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EPA issues new worker protection regulations

On August 21, 1992, the Environmental Protection Agency (EPA) issued final revisions to the regulations governing the protection of agricultural workers from agricultural pesticides. 57 Fed. Reg. 38,102 (1992) (to be codified at 40 C.F.R. pts. 156 & 170). The new regulations amend the current regulations at 7 C.F.R. pt 170 entitled *Worker Protection Standards for Agricultural Pesticides* by both expanding the applicability of the pesticide protection provisions and expanding the protections required. The new regulations also add new regulations entitled *Labeling Requirements for Pesticides and Devices* at 40 C.F.R. pt 156. The effective date for the regulations is October 20, 1992, although later compliance dates are applicable for the various provisions. The new regulations are extensive, and this article provides only a brief summary.

As justification for the revisions, the prefatory comments to the regulations state that the EPA estimates that:

> [T]ens of thousands of acute illnesses and injuries and a less certain number of delayed onset illnesses occur annually to agricultural employees as the result of occupational exposures to pesticides used in the production of agricultural plants.

57 Fed. Reg. 38,102, 38,105 (1992). The EPA asserted that as these illnesses and injuries are occurring under the current regulations, more restrictive measures were appropriate. Accordingly, the new regulations place more restrictions on employers, require increased worker protections, and require manufacturers to adopt new labeling requirements. *Id.*

The new worker protection regulations are directed primarily toward two categories of agricultural employees: those who handle agricultural pesticides, the handlers; and those who perform tasks such as cultivating and harvesting the crop, the hand laborers or workers. *Id.* at 38,151 (to be codified at 40 C.F.R. § 170.3). Handlers are those who deal directly with the pesticides and include those who mix, load, apply, clean, or repair pesticide equipment. The new section 170.3 contains a listing of handler activities and provides that a person may be classified as a handler whether he is an employee or is self employed. *Id.* Hand labor is defined as any agricultural activity performed by hand so that the worker comes in contact with surfaces (such as foliage) that contain pesticide residues. *Id.* The new regulations expand these categories by now including in them those who work in forests, nurseries, and greenhouses. *Id.* Prior regulations applied only to workers in fields treated with pesticides. 40 C.F.R. pt. 170 (1992). In addition to the handler and worker protections, however, some protections also now apply to all persons in a general sense. This

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USDA National Appeals Division Act of 1992 introduced

On July 31, 1992, Senators Conrad, Heflin, Daschle, Harkin, Bumpers, Kerry (Neb.),and Wellstone and Representatives Espy, Glickman, Johnson (S.D.), and Doolley introduced the USDA National Appeals Division Act of 1992 (S. 3119, H.R. 5742). If enacted, the legislation will create an independent administrative appeals division within the USDA, known as the National Appeals Division (USDA NAD). The Director of USDA NAD will make the USDA's final administrative decision on producer appeals of Agricultural Stabilization and Conservation Service (ASCS), Commodity Credit Corporation (CCC), Farmers Home Administration (FmHA), Rural Development Administration (RDA), and Soil Conservation Service (SCS) determinations.

Currently, the ASCS, CCC, FmHA, RDA, and SCS have different administrative appeal systems, none of which are independent of the agency. For example, under current law, appeals of federal farm program determinations made by ASC county and

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protection is aimed at the non-employee who may be in the area of a pesticide application. *See* 57 Fed. Reg. at 38,107.

The expanded requirements in the new regulations can be divided into three areas according to the result the requirements are designed to achieve: provisions to eliminate or reduce pesticide exposures, provisions to mitigate exposure, and provisions to inform employees about pesticide hazards. *Id.* at 38,104.

In an attempt to eliminate or reduce pesticide exposure, the new regulations require compliance with stricter application guidelines. Pesticides may not be applied in any manner that will cause contact with any person except a trained and equipped handler. *Id.* at 38,161 (to be codified at 40 C.F.R. § 170.210). Similarly, no person, except a properly trained and equipped handler, may be in or near an area while it is being treated with pesticides. *Id.* at 38,153 (to be codified at 40 C.F.R. § 170.110). The new regulations also require employers to assure that handlers working with pesticides labeled with a skull and crossbones symbol be monitored at least every two hours. *Id.* at 38,161 (to be codified at 40 C.F.R. § 170.210). Handlers using fumigants in greenhouses must be in continual visual or voice contact with another. *Id.*

