Agricultural Law Update

VOLUME 24, NUMBER 9, WHOLE NUMBER 286 SEPTEMBER 2007

AALA
AMERICAN AGRICULTURAL LAW ASSOCIATION

INSIDE

Solicitation of articles: All AALA members are invited to submit articles to the Update. Please include copies of decisions and legislation with the article. To avoid duplication of effort, please notify the Editor of your proposed article.

Court says IRS position "subverts common sense," but it's their position and they're sticking to it

The Tax Reform Act of 1986[1] created the passive loss rules.[2] The rules were enacted to prevent individuals from using tax shelters to reduce tax liability on their tax return by offsetting losses from passive activities (mere investment activities) against other taxable income. Passive losses are subject to stringent rules regarding deductibility – losses from passive activities can only be deducted against income from passive activities.[3] In turn, for taxpayers involved in passive activities, IRS has the power to recharacterize passive activities as non-passive.[4]

An activity is considered a passive activity, and the passive loss rules are invoked, if the activity involves a trade or business and the taxpayer does not materially participate in the activity "on a basis which is regular, continuous and substantial."[5] As mentioned above, the passive loss rules prevent deductions (losses) from passive trade or business activities, to the extent they exceed income from all passive activities, from being deducted against other income (non-passive activity gains).[6] So, in order to deduct losses from trade or business activities, a "taxpayer" must materially participate in the activity. In other words, the taxpayer must be involved in the business activity on a regular, continuous, and substantial basis. That is a tough test for many individual taxpayers to meet.

While IRS regulations set forth several material participation tests for individual taxpayers,[7] IRS has never issued regulations addressing the material participation requirement for non-grantor trusts (as well as estates).[8] For pass-through entities, material participation is determined with respect to each member of the entity, with reference to the tax year of the entity.[9] For closely held C corporations (and personal service corporations), material participation is generally required by shareholders with aggregate ownership of more than 50 percent in value of the corporation's outstanding stock.[10] Also, C corporations (but not personal service corporations) meet the test if the corporation's business activities are exempt from the at-risk rules under I.R.C. §465(c)(7) – which attribute the activities of employees to the corporation.[11]

So, for a non-grantor trust, who is the "taxpayer"? For purposes of the passive loss rules, the statute defines a "taxpayer" as "any individual, estate, or trust,"[12] or any closely held C corporation[13] as well as any personal service corporation.[14] Thus, while the statute is clear that a trust (rather than a trustee) is the taxpayer whose material participation is decisive, the statute is silent on how to determine if the test has been satisfied. In other words, since the trust can only act through other people to satisfy the material participation test, who are the key other people whose activity counts?

The *Mattie K. Carter Trust* case

Mattie K. Carter Trust v. United States,[15] involved a testamentary trust established in 1956. A trustee, who had been in place since 1984, managed the trust assets, including, initially, a one-half interest in a ranch that the trust had operated since 1956. The trust acquired the balance of the ranch in 1992 upon the death of Mattie's husband. The ranch covered 15,000 acres and included cattle ranching operations in addition to oil and gas interests. The trust employed a full-time ranch manager and other employees who performed essentially all of the ranch's activities. The trustee also devoted a great deal of time and attention to ranch activities. The trust claimed deductions for losses it incurred in connection with the ranch operations for 1994 and 1995 of $856,518 and $796,687 respectively. In 1999, IRS issued a deficiency notice disallowing the deductions because of the passive loss rules. The trust paid the disputed tax in full (plus interest) and filed for a refund, which IRS denied. The trust then sued for a refund in federal district court.

