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An Early Look at the USDA NAD

The USDA National Appeal Division (USDA NAD) was created by the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994.[1] The Act was signed by President Clinton on October 13, 1994, and Secretary Espy began implementing the reorganization on October 20, 1994. Although regulations implementing the USDA NAD have not yet been published in the *Federal Register*, the USDA NAD has been deciding appeals since October 20, 1994. This article examines functions, structure, and the early workings of the USDA NAD, with an emphasis on farm program disputes. Although the USDA NAD has been operational for only a few months, several questions over its structure and practices have already arisen.

Intended to be an "independent" appeal authority,[2] the USDA NAD now hears final administrative appeals from the Consolidated Farm Service Agency (CFSA) (the successor to the Agricultural Stabilization and Conservation Service (ASCS), Federal Crop Insurance Corporation (FCIC), and the Farmers Home Administration (FmHA)); the Commodity Credit Corporation (CCC);[3] the FmHA; the FCIC; the Rural Development Administration (RDA); the Natural Resources Conservation Service (NRCS) (successor to the Soil Conservation Service (SCS);[4] and the state, county, and area committees established under the Soil Conservation and Domestic Allotment Act.[5] Participants in the programs administered by these agencies and committees are now required to exhaust their administrative remedies by appealing to the USDA NAD before seeking judicial review.[6]

Historically, the farm program appeal process has had three levels. Because most program determinations were made by a county ASC committee, the appeal process began with a request for the county committee to reconsider its initial determination. If the county committee declined to change its initial decision, the aggrieved program participant could appeal to the state ASC committee. Appeals from state committee determinations were taken to the ASCS National Appeals Division (ASCS NAD).

The USDA Reorganization Act preserves the county and state committee appeal process by requiring the CFSA to hold informal hearings at the request of the participant adversely affected by a committee's or a CFSA official's determination and hy directing the Secretary to "maintain the informal appeals process applicable to such programs [administered by the CFSA], as in effect on the date of the enactment of the subtitle."[7] The Act, however, does not expressly require participants to exhaust any available appeals to the county or state committees before appealing to the USDA NAD. To the contrary, it appears to permit an appeal of any "adverse decision" directly to the USDA NAD.[8] By regulation, however, the USDA NAD may attempt to "clarify" the Act's definition of an "adverse decision" to require committee review as a prerequisite to an appeal to the USDA NAD.

Under the Act, the Secretary is required to notify affected program participants of the

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Third Circuit Rejects Farmer's "Normal Farming Activities" Exemption Claim in Clean Water Act Proceeding

The United States Court of Appeals for the Third Circuit has rejected a farmer's claim that he was not required to get a Clean Water Act section 404 permit before discharging dredged or fill material in a wetland because his activities were covered by the "normal farming activities" exemption. The farmer made his claim in response to an action brought by the government to require him to restore the site, to refrain from further discharges, and to pay civil penalties. *United States v. Brace*, No. 94-3076, 1994 WL 653382 (3rd Cir. Nov. 22, 1994).

The farmer conceded that the thirty-acre site in dispute was a wetland. The site had been in the farmer's family since the 1930s and had been used as pasture until the farmer's purchase of it from his father in 1975. When the farmer acquired the site to convert it to cropland, the site was vegetated with areas of scrub brush. The existing

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decision and their appeal rights within ten working days of an adverse decision.[9] To be entitled to a hearing before the USDA NAD, the aggrieved participant must "request the hearing not later than 30 days after the date on which the participant first received notice of the adverse decision."[10] The author is aware of several program participants who have been advised that they have fifteen days to appeal, the limit that was in effect before the Act's enactment.

The USDA NAD Director

The Act mandates that the USDA NAD Director be "appointed by the Secretary from among persons who have substantial experience in practicing administrative law,"[11] The Secretary was also directed to consider "persons currently employed outside Government as well as Government employees."[12] Only the Secretary has authority over the Director, and "[t]he Secretary may not delegate to any other officer or employee of the Department, other than the Director, the authority of the Secretary with respect to the Director."[13] The Director will serve for a six-year term and is otherwise removable only for cause.[14]

In addition to supervising the operation of the Division, the USDA NAD Director has two primary functions. First, the Director determines whether a matter is properly appealable to the USDA NAD.[15] Determinations based on generally applicable program rules are not appealable.[16] Second, on the request of either the program participant or the agency, the Director reviews hearing officer determinations.[17]

To date, a Director has not been hired. Thus, an unanswered question is whether the USDA reads the Act as requiring the appointment of an attorney. Fred Young, the current Acting Director, is not an attorney. Another unanswered question is whether the Director will serve as a chief judicial officer or as an administrator. Early indications are that the Director will serve only as an administrator and will delegate the Director's adjudicatory functions to others. When this article was prepared, Ms. Carolyn Burchett, the former ASCS NAD Director, was signing USDA NAD Director determinations involving farm program disputes on behalf of Mr. Young. Ms. Burchett is not an attorney.