Additional requirements for the use of "personal protective equipment" (PPE) are also part of the attempt to eliminate or reduce pesticide exposure. These requirements work in conjunction with new labeling requirements, as the appropriate PPE for a given pesticide is dependent upon the product's toxicity and the mode of exposure. As such, specific PPE instructions will be included on the pesticide label. *See generally* 57 Fed. Reg. at 38,146-51 (to be codified at 40 C.F.R. pt. 156). In general terms, however, the regulations require that both handlers and all persons entering a treated area prior to the expiration of a "restricted entry interval" (REI) established for that pesticide must wear the appropriate PPE. 57 Fed. Reg. at 38,154, 38,163 (to be codified at 40 C.F.R. §§ 170.112, 170.240). In addition, when a PPE is required, the employer must provide the PPE for each worker or handler; clean and maintain the PPE; assure that the worker or handler wears the PPE; prevent workers or handlers from taking home contaminated PPE; and take action to prevent heat stress as a result of the PPE. *Id.*

A third approach for eliminating or reducing pesticide exposure involves changes to the REI requirements. The new regulations provide for minimum REIs for all pesticides used in agricultural production, including those older pesticides for which entry data has not yet been obtained and evaluated. 57 Fed. Reg. at 38,146-51 (to be codified at 40 C.F.R. pt. 156).

The fourth approach for eliminating or reducing pesticide exposure places notice requirements on employers. To help workers avoid inadvertent exposure to treated areas, the new regulations require employers to inform workers of pesticide applications. 57 Fed. Reg. at 38,156 (to be codifed at 40 C.F.R. § 170.120); *see also* 57 Fed. Reg. at 38,148 (to be codifed at 40 C.F.R. § 156.210) and 57 Fed. Reg. at 38,161-62 (to be codifed at §§ 170.222, 170.224). The type of notification required varies with the toxicity of the pesticide applied and the locale of the application. 57 Fed. Reg. at 38,156 (to be codifed at 40 C.F.R. § 170.120).

The new regulations also contain provisions designed to mitigate the dangers of exposure should it occur. These provisions require employers to provide handlers and workers with facilities for washing. *Id.* at 38,160, 38,165 (to be codified at §§ 170.150, 170.250). They also require employers to take measures to assure that proper emergency medical assistance is available. These measures include posting of information regarding the nearest medical facility, providing transport to medical facilities, and dislosing information regarding the pesticide that triggered the emergency. *Id.* at 38,161, 38165 (to be codifed at 40 C.F.R. §§ 170.160, 170.260).

The new regulations alo contain provisions to assure that employees are informed of pesticide hazards. These provisions require safety training for all workers and handlers, the use of safety posters, access to labeling information, and disclosure of product-specific information on the pesticides that have been applied. *Id.* at 38,159-60, 38,162-63 (to be codified at 40 C.F.R. §§ 170.130, 170.135, 170.230, 170.235).

As is apparent in many of the provisions, the new protections will be implemented in part through specific labeling requirements. The new regulations that specifically address the labeling requirements are at 57 Fed.Reg. 38,146 and will be codified at 40 C.F.R. pt. 156.

As a companion to the final worker protection rules published, the EPA has also promulgated two proposed rules that address protection issues. One proposed rule requires that specific hazard information be made available to workers. 57 F.R. 38,172 (proposed Aug. 21, 1992). This rule is modeled after the hazard standards promulgated by the Occupational Safety and Health Adminsitration (OSHA). *See* 57 Fed. Reg. 38,167 (prefatory comments to the proposed rule). Another proposed rule suggests certain exceptions for hand labor tasks performed on cut flowers and ferns. 57 Fed. Reg. 38,175 (proposed Aug. 21, 1992).

The prefatory comments to the final regulations state that the EPA assumes that the new regulations will affect the "minor crop" industry the most. This includes the vegetable, fruits, nuts, herbs, ornamentals, trees, and turfgrass producers. 57 Fed. Reg. 38,106. Anyone involved in this industry, or any other producer with employees or others who handle or come in contact with pesticides on the farm is well advised to review the new regulations carefully.

—Susan A. Schneider, Associate, Arent, Fox, Kintner, Plotkin & Kahn, Washington, D.C.

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USDA National Appeals Division Act/Continued from page 1.
state committees or ASCS and CCC officials are finally decided by the Director of the ASCS National Appeals Division, but the ASCS Administrator has the authority to reverse or modify any determination made by the Director. 7 U.S.C. § 1433e(c)(7), (f); 7 C.F.R. § 780.23 (1992).

The proposed legislation fundamentally alters the ASCS, CCC, FmHA, RDA, and SCS appeal systems in two respects. First, it consolidates the appeal systems for those agencies into one system at the final level of the administrative appeal process. The final level in each agency's administrative appeal process will be before the USDA NAD. The legislation, however, does not alter the current appeal authority of ASC county and state committees and SCS county and state employees.

Second, the proposed legislation provides that the Director of the USDA NAD "shall be free from the direction and control of ... any person other than the Secretary [of Agriculture]." S. 3119, 102d Cong., 1st Sess. § 3(b)(3) (1992). It also provides that determinations of USDA NAD "shall be administratively final, conclusive, and binding on the relevant agency." *Id.* at § 7(h)(1). Thus, under the proposed legislation, the final administrative appeal authority will be independent of the agency involved.