The issue before the court was whether the trust materially participated in the ranching operations or was otherwise "passively" involved. IRS conceded during trial that its existing regulations (Treas. Reg. §1-469-5T) applied only to individuals.[16] Furthermore, IRS could not cite any case law to support its position, instead relying on a "snippet" of

Cont. on page 2

legislative history that states, "an estate or trust is treated as materially participating in an activity…if an executor or fiduciary, in his capacity as such, is so participating."[17] But, that language simply restates the obvious and does not say that a fiduciary's participation is the *only* way a trust can satisfy the material participation test. The trust, on the other hand, maintained that the trust was the taxpayer, not the trustee, and that material participation should be determined by assessing the trust's activities through its fiduciaries, employees, and agents. The trust also maintained that, as a legal entity, it could participate only through the actions of those individuals.Their collective efforts on the ranching operations during 1994 and 1995, the trust argued, were regular, continuous, and substantial.

The court agreed with the trust, and noted that the IRS's argument that the trust's participation in the ranch operations should be measured by referring to the trustee's activities had no support within the plain meaning of the statute.[18] Since the statute was clear on the matter, legislative history was irrelevant (and it is not helpful to the IRS's position anyway). The court stated that the IRS view was "arbitrary, subverts common sense, and attempts to create ambiguity where there is none."[19] As such, the trust's participation in the ranch operations involved an assessment of the activities of those who labored on the ranch, or otherwise conducted ranch business on the trust's behalf. Their collective activities during the times in question were regular, continuous, and substantial enough to constitute material participation (the court also noted, based on the evidence, that the trustee would have satisfied the test personally under the facts of the case). Thus, the trust's losses were not passive losses, the IRS had improperly disallowed the ranching losses as passive activity losses, and the trust was entitled to a refund of the overpaid taxes with interest. IRS did not appeal.

2007 TAM

So, what has IRS learned from its judicial defeat on the issue. Apparently, not a great deal. They still have not issued regulations for non-grantor trusts, and in an undated Technical Advice Memorandum (TAM)[20] released on Aug. 17, 2007, have again taken the position that a trust satisfies the material participation test only if the fiduciary is involved in the operations of the trust's business activities on a regular, continuous, and substantial basis. Under the facts of the TAM, a testamentary trust acquired an interest in an LLC. The trustees provided services to the LLC encompassing a range of administrative and operational activities for the LLC's business. The will establishing the trust provided for the appointment of a special trustee for part or all of the trust property. A contract between the trust and the special trustees stated that the special trustees' involvement in the LLC's business is intended to satisfy the material participation test requirement under the passive loss rules. The special trustees reviewed operating budgets, analyzing a tax dispute, preparing and examining financial documents, and negotiating the sale of the trust's interests in the LLC to a new partner. Ultimate decision-making authority remained solely with the trustees, however. IRS restated its disagreement with the *Mattie K. Carter* decision,[21] holding firm to its position that only the trustee can satisfy the test. IRS determined that the special trustees did not have the discretionary power to act on behalf of the trust, even though they were deeply involved in the trust's business activity. As such, the trustees' involvement in the business was not regular, continuous and substantial, and the trust did not materially participate in the LLC's business.

The correct approach

The *Mattie K. Carter*[22] court essentially decided the matter correctly, but did not quite go far enough to nail down the rationale. The part of I.R.C. §469 applicable to closely held C corporations (other than personal service corporations) ties material participation for I.R.C. §469 purposes to the exemption under I.R.C. §465 of active businesses from the at-risk rules under I.R.C. §465(c)(7).[23] Those rules attribute the activity of employees to the entity.[24] Similarly, under the statute[25]a trust is an entity and, like a corporation, looks to the activities of employees and agents to conduct its business. Finally, apart from the statutory rationale, to require a fiduciary to be the sole means of satisfying the material participation test would make material participation by corporate fiduciaries (i.e., a bank trust department or a private trust company) impossible. That could not have possibly been the intent of I.R.C. §469.

Conclusion

Clearly, IRS needs to finalize a regulation concerning the application of the passive loss rules to trusts. When a government agency is told that its litigating position has "no support within the plain meaning of the statute" and "subverts common sense," the agency has a responsibility either to appeal the court's decision or develop reasonable regulations rather than continue maintaining its judicially-rejected position.