USDA NAD Hearing Officers and Hearings

Evidentiary hearings before the USDA NAD are conducted by hearing officers. The hearing officers are given a right of access to the case record developed in the administrative proceedings leading to the appeal[18] and the authority to issue subpoenas and administer oaths and affirmations.[19]

When an appellant requests a hearing, the hearing must be held within forty-five days.[20] The hearing is to be held in the state of the appellant's residence or at another location convenient to the appellant and the USDA NAD.[21] An appellant may waive the right to a personal hearing and either conduct the hearing by telephone or on the basis of the existing case file.[22]

Hearings before the hearing officer are *de novo*:

> The hearing officer shall not be bound by previous findings of fact by the agency in making a determination. . . . The hearing officer shall consider information presented at the hearing without regard to whether the evidence was known to the agency officer, employee, or committee making the adverse decision at the time the adverse decision was made.[23]

The Act expressly provides that the appellant bears the burden of "proving that the adverse decision of the agency was erroneous."[24] This provision, however, merely codifies what has always been the USDA's position. More significant is a provision requiring hearing officers and the Director to base their determinations "on information from the case record, laws applicable to the matter at issue, and applicable regulations published in the Federal Register...."[25]

While it may seem unremarkable to require that determinations be based on statutory law and duly promulgated regulations, the requirement represents a departure from past practices. In the past, the ASCS made determinations based on ad hoc rules or *ASCS Handbook* directives without consistent regard to whether the ad hoc rules or directives were authorized by, or consistent with, the agency's duly promulgated regulations.[26] Accordingly, this provision may be among the Act's most salutary. In addition, consistent with long-standing agency practice, the Act specifically directs hearing officers to leave the record open after the hearing for a "reasonable period" for the submission of information "to the extent necessary to respond to new facts, information, arguments, or evidence presented or raised by the agency or appellant."[27]

Prohibition Against Ex Parte Communications

One of the most significant provisions of the USDA Reorganization Act's specifications for a USDA NAD is a prohibition against ex parte communications.

> Except to the extent required for the disposition of ex parte matters as authorized by law —
> (A) an interested person outside the Division shall not make or knowingly cause to be made to the Director or a hearing officer who is or may reasonably be expected to be involved in the evidentiary hearing or review of an adverse decision, an ex parte communication (as defined in section 551(14) of title 5, United States Code) relevant to the merits of the proceeding;
> (B) the Director and such hearing officer shall not make or knowingly cause to be made to any interested person outside the Division an ex parte communication relevant to the merits of the proceeding.[28]

This provision apparently was a response to the ASCS NAD's practice of engaging in ex parte discussions about the merits of pending appeals with ASCS personnel outside of the ASCS NAD without so informing the program participant or making the discussions part of the administrative record.

Director Review of Hearing Officer Decisions

Hearing officers are to render their decisions within thirty days after the hearing, although the Director may establish an earlier or later deadline.[29] Hearing officer decisions are appealable to the Director; otherwise, they are administratively final.[30]

Program participants have thirty days within which to appeal a hearing officer's decision to the Director.[31] Agency heads may also appeal, and they are subject to a

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fifteen-business day limit.[32] The author is aware of a recent appeal in which the USDA NAD did not inform a program participant who had prevailed before a hearing officer of the grounds asserted by the CFSA when the CFSA appealed. The CFSA also did not provide the program participant with a copy of its multi-page grounds for its appeal. The USDA NAD merely informed the program participant that the CFSA had appealed, and it provided a copy of the CFSA's statement of grounds only after the program participant's attorney requested a copy. On the basis of the CFSA's communication, the hearing officer's determination was reversed.[33] Although the CFSA's lodging of an appeal supported by a statement of grounds without notice to the program participant placed the participant at an extraordinary disadvantage, the USDA NAD apparently has not taken measures to deal with this problem.

When a program participant appeals a hearing officer decision to the Director, the Director must either decide the matter or remand it to complete the record or for new hearing within thirty business days.[34] When an agency appeals, that limit is shortened to ten business days.[35] The Director's review is based on the record developed before the hearing officer, "the request for review, and such other arguments or information as may be accepted by the Director."[36]

Equitable Relief

Many, if not most, federal farm program administrative appeals involve requests for administrative equitable relief under 7 C.F.R. Parts 790 or 791 or comparable regulations. Because the statutory authority for administrative equitable relief vests the power to grant it in the Secretary, there was some debate within the ASCS over whether the ASCS NAD Director could grant equitable relief. In practice, the ASCS NAD Director granted equitable relief, albeit sparingly. The USDA Reorganization Act removes any possibility for such a debate with regard to the USDA NAD's authority to grant equitable relief by expressly giving the USDA NAD Director the same authority enjoyed by the Secretary.[37] Significantly, the Act reserves to the Secretary "the authority to grant equitable or other types of relief to the appellant after an administratively final determination is issued by the Division."[38] Under this provision, agencies appear to be free to settle disputes with program participants.

Effective Date and Implementation of Decisions

The Act provides that the effective date of a USDA NAD final determination is "as of the date of [the] filing of an application, the date of the transaction or event in question, or the date of the original adverse decision, whichever is applicable."[39] In addition, the Act requires agency heads to implement "the final determination not later than 30 days after the effective date of the notice of the final determination."[40] Whether these provisions enlarge the right of farm program participants whose appeals are successful to recover interest due on payments withheld during the appeal process is uncertain. Prior to the USDA Reorganization Act's enactment, the ASCS took the position that the Prompt Payment Act, 31 U.S.C. §§ 3901-07, limits the recovery of interest to a one-year period,[41] and it declined to pay interest to program participants who were granted administrative equitable relief.

Judicial Review

The USDA Reorganization Act provides that final determinations of the USDA NAD are reviewable in the federal district courts under the judicial review provisions of the Administrative Procedure Act, 5 U.S.C. §§ 701 - 706.[42]

Extension of Mediation to Farm Program Disputes

The Act also includes, for the first time, farm program compliance disputes under the certified state mediation programs.[43] If mediation is available, program participants must be offered the right to chose mediation.[44] How mediation rights will be coordinated with appeal rights, and whether mediation will prove to be an effective and efficient way to resolve farm program disputes are questions that must at least await the promulgation of implementing regulations.

—Christopher R. Kelley, Lindquist & Vennum P.L.L.P., Minneapolis

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[1] Pub. L. No. 103-354, §§ 271 - 283, 108 Stat. 3178, 3228 -3235 (USDA Reorganization Act) (to be codified at 7 U.S.C. §§ 6991 - 7002).