In addition, the proposed legislation provides that final decisions of the USDA NAD will be judicially reviewable under the Administrative Procedure Act, 5 U.S.C. §§ 701-706. *Id.* at § 9. In essence, this means that the federal courts will be able to set aside any decisions that are arbitrary, capricious, an abuse of discretion, or otherwise contrary to law. *See* 5 U.S.C. § 706(2)(A).

As significant, the proposed legislation repeals two statutes that the ASCS has used to attempt to limit judicial review of its determinations. For years, the ASCS has consistently sought to keep courts from reviewing its determinations by claiming that two statutes, 7 U.S.C. §§ 1385 and 1429, prevent courts from setting aside its determinations for any reason. *See, e.g., Garvey v. Freeman*, 397 F.2d 600, 604-05 (10th Cir. 1968); *Simons v. United States*, 25 Cl. Ct. 685, 695-99 (1992). Although the ASCS has not been completely successful in barring judicial review of its determinations, the proposed legislation repeals 7 U.S.C. §§ 1385 and 1429, both of which were originally enacted over forty years ago. S. 3119, 102d Cong., 1st Sess. § 16 (1992).

In hearings before the Senate Committee on Agriculture, Nutrition, and Forestry's Subcommittee on Agricultural Credit on August 10, 1992, witnesses supporting the legislation commended the legislation's provision for independent appeal determinations on the grounds that it would result in a fairer appeals process for producers. Testifying on behalf of the affected agencies in opposition to the legislation, the ASCS Administrator asserted that the legislation would be costly and would reduce producer accessibility to the appeals process. The Administrator also contended that the independence of the USDA NAD would impair the administration of the federal farm programs. Hearings before the House Agriculture Committee have not yet been scheduled.

—Christopher R. Kelley, Of Counsel, Arent, Fox, Kintner, Plotkin & Kahn

Montana Bankruptcy Court acknowledges but defers setoff of CRP payments

Considering the frequently litigated issue of setoff of government farm program payments, a Montana bankruptcy court has followed *In re Allen*, 135 B.R. 856, 866 (Bankr. N.D. Iowa 1992), in holding that the government's obligation to pay under a Conservation Reserve Program (CRP) contract and a deficiency contract can be setoff against debt to federal agencies. *In re Mohar*, 140 B.R. 273, 277-79 (Bankr. D. Mont. 1992).

The *Mohar* court first addressed the withholding of payments by ASCS and concluded that a violation of the automatic stay had occurred. *Id.* at 275-6, referencing 11 U.S.C. 362(a) (1988). Although the court stated that § 362(h) makes the assessment of damages mandatory when a violation of § 362(a) occurs, the debtor still has the burden to prove damages. The court found that the debtor failed to show damages, and accordingly, none were awarded. *Id.*

On the issue of whether setoff is appropriate, the *Mohar* court followed the *Allen* court in holding that the government's obligation to pay under a CRP contract and a deficiency contract arises at the date of the contract. *In re Mohar*, 140 B.R. 273, 277-79 (Bankr. D. Mont. 1992). Adopting the reasoning of *Allen*, the court found that the liquidated damages clause in CRP contracts, which permits the government to suspend performance and recover specified damages from the CRP participant, prevents payments under CRP contracts from being considered subject to conditions precedent. *Id.* at 277-79 (citations omitted).

The *Mohar* court also followed *Allen* in holding that the post-petition debtor is the same "entity" as the pre-petition debtor for setoff purposes. The debtor in *Mohar* had argued that the contracts with ASCS were executory and that when she affirmed them, a new obligation to a new entity, the debtor in possession, was created. *Id.* at 279 (citations omitted). The court adopted the *Allen* court's rejection of this "new entity" theory. *See generally* Christopher R. Kelley & Susan A. Schneider, *Selected Issues of Federal Farm Program Payments in Bankruptcy*, 14 J. Agric. Tax'n & L. 99, 110-15 (1992)(discussing *In re Allen* and the setoff of federal farm program payments).

Similarly, the court rejected the argument that a new obligation was created by affirming the contract. *Mohar*, 140 B.R. at 277. According to this argument, the effective date of the new obligation would be post-petition, and thus setoff would be precluded as mutuality of obligation would be lacking. The court noted that the CRP contract contains a provision that sets the effective date of the contract as the date that it is signed. Relying on this provision, the court stated that the debtor's argument would essentially allow the debtor to modify the terms of the contract by affirming it, a result the court believed was not contemplated by § 365 of the Code. 11 U.S.C. § 365 (1988)(setting forth the rules for executory contracts in bankruptcy). *Mohar*, 140 B.R. at 277.

