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THE WHITE HOUSE  
WASHINGTON

ACTION

December 23, 1974

MEMORANDUM FOR THE PRESIDENT

FROM:

KEN *COLE*

SUBJECT:

Mushroom Processors' Request for SBA Disaster Loans

Background

In 1973, botulism was discovered in several cans of American produced mushrooms. The subsequent recall of the product and the resultant consumer reluctance to buy caused a severe business decline for the mushroom processing industry, which is primarily located in Michigan, Pennsylvania, Ohio and New York. The Food and Drug Administration does not establish specific standards for the processing of low acid foods like mushrooms but does require that processors use procedures which safely prevent botulism. The mushroom processors for the most part were following generally accepted industry procedures when the botulism occurred, but the procedures had become inadequate due to changes in the handling of the product.

The processors, faced with debts to banks and to the farmers that supply them, have requested assistance in the form of direct Small Business Disaster Loans. The terms of these loans at the time of the disaster included a one percent interest rate with a \$5,000 forgiveness feature, which would be applicable to the mushroom processors. The disaster loans have no ceiling while other SBA lending programs, including Direct and Guaranteed Loans, available to the mushroom industry at higher interest rates, are limited to \$350,000. The availability of these other loans is limited by the lack of private capital for Guaranteed Loans and budget limitations on Direct Loans, which SBA claims are allocated elsewhere. The processors claim that these other loan programs are too limited to supply the capital they need.

The law requires that loans may only be granted where "natural" or "undetermined" causes led to the disaster. The FDA inspection of the mushroom processors whose cans were discovered to contain botulism revealed that the problem was due to deficiencies in the processing. About half the firms were operating with deficiencies in equipment or operating procedures which according to FDA "would not be tolerated by knowledgeable and conscientious cannery management".

The SBA ultimately decided to grant the disaster loans but needed the endorsement of the Federal Disaster Assistance Administration (FDAA) located in HUD, As a matter of course, FDAA forwarded the matter to the Domestic Council. Because of the potentially precedential nature of this and its political and budgetary implications it was also referred to OMB and to the Office of the Legal Counsel (OLC) in the Justice Department. The industry demand has been estimated at \$20-30 million loans, if all of the approximately 50 processors apply.

There are two options in this case:

- (1) To grant the disaster loans
- (2) Deny them and let the processors apply for other SBA loans.

If this latter course is followed, additional direct loan authority could be sought from the Congress to increase the availability of this type of funding or additional funding could be obtained by the sale of SBA assets contained in the SBA loan portfolio.

#### Factors Favoring Granting Disaster Loans to Processors

- SBA maintains that it has the legal authority to grant the loans and OLC concurs. OLC claims that the factors inherent in the botulism found in smoked fish from the Great Lakes in 1963, which led to the statute providing for Small Business Disaster Loans, are similar to those found in the case of mushrooms. The OLC opinion points out that the botulism bacterium is a natural occurrence in some foods including fish and mushrooms but to become toxic in foods it must have a growth environment provided by improper or negligent processing. The OLC claims that the natural occurrence of botulism qualifies this case for the disaster loans and argues that evidence of negligence does not render a claimant ineligible.
- Congressmen and Governors from Michigan, Ohio, Pennsylvania and New York (including Senators Scott, Hart, Javits, and Schweiker; Congressmen Vander Jagt and Huber; Governor Milliken) have kept a steady pressure for a decision on behalf of the mushroom processors.
- According to the processors' impact statement and other outside sources the canned mushroom industry is in danger of collapsing, affecting both processors and farmers. The six processors

which have applied for disaster loans to date claim that the regular SBA loans, with a maximum of \$350,000, would be inadequate to meet their needs. They are requesting an average of \$750,000 each.

- The processors have pointed out that in 1974, after the botulism scare, the World Bank underwritten by U.S. funds, granted \$7 million in loans to the Korean mushroom industry to improve their processing techniques to meet FDA requirements, helping them compete in U.S. markets.
- The processors claim the loans would enable a formerly viable, small industry return to full production.

SBA is in favor of granting the loans because they would enable a small industry to survive, and would demonstrate the Administration's concern for small business in a time of economic dislocation.

#### Against

- The FDA report on the matter appears to indicate that the botulism was primarily due to management deficiencies rather than "natural" or "undetermined" causes. The firms involved had changed operating conditions without altering processing standards to assure adequate safety. Also, several firms were operating with deficient equipment including broken thermometers and inaccurate timing devices. Providing loans in this case, therefore, may set a precedent for assisting firms which suffer losses due to management deficiencies rather than from factors beyond their control. This would be the first instance where the loss is due to human failure to produce a safe product.
- If this precedent is established, firms previously "injured" by FDA recalls of unsafe products may now request this assistance. In fiscal year 1974, FDA instituted 170 recalls of contaminated food products and 1273 recalls of other products. Since there is no time limit on when firms affected by disasters are no longer eligible for loans, positive action on the mushroom industry's request could result in a flood of requests from industries previously affected by FDA recalls, like cyclamates.

- The potential cost of this precedent could be high. The mushroom case, with a cost of \$20-30 million, is an example of the cost of one FDA recall. It is estimated that in 1972, the FDA ruling on cyclamates resulted in industry losses of \$250-\$500 million. Just in the food processing industry alone there are about 26,000 small businesses which would be eligible for SBA disaster assistance. These firms have annual sales of about \$29 billion.
  
- If the disaster loans were provided in this case, they would have an interest rate of only 1%, and \$5,000 of each loan would not have to be repaid. There is no evidence that the processors need such favorable loan terms or the \$5,000 grant, in order to survive and remain competitive.
  
- At a time of severe budget stringency, actions which could increase the Federal deficit should be avoided.

The Office of Management and Budget recommends against allowing these loans because of the possible precedent for assisting firms with product losses due to management deficiencies, and the potentially high cost of such a precedent. If it is determined that special actions should be taken to assist this industry, OMB recommends that it take the form of conventional SBA loans at 6  $\frac{1}{2}$ % with a limitation of \$350,000 per loan.

### RECOMMENDATIONS

Thomas Kleppe  
SBA Administrator

#### Option 1

That the disaster loans be granted because the funds are immediately available and many of the processors need larger sums than the \$350,000 available to them from the 7(a) loans to stay in business. If the decision is made to deny the disaster loans, Kleppe promises SBA will do everything to expedite 7(a) loan applications from the processors.

Ash, Buchen, Seidman, Cole

#### Option 2

That the SBA Disaster Loans be denied to the mushroom processors. All agree that SBA should be directed to expedite handling

of 7(a) loan applications from the mushroom operators. Buchen and Seidman feel that the \$350,000 from these loans to those who qualify would be sufficient to keep many of the processors financially afloat.

Friedersdorf

Does not recommend either option but advises that this is an acute political problem because of the interest of Senator Hugh Scott and that whatever assistance deemed feasible should be afforded the processors.

DECISION

Option 1 \_\_\_\_\_

Grant the mushroom processors Disaster Loans.

Option 2 MC9

Deny them and direct SBA to expedite 7(a) loan applications from the processors.