Agricultural Law Update

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INSIDE

IN FUTURE ISSUES

The Poultry Producers Financial Protection Act of 1987

The Poultry Producers Financial Protection Act of 1987 (the "Act"), an amendment to the Packers and Stockyards Act, was enacted on November 23, 1987. Pub. L. No. 100-173, 101 Stat. 917, to be codified at 7 U.S.C. § 181 *et seq.* It becomes effective on February 22, 1988. The Act's key provisions include the extension of "unlawful practices" liability to live poultry dealers and handlers, the establishment of a statutory trust to insure payment to growers under cash sale and poultry growing arrangements, and the requirement of prompt payment by dealers who purchase poultry. The Act's provisions are closely analogous to other Packers and Stockyards Act provisions that regulate purchase payment obligations of livestock dealers and handlers. *See, e.g.*, 7 U.S.C. §§ 196 and 228b (West Supp. 1987).

The Act defines the following key terms:

(a) Poultry grower: "Any person engaged in the business of raising and caring for live poultry for slaughter by another, whether the poultry is owned by such person or by another, but not an employee of the owner of such poultry." § 2a(8), to be codified at 7 U.S.C. § 182(8).

(b) Poultry growing arrangement: "Any growout contract, marketing agreement, or other arrangement under which a poultry grower raises and cares for live poultry for delivery, in accord with another's instructions, for slaughter." § 2(a)(9), to be codified at 7 U.S.C. § 182(9).

(c) Live poultry dealer: "Any person engaged in the business of obtaining live poultry by purchase or under a poultry growing arrangement for the purpose of either slaughtering it or selling it for slaughter by another. . . ." § 2a(10), to be codified at 7 U.S.C. § 182(10).

(d) Cash sale: "A sale in which the seller does not expressly extend credit to the buyer." §§ 207(e) and 410(c), to be codified at 7 U.S.C. §§ 197 and 228b-1.

The statutory trust is intended to remedy the obstruction to commerce which is caused by financing arrangements in which live poultry dealers grant a security interest in poultry which they obtain by cash purchase or poultry growing arrangements. The trust applies to all poultry obtained by a live poultry dealer, whether by cash purchase or by a poultry growing arrangement. *(Continued on next page)*

Diesel fuel excise tax collection procedures

Effective April 1, 1988, the Omnibus Reconciliation Act of 1987 will require farmers to pay their fuel marketers the 15.1 cents per gallon motor fuel excise tax on diesel fuel. Farmers then would have to apply to the Internal Revenue Service for a per gallon refund of this tax.

Traditionally, Congress has exempted off-highway agricultural use from the payment of diesel fuel excise taxes. Congress also has exempted from this tax state and local government fleets and railroad trains. However, under the Omnibus Budget Reconciliation Act, Pub. L. No. 100-203 (Dec. 22, 1987), Congress expressly gives IRS the discretion to exempt only these government fleets and railroad trains from the tax, where the purchaser demonstrates to IRS' satisfaction that the fuel will be used for a non-taxable use. These select purchasers also must obtain a Certificate of Registration from the IRS and post bond in an amount that the IRS may require. Congress, given the statute, does not provide the IRS discretion to exempt sale for off-highway agricultural use. Farmers, therefore, would incur a temporary, but significant, additional cost on the purchase of diesel fuel for non-motor fuel use. Congress also does not provide farmers a period of time in which IRS must submit a refund after receipt of a claim.

Some confusion exists with respect to refund procedures for farmers who owe no income tax. Proposed rules which should clarify this and other aspects of the new collection procedures should be issued shortly.

– *Mark J. Riedy*

The trust "assets" include all inventories of, or receivables or proceeds from, poultry obtained by the dealer, or the products derived therefrom. The grower-seller is protected from the risk of nonpayment as an "unsecured creditor" under a cash sale because the value of the trust assets is held for the benefit of all unpaid cash sellers or poultry growers until they have received full payment. § 207(b), to be codified at 7 U.S.C. § 197. In addition to failure to tender payment, payment is considered not to have occurred if the cash seller or poultry grower receives a payment instrument that is dishonored. § 207(c), to be codified at 7 U.S.C. § 197(c).

Live poultry dealers are exempt from the statutory trust provisions if they (a) have $100,000 or less in average annual value of live poultry, or (b) have $100,000 or less in average annual value of live poultry obtained by purchase or by a poultry growing arrangement. § 207(b), to be codified at 7 U.S.C. § 197.

Concomittantly, live poultry dealers must make prompt payment for poultry. Specifically, a dealer must deliver the full payment amount due to the seller grower (a) before the close of the next business day following the purchase of poultry, in the case of a cash sale, or (b) by the close of the fifteenth day following the week in which the poultry is slaughtered, in the case of poultry obtained under a poultry growing arrangement. § 410(a), to be codified at 7 U.S.C. § 228b-1.