—Roger A. McEowen,Leonard Dolezal Professor in Agricultural Law, Iowa State University, Ames, Iowa; Director of the ISU Center for Agricultural Law and Taxation

[1] Pub. L. No. 99-514, §501(a), 100 Stat. 2233 (1986), *adding* I.R.C. §469.

[2] I.R.C. §469.

[3] *Id*.

[4] Treas. Reg. §1.469-2T(f).

[5] I.R.C. §§469(c)(1); 469(h)(1).

[6] *See* note 3, *infra*.

[7] Temp. Treas. Reg. §§1.469-5T(a)(1)-(7).

[8] Temp. Treas. Reg. §§ 1.469-5T(g); 1.469-8. Grantor trusts are not subject to the passive activity loss rules. Temp. Treas. Reg. §1.469-1T(b)(2). Instead, the grantor, personally, is subject to the rules, and it is the grantor's material participation that is the key. *See* Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1986, at 242, n. 33, 100th Cong., 1st Sess. (1987).

[9] Temp. Treas. Reg. §1.469-2T(e)(1).

[10] I.R.C. §469(h)(4)(A); Temp. Treas. Reg. §1.469-1T(g)(3)(i).

[11] I.R.C. §469(h)(4)(B). Under I.R.C. §465(c)(7)(C), the at-risk rules do not apply if, (i) during the entire 12-month period ending on the last day of the taxable year, the corporation had at least 1 full-time employee substantially all the services of whom were in the active management of such business; (2) the corporation had at least 3 full-time, non-owner employees substantially all of the services of whom were services directly related to such business; and

Cont. on page 3

Agricultural Law Update

VOL. 24, NO. 9 WHOLE NO. 286 SEPTEMBER 2007
AALA Editor.....Linda Grim McCormick

2816 C.R. 163, Alvin, TX 77511
Phone: (281) 388-0155
E-mail: lindamccormick@aglaw-assn.org

Contributing Editors: Roger McEowen, Iowa State University; Erin C. Herbold, Iowa State University; Beth A. Baumstark, Bismarck,ND; John Becker, Penn State University; Robert P. Achenbach, Eugene, OR.

For AALA membership information, contact Robert Achenbach, Executive Director, AALA, P.O. Box 2025, Eugene, OR 97405. Phone 541-485-1090. E-mail RobertA@aglaw-assn.org.

Agricultural Law Update is published by the American Agricultural Law Association, Publication office: County Line Printing Inc.,6292 NE 14th Street, Des Moines, IA 50313. All rights reserved. First class postage paid at Des Moines, IA 50313.

Cont. on page 1

Federal Register summary from August 11 to September 21, 2007

CROP INSURANCE. The FCIC has adopted as final regulations amending the Common Crop Insurance Regulations, Millet Crop Insurance Provisions to remove the reduction in indemnity for any unharvested millet acreage to better meet the needs of insured producers. The changes will apply for the 2008 and succeeding crop years. 72 Fed. Reg. 48227 (Aug. 23, 2007).

EMERGENCY CONSERVATION PROGRAM. The FSA has adopted as final regulations applying the adjusted gross income (AGI) limitation to $16 million appropriated to the emergency conservation program (ECP). The AGI limitation is provided in 7 C.F.R. §§ 1400.600 to 1400.603. In general, under Section 1400.600, an individual or entity is not eligible for certain program benefits during a crop, program, or fiscal year, if (1) the preceding three-year average of the AGI for the individual or entity exceeds $2.5 million and (2) less than 75 percent of the average AGI is derived from farming, ranching, or forestry operations. Section 1400.601 specifies the determination of average adjusted gross income. Section 1400.602 specifies the information applicants must provide to comply with the regulations. Section 1400.603 specifies the amount payment will be reduced commensurate with the AGI limitation. 72 Fed. Reg. 45879 (Aug. 16, 2007).