[2] Id. at § 272(a), 108 Stat. at 3229 (to be codified at 7 U.S.C. § 6992(a)). While the USDA NAD is independent of other USDA agencies, it is not independent of the Secretary. The USDA NAD Director is subject to the Secretary's "direction and control." Id. at § 272(c), 108 Stat. at 3229 (to be codified at 7 U.S.C. § 6992(c)).

[3] Only appeals involving the CCC's domestic programs are within the USDA NAD's jurisdiction. Id. at § 271(2), 108 Stat. at 3228 (to be codified at 7 U.S.C. § 6991(2)).

[4] Separately from the USDA NAD provisions, the Act also requires the promulgation of rules relating to the appeal of NRCS technical determinations and the CFSA's reliance on those determinations. Id. § 226(d), 108 Stat. 3178, 3215 (to be codified at 7 U.S.C. § 6932(d)).

[5] Id. at § 271(2), 108 Stat. at 3228 (to be codified at 7 U.S.C. § 6991(2)); See also id. § 227, 108 Stat. at 3216 - 3218 (amending 16 U.S.C. § 590h) These committees used to be known as the state and county ASC committees. The FmHA committees are abolished. Id. at 108 Stat. at 3218.

[6] Id. at § 212(e), 108 Stat. at 3211 (to be codified at 7 U.S.C. § 6912(e))

[7] Id. § 275, 108 Stat. 3178, 3230 (to be codified at 7 U.S.C. § 6995).

[8] Id. § 276(a), 108 Stat. 3230 (providing that "a participant shall have the right to appeal an adverse decision to the Division for an evidentiary hearing. . . .") (to be codified at 7 U.S.C. § 6996(a)). An "adverse decision" is defined to include an "administrative decision made by an officer, employee, or committee of an agency that is adverse to a participant." Id. § 271, 108 Stat. at 3228 (to be codified at 7 U.S.C. § 6991(1)).

[9] Id. § 274, 108 Stat. at 3230 (to be codified at 7 U.S.C. § 6994).

[10] Id. § 276(b), 108 Stat. 3230 (to be codified at 7 U.S.C. § 6996(b)) The phrase "first received notice" is potentially problematic since it may include oral notice of the decision or some other notice received before the written adverse decision was received.

[11] Id. § 272(b)(1), 108 Stat. 3178, 3229 (to be codified at 7 U.S.C. § 6992(b)(1)).

[12] Id.

[13] Id. at § 272(c), 108 Stat. at 3229 (to be codified at 7 U.S.C. § 6992(c)) Whether this provision constrains the Director's authority to subdelegate the Director's authority to others within the USDA NAD is a potential issue.

[14] Id. § 272(b)(2), 108 Stat. 3229 (to be codified at 7 U.S.C. § 6992(b)(2)). The Director cannot be a political appointee or noncareer employee. Id.

[15] Id. at § 272(d), 108 Stat. at 3229 (to be codified at 7 U.S.C. § 6992(d)).

[16] Id.

[17] Id. § 278, 108 Stat. at 3232 (to be codified at 7 U.S.C. § 6998).

[18] Id. at 277(a)(1), 108 Stat. at 3230 (to be codified at 7 U.S.C. § 6997(a)(1))

[19] Id. § 277(a)(2), 108 Stat. at 3231 (to be codified at 7 U.S.C. § 6997(a)(2)). Regulations implementing the subpoena authority are likely to impose on parties to an appeal a time limit and a showing of need for requesting a subpoena.

[20] Id. § 277(b), 108 Stat. at 3231 (to be codified at 7 U.S.C. § 6997(b)) The statute does not specify the consequences of the failure to hold a timely hearing. "[T]he courts generally hold that such time limits are directory, not mandatory, and refuse to invalidate agency action merely because the limits have been violated." Bernard Schwartz, Administrative Law 661 (1991) (footnote omitted).

[21] USDA Reorganization Act, Pub. L. No. 103-354, § 277(b)(1), 108 Stat. 3178, 3231 (to be codified at 7 U.S.C. § 6997(c)(1)).

[22] Id. § 277(b)(2), 108 Stat. at 3231 (to be codified at 7 U.S.C. § 6997(c)(2)).

[23] Id. § 277(c)(3), 108 Stat. at 3231 (to be codified at 7 U.S.C. § 6997(c)(3)).

[24] Id. § 277(c)(4), 108 Stat. at 3231 (to be codified at 7 U.S.C. § 6997(c)(4)).

[25] Id. at § 278(c), 108 Stat. at 3232 (to be codified at 7 U.S.C. § 6998(c))

[26] See, e.g., Jones v. Espy, No. 90-2831-LFO, 1993 WL 102641 (D.D.C. Mar. 17, 1993)

[27] Id. § 277(c)(3), 108 Stat. at 3231 (to be codified at 7 U.S.C. § 6997(c)(3)).

[28] Id. § 277(a)(2), 108 Stat. at 3231 (to be codified at 7 U.S.C. § 6997(a)(2)). Section 551(14) of the Administrative Procedure Act (APA), 5 U.S.C. § 551(14), defines an "ex parte communication" as "an oral or written communication not on the public record with respect to which reasonable prior notice to all parties is not given, but it shall not include requests for status reports on any matter or proceeding covered by this subchapter." Section 557 of the APA, 5 U.S.C. § 557(d)(C) - (E), provides as follows:

(C) a member of the body comprising the agency, administrative law judge, or other employee who is or may reasonably be expected to be involved in the decisional process of such proceeding who receives, or who makes or knowingly causes to be made, a communication prohibited by this subsection shall place on the public record of the proceeding.

(i) all such written communications.

(ii) memoranda stating the substance of all such oral communications, and

(iii) all written responses, and memoranda stating the substance of all oral responses, to the materials described in clauses (i) and (ii) of this subparagraph.

