings." App. 157. The court's order specifically stated: "The Rule 12(b)(6) motion currently before the Court is intended to test the legal sufficiency of the claims, and the law accords heavy presumptions in plaintiffs' position in such a motion. Therefore, any discovery before the Court ultimately rules on the motion to dismiss would be inappropriate." App. 171.

B. The Court's Consideration of Matters Outside the Pleadings Was Erroneous.

USDA's claim that no error occurred should be rejected. USDA characterizes the court's statement it considered "the submissions of the parties and the entire file" as "boilerplate." Appellees' Brief at 33. Such a characterization of

the Court's Order makes no sense: this was not a pre-printed form that would be presented to a court for signature. The court carefully crafted this Order to the circumstances of this case. USDA has no basis to assume the court did not mean what it said.

Moreover, the court's statement that it considered the submissions of the parties and the entire file is corroborated by the conclusions in the Order that USDA "always" had deemed the amount written down as the maximum amount collectible and had "never" done otherwise. Add. A18. ("USDA further claims it was always entitled to recapture the amount written down, arguing the equity recapture account never established a maximum amount that could be recaptured. The Court accepts USDA's arguments.")

Further, USDA's self-serving characterization of the court's order does not alter the fact that the court's dismissal was made *with prejudice*,⁶ a result that is *de facto* the same as a summary judgment but without the procedural safeguards of Rule 56. A Rule 12(b)(6) order typically has no such binding effect. *See generally, Wright & Miller, Federal Practice & Procedure: Civil 2d* § 1357 (a dismissal under Rule 12(b)(6) generally is not final or on the merits; a court that thinks it convenient to test the merits under a preliminary motion should do so by converting the motion to dismiss into one for summary judgment).

⁶ *See* Order, footnote 6, page 21; Add. A21.

USDA also contends that the court did not consider “evidence.” This is not the case. The court’s own statement that it considered evidence is conclusive: “when evaluated in light of this [statutory and SAA system] intent, there is simply insufficient evidence to support plaintiffs’ contentions and to undermine USDA’s contention that the equity recapture account amount did not establish a cap on recapture.” Order p. 19, A19. (Emphasis added.) USDA claim that this reference to evidence was only to “textual evidence” and not to the kind of evidence that could be produced through discovery is illogical and is not supported by the court’s Order.

USDA cites two cases to support its claim that the court’s consideration of AN No. 1934 and the letter from the Internal Revenue Service did not trigger conversion to a Rule 56 motion because they were public records. Porous Media Corporation v. Pall Corporation, 186 F.3d 1077 (8th Cir. 1999) dealt with a case that had been to the Eighth Circuit three times. The public record considered in Porous Media was a prior trial court ruling that held a counterclaim was meritorious and not subject to dismissal as a matter of law. In appellants’ suit based on malicious prosecution of that counterclaim, the prior court’s ruling was dispositive as a matter of law and the court could take judicial notice of the ruling. Jenisio v. Ozark Airlines, Inc. Retirement Plan, 187 F.3d 970 (8th Cir. 1999) also does not support USDA. It held a district court could consider documents on a

motion to dismiss where the plaintiffs' claims were based solely on the interpretation of the documents and the parties did not dispute the actual contents of the documents.

The documents presented by USDA and considered by the court do not fall into any exception from the general rule prohibiting consideration of matter outside the pleadings in a Rule 12(b)(6) motion. *See* Appellants' Brief at 21-27 (strict compliance with Rule 12(b)(6) required by the Eighth Circuit).

When courts have considered "public records" in conjunction with a Rule 12(b)(6) motion, they generally have restricted their review to matters capable of judicial notice under F.R.Evid. Rule 201. The truth of the purposes for AN No. 1934, for example, cannot be judicially noticed. *See Holloway v. Lockhart*, 813 F.2d 874, 878-879 (8th Cir. 1987) (applying F.R.Civ.P. Rule 201(f) to disallow judicial notice of public court records). *See also, Lovelace v. Software Spectrum Inc.*, 78 F.3d 1015, 1018, 1021, n. 6 (5th Cir. 1996)

USDA's argument that the court's acceptance of the statements in AN No. 1934 was "harmless error" because Plaintiffs do not dispute that AN No. 1934 was authentic. Authenticity is not the issue, however. The truth of the matters in the document are disputed. Plaintiffs' discussion of AN No. 1934 in their reply brief to Defendant's Motion to Dismiss contested the truth of the statements in the AN. *See* Appellee's Separate Appendix at 61-64.

USDA argues that any consideration by the court of the Hall Affidavit, and the IRS letter are also harmless error. They were not. They cannot be judicially noticed and their presentation by USDA in support of the motion triggered conversion, unless the Court excluded them, which it did not do.

C. The Error Was Not Harmless.

Harmless error can occur only “if the nonmoving party had an adequate opportunity to respond to the motion and material facts were neither disputed nor missing from the record.” Gibb v. Scott, 958 F.2d 814, 816 (8th Cir. 1992).

As stated above, Plaintiffs had no notice at all. If Plaintiffs had received notice of a conversion to a summary judgment motion, Plaintiffs would have moved for a continuance and discovery under Rule 56(f) and submitted a statement of material disputed facts. Depositions or documentary evidence could have been introduced to defeat the motion for summary judgment.

USDA claims that the type of information Plaintiffs sought in their August 30, 2001, motion “could not possibly have been relevant to any legal issue in this case.” Appellees Brief at 38. Depositions, training material, and related documents showing the original interpretation of USDA are extremely relevant to Plaintiffs’ claims. They would provide evidence confirming USDA’s original interpretation, support a finding of ambiguity, and establish disputed issues of material fact.

In this case, the court's dismissal has an extremely harsh effect. Plaintiffs had not even been afforded the opportunity to seek evidence through discovery in support of their claims. Such a binding precedential effect as to the five claims made here will be used by USDA to prevent Plaintiffs from interposing these defenses when USDA seeks to foreclose their farms, although the arguments are among the type of equitable defenses that are appropriate in such cases. The stakes for Plaintiffs are too high and the departure from the mandatory requirements of Rule 12(b)(6) too great to be considered harmless error.

Ordinarily a declaratory judgment claim seeking clarification of the terms of a "poorly drafted and confusing" contract with the United States government that involves hundreds of millions of dollars and affects thousands of citizens would be accepted as a claim for which relief may be granted without question. But this was not the case here. Dismissal of a case for failure to state a claim should not occur unless "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim that would entitle him to relief." Conley v. Gibson, 355 U.S. 41, at 45-46 (1957).

Dated this 4th day of November, 2002.

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CERTIFICATE OF COMPLIANCE

I hereby certify, pursuant to Federal Rule of Appellate Procedure Rule 32(a) and Eighth Circuit Rule of Appellate Procedure 28a(c) that this brief complies with the type-volume limitations. It was prepared in Times New Roman, 14 pt., a proportional font, and the word counter on Microsoft Word Office 2000 counted 6,807 words.

The floppy disks submitted with this brief have been scanned and are clean and free of any viruses.

Sarah Vogel, Attorney

CERTIFICATE OF SERVICE

I hereby certify that on this 4th day of November, 2002, I served two copies of the foregoing Reply Brief of the Plaintiffs/Appellants and one diskette upon counsel of record, postage prepaid, to:

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