In contrast to *Allen*, however, the court held that the CRP and deficiency funds were essential to the debtor's reorganization. *Id.* at 279. Noting that setoff under § 553 is permissive, not mandatory, the court acknowledged the right to setoff, but deferred the agencies' rights. *Id.* Relying upon *In re Blanton*, 105 B.R. 321, 337 (Bankr. E.D. Va. 1989), the court held that the right to setoff elevates the claim to secured status. Accordingly, the court denied the immediate right to setoff, but held that the claims, up to the amount due from the CRP and deficiency payments, must be treated as secured claims subject to the confirmation requirements of § 1225(a)(5). 11 U.S.C. § 1225(a)(5)(1988). *Mohar*, 140 B.R. at 279-80.

—Christopher R. Kelley, Of Counsel, Arent, Fox, Kintner, Plotkin, & Kahn

Legal issues in private timber management: federal income taxes and the proceeds of timber sales

By John S. Harbison and Vivica D. Pierre

Income realized from the sale of timber must be reported to the Internal Revenue Service as either ordinary income or as capital gain. Whether or not capital gains treatment is advantageous is a question that can only be answered by analyzing a taxpayer's individual financial situation. This article provides a general explanation of the special rules for capital gains treatment of timber. The taxpayer wishing a more complete explanation should consult *Forest Owner's Guide to Timber Investments, the Federal Income Tax, and Tax Recordkeeping,* United States Department of Agriculture, Forest Service Agriculture Handbook No. 681.

When would capital gains treatment be advantageous?

Capital gains treatment of income received from the sale of timber could be advantageous when:

(1) the taxpayer has capital losses that exceed $3,000, and no other capital gains;

(2) additional ordinary income of the taxpayer would be subject to the federal self-employment tax; or

(3) the taxpayer would be in the top income tax bracket in 1991 and any subsequent years in which there is a differential between the tax rates on ordinary income and capital gains.

How would a taxpayer with capital losses benefit from the treatment of timber receipts as a capital gain?

Capital losses can be deducted from taxpayer's gross income to reduce the amount of income on which federal income taxes are payable. If the deduction is made from ordinary income, up to $3,000 can be offset. Assume that a taxpayer sells an asset at a capital loss of $50,000 and then receives $75,000 from a separate timber sale, his only income of the tax year. If these timber receipts were ordinary income, the taxpayer could reduce his taxable income to $72,000 by taking advantage of the allowed $3,000 deduction.

If this same taxpayer's timber receipts were reported as capital gains rather than ordinary income, however, there would be no limit on the amount he could deduct from his gross income. This means that the taxpayer who has lost $50,000 on the sale of capital assets would be able to reduce his taxable income to $25,000 by deducting the full amount of his loss from his capital gains. By qualifying his timber receipts as a capital gain, he could significantly reduce his tax liability.

How would a timber seller subject to the federal self-employment tax benefit from capital gains treatment?

The sole proprietor of a business that sells timber in the regular course of its trade is subject to the federal Social Security self-employment tax on ordinary income. Currently, this tax is 15.3% of the first $53,400 of net income (for 1991).[1] However, the timber owner who would be able to qualify his income from timber sales as capital gains would not be subject to the self-employment tax.[2]

How would a taxpayer in the highest tax bracket benefit from the treatment of timber receipts as a capital gain?

One consequence of the Tax Reform Act of 1986 has been the elimination of the differential between tax rates applied to ordinary income and capital gains during the years since its enactment. Prior to the passage of the Act the tax rate on capital gains was significantly lower than the rate on ordinary income. In the 1991 tax year, a small differential not to exceed three per cent will reappear for taxpayers in the top income tax bracket.[3] This modestly higher tax rate on ordinary income could make capital gains treatment of timber income beneficial to high income taxpayers.

How does a taxpayer qualify income as capital in nature?

The federal tax code provides three ways of qualifying income from the sale of timber as a capital gain.

First, a sale of timber will qualify if the timber has been held as an investment. This will often be the case, especially when the seller holds a relatively small timber acreage. Timber may be held as an investment asset when the owner is not in the regular trade or business of selling timber, provided it is held for the eventual production of a profit. Proceeds from the sale of an investment asset are capital gains under section 1221 of the federal income tax code.

In addition, a taxpayer can qualify income from a timber transaction as capital in nature even if it is not an investment asset under section 1221 in certain special circumstances. These circumstances are identified in section 631.

Under section 631(a), a taxpayer who cuts his own timber and either sells it later or uses it in his regular trade or business can obtain capital gains treatment, provided he makes the election offered in section 631(a) to treat the cutting as a taxable event. Most taxpayers who use section 631(a) eventually sell their timber as processed wood products. The proceeds from these sales are ordinary income. If a capital gain is taken at the time of cutting under section 631(a), however, the fair market value of the timber at that time is subtracted from the amount of ordinary income earned for reporting purposes.

Under section 631(b), a taxpayer who sells standing timber in his regular trade or business can obtain capital gains treatment, provided he retains an economic interest in the timber during the executory period of the contract of sale.