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Chapter 12 "Direct Payments" and Trustee Compensation

By Susan A. Schneider

Since the first Chapter 12 cases were filed, the compensation of the Chapter 12 trustee has been a matter of controversy and concern for family farm debtors attempting to reorganize their obligations. While few could challenge the need for the Chapter 12 trustee, many reorganizing farmers have disputed both the means of calculation and the amount of compensation awarded to the trustee appointed to the case. Trustees, on the other hand, have vigorously argued that in the self-funded system that exists, rigorous efforts must be made to protect their right to payment.

Many Chapter 12 reorganization plans raise serious feasibility concerns, even without the addition of a fee to compensate the trustee. In some cases, the addition of what is frequently a ten percent trustee's commission on top of the payments to creditors puts reorganization out of reach. Thus, it is not surprising that debtors have sought various ways to get around paying the trustee. What is surprising, however, is that the courts have still not arrived at a consistent interpretation of the most fundamental aspect of this compensation system: whether a debtor is allowed to pay his or her creditors directly, bypassing the trustee and avoiding the percentage commission fee.

The mechanism for compensating standing Chapter 12 trustees is set forth at 28 U.S.C. section 586(e). This section provides that the Chapter 12 trustee is to be compensated by receiving a percentage of the payments that the debtor makes under his or her plan, up to a maximum amount capped by the highest annual rate for a level V Executive Schedule employee. 28 U.S.C. § 586(e)(1)(A). The percentage is set as a maximum fee of ten percent on payments up to $450,000 and three percent on payments in excess of $450,000. 28 U.S.C. § 586(e)(1)(B). The statute authorizes the trustee to:

> collect such percentage fee from all payments received by such individual under plans in the cases under chapter 12 or 13 of title 11 for which such individual serves as standing trustee.

28 U.S.C. § 586(e)(2).

Two circuit courts recently addressed the issue of direct payments, reaching consistent results, but confirming a split between the circuits on this important issue. *In re Wagner*, 36 F.3d 723 (8th Cir. 1994); *In re Beard*, 45 F.3d 113 (6th Cir. 1995). Two bankruptcy courts recently addressed this issue as well, reaching opposite results. *In re Westpfahl*, 168 B.R. 337 (Bankr. C.D. Ill. 1994); *In re Marriott*, 161 B.R. 816 (Bankr. S.D. Ill. 1993). This article discusses the direct payments issue and the recent cases discussing it.

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Conflicting Analysis

Beginning with some of the first Chapter 12 cases filed, debtors have attempted to minimize the trustee's fee by making direct payments to at least some of their creditors. *See, Greseth v. Federal Land Bank (In re Greseth)*, 78 B.R. 936 (D. Minn. 1987); *In re Rott*, 73 B.R. 366 (Bankr. D.N.D. 1987); *In re Citrowski*, 72 B.R. 613 (Bankr. D. Minn. 1987); *In re Hildebrandt*, 79 B.R. 427 (Bankr. D. Minn. 1987). Because section 586(e)(2) provides that the trustee is to collect the percentage fee from "all payments *received by such individual* [the trustee] under plans in the cases under chapter 12 or 13" (emphasis added) these debtors have argued that if they make a payment directly to the creditor, without using the trustee, the trustee's percentage fee should not be assessed. *Id.*, discussing 11 U.S.C. § 586(e).

The direct payments issue has produced numerous reported decisions, with the result being three lines of cases with conflicting holdings. One line of cases has held that at least certain payments can be made directly, and the trustees fees do not apply to these direct payments. *See, e.g., In re Overholt*, 125 B.R. 202 (S.D. Ohio 1990); *In re Erickson Partnership*, 83 B.R. 725 (D.S.D. 1988). Under this approach, the total amount of trustee compensation can be adjusted downward by plan provisions that provide for direct payments to certain creditors.

A second line of cases has held that although direct payments to certain creditors are permissible, the debtor cannot avoid the trustee's fee on any impaired claim. *See, e.g., In re Rott*, 73 B.R. 366 (Bankr. D.N.D. 1987). According to these cases, the trustee's commission must be assessed on any payment made on a claim that has been modified under the Chapter 12 plan, even if the debtor makes the payment directly. The only payments that avoid the commission fee would be those made on long term debts that have not been altered by the bankruptcy.

The third line of cases has held that a Chapter 12 debtor is not allowed to make direct payments to impaired creditors, and consequently, there is no means to avoid the trustee's fee. *Fulkrod v. Savage (In re Fulkrod)*, 973 F.2d 801, 803 (9th Cir. 1992) (per curium). In *Fulkrod*, the court examined the trustee compensation scheme and reasoned that if the debtor were allowed to make direct payments without compensating the trustee, the trustee would receive nothing. The court stated that this was "hardly an outcome Congress could have intended." *Id.* at 802. Taking its analysis a step further, the court stated that it could find "nothing in Chapter 12 that explicitly authorizes a debtor to make direct payments to impaired creditors." *Id.* Based on the logical inference that Congress intended to provide funding for Chapter 12 trustees, the court held that a Chapter 12 debtor was not authorized to make direct payments to his or her impaired creditors. All payments to impaired creditors had to be made through the trustee, who was then entitled to assess a fee on the payments. *Id.* at 803.

Recent Circuit Decisions

Despite a number of bankruptcy and district court opinions discussing the direct payments issue, until late 1994 the *Fulkrod* decision was the only circuit court decision that directly ruled on the permissibility of direct payments as a means of limiting trustee compensation. The Tenth Circuit addressed the issue of standing Chapter 12 trustee compensation in *In re Schollett*, 980 F.2d 639 (10th Cir. 1992), but held only that the amount percentage fee assessed was not reviewable. The lower courts continued to issue conflicting decisions.

Within the last year, however, two circuit courts reached decisions on the direct payments issue, and both adopt the first line of cases, holding that direct payments can be made and that these payments are not subject the trustee's fee. *Wagner*, 36 F.3d at 723; *Beard*, 45 F.3d at 119-120.