Furthermore, the following actions are to be considered "unfair practices" in violation of the Act: any attempt by a live poultry dealer to delay making payment due under the Act, or any actual delay in making payment; and any attempt made by the dealer for the purpose of, or resulting in, an extension of the normal payment period. § 410(b), to be codified at 7 U.S.C. § 228b-1.

If, after a hearing, the Secretary finds that a live poultry dealer has violated either the statutory trust or prompt payment provisions of the Act, he shall issue a cease and desist order against the dealer. § 411(b), to be codified at 7 U.S.C. § 228b-2. The Secretary may also assess a civil penalty of up to $20,000 for each such violation. *Id.* However, the regulations provide that "in no event can the penalty assessed by the Secretary take priority over or impede the ability of the live poultry dealer to pay any unpaid cash seller or poultry grower. *Id.*

– Julia R. Wilder

Restrictive transfer provisions of cooperative upheld in bankruptcy

The district court of appeals decision in *Calvert v. Bongards Creameries (In re Schauer)*, 835 F.2d 1222 (8th Cir. 1987) has affirmed a lower court decision precluding a trustee in bankruptcy from transferring patronage margin certificates without approval of the cooperative's board of directors.

Cooperative patrons Gerald and Corrine Schauer voluntarily filed a Chapter 7 bankruptcy petition and transferred to their bankruptcy estate patronage margin certificates. The trustee in bankruptcy asked the cooperative's board of directors to redeem the certificates or to consent to the assignment or transfer of the certificates to third parties.

Bylaw provisions of the cooperative granted the board of directors discretion in transferring certificates, required redemption on a first issued – first redeemed basis, and precluded redemption of certificates of any patron without entitlement to redemption of all of the certificates representing contributions of the same year.

Following these bylaw provisions, the board refused to redeem or transfer the certificates, prompting the trustee to initiate an adversary action against the cooperative seeking authority to dispose of the patronage margin certificates.

The trustee argued that bankruptcy law preempted state law to allow the liquidation of the bankruptcy estate without undue interference of state law "idiosyncrasies." Relying upon 11 U.S.C. sections 704(1) and 363(b)(1), the trustee requested permission to collect and reduce to money the property of the bankruptcy estate and to liquidate estate property.

The trustee also argued that equitable considerations justified voidance of the cooperative's transfer restrictions. The major considerations set forth were lengthy delay in creditors receiving payment and the necessity for creditors to file amended tax returns.

The Eighth Circuit declined to invalidate the restriction on transferability. Although the court noted that the lower court's holding does not further one of the goals of federal bankruptcy law, which is to encourage expeditious administration of the estate for the benefit of creditors, the more basic principle that bankruptcy jurisdiction does not create new substantive rights in the property of the estate was found to be superior. Accordingly, the lower court's judgment limiting the trustee's rights to those the debtor had under state law was affirmed.

– Terence J. Centner

Federal Register *in brief*

The following is a selection of matters that have appeared in the *Federal Register* in the past few weeks.

1. USDA; Privacy Act of 1974; System of Records; Salary Offset. Effective date Feb. 29, 1988. 53 Fed. Reg. 2517.

2. USDA; Privacy Act of 1974; Amendment of Existing System of Records. 53 Fed. Reg. 3610.

3. USDA; Highly Erodible Land and Wetland Conservation; Correction; Final Rule. Effective date Feb. 11, 1988. 53 Fed. Reg. 3997.

4. USDA; Privacy Act of 1974; System of Records; Notice of Revision. 53 Fed. Reg. 4047.

5. APHIS; Availability of Environmental Assessment and Finding of No Significant Impact Relative to Issuance of a Permit to Field Test Genetically Engineered Herbicide Tolerant Tomato Plants. 53 Fed. Reg. 2610.

6. APHIS; Federal Indemnity Payments for Brucellosis Reactor Cattle and Bison; Proposed Rule. Comments due Apr. 1, 1988. 53 Fed. Reg. 2759.

7. FCA; Loan Policies and Operations; Borrower Rights. Effective date Feb. 2, 1988. 53 Fed. Reg. 2825.

8. FCA; Disclosure to Shareholders;

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STATE ROUNDUP

NEBRASKA. *Agricultural land valuation statute unconstitutional.* In *Banner County v. State Board of Equalization*, 411 N.W.2d 35 (1987), the Nebraska Supreme Court invalidated agricultural land preferential assessment statutes for violating a state constitutional uniform assessment clause. The decision was surprising because neither party had briefed or argned the uniformity issue.