FOOD SAFETY. The FSIS has announced the publication of its report entitled, "Review of the Pathogen Reduction; Hazard Analysis and Critical Control Point Systems Final Rule Pursuant to Section 610 of the Regulatory Flexibility Act, As Amended." The report is available in Room 102, Cotton Annex, 300 12th Street, SW., Washington, D.C. 20250-3700, between 8:30 a.m. and 4:30 p.m., Monday through Friday, except federal holidays. It is also available on the Internet at http://www.fsis.usda.gov/regulations—&—policies/2007—Proposed—Rules—Index/index.asp. 72 Fed. Reg. 50260 (Aug. 31, 2007).

IMPORTS. The APHIS has adopted as final amendments to the regulations regarding the importation of animals and animal products to establish conditions for the importation of the following commodities from regions that present a minimal risk of introducing bovine spongiform encephalopathy into the United States: (1) live bovines for any use born on or after a date determined by the Animal and Plant Health Inspection Service to be the date of effective enforcement of a ruminant-to-ruminant feed ban in the region of export; (2) blood and blood products derived from bovines; and (3) casings and part of the small intestine derived from bovines. The APHIS conducted a risk assessment and comprehensive evaluation of the issues and concluded that such bovines and bovine products can be safely imported under the conditions described in this rule. 72 Fed. Reg. 53313 (Sept. 18, 2007).

—Robert P. Achenbach, AALA Executive Director

FEDERAL ROUNDUP

PERFECTION. The debtor had granted to a bank a blanket security interest in the debtor's personal property. The debtor also purchased two pieces of farm equipment from a dealer and granted the dealer a security interest in the equipment. The dealer filed financing statements but listed the name of the debtor as "Mike Borden" instead of the debtor's full name of "Michael Borden." The bank argued that the dealer's security interest was unperfected because the financing statement included a misleading name in using Mike instead of Michael. The evidence showed that the debtor often signed legal documents with the name Mike. The court noted that the state's web-based U.C.C. search system did not allow for generic character searches to account for all variations of a debtor's name. The court held that the full legal name of a debtor was required for perfection of a financing statement, placing the burden on a filing creditor to determine the debtor's legal name and not on a searching creditor who would have to guess at the possible legal name. The appellate court affirmed, noting that standard search of UCC filings did not account for the use of nicknames in filing statements. *In re Borden*, 2007 U.S. Dist. LEXIS 61883 (D. Neb. 2007), *aff'g*, 353 B.R. 886 (Bankr. D. Neb. 2006).

COTTON. The plaintiffs purchased cotton from the defendant which had been delivered to the defendant for ginning and storing. The plaintiffs alleged that the defendant stored the cotton with excess moisture and failed to identify any defects in the cotton on the warehouse receipts. The plaintiffs argued that the failure violated Mo. Rev. Stat. § 400.7-203. The defendants operated federal licensed warehouses and argued that the federal regulation of warehouses pre-empted any state action concerning the storing of cotton. The court held that the plaintiffs' claims based on false warehouse receipts were pre-empted by the federal regulation of the warehouses. The plaintiffs also claimed that the cotton was improperly stored. The court also held these claims were pre-empted by the federal warehouse statutes and regulations. *Staple Cotton Coop. Ass'n v. D.G. & G., Inc.*, 2007 U.S. Dist. LEXIS 61284 (E.D. Mo. 2007).

COMBINE. The plaintiff purchased a used corn harvesting combine manufactured by the defendant. The plaintiff and prior owner testified as to their maintenance of the combine, especially as to the changing of the oil and inspections for oil leaks. The combine was damaged by an engine fire which occurred while the plaintiff was harvesting corn. The plaintiff sued for damages under theories of breach of warranty and strict liability. Both sides provided expert testimony but the trial jury awarded damages to the plaintiff under both theories. The defendant argued on appeal that the plaintiff's expert testimony should have been excluded because the testimony exceeded the scope of the expert's written report and the expert failed to test any of the engine components. The court noted that the defendant's own expert also failed to make any tests on the engine parts to support that expert's testimony. The court held that the plaintiff's expert's testimony was within the general scope of the report and had sufficient basis for admission at the trial. *Shuck v. CNH America, LLC*, 2007 U.S.