The *Wagner* case represents the Eighth Circuit's first analysis of the direct payments issue. 36 F.3d at 723. This case concerned four Chapter 12 cases, consolidated for the purpose of determining whether the debtors were allowed to pay certain creditors directly and bypass the trustee's fee. *Id.* at 725. In each of the cases, the Minneapolis regional office of the U.S. Trustee had moved to dismiss the case for the debtors' failure to pay the trustee's proper fee. *Id.* In each of the cases, however, the debtors' confirmed plan provided that "[t]o the extent the trustee is not involved and a direct payment is made, no fee will be paid." *In re* Wagner, 159 B.R. 268, 270 (D.N.D. 1993) (discussed in 11 Agricultural Law Update No. 4, Whole No. 4, 1 (February 1994)). The bankruptcy court granted the motion to dismiss in each case, and appeal was taken to the district court. *Id.*

Upon review, the district court reversed,

but based this reversal on the fact that the plans had all been confirmed with the direct payments language included. *Id.* at 272. The court stated that the issue of direct payments should be addressed at plan confirmation and viewed the motion of the U.S. Trustee's office as an attempt "to put milk back in the bottle." The court stated, however, that the reasoning of the line of cases that did not allow direct payments "seemed preferable." *Id.*

On appeal, the Eighth Circuit court took a different approach by focusing primarily on statutory interpretation. *Wagner*, 36 F.3d at 726-28. The Eighth Circuit saw three distinct issues. The first issue was whether direct payments are prohibited under the provisions of Chapter 12. *Id.* The second issue was whether the confirmed plan provided for direct payments. *Id.* The third issue was then to apply the fee structure for the trustee under section 586(e) to the direct payment. *Id.* The court held that the debtors were not prohibited from making direct payments to impaired creditors, that their plan provided for direct payments, and that they did not need to pay the trustee's fee on these direct payments. *Id.*

Supporting its decision that Chapter 12 does not prohibit debtors from making direct payments to their creditors, the court cited section 1226 under which the trustee is required to make payments to creditors under the plan "[e]xcept as otherwise provided in the plan or in the order confirming the plan." *Id.* at 726 (citing 11 U.S.C. § 1226(c)(1988)). The court also cited section 1225 which references "property to be distributed by the trustee or the debtor under the plan." *Id.* at 726 (citing 11 U.S.C. § 1225(a)(5)(B)(ii) (1988)). The court stated that "[w]hen these two sections are read in conjunction, it becomes clear that the code does not forbid plan provisions allowing direct payments by the debtor to impaired secured creditors." *Id.* (citations omitted).

The court next examined the specific language contained in the debtors' confirmed plans. These plans each included the statement that "[t]o the extent the trustee is not involved and a direct payment is made, no fee will be paid." *Id.* at 726-27. Although other language in the plans may have been less than clear, the court held that this language supported the conclusion that the plan contemplated direct payments to impaired creditors.

The court then turned to its analysis of the appropriate trustee compensation. Supporting its decision that the trustee was not entitled to receive his or her ten percent fee from the direct payments, the court analyzed section 586. 11 U.S.C. § 586. The United States Trustee's Office argued that under section 586, the standing trustee was entitled to receive up to "ten percent of the payments made under the plan" regardless of whether they were paid directly by the debtor. The court, however, rejected this argument, holding that under the specific language contained in section 586, the trustee is authorized to collect fees only on "payments received by the trustee." *Id.* at 727 (citing 11 U.S.C. § 586(e)(1)(B)(ii)). The court stated that "§ 586(e)(2) means what it says and requires trustee's fees only on those payments 'received by' the trustee." *Id.* at 728.

The court further supported its decision by reference to Chapter 13. Prior to the enactment of either Chapter 12 or section 586, Chapter 13 provided that the trustee's fees should be collected "from all payments under [Chapter 13] plans." 11 U.S.C. § 1302(e)(1982). According to the court, much litigation over the scope of trustee's fees ensued. *Wagner*, 36 F.3d at 727. In 1986, Congress replaced section 1302 with section 586(e)(2), amending the language to require fees "from all payments received by" the trustee. *Id.* Section 1202(d)(2) as originally enacted contained the language from section 1302(e), but Congress replaced it almost immediately with the present language of section 586(e)(2) when it placed the standing trustee system under the United States Trustee. The court noted that "[i]n light of the frequency with which disputes over trustee's fees under Chapter 13 were litigated prior to 1986, the revision is significant." *Id.* at 728 (citations omitted). The court concluded that section 586(e)(2) "means what it says and requires trustee's fees only on those payments 'received by' the trustee." *Id.*

The *Wagner* court discussed and rejected the Ninth Circuit decision in *Fulkrod*. It criticized the *Fulkrod* court's statutory analysis and also criticized its reliance on policy grounds and an inference of Congressional intent. *Id.* Based on the compensation scheme set forth in section 586, *Fulkrod* held that Congress could not have intended debtors to have the authority to make direct payments. *Fulkrod*, 973 F.2d at 803. The *Wagner* court stated that "Congress's intent is best evidenced by the language of the laws Congress enacts." *Id.*

The Sixth Circuit reached the same conclusion in the recent case of *In re Beard*, 45 F.3d 113 (6th Cir. 1995). In another case of first impression, the court also addressed the direct payments issue by an analysis of the statutory language. As an interesting twist in this analysis, however, the decision begins with the conclusion that fully secured claims can be paid directly, avoiding the trustee's fee. The court extends this right to make direct payments to the secured portion of undersecured claims, allowing the debtor to make direct payments avoiding the trustee's commission.