The valuation statutes were adopted in 1985 pursuant to a 1984 constitutional amendment establishing agricultural land as a separate valuation category. The constitutional amendment did not, however, explicitly exempt agricultural land from the uniformity requirement. The constitutional amendment was adopted by the legislature and subsequently by Nebraska voters in response to *Kearney Convention Center v. Buffalo County Board of Equalization*, 344 N.W.2d 620 (1984), in which the Nebraska Supreme Court ruled that preferential agricultural land assessment violated the uniformity clause.

The political intent of the 1984 constitutional amendment was to overrule *Kearney Convention Center* and continue the historical preferential assessment of agricultural land. However, the *Banner County* court ruled that the 1985 agricultural land valuation statute violated the uniformity clause. The court further stated that the legislature could not do indirectly what it was not authorized to do directly, i.e. provide for preferential agricultural land assessment without first amending the uniformity clause.

As a result of *Banner County*, agricultural land valuations are likely to increase. Agricultural groups are thus far unwilling to undertake another constitutional amendment campaign, however, which would require them to ask voters to authorize preferential assessment of agricultural land. This political attitude may change when agricultural land values increase. – *J. David Aiken*

CALIFORNIA. *Crop production loans – subordinate creditor with unjust enrichment claims prevails over prior lender.* The California Court of Appeals recently held in *Producers Cotton Oil Co. v. Amstar Corp.*, 242 Cal. Rptr. 914 (1988), that where, through course of dealing, a secured crop lender impliedly authorizes the sale of the debtor's crops, the lender nevertheless retains its security interest in the crop proceeds. However, the court further held that under the circumstances of that case, a subordinate lender's application of crop proceeds to pay for harvesting costs prevails over the claim of the superior lender. There, a subordinate lienholder received the crop proceeds and used a portion to pay the costs of harvesting the crop. The court applied the equitable principle of unjust enrichment and held that the subordinate lienholder was not required to repay the amount of those costs to the prior lender. – *Kenneth J. Fransen*

NEBRASKA. *Secured creditor claim to generic commodity certificates.* In a decision much like that of the Iowa court in *In re Halls*, 79 Bankr. 417 (1987), reported in the February State Roundup column, the Nebraska bankruptcy court in *In re Lehl*, 79 Bankr. 880 (1987), rejected a secured creditor's claim to federal farm program payments in the form of commodity certificates and to the proceeds. The court reached the result by concluding that the language of the federal regulations concerning treatment of generic certificates clearly preempted the application of state commercial law to the payments. 7 C.F.R. § 770.4(b)(1)-(3)(1987).

The court rejected the creditor's claim that the new regulations could not be applied retroactively to this transaction. The court noted that the certificates were received post-petition, at a time when the applicable regulations were in effect. The Nebraska court also rejected the argument that the Eighth Circuit's decision in *Sunberg*, 729 F.2d. 561 (1984) controlled the dispute. Once the court concluded the certificates were exempt from state security interests, the court could not see how the bank could claim the proceeds of the certificates.

– *Steven Turner*

Arcoren v. Peters *continued*

The issue facing the full bench of the Eighth Circuit Court of Appeals in this latest consideration of *Arcoren v. Peters*, 829 F.2d 671 (8th Cir. 1987) is: "whether it was clearly established in 1980 that the FmHA officials could not, consistent with the Fifth amendment, use the self-help remedy permitted under South Dakota's Uniform Commercial Code, S.D. Codified Law Ann. 57A-9-503 (1980), in repossessing Arcoren's cattle when they believed he was in default of his FmHA loan." 829 F.2d at 672.

The court answered this question in the negative, disagreeing with an earlier opinion written by a panel of the court, and affirming the district court's decision dismissing the case. (For a discussion of the *Arcoren* facts and case history, *see* 4 *Agric. L. Updote* 9 (June 1987).

A majority of the court reasoned that in 1980, the time of repossession, there existed authority for the hypothesis that when the FmHA functioned as a lender, it did so in a commercial, not a sovereign, capacity. Thus, the FmHA could turn to the self-help provisions of the U.C.C. in repossessing Arcoren's cattle, regardless of its status as a governmental agency.

After constructing this foundation, the court moved on to decide whether Arcoren possessed in 1980 a clearly established constitutional right to notice and a hearing prior to repossession. Declining to adhere to the panel's conclusion that 7 U.S.C. section 1981a (1982) and *Allison v. Block*, 723 F.2d 631 (8th Cir. 1983) unequivocally created a constitutional right to a pre-repossession notice and hearing, the appeals court held that:

> FmHA officials could not be on notice in 1980 that section 1981a, which protects farmers with financial difficulties in bad times, would be extended by a court to encompass default in a case such as this where financial difficulty was not an issue. We do not believe that *Allison* – decided in 1983 – makes this extension, and it certainly does not indicate that Arcoren had a clearly established constitutional right in 1980.
>
> (footnotes omitted) (829 F.2d at 676).