Cont. on page 7

IRS position/Cont. from page 2

(3) the amount of the deductions attributable to the corporation which are allowed to the business under I.R.C. §§ 162 and 404 for the tax year exceed 15 percent of the corporation's gross income.

[12] I.R.C. §469(a)(2)(A).

[13] I.R.C. §469(a)(2)(B).

[14] I.R.C. §469(a)(2)(C).

[15] 256 F. Supp. 2d 536 (N.D. Tex. 2003).

[16] Indeed, a subsection in the Temporary Regulation has been reserved for material participation by trusts and estates, but has never been promulgated. *See* Temp. Treas. Reg. §1.469-5T(g).

[17] S. Rep. No. 99-313, 99th Cong., 2d Sess. 735 (1986).

[18] I.R.C. §469(a)(2)(A).

[19] *See, e.g., Mattie K. Carter Trust v. United States*, 256 F. Supp. 2d (N.D. Tex. 2003). IRS did not appeal the court's decision (probably because the court also stated that the trustee, in any event, satisfied the material participation test).

[20] 200733023 (undated).

[21] 256 F. Supp. 2d 536 (N.D. Tex. 2003).

[22] *Id*.

[23] *See* note 11 *infra*., and accompanying text.

[24] *Id*. Treas. Reg. §1.469-1T(g) adopts the I.R.C. §465(c)(7)(C) route for corporate material participation.

[25] I.R.C. §469(a)(2)(A).

Claiming compensation for costs and fees incurred in successful USDA appeals

By Roger A. McEowen, Erin C. Herbold, and Beth A. Baumstark

The Equal Access to Justice Act[1] (EAJA) provides that a party who prevails administratively against government action can recover fees and expenses if the administrative officer determines that the government's position was not substantially justified.[2] However, the USDA's long-held position is that the EAJA does not apply to administrative hearings before the National Appeals Division (NAD) because NAD proceedings are not adversarial adjudications that are held "under" the Administrative Procedure Act[3] (APA). The Eighth Circuit Court of Appeals rejected the USDA's position in 1997,[4] and now the Ninth Circuit has agreed.[5]

USDA administrative appeals

The USDA's NAD handles the administrative appeals filed by private parties of some adverse agency decisions within the USDA, primarily those involving participation in, benefits under, compliance with, and payments from USDA programs.[6] The NAD is an independent organization within the USDA, and the NAD Director reports directly to the Secretary of Agriculture.[7] The NAD Director's duties may not be delegated to any person or office within the USDA.[8]

Before filing a NAD appeal, a program participant may seek and, in some cases may be required to seek, an informal appeal.[9] In the Farm Service Agency, this requires appealing up the chain of authority. Decisions made by local office personnel may be appealed to the county committee, with adverse county committee decisions appealable to the state committee. The NAD process begins when a program participant requests an appeal from an adverse agency decision. After the request is filed, a telephonic pre-hearing conference is held, and a hearing date is set. A NAD hearing officer typically conducts a live evidentiary hearing and makes a determination. The hearing officer's decision is final unless a party requests review by the NAD Director. If Director review is requested, the Director makes an on-the-record review of the hearing officer's decision to ensure that it is supported by substantial evidence.[10]

After a final determination in the NAD process, the program participant may seek judicial review in federal district court.[11] The judicial review follows the guidelines described in the APA, including the exhaustion of administrative remedies. A final NAD determination either from a hearing officer or the NAD Director will usually suffice as an exhaustion of remedies.