The effect of meeting the requirements of section 631(a) or 631(b) is that the taxpayer's timber will be treated as a capital asset under section 1231.

The principal requirements of sections 1221 and 631 are summarized in the chart at the bottom of page 5.

What is a capital asset?

If timber is held as a capital asset, proceeds from its sale can always be treated as capital gains under section 1221. Basically, timber will be considered to have been held as a capital asset if its sale is not in the course of the seller's regular trade or business. This, of course, will always be a question of fact turning on the particular circumstances of each taxpayer's peculiar situation. However, the IRS and the federal courts frequently, take into account the following factors:

(1) the frequency and regularity of timber sales by the taxpayer;[4]

(2) the extent of the taxpayer's personal

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involvement in the sale process;[5]

(3) the size of the transaction; and

(4) the relative portion of the taxpayer's income from timber sales.

The taxpayer who is making frequent periodic timber sales generating a significant portion of his annual income year after year would probably be in the trade or business of selling timber. Accordingly, his timber sales would fail to meet the requirements of section 1221.

On the other hand, the taxpayer who is making infrequent, irregular, and small sales of timber through hired agents would probably not be in the trade or business of selling timber. Accordingly, his timber sales would meet the requirements of section 1221.

If the timber is not a capital asset, how can the taxpayer qualify for capital gains treatment under section 631(a)?

The taxpayer who has cut his own timber for use or subsequent sale in his trade or business can qualify for capital gains treatment under section 631(a) by meeting three qualifications.

First, the taxpayer must satisfy the holding period requirement. Generally, he must have owned the timber for more than one year as of the date of cutting. There is, however, one exception to this general rule. If the taxpayer acquired the timber between June 22, 1984 and January 1, 1988, the required holding period is only six months.[6] The holding period begins on the date of acquisition and ends on the date of cutting. Logs are deemed to be "cut" on the day they are "scaled" or measured to determine their quantity in board feet.[7] In some instances, logs are "scaled" many months after they are actually felled.

Second, the taxpayer must have cut the timber for sale or use in his regular trade or business.

Third, the taxpayer must indicate his intention to have section 631(a) apply by providing certain information requested by the IRS on his tax return. By doing so, the taxpayer "elects" to treat the cutting of timber for his own use as a hypothetical sale and taxable event.

How is a capital gain measured under section 631(a)?

The information the taxpayer must provide to make the election under section 631(a) is the computation of the timber's fair market value.

Normally, a capital gain equals the difference between the sale price of the capital asset and the asset's adjusted basis.[8] This computation cannot be made under section 631(a), however, because there is no actual sale of the timber. If the taxpayer converts the timber into wood products for subsequent sales, he will then have ordinary income. Section 631(a) allows him to report a capital gain at the time of cutting and thereby reduce the ordinary income he will have to report at a later date.

Essentially, section 631(a) allows a taxpayer who cuts timber for his own use to qualify hypothetical proceeds as a capital gain. Section 631(a) treats the taxpayer's use of the timber as a sale to himself. The capital gain is equal to the difference between the timber's fair market value and its adjusted basis. This is the selling price a buyer and seller would agree upon if there were an actual sale.

First, the taxpayer must evaluate the quantity, quality and condition of the timber. This includes the tree species and their age, size and other pertinent characteristics. The taxpayer should also consider the timber's accessibility to buyers and local transportation costs.[9]

Second, the taxpayer should obtain evidence of comparable sales in the vicinity. The fair market value of the taxpayer's timber would be shown by the average price of similar timber in these actual sales. Alternatively, the taxpayer should determine the likely final selling price of the wood products that could be produced from his timber. This is the "net-back-to-stumpage" method of valuation. The timber's fair market value would be shown by subtracting the cost of converting the timber into wood products from the final selling prices of these products.

If the timber is not a capital asset, how can the taxpayer qualify for capital gains treatment under section 631(b)?

Instead of cutting it themselves, many timber owners sell standing timber under contract. The timber owner conveys a right to cut the timber to some other person. Even if the timber is not a capital asset, the timber owner can qualify for capital gains treatment under section 631(b). This section of the tax code allows a taxpayer who sells timber in his regular trade or business to treat the transaction as a capital gain. To take advantage of section 631(b), the taxpayer must meet three requirements.

First the taxpayer must satisfy a holding period requirement which is identical to the one discussed above with reference to section 631(a).

Second, the taxpayer must "dispose" of the timber under a "contract." Disposal occurs when the taxpayer transfers actual ownership of the timber to someone else. In addition, the purchaser must obtain the right and obligation to cut the timber. If the taxpayer cuts it himself, there is no disposal.

The contract of sale does not have to be a formal written instrument. An informal oral agreement, provided it is legally binding, is sufficient. But the contract must create a duty on the part of the purchaser to cut the timber. A contract that gives the purchaser a discretionary right to cut the timber, rather than a duty, does not satisfy section 631(b).