– *Michael B. Thompson*

Ahlers *reversed*

The United States Supreme Court has reversed the Eighth Circuit case of *Norwest Bank Worthington v. Ahlers*, No. 86-958 (Mar. 7, 1988). Text of the case can be found on WESTLAW at 1988 WL 17016 (U.S.). Discussion of the implications of this holding will appear in a future issue of *Agricultural Law Update*.

– *Linda Grim McCormick*

Major changes in ASCS payment limitation law commencing in 1989

by Kenneth J. Fransen

Legislation has been passed by Congress and signed by the President making major changes in the payment limitation provisions of the law relating to agricultural subsidies. However, most of these changes will not be effective until the 1989 crop year.

Under most government payment programs administered by the Agricultural Stabilization and Conservation Service (ASCS), benefits are limited to $50,000 per person. Payment limitation provisions determine how many "persons" a particular farm has, and therefore how many separate $50,000 payments may be made in connection with farming operations on a farm.

The major provisions of the new legislation are as follows:

1. LIMIT ON NUMBER OF ENTITIES. Beginning in 1989, there will be a limit on the number of entities through which an individual may obtain government payments. Specifically, an individual will be unable to obtain government payments through more than two farm entities in addition to himself or herself. Thus, the farmer can continue to obtain a direct payment based on the farmer's own farming operation, and may also indirectly receive a payment through two other entities (such as a corporation or a partnership). An individual who does not have an individual farming operation may receive indirect payments through three entities. Under prior law, there was no limit on the number of entities through which an individual could receive subsidy payments. Thus, various structures had been permitted (one of which had been referred to, somewhat derogatorily, as the "Mississippi Christmas Tree") the effect of which was to allow individuals to receive far more than $50,000 by indirect payments through entities.

The new legislation will create an artificial limit on the number of entities in which an individual may participate, even if the entity is not used for the purpose of circumventing the $50,000 limitation. On the other hand, those desiring to circumvent the $50,000 limitation may still do so under the three payment limit, resulting in the possibility that an individual may receive a total of $100,000 ($50,000 for himself or herself, and $25,000 through each of two corporations owned one-half by the individual). A much simpler and more direct method of closing this loophole would have been to attribute entity payments pro rata to individual holders of interest in the entity.* Thus, the Mississippi Christmas Tree lives, its growth now somewhat stunted.

A new requirement, in connection with the three-entity limit, obligates any entity receiving government payments to notify each person who holds a substantial beneficial interest in the entity of the provisions of the law, and also obligates the entity to provide to ASCS relevant information regarding the holders of such interests. A beneficial interest that is less than ten percent of all beneficial interests in the entity is now a "substantial beneficial interest, unless ASCS determines, on a case-by-case basis, that a smaller percentage should apply. . . ." If an individual in fact holds interests in more than the permitted number of entities, the individual is permitted to designate those entities that are to be considered permitted entities for the purpose of applying the limitations. Each remaining entity in which the individual holds a substantial beneficial interest will be subject to reductions in payments. If the individual does not designate permitted entities, then all entities in which the individual participates will be subject to such reductions. In that event, the legislation requires ASCS to notify all other participants affected and permit them to adjust among themselves their interest in the designated entity or entities.

2. ACTIVE ENGAGEMENT REQUIREMENT. Again beginning with the 1989 crop year, a new eligibility requirement has been imposed for the receipt of government subsidy payments. Henceforth, payments are as a general rule to be limited to those who are actively engaged in farming. With respect to individuals, this requires that the individual make a significant contribution (based on the total value of the farming operation) of: (1) capital, equipment or land, *and* (2) personal labor or active personal management. Furthermore, the individual's share of profits and losses must be commensurate with the individual's contributions to the operation, and the individual's contributions must be at risk. With respect to farming operations conducted by corporations, the entity itself must make the significant contribution of capital, equipment or land, while the shareholders or members of the corporation or other entity must collectively make the significant contribution of personal labor or active personal management. Even as to corporations and other entities, the entity's share of profits and losses must be commensurate with its contributions, and the entity's contributions must be at risk. With respect to partnerships, joint ventures, and similar entities, the personal labor/active personal management requirement is to be met by the partners separately; if a partner does not meet that requirement, then that partner is not entitled to a payment through that partnership or similar entity.

In making determinations under this provision, the government is required to take into consideration the equipment and personal labor normally and customarily provided by farm operators in the area. Landlords contributing land to a farm operation on a cash rent or guaranteed crop share basis are specifically determined *not* to be considered "actively engaged in farming" with respect to that farm operation.