The EAJA, APA, and the USDA's position on fees and costs

The EAJA[12] was enacted in 1980 with the intent of providing small businesses and individuals an avenue for recovering attorneys' fees and costs upon successful challenge of a federal agency action or defense of a complaint, and to level the playing field between federal agencies and small businesses or individuals.[13] The EAJA is made applicable to federal government administrative adjudications through Section 504 of the APA. That section specifies that a prevailing party in an "adversary adjudication" is entitled to an award of fees and costs unless the adjudicative officer finds that the position of the agency was substantially justified or that special circumstances would make such an award unjust.[14] The agency has the burden of proving that its action was substantially justified. The statute defines "adversary adjudication" as "an adjudication under section 554 of this title in which the position of the United States is represented by counsel or otherwise."[15] A federal government agency proceeding is "under" section 554, if (1) it is an adjudication; (2) there is an opportunity for a hearing; and (3) the hearing is on the record.[16]

The USDA's position has been that successful appeals from adverse agency decisions are not subject to EAJA, because NAD appeals do not fall under the realm of the APA.[17] According to the USDA, NAD administrative appeals involve an exclusive administrative appeal process that is not subject to the APA.[18] But, that position was rejected by the U.S. Court of Appeals for the Eighth Circuit in *Lane v. United States Department of Agriculture*,[19] where the court determined that nothing in the NAD authorizing statutes stated that the NAD was to be the exclusive means of adjudicating issues with the USDA.[20] The court further held that NAD proceedings involved an adversarial administrative adjudication, thereby subjecting them to the EAJA by virtue of the APA.[21]

The *Aageson*[22] case

Following the Eight Circuit's decision in *Lane*,[23] the USDA has abided by the court's decision in the Eighth Circuit, but has continued to maintain its position that *Lane*[24] was wrongly decided and that the EAJA does not apply to NAD administrative appeals outside the Eighth Circuit.

In *Aaegson Grain & Cattle, et al. v. United States Department of Agriculture*,[25] several Montana farmers filed claims with the USDA's Farm Service Agency (FSA) under the Noninsured Crop Disaster Assistance Program (NAP) for losses to perennial grasses. FSA denied the claim on the basis that it was the state FSA's policy that all perennial grasses were not covered during their first year. The farmers appealed to the NAD, and the NAD held a hearing that resulted in the NAD hearing officer reversing the FSA's decision on the basis that it was "over-restrictive and avoided the requirement for NAP coverage. The FSA did not request NAD Director review, which had the effect of making the hearing officer's decision final. The farmers applied for an award of attorneys' fees and expenses under the EAJA in the amount of $17,943.84, and the NAD refused to consider the application based on the USDA's longstanding position that the EAJA did not apply to NAD proceedings outside the Eighth Circuit. The farmers filed a petition for judicial review, and the Montana district court ruled in the farmers' favor,[26] determining that *Lane*[27] was correctly decided and directly applicable to the case. The court remanded the case to the NAD, but the USDA appealed.

On appeal, the USDA continued to maintain that *Lane*[28] was incorrectly decided because NAD administrative proceedings are, in the USDA's view, the sole and exclusive procedure for determining eligibility for farm program benefits and, as such, are not subject to the EAJA. The court rejected the USDA's argument, agreeing with the *Lane*[29] court that the statutory language governing NAD proceedings did not create an exclusive means of adjudicating issues with the USDA. Thus, the pertinent question became whether NAD proceedings were subject to the EAJA by virtue of the APA. On that issue, the court noted that the USDA's position at the NAD hearing was represented by two program specialists. Thus, USDA had taken a position which had the effect of making the proceeding adversarial – a threshold requirement for potential EAJA application.[30] Second, on the question of whether NAD proceedings are "under" Section 554 of the APA, the court noted that the governing statute re-

Roger A. McEowen is Leonard Dolezal Professor in Agricultural Law, Iowa State University, Ames, IA and Director, Iowa State University Center for Agricultural Law and Taxation; Erin C. Herbold is a staff attorney at the Iowa State University Center for Agricultural Law and Taxation; Beth A. Baumstark is attorney for Aageson Grain and Cattle and a member of Sarah Vogel Law Firm, P.C., Bismarck, N.D.