Under the plan at issue in *Beard*, the debtors divided the claims that would be paid directly into four categories: 1) the fully secured claim of Farm Credit Services; 2) the secured portion of the FmHA claim; 3) the claims for unpaid real estate taxes; and, 4) various postpetition administrative expense claims including attorneys fees. The bankruptcy court allowed direct payments for the first two categories, but disallowed direct payments for the latter two categories. The district court affirmed. The debtors did not appeal the denial of direct payments to the latter categories; similarly, the trustee did not appeal the allowance of direct payments on the first category. Thus, the only issue on appeal was whether the debtors could make direct payments on the secured portion of an undersecured claim and avoid the trustee's fee thereon.

The bankruptcy court in *Beard* supported its decision to allow the direct payment by referencing two decisions, *In re Overholt*, 125 B.R. 202 (S.D. Ohio 1990) and *In re Pianowski*, 92 B.R. 225 (Bankr. W.D. Mich. 1988). These decisions upheld the right of debtors to make direct payments and avoid the trustee's fee. In each of these cases, however, the court acknowledged that some debts were appropriate for direct payment and others were not. Each developed a test for making this distinction. After considering both of these tests, the bankruptcy court in *Beard* determined that the debtors were allowed to make the direct payment on the secured portion of the undersecured claim.

On appeal, the trustee argued that the *Overholt*, *Pianowski*, and the lower court *Beard* decisions all overlooked Congress' intentions in creating the trustee compensation system for standing Chapter 12 trustees. Citing *Fulkrod*, the trustee alleged that allowing direct payments would virtually eliminate all trustee compensation. *Beard*, 45 F.3d at 118 (citing *Fulkrod*, 973 F.2d at 802-03). In addition, the trustee cited *Schollett*, for the proposition that Congress placed the trustees in the executive branch of government under the Attorney General, and thus, deliberately limited the oversight authority of the courts. *Beard*, 45 F.3d at 118 (citing *Schollett*, 980 F.2d at 643). Finally, the trustee argued that the compensation derived from each successful case must make up for the financial risks assumed by the trustee with regard to the unsuccessful cases.

Rejecting the trustee's arguments, the circuit court turned to the statutory authority given the Chapter 12 debtor. Citing section 1225, the court noted that an "allowed secured claim" could be distributed "by the trustee or the debtor." 11 U.S.C. § 1225(a)(5)(B)(ii). Citing section 586, the court noted that Congress could have extended the reach of the trustee's commission to "payments made by the trustee or debtor" (or similar language), but it did not. Viewing these sections together, the court

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stated that Congress "envisioned a scheme that debtors would at times be able to pay their debts directly to their creditor, allowing them to bypass the trustee." *Beard*, 45 F.3d at 119. Noting that the trustee had not objected to the direct payment of the fully secured claim, the court held that fully secured claims can be paid directly, without the assessment of the trustee's fee. *Id*.

The court then addressed the issue of the secured portion of undersecured claims. *Id*. The court found that under section 506, an undersecured debt can be bifurcated into two separate claims, a secured claim to the extent of the value of the collateral and an unsecured claim for the deficiency. *Id*. at 120 (referencing 11 U.S.C. § 506(a); other citations omitted). The court found that there was no reason to treat this bifurcated secured claim any differently than a wholly secured claim and allowed direct paymeuts thereon. *Id*. The court held that "based on the plain lauguage of the statute ... just as a Chapter 12 debtor may bypass the trustee and directly pay fully secured claims, so may the debtor directly pay the secured portion of undersecured claims." *Id*. Seemingly unsympathetic to the financial appeals of the trustee, the court stated that "[i]f our holding results in a reduction of trustee's fees, it also results in a reduction of their workload." *Id*. The court noted that because the parties had not raised the issue of the direct payment of unsecured claims, it need not consider it. *Id*. at 119.

Recent Bankruptcy Court Decisions

In addition to the *Wagner* and *Beard* decisions, two bankruptcy courts recently addressed the direct payment issue. In *In re Westpfahl*, 168 B.R. 337 (Bankr. C.D. Ill. 1994), the court held that a Chapter 12 debtor is entitled to make payments directly to both impaired and unimpaired creditors, bypassing the trustee and eliminating the assessment of his/her percentage fee. *Id*. at 362-63. The court based this holding in part on *Matter of Aberegg*, the Seventh Circuit opinion addressing this issue in a Chapter 13 bankruptcy. *Id*. at 361 (citing *Aberegg*, 961 F.2d 1307 (7th Cir. 1992)). In *Aberegg*, the court interpreted Chapter 13 provisions identical to those in Chapter 12 and held that the debtors were entitled to make payments directly to their creditor and avoid the trustee's fee on that payment. *Id*. at 362.

The court in *Westpfahl*, however, also held that the right to make direct payments is not an "unfettered right," and ruled that each case should be decided on its own facts. *Westpfahl*, 168 B.R. at 364. The court listed the factors that were considered by two other courts as follows:

1. the past history of the debtor;
2. the business acumen of the debtor;
3. the debtor's post-filing compliance with statutory and court-imposed duties;
4. the good faith of the debtor;
5. the ability of the debtor to achieve meaningful reorganization absent direct payments;
6. the plan treatment of each creditor to which a direct payment is proposed to be made;
7. the consent, or lack thereof, by the affected creditor to the proposed plan treatment;
8. the legal sophistication, incentive and ability of the affected creditor to monitor compliance;
9. the ability of the trustee and the court to monitor future direct payments;
10. the potential burden on the Chapter 12 trustee;
11. the possible effect upon the trustee's salary or funding of the U.S. Trustee system;
12. the potential for abuse of the bankruptcy system;
13. the existence of other unique or special circumstances.

Id. (citing *In re* Heller, 105 B.R. 434 (Bankr. C.D. Ill. 1989); *In re* Pianowski, 92 B.R. 225 (Bankr. W.D. Mich. 1988)).

With these factors in mind, the court ordered further hearings on this issue in each case. *Id*. at 365.