There are certain exceptions to the foregoing application of th "active engagement" requirement. A landowner contributing land to the farming operation is deemed to meet the personal labor/active personal management requirement if the landowner receives rent or income for such use of the land based on the land's production or the operation's operating results, and if the individual's share is commensurate with contributions, and the contributions are at risk. This is commonly called the "widow's exception." While this will typically be applicable to crop share land-

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lords, it should also be applicable to partners of partnerships who contribute the use of their land as their capital contribution to the entity.

Another exception relates to family members. One of the committee reports indicates that the intention of Congress was as follows:

> Also, to enable sons and daughters to take the place of their parents in farming, when a farming operation is conducted by persons a majority of whom are family members, a member of the family would qualify as actively engaged farming by contributing personal labor or active personal management, *if* the family member's share of profits or losses is commensurate with the contribution and the contribution is at risk.

"Description of the Key Provisions of the Farm Program Payment Integrity Act of 1987", page 5 (October 14, 1987). Unfortunately, the language of the statute itself is somewhat more ambiguous. However, since this portion of the legislation was unchanged (other than the inclusion of spouses as family members) after the above-quoted report was issued by staff, it would appear that Congress' intention was as set forth in the report. The regulations to be issued by ASCS should clarify the matter in favor of the staff interpretation.

Finally, a sharecropper making a significant contribution of personal labor is to be considered "actively engaged" if the sharecropper's share of proceeds is commensurate with the sharecropper's contributions, and the contributions are at risk.

In connection with the "active engagement" requirement, a drastic change was made relating to a complex series of custom farming regulations in existing law. Specifically, if a person meets the "active engagement" requirement, then that person is separately eligible for payments and "no other rules with respect to custom farming shall apply."

3. ELIGIBLE ENTITIES AND SUBSTANTIVE CHANGE RULE. Also commencing in 1989:

a. Cooperatives are ineligible for payments with respect to commodities they market.

b. A husband and a wife may each continue to receive separate payments if, prior to their marriage, they were separately engaged in unrelated farming operations. Under existing regulations, the validity of which is presently being litigated by WIFE (Women Involved in Farm Economics), husbands and wives are combined for payment limitation purposes, even if they have separate farm operations that pre-date the marriage.

c. Any tenant renting land on a cash or guaranteed crop share basis, who does not make a significant contribution of personal labor shall be combined with the landlord unless the tenant makes a significant contribution of equipment used in the farming operation. It is anticipated that upcoming regulations will make clear that the equipment may be provided by a custom farming operator unrelated to the landlord, or may be leased from a third party unrelated to the landlord.

d. The "substantive change" requirement of current regulations (requiring that any increase in payments on a farm due to a change in operations requires that the change be bona fide and substantive) has been made statutory. The addition of a family member (provided the family member meets other necessary criteria) is expressly considered to meet this requirement.

4. ASCS EDUCATIONAL PROGRAM. Effective immediately, ASCS is required to implement a payment limitation education program for all appropriate ASCS personnel to assure the fair, accurate, and uniform application of the law. The education program is to be completed within thirty days after final regulations are issued.

5. SCHEME AND DEVICE PROVISIONS. Effective in 1989, the scheme and device provisions of current regulations (rendering ineligible any person adopting a scheme or device to evade payment limitation law) have been made statutory.

6. NON-RESIDENT ALIEN RULES. Effective in 1989, nonresident aliens are ineligible for government payments. If nonresident aliens own more than ten percent of the beneficial ownership of an entity, the entity will likewise be considered ineligible; provided, that the Secretary may make reduced payments reflecting the percentage interest held by citizens and permanent residents.

7. REGULATIONS. New regulations implementing the new legislation are required to be proposed by April 1, 1988, and final regulations are to be issued by August 1, 1988. Draft regulations are already being circulated within the ASCS, and it is anticipated that the regulations will in fact be issued in advance of these deadlines. For 1988, ASCS has indicated that it will not impose any new requirements but will operate according to the rules effective in 1987, with one exception: pursuant to ASCS Notice CM-125, the custom farming rules will apply only if the service is performed for program crops or on acreage needed to earn program payments.

8. WAIVER OF SUBSTANTIVE CHANGE RULE. To allow for equitable reorganizations of farming operations to conform to the new rules, ASCS is authorized to waive the substantive change rule for reorganizations applied for prior to the final date for sign up for the 1989 crop year.

9. AGENCY TIME LIMITS. ASCS is required to establish by regulation time limits for notice, hearing, decision, and appeals procedures in order to insure expeditious handling of payment limitation disputes. Actions taken by an individual or entity in good faith reliance on action or advice of an authorized representative of ASCS may be accepted as meeting payment limitation requirements, but only to the extent that ASCS deems it desirable in order to provide fair and equitable treatment.