The third requirement of section 631(b) is that the seller retain an economic interest in the timber. Proceeds from the sale must "be contingent upon the severance of the timber, and be payable to the owner solely out of the proceeds of the natural resource."[10] The taxpayer can satisfy this

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	§ 1221	§ 631(a)	§ 631(b)
Capital Asset	Required	Not Required	Not Required
Self-Cut	Not Required	Required	Not Required
Retained Interest	Not Required	Not Required	Required

requirement by selling timber under a pay-as-cut contract. A pay-as-cut contract is an agreement under which the seller is paid for the timber as it is severed in a specified amount for each thousand board feet (or other unit) of timber actually cut.

Under a pay-as-cut contract, timber is sold on the stump, cut by the purchaser, and then scaled. After scaling, the seller is paid in accordance with the amount of timber severed. In short, the seller is paid on a per unit cut basis. This should be contrasted with a contract that obligates the purchaser to pay the seller a fixed amount regardless of the amount of timber severed. Under a fixed payment contract, the seller does not retain an economic interest. Fixed payments unrelated to severance are land rents, which are treated as ordinary income.

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[1] *See* 1991 Schedule SE. For income above this amount the tax rate drops to 2.9% until net income exceeds $125,000, when it drops off altogether.
[2] I.R.C. § 1402 (1988).
[3] I.R.C. § 1(h)(1988).
[4] *See, e.g., Scott v. United States*, 305 F.2d 460 (Ct. Cl. 1962).
[5] *See, e.g., Kirby Lumber Corp. v. Scofield*, 89 F. Supp. 102 (W.D. Tex. 1950).
[6] Tax Reform Act of 1984, Pub. L. No. 98-369, 98 Stat. 494, 1001 (1984).
[7] Treas. Reg. § 1.631-2(b)(2)(1991).
[8] The concept of adjusted basis is discussed in Producer Bulletin Number 8.
[9] Treas. Reg. § 1.631-3(f)(1)(1991).
[10] *Dyal v. United States*, 342 F.2d 248 (5th Cir. 1965).

Ninth Circuit finds no FTCA action for breach of covenant of good faith under Montana law

The Ninth Circuit has affirmed the dismissal of a Montana farmer's Federal Tort Claims Act (FTCA) action alleging breach of the covenant of good faith against the Farmers Home Administration (FmHA), the Soil Conservation Service (SCS), and the Agricultural Stabilization and Conservation Service (ASCS). *Winchell v. United States Dep't of Agric.*, 961 F.2d 1442 (9th Cir. 1992). The Ninth Circuit upheld the district court's dismissal of the action for lack of subject matter jurisdiction after concluding that the plaintiff failed to satisfy the Montana Supreme Court's recently narrowed requirements for tortious breach of the covenant of good faith.

Tom Winchell, a Montana farmer, had entered into contracts with the FmHA, the SCS, and the ASCS in the early 1980s. Allegedly as a result of the FmHA's withdrawal of credit, the SCS's delay in making payments under the Great Plains Conservation Program, and the ASCS's termination of his diversion program contract, Mr. Winchell was forced into bankruptcy where he ultimately lost his property.

Mr. Winchell sued each agency under the FTCA alleging tortious breach of the implied covenant of good faith. Under the FTCA, he was required to show that the government's conduct would be actionable under state law. *Id.* at 1443 (citing *Love v. United States*, 915 F.2d 1242, 1245 (9th Cir. 1990).

In concluding that Mr. Winchell's claims would not be actionable under Montana law, the Ninth Circuit traced the development of the tort of breach of the covenant of good faith and fair dealing in Montana, noting that "[t]he course of Montana's romance with the covenant of good faith tort has not been smooth." *Id.* at 1443-44 (citing *Story v. City of Bozeman*, 791 P.2d 767 (Mont. 1990); *First Security Bank & Trust v. VZ Ranch*, 807 P.2d 1341 (Mont. 1991)).

The Ninth Circuit concluded that under current Montana law the tort "might be available `in contracts involving special relationships'" where the following elements were satisfied:

(1) The contract must be such that the parties are in inherently unequal bargaining positions; [and] (2) the motivation for entering the contract must be a non-profit motivation, i.e., to secure peace of mind, security, future protection; [and] (3) ordinary contract damages are not adequate because (a) they do not require the party in the superior position to account for its actions, and (b) they do not make the inferior party 'whole;' [and] (4) one party is especially vulnerable because of the type of harm it may suffer and of necessity places trust in the other party to perform; and (5) the other party is aware of this vulnerability.

Id. at 1443-44 (citing *Story v. City of Bozeman*, 791 P.2d at 776). In concluding that Mr. Winchell's claims did not satisfy each of those elements, the Ninth Circuit found that Mr. Winchell had entered into his contracts with the USDA agencies in order to profit, and his ability to meet the other requirements was "highly problematic." *Id.* at 1444.