The bankruptcy court subsequently considered the types of debts involved and determined which could he paid by the debtor directly, avoiding the trustee's fee. *In re Westpfahl*, 171 B.R. 330 (Bankr. C.D. Ill. 1994). The court held that payments to secured creditors on long term real estate debt and real estate taxes could be paid directly. *Id*. at 332. The court held, however, that short term secured equipment loans should be paid through the trustee. *Id*.

Another Illinois bankruptcy court addressing this issue reached a conflicting result, however. In *In re Marriott*, 161 B.R. 816 (Bankr. S.D. Ill. 1993). the court held that the debtors were not entitled to avoid payment of the trustee's fee by making payments directly to their creditors. *Id*. at 820. The court noted the "divergent judicial interpretations" on this issue, finding this to be "evidence of a statutory ambiguity." *Id*. at 818. Reviewing section 1225, the provision that appears to give the debtor the authority to make direct payments, the court relied upon the maxim that statutes should be interpreted so as to not render other provisions superfluous or without effect. *Id*. (citations omitted). The court found that allowing direct payments free of the trustee's fee would render the compensation language of section 586 ineffectual. The court held that all payments to creditors whose claims are impaired must be considered payments made "under the plan", regardless of whether direct payment is made, and the trustee's fee must be assessed on all of these payments. *Id*. at 821.

Given the tight cash flow in many Chapter 12 cases, the issue of direct payment as a means to reduce trustee compensation is a tool that may be critical to the feasibility of a debtor's plan. It is unfortunate that debtors in different courts may have vastly different rights with regard to this issue.

—Susan A. Schneider, Hastings, MN

NORMAL FARMING/cont. from p. 1

drainage system was incomplete and in poor condition. The farmer began repairing the existing drainage system in 1976, and, by the following year, the essential portions of the improvements were in place. By 1979, the site was dry, except after heavy rainfalls. As funds were available, improvements continued to be made on interconnected portions of the drainage system until 1987. In the mid-1980s the farmer cleared, mulched, churned, leveled, and drained the site. In addition, the farmer installed four miles of plastic drainage tile on the site to drain it, and he grew corn on the site in 1986 and 1987. In 1987 and 1988, administrative orders and a complaint were issued against the farmer.

In general, section 404 of the federal Clean Water Act requires a permit for the discharge of dredged or fill material into the waters of the United States, including wetlands. 33 U.S.C. § 1344. Here, however, the farmer did not seek a permit for his activities. Instead, he claimed that his activities were exempt from the section 404 permit requirement under the "normal farming activities" exemption. This exemption applies to "normal farming activities . . . such as plowing, seeding, cultivating, minor drainage, harvesting . . . or upland soil and water conservation practices." 33 U.S.C. § 1344(f)(1)(A). The exemption applies only to discharge activities that are "part of an established (i.e., on-going) farming . . . operation," and it does not apply to "activities which bring an area into farming . . . use" or in circumstances where "modifications to the hydrological regime are necessary to resume operations." 33 C.F.R. § 323.4(a)(1)(iii); 40 C.F.R. § 232.3(c)(1)(ii)(A), (B). Also, the term "plowing" as used in the regulatory definition of "normal farming operations" does not include "the redistribution of surface materials by blading, grading, or other means to fill in wetland areas," and the term "minor drainage" does not include "drainage associated with the immediate or gradual conversion of a wetland to a non-wetland . . ., or conversion from one wetland use to another." 33 C.F.R. § 323.4(a)(1)(iii)(D); 40 C.F.R. § 232.3(d)(4); 33 C.F.R. § 323.4(a)(1)(iii)(C)(2); 40 C.F.R. §232.3(d)(3)(ii).

A person seeking to rely on the "normal farming activities" exemption hears the burden of showing the exemption applies. In *Brace*, the Third Circuit held that the farmer did not satisfy this burden because the farmer's activities were neither part of an "established (i.e., ongoing) farming op-

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STATE ROUNDUP

NEBRASKA. *Airborne transmission of infectious disease.* The Nebraska Supreme Court recently considered whether the loss of swine caused by a virus transmitted by a tornado was covered by an insurance policy. *Griess & Sons, Inc. v. Farm Bureau Insurance Company of Nebraska*, No. S-93-342, 1995 WL 107117 (Neb. Mar. 10, 1995).

On March 13, 1990, a windstorm moved through Clay County, Nebraska. The tornado traveled across several herds of pseudorabies-infected swine that had been quarantined. The virus was subsequently carried to Griess' swine herd. After Griess' swine herd became infected with pseudorabies, Griess incurred $128,732 in veteriinarian expenses. Griess also refunded $19,900 to purchasers of breeding gilts sold shortly after the tornado, before symptoms could be detected. Farm Bureau Insurance denied coverage for the loss and Griess brought a declaratory judgment action. The district court granted partial summary judgment for Griess on the issue of liability and a jury returned a verdict for Griess on the issue of damages.

The insurance policy covered "physical loss to the property described in the coverage caused directly hy an applicable peril ... unless the loss is excluded...." Windstorm was a peril insured against, while infectious diseases were not explicitly excluded...." Windstorm was a peril insured against, while infectious diseases were not excluded. On appeal, Farm Bureau Insurance argued that physical loss caused directly by windstorm does not include airborne transmission of an infectious disease. Essentially, Farm Bureau Insurance asserted that the immediate, dominant, and proximate cause of Griess' loss was pseudorabies and not the tornado. Further, since airborne transmission of an infectious disease was not a covered peril, Farm Bureau Insurance could not be liable under the policy.