10. GOVERNMENTAL ENTITIES. Effective beginning in 1989, states, political subdivisions, and governmental agencies will be subject to the $50,000 limitation. Previously, unlimited payments were allowed.

*Such was the concept contained in a proposed amendment championed by Senator Harkin. His proposed amendment failed, however, in the face of opposition from southern and southwestern senators who realized that their farmers would be adversely affected by such a change in the law.

An argument for PIK and roll with section 77 election

Rev. Rul. 87-103, 1987-43 I.R.B. 10, (*See, 5 Agric. L. Update* 1 (Nov., 1987), created an income tax problem for producers who have made the IRC section 77 election to report CCC loans as income in the year they are received. According to the IRS in Rev. Rul. 87-103, if such a producer receives a CCC loan on a crop in the same year that the crop is redeemed with commodity certificates, the producer must report the loan as income *and* must report the certificates as income (if they were received from the government) or is not allowed to deduct the cost of the certificates (if they were purchased). Instead, the producer has a basis in the commodity equal to the amount of the loan reduced by the difference between the basis of the certificates used to pay off the loan and the amount of the loan. (Consequently, the producer's basis in the commodity is equal to the basis he or she had in the certificate). If the redeemed commodity is not sold in the same year as the PIK and roll, Rev. Rul. 87-103 causes a bunching of income.

Some producers face this problem on their 1987 tax return since they received a loan on their 1987 crop and PIKed and rolled in 1987. All producers who report their CCC loans as income may face the problem in the future.

The problem comes about because the IRS treats the IRC section 77 election as an election to treat the CCC loan as if it were a sale of the commodity to the CCC for the loan amount.

Consequently, a loan that is repaid in the same year is treated as a sale and repurchase in the same year resulting in income equal to the loan amount and a basis in the commodity equal to the amount of the loan that is paid off to redeem the grain. The IRS successfully made that argument in *United States v. Isaak*, 400 F.2d 869 (9th Cir. 1968) and has reasserted that position in Rev. Rul. 80-19, C.B. 185 and again in Rev. Rul. 87-103, *supra*.

However, there is one case that rejects the IRS position. In *Thompson v. Commissioner*, 322 F.2d 122 (5th Cir. 1963), the court ruled that a taxpayer who had made the section 77 election in a prior year did not have to report a CCC loan as income since he had repaid the loan by the end of the year the loan was received. In reaching this result, the court looked at the purpose of IRC section 77 and concluded that it was designed to allow a producer to take advantage of the CCC loan without losing the opportunity to offset the income from the commodity pledged as collateral with the expenses of raising that commodity. To avoid abuse of the rules, a taxpayer is bound for life with an election to report a loan as income. However, the court reasoned that a producer who has both received and repaid a loan in one tax year is in the same position as not having received a loan and therefore should not have to report the loan as income. Requiring a taxpayer to follow the same pattern from year to year is important only if the loan is repaid in a year after the loan is received.

A taxpayer who has previously made the section 77 election and now wants to take advantage of the PIK and roll alternative has a more compelling case than the taxpayer in *Thompson v. Commissioner*. To illustrate, assume a producer harvests 50,000 bushels of corn in 1988 and for income tax reasons, wants to sell the corn in 1989. The CCC loan rate is $.20 higher than the posted county price.

To take advantage of the $.20 differential, the producer must first pledge the corn as collateral on a CCC loan and then use commodity certificates to redeem the corn. If the producer had not made the section 77 election, income taxes do not affect the decision of whether or not to take advantage of the $.20 differential between the loan rate and the posted county price since the loan does not have to be reported as income. However, if the producer has made the section 77 election, according to the IRS, he or she must pay tax on the CCC loan in order to take advantage of the $.20 differential. Based on *Thompson*, a producer could argue that section 77 should not be used to discourage his or her participation in PIK and roll since section 77 was enacted to overcome an unintended adverse effect of the CCC loan program.

In conclusion, a producer who has made the section 77 election and either has or plans to PIK and roll in the same year as receiving the CCC loan can argue, based on *Thompson v. Commissioner*, that the loan does not have to be reported as income. However, the IRS does not agree with that position and the Ninth Circuit Court of Appeals agreed with the IRS in *United States v. Isaak*.

– Philip E. Harris

AG LAW CONFERENCE CALENDAR

Ninth Annual AALA Conference and Annual Meeting.
Oct. 13-14, 1988. Westin Crown Center, Kansas City, MO.

Topics to include: annual review of agricultural law; international agricultural trade; farm program participation; agriculture and the environment; agricultural taxation; and agricultural financing and credit.

Reserve these dates now. Details to follow.