Noting that its decision rejecting Mr. Winchell's claims was inconsistent with its earlier decision in *Love v. United States*, 871 F.2d 1488 (9th Cir. 1989), *amended*, 915 F.2d 1242 (9th Cir. 1991), the Ninth Circuit reconciled the two decisions by explaining that Montana law had changed in the interim. In the court's words, "[t]he law is sometimes afflicted with caducity. This is one of those times. What may once have been a viable claim of tort liability vanished when the Montana Supreme Court deracinated the landscape of the covenant of good faith tort." *Id.* at 1445.

—Christopher R. Kelley, Of Counsel, Arent, Fox, Kintner, Plotkin & Kahn

AG LAW CONFERENCE CALENDAR

Eighth Annual Farm, Ranch and Agri-Business Bankruptcy Institute
October 8-10, 1992, Lubbock Plaza Hotel, Lubbock, TX.
Topics include: disposable income; perfecting and protecting security interests in ag collateral; mediation role and practice.
Sponsored by West Texas Bankruptcy Bar Association, Texas Tech U. School of Law, Association of Chapter 12 Trustees.
For more information, call (806) 765-8851.

Wetlands Regulation conference
September 9-10, 1992, Hyatt Regency, Atlanta, GA; November 12-13, 1992, Sheraton Carlton Hotel, Washington, DC.
Sponsored by: Executive Enterprises, Inc.
For more information, call (800) 831-8333.

Hazardous Wastes, Superfund, and Toxic Substances
October 29-31, 1992, Washington, DC.
Topics include: forcing EPA to look for other responsible parties; insurance; obtaining early settlements.
Sponsored by: ALI-ABA.
For more information, call (800) CLE-NEWS.

Nonpoint Source Water Pollution: Causes, Consequences, and Cures
October 30-31, 1992, Center for Continuing Education, Fayetteville, AR.
Topics include: Nature and consequences of nonpoint source runoff from agricultural operations, forestry activity, and urban areas; current federal and state regulation of NPS; potential methods for controlling NPS including best management practices; watershed management; and voluntary v. mandatory controls.
Sponsored by: NCALRI, Arkansas Water Resources Research Center.
For more information, call (501) 575-7646.

Virginia proposes unique solution to environmental liability

The Commonwealth of Virginia has proposed a unique solution to the environmental liability of a Virginia farmer, whom we will call Frank Farmer. The proposal centers on a manure spill which flowed into a river, killing over 180,000 fish.

Frank Farmer is a dairy farmer in Farm Town, Virginia. He owns a fifty-eight acre farm where he keeps approximately 125 cattle and milking equipment. He owns another 100 acres nearby that he uses for fodder and twenty acres in the county that has development potential. Frank also rents 225 acres. Since all of the land has been purchased within the last ten years, the farm operation carries a heavy debt load. Interest alone costs Mr. Farmer about $30,000 per year.

In 1980, Frank purchased a manure tank from Virginia Harvest Store (VHS), "the Cadillac of all tanks." About three years ago, Frank felt that the tank, installed by VHS, would agitate the manure more effectively if a side pump were installed. VHS installed the side pump.

All went well until fall, 1991 when a rock became lodged in the tank mechanism, causing approximately 200,000-275,000 gallons of liquid manure to back flow to the sump, which overflowed to a dry creek bed. (Memorandum of the State Water Control Board [SWCB], dated September 19, 1991). Approximately 150,000 to 200,000 gallons of the manure made its way into an unnamed tributary of a Virginia River, then to the river itself.

Frank thought that the manure would become diluted and cause no harm, so he failed to report the incident. Instead, more than 180,000 fish, including a number of endangered species and threatened species, were killed along a fifteen mile stretch of the waterway. (SWCB Fact Sheet).

Virginia law requires that no one shall discharge any pollutant, including wastes of any kind, into, or adjacent to, state waters except as authorized by permit issued by the state. Va. Regs. Reg. 680-14-01 § 1.5. Farmers with concentrated animal feed lots must have a Virginia Pollution Discharge Elimination System permit. Frank held a "no discharge" certificate, allowing him to store the liquid manure, but not to discharge it into state waters. [SWCB memorandum dated September 19, 1991.]

The SWCB holds the authority and duty to investigate any large-scale killing of fish. Va. Code Ann. § 62.1-44.15(11). The Board is further empowered and directed to reach a settlement or institute a civil action to recover the costs incurred by the Board and the Department of Game and Inland Fisheries in investigating such killing of fish plus the replacement value of the fish destroyed. In Frank's case, the cost of investigation is approximately $6,000.00, and the value of the fish destroyed, including about 330 endangered Roanoke log perch, is around $39,000.00.