The Supreme Court disagreed, noting that "[T]he wind need not pick up and throw the swine to the earth to constitute a direct cause of the loss. In support of their reasoning, the court cited *Qualls v. Farm Bureau Mutual Insurance Company*, 184 N.W.2d 710 (Iowa 1971), in which fourteen heifers died of pseudorabies transmitted following an attack of wild animals. In *Qualls*, the Iowa Supreme Court held that the attack, a covered peril, was the proximate cause of the loss. Finding *Qualls* analogous, the Nebraska Supreme Court noted that absent the windstorm, Griess' swine would not have been infected. Accordingly, as the windstorm was the proximate cause, and the direct cause, of Griess' loss, the judgment of the trial court was affirmed.

—Scott D. Wegner, Lakeville, MN

NORMAL FARMING/cont. from p. 6

eration" nor were they within the limits of "normal farming activities" as defined under the applicable regulations.

The Third Circuit ruled that the farmer's activities were not part of an "established (i.e., ongoing) farming operation" because the activities, by intention and result, "converted a thirty-acre site that was not suitable for farming into a site that is suitable for farming, and thus 'brought an area into farming use.'" *Brace*, 1994 WL 653382 at *9. The court also ruled that even if the acreage's pre-1975 use as a pasture by the farmer's father could be considered a prior, "established farming operation," the regulations specify that a farming operation is not "ongoing" where "modifications to the hydrological regime are necessary to resume operations." By the farmer's admission and conduct, modifications to the hydrological regime were necessary to grow crops on the site. *Id.*

The Third Circuit also ruled that the farmer's excavation and discharge of soil in connection with hurying approximately four miles of drainage tile, his leveling and clearing the formerly wooded and vegetated site, and bis spreading dredged material were not "normal farming activities" because the regulatory definition of "normal farming activities" excludes activities that significantly modify a wetland or convert a wetland to a non-wetland or another use. In so ruling, the court rejected the farmer's claim that he was simply maintaining rather than constructing drainage ditches. While a section 404 permit is not required for the discharge of dredged or fill material for the purpose of maintaining drainage ditches, the court reasoned that it was "not realistic" to characterize the excavation of the site and the burying of several miles of drainage tile to facilitate drainage as "continuing maintenance." *Id.* at *11-12.

—Christopher R. Kelley, Lindquist & Vennum, Minneapolis, MN.

USDA NAD/cont. from p. 3

(D) upon receipt of a communication knowingly made or knowingly caused to be made by a party in violation of this subsection, the agency, administrative law judge, or other employee presiding at the hearing may, to the extent consistent with the interests of justice and the policy of the underlying statutes, require the party to show cause why his claim or interest in the proceeding should not be dismissed, denied, disregarded, or otherwise adversely affected on account of such violation; and

(E) the prohibitions of this subsection shall apply beginning at such times as the agency may designate, but in no case shall they begin to apply later than the time at which a proceeding is noticed for hearing unless the person responsible for the communication has knowledge that it will be noticed, in which case the prohibitions shall apply beginning at the time of his acquisition of such knowledge.

Although § 557 of the APA does not apply to USDA NAD hearings because such hearings are not formal adjudications within the contemplation of APA § 554(a), the USDA NAD regulations are likely to impose requirements similar to those found in § 557(C) - (E). Incidentally, because USDA NAD proceedings are not formal adjudications, attorneys fees may not be awarded to a prevailing appellant under the Equal Access to Justice Act, 28 U.S.C. § 2412.

[29] *USDA Reorganization Act, Pub. L. No. 103-354, § 277(d), 108 Stat. 3178, 3231 (to be codified at 7 U.S.C. § 6997(d)).*

[30] *Id.*

[31] *Id. § 278(a)(1), 108 Stat. at 3232 (to be codified at 7 U.S.C. § 6998(a)(1)).*

[32] *Id. § 278(a)(2), 108 Stat. at 3232 (to be codified at 7 U.S.C. § 6998(a)(2)).*

[33] *In re appeal of Darwin West.*

[34] *Id. at § 278(b), 108 Stat. 3232 (to be codified at 7 U.S.C. § 6998(b)).*

[35] *Id.*

[36] *Id.*

[37] *Id. at § 278(d), 108 Stat. at 3232 (to be codified at 7 U.S.C. § 6998(d)).*

[38] *Id.*

[39] *Id. § 278(e), 108 Stat. at 3232 (to be codified at 7 U.S.C. § 6998(e)).*

[40] *Id. § 280, 108 Stat. at 3233 (to be codified at 7 U.S.C. § 7000).*

[41] *See Doane v. Espy*, No. 91-C-0852-C (W.D. Wis. Jan. 4, 1995).

[42] *USDA Reorganization Act, Pub. L. No. 103-354, § 279, 108 Stat. 3178, 3233 (to be codified at 7 U.S.C. § 6999).*

[43] *Id. § 282, 108 Stat. at 3233-35 (to be codified at 7 U.S.C. § 5101(c)).*

[44] *Id. § 275, 108 Stat. at 3230 (to be codified at 7 U.S.C. § 6995).*

Federal Register *in Brief*

The following matters were published in the *Federal Register* from February 1, 1995 to February 21, 1995.

1. Ag. Marketing Service; Recordkeeping requirement for certified applicators of federally restricted use pesticdes; final rule; effective date: 5/11/95. 60 Fed. Reg. 8118.

2. APHIS; NEPA implementing procedures; final rule; effective date 3/3/95. 60 Fed. Reg. 6000.

3. CCC; Agreement for tbe development of foreign markets for agricultural commodities; final rule; effective date: 2/1/95. 60 Fed. Reg. 6352.

4. EPA; Policy for special local needs registrations; notice of availability and request for comments. 60 Fed. Reg. 6091.

—Linda Grim McCormick, Alvin, TX

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Agricultural Law Symposium

May 12, 1995, Wichita, Kansas Airport Hilton

Topics include: farm estate and business planning, property rights, oil and gas issues, and update on agricultural law developments.

For more information, call 913-532-1501.

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