Agricultural biotechnology and the public.
Mar. 28-30, 1988. John Ascuaga's Nugget Hotel, Reno, NV.
Apr. 18-20, 1988. Hyatt Regency, New Brunswick, NJ.
May 16-18, 1988. Minneapolis-St. Paul Airport Hilton, Minneapolis, MN.

Topics include: running the regulatory maze; biotechnology at USDA; and implications of policy for biotechnology.

Sponsored by the USDA in cooperation with land grant universities, state ag experiment stations, and the Cooperative Extension Service

For further information, call 202-447-8181

23rd Annual Banking Law Institute.
May 5-6, 1988. Marriott Crystal Gateway, Arlington, VA.

Topics include: lender liability; tax reform; and workouts and bankruptcy.

Sponsored by the Banking Law Institute and the Bank Lending Institute

For more information, call 1-800-223-0787.

Lender liability.
Apr. 6-7, 1988. Back Bay Hilton, Boston, MA

Topics include: common law theories of lender liability; lender liability defense and counterclaim; environmental liability, and workout techniques.

Sponsored by the Banking Law Institute, and the Bank Lending Institute

For more information, call 1-800-223-0787

Second Annual Corporate Counsel Bankruptcy Law Institute.
Apr. 28-May 1, 1988. The Arizona Biltmore, Phoenix, AZ.

Topics include: Farm and agri-business bankruptcy; lender liability; and defense of security interests and avoidance actions.

Sponsored by the Corporate Counsel Bankruptcy Law Institute, Norton Bankruptcy Law and Practice

For more information, call 404-535-7722.

(Continued from page 2)

Interim Rule with request for comments. Effective date Feb. 12, 1988. 53 Fed. Reg. 3334.

9. FCA; Disclosure to Shareholders; Accounting and Reporting Requirements; Final Rule. 53 Fed. Reg. 3335.

10. BLM; Grazing Administration; Exclusive of Alaska; Grazing Feeds of 1988. Effective Feb. 2, 1988. 53 Fed. Reg. 2984.

11. FmHA; Election of County Committee Members; Proposed Rule. 53 Fed. Reg. 3176.

12. CCC; Referral of Delinquent Debts to IRS for Tax Refund Offset; Final Rule. Effective date Feb. 5, 1988. 53 Fed. Reg. 3330.

13. FGIS; Regulations and Standards for Inspection and Certification of Certain Agricultural Commodities and Their Products; Final Rule. Effective date April 11, 1988. 53 Fed. Reg. 3721.

– Linda Grim McCormick

Florida Ag Department's destruction of healthy citrus trees

Two recent Florida cases have limited the police power of the Florida Department of Agriculture and Consumer Services to destroy healthy citrus plants. These two cases held that the Department must compensate grove owners for destroying healthy but suspect plants in a grove containing plants found to suffer Citrus Canker A.

In *Richard Polk Nursery v. Conner*, Case No. GC-G-86-3964 (January 7, 1988), the Circuit Court of Polk County considered the Department of Agriculture's quarantine and destruction of 510,059 trees in plaintiff's grove. The defendant claimed that these acts were performed under the Department's discretionary role and were therefore protected by sovereign immunity. It was argued that the threat of Canker justified the destruction of healthy but suspected trees as public nuisances. The plaintiff contended that the defendant had effected a taking without compensation because the trees presented no imminent danger to the public welfare. The circuit court held that sovereign immunity did not bar an action for inverse condemnation.

The court applied *Graham v. Estuary Properties, Inc.* 399 So. 2d 1374, 1380-81 (Fla. 1981), in determining whether the Department had taken the trees without compensation. The *Estuary* test considers: (1) whether a physical invasion occurred; (2) the degree of diminution of value; (3) whether the regulation promotes public health, safety, welfare or morals; (4) whether the regulation has been arbitrarily and capriciously applied; (5) whether the regulation confers a public benefit or prevents a public harm; and (6) whether the regulation curtails investment-backed expectations.

The parties agreed that the destruction affected factors (1), (2), and (6). They differed as to the existence and degree of the remaining issues.

The court first considered whether the regulation had been arbitrarily and capriciously applied. The plaintiff argued that the destruction must have been necessary to "have *actually* prevented a public harm" to meet this test. The plaintiff alleged that this required a showing of "imminent danger" based on all available scientific evidence. The Department, however, asserted that the necessary imminent danger could be determined merely from scientific evidence that the State actually possessed. The court held for the plaintiff on this point.

The court then turned to a scientific analysis of Canker to determine whether an imminent danger had existed. It cited evidence of at least two other citrus diseases that are more serious than Canker,
but do not require eradication. Further testimony showed that Canker can be controlled economically.