In addition, state law provides for a civil penalty, determined by a judge, not to exceed $25,000 for each violation. (Each day that a violation continues is a separate violation.) Va. Code Ann. § 62.1-44.32(a). Civil fines are paid to the Virginia Environmental Emergency Response fund or, if the court orders, to the city, town, or county where the violation occurred to abate pollution within that locality, as directed by the judge.

Willful or negligent violations constitute a misdemeanor punishable by a fine of not less than $2,500 and not exceeding $25,000, jail sentence of not more than twelve months, either or both. Va. Code Ann. § 62.1-44.32(b).

Penalties are cumulative to any fines imposed. Therefore, Frank faces costs and damages of up to a maximum of $45,000 plus up to $50,000 *per day* in criminal fines and civil penalties for each *day* he was not in compliance, plus possible jail time. No criminal prosecution has been mentioned in Frank's case. Criminal prosecution is available and stiff penalties are more likely if the degradation of the waters was from willful or wanton negligence. Frank did not exhibit this type of behavior. Penalties are cumulative to any civil penalties imposed. Frank therefore could have been facing from $45,000 to $90,000 to $45,000 plus $25,000 or $50,000 per day for each *day* he was not in compliance with the laws.

Frank, like many farmers, can not readily afford a payment of $45,000 or more. In addition to current debt load, weak farm prices and a need for income to live on, the $45,000 was not a feasible payment out of "cash" or additional debt and the resulting debt service.

The SWCB has proposed that the matter be settled by a gift by Frank to the Outdoors Foundation of a scenic easement on the fifty-eight acre parcel and a two thousand payment by Frank to fund a study on the Roanoke log perch. The conveyance, if it occurs, essentially mandates, in perpetuity, that the farm remains either in farming or in open space. The transfer would prohibit any future development or non-agricultural use of the property.

In exchange, Frank would share the opportunity to continue his farm operation, whereas imposition of costs and civil penalties would undoubtedly force Frank into bankruptcy.

As legal title holder under one or more deeds of trust, the lender in Frank's case must sign any documents conveying a scenic easement. However, the easement reduces the value of Frank's farm (since it cannot be subdivided and developed.) Therefore, the easement impairs the bank's collateral. In most cases, then, no reason exists for a bank to sign the document. In fact, the signing of the easement might reduce the value of the farm to less than the debt on the farm.

The bank has priority over the penalties and costs imposed by the SWCB. If the farm must be sold to pay debts, the bank will be paid *in full* prior to any payment to the SWCB. Since Frank's debt to the bank is thought to approach, or exceed, the value of the farm, the bank is faced with a difficult choice.

Frank's case is important because it may begin a trend of similar proposals across the country. Reactions vary to the proposal, ranging from joy to horror. At this point in time, it is unclear whether the proposal will be implemented. If implemented, it is similarly unclear as to what the long range effects would be.

—Jesse J. Richardson, J.D., Research Assistant, Virginia Tech;
L. Leon Geyer, J.D., Ph.D., Associate Professor, Virginia Tech

Federal Register *in brief*

The following is a selection of items published in the *Federal Register* in the month of July, 1992. Please be aware that the following dates were missing when this research was done: July 7, July 9, and July 13.

1. USDA; Highly erodible land and wetland conservation; proposed rule. 57 Fed. Reg. 29658.
2. Farm Credit Administration; Application for award of fees and other expenses under the Equal Access to Justice Act; proposed rule. 57 Fed. Reg. 31463.
3. FmHA; Establishment of wetland conservation easements on FmHA inventory property; final rule; effective date 7/17/92. 57 Fed. Reg. 31636.
4. CFTC; Exemption from speculative position limits for positions which have a common owner, but which are independently controlled; proposed rule. 57 Fed. Reg. 31674.
5. EPA; Incentives for development and registration of reduced risk pesticides; request for comments due 9/18/92. 57 Fed. Reg. 32140.
6. APHIS; Scrapie indemnification; proposed rule; comments due 9/14/92. 57 Fed. Reg. 33656.

—Linda Grim McCormick, Toney, AL

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ADDRESS
CORRECTION REQUESTED

AMERICAN AGRICULTURAL LAW ASSOCIATION NEWS

AALA Job Fair

The Association's Eighth Annual Job Fair will be held in conjunction with the September Educational Meeting in Chicago. The Association initiated this Job Fair as a service to its members. It offers an efficient, virtually cost free interviewing program for both our student and professional members. Potential employers are encouraged to contact the coordinator for additional information. Law students and attorneys interest in interviewing should send their resumes to the Job Fair Coordinator. Resumes will be forwarded to interested firms and organizations. Interviews may be scheduled during the conference.

To obtain further information or to arrange an interview contact: Mr. J.D. Walt, AALA Job Fair Coordinator— University of Arkansas Law School— Fyaetteville, AR 72701. Mr. Walt can also be reached at (501) 575-3706.

Rhodes Travel

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