The court found that the presence of Canker did not present an imminent danger warranting destruction. It stated: "The court is not unmindful of the possible public surprise its conclusion that Canker A is not imminently dangerous may evoke." Nonetheless, it determined that this finding required a holding that the Department had acted in an arbitrary and capricious manner.

The case was further complicated by the fact that expert testimony showed that the disease at issue was not Canker but was instead, "Florida nursery strain," which is far less damaging than Canker. Therefore, the court held that the Department's acts were even more arbitrary and capricious than if the trees had been diseased by Canker.

The arbitrary and capricious act did not promote public health, safety, and welfare and did not prevent a public harm. Under the *Estuary* test, then, the court held that a taking had occurred.

The court did determine that the actually diseased trees and all plants within a surrounding 125 foot buffer zone had no marketable value. The Florida risk assessment procedures for treating such diseases required destroying those plants, but all other destroyed trees in the grove required just compensation.

Two weeks after the *Polk* holding was published, the Florida Supreme Court ruled in *Florida Department of Agriculture v. Mid-Florida Growers, Inc.*, No. 70, 524 (Jan. 21, 1988), answering the following question as certified by the Second District Court of Appeals as being of great public importance: "Whether the State, pursuant to its police power, has the constitutional authority to destroy healthy, but suspect citrus plants without compensation."

Mid-Florida and Himrod & Himrod Citrus Nurseries had purchased a total of about 17,000 citrus hudeyes from a nursery where a form of citrus Canker was subsequently detected. The Florida Department of Agriculture tested samples from Mid-Florida's and Himrod's nurseries for Canker. These tests did not establish that any of the stock had been infected by Canker. Nonetheless, the Department burned large areas of the two nurseries.

The nurseries filed an inverse condemnation suit against the Department. The agency defended by stating that the destruction was a police power regulation and not a taking. The trial court held that the Department had acted under its police power, but found that the absence of showing of infection rendered the acts a compensable taking. The district court of appeal affirmed, stating that "while the state validly exercised its police power in destroying the citrus trees, a taking occurred when the healthy trees were destroyed." 505 So.2d at 595.

The Florida Supreme Court affirmed the findings of the lower courts. The court stated that, under the *Estuary* test, the destruction of healthy trees had benefited Florida's citrus industry and thereby conferred a public benefit rather than prevented a public harm. The supreme court affirmed the findings of the lower courts. The court stated that, under the *Estuary* test, the destruction of healthy trees had benefited Florida's citrus industry and thereby conferred a public benefit rather than prevented a puhlic harm. The court affirmed the proposition that a regulation which creates a public benefit is more likely to cause a taking.

The court denied the Department's claim that the destruction was not compensable because it was done pursuant to the state's police power. In so holding, the court cited the following recent United States Supreme Court language: "The [Fifth] Amendment makes clear that it is designed not to limit the government interference with property rights *per se*, but rather to secure *compensation* in the event of otherwise proper interference amounting to a taking." No. 70, 524 at 4, citing *First English Evangelical Lutheran Church of Glendale v. County of Los Angeles, California*, 107 S.Ct. 2378, 2386 (1987).

Absent a showing that Canker was present, the court in *Mid-Florida* determined that the nursery owners must be compensated.

Chief Justice McDonald dissented in *Mid-Florida*, stating that acts to prevent the spread of Canker are designed to prevent a public harm. McDonald said that the court could not review the Department's actions by hindsight but in light of the duty to prevent a perceived harm. "The issue is not whether the plaintiff's trees were actually healthy, but rather whether the government, acting responsibly, had reasons to conclude that they might not have been and that it was necessary to destroy the trees to prevent the spread of a deadly disease." No. 70, 524 at 10 (McDonald, C.J., Dissenting). Therefore the Chief Justice stated that the evidence failed to support a claim for inverse condemnation.

– Sidney F. Ansbacher

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American Agricultural Law Association News

Fifth Annual Student Writing Competition. The AALA is sponsoring its fifth annual Student Writing Competition. This year, the AALA will award two cash prizes in the amounts of $500 and $250.

The competition is open to all undergraduate, graduate, and or law students currently enrolled at any of the nation's colleges or law schools. The winning paper must demonstrate original thought on a question of current interest in agricultural law. Agricultural Law is defined broadly to include any topic that discusses the impact of domestic or international law or legal institutions on the agricultural sector of society.

Articles will be judged for perceptive analysis of the issues, thorough research, originality, timeliness, and writing clarity and style. A board of judges comprised of lawyers, law professors, and other experts in agricultural law will evaluate the papers and select the winner.

Papers must be submitted by June 30, 1988. For complete competition rules, contact Professor John Becker, Department of Agricultural Economics, Penn. State University, University Park, PA 16802; 814-865-7656.