quired a NAD adjudication[31] that was on the record[32] and also required an opportunity for a hearing.[33] As such, the court reasoned that NAD proceedings occur "under" Section 554 of the APA and are subject to the EAJA. In addition, the court noted that the statute governing NAD proceedings provide for judicial review pursuant to the provisions of the APA.[34]

The court affirmed the trial court and remanded the case to the NAD for consideration of the farmers' request for fees and costs. The court also held that the district court correctly found that the USDA's position was not substantially justified.[35]

Conclusion

While the Eighth Circuit's 1997 decision in *Lane*[36] did not result in a change of USDA policy on the issue of whether the EAJA applied to NAD proceedings, the USDA's loss in *Aageson*[37] could cause them to rethink their position. Combined, the states within the Eighth and Ninth Circuits comprise a significant land mass and a great deal of agricultural activities in the United States. Due to the Ninth Circuit's opinion in *Aageson*,[38] farmers in Alaska, Arizona, California, Guam, Hawaii, Idaho, Montana, Northern Mariana Islands, Nevada, Oregon and Washington will also be able to receive fees and costs when they prevail in administrative appeals through the NAD when the USDA takes positions that are not "substantially justified."

---

[1] 5 U.S.C. §504; 28 U.S.C. §2412 (d)(2)(A). Under 28 U.S.C. §2412 (d)(2)(A), "fees and other expenses" includes the reasonable expenses of expert witnesses, the reasonable cost of any study, analysis, engineering report, test, or project which is found by the court to be necessary for the preparation of the party's case, and reasonable attorney fees compensable at a maximum hourly rate of $125 (unless the court determines that an increase in the cost of living or a special factor, such as the limited availability of qualified attorneys justifies a higher rate). The term "party" is defined as an individual whose net worth did not exceed $ 2,000,000 at the time the civil action was filed, or an owner of an unincorporated business, partnership, corporation, association, unit of local government, or organization, with a net worth of $7,000,000 or less at the time the action was filed, with 500 or fewer employees except that certain charitable organizations or cooperatives are not subject to the net worth limitation. 28 U.S.C. §2412(d)(2)(B).

[2] *See* 5 U.S.C. §504(a)(1)(eligible party may receive an award when it prevails over the government, unless the government's position was "substantially justified" or special circumstances otherwise make an award unjust).

[3] 67 Fed. Reg. 63237 (Oct. 11, 2002).

[4] *Lane v. United States Department of Agriculture,* 120 F.3d 106 (8th Cir. 1997).

[5] *Aageson Grain and Cattle, et al. v. United States Department of Agriculture*, No. 05-36172, 2007 U.S. App. LEXIS 20960 (9th Cir. Aug. 31, 2007).

[6] *See* 7 U.S.C. §§6992-7002. Conversely, the NAD does not review decisions for which alternate review proceedings exist such as those for Packers and Stockyards Act enforcement proceedings, Board of Contract appeals, and tenant grievances under the Rural Housing Service program The NAD's current form dates to the reorganization of the USDA in 1994.

[7] 7 C.F.R. §11.9.

[8] 7 U.S.C. §6992(c).

[9] 7 C.F.R. §11.5.

[10] A party may seek reconsideration of the Director's determination, primarily for the correction of errors and not for changing determinations or opinions. 7 C.F.R. §11.11. Even after Director review, a party may ask the Secretary of Agriculture to grant relief from an adverse Director decision. The Secretary of Agriculture retains discretion to grant relief from adverse agency decisions to farm program participants even after the participant loses a final appeal in the NAD process. In this situation, the Secretary's decision is discretionary and is not appealable.

[11] 7 U.S.C. §6998.

[12] 5 U.S.C. §504; 28 U.S.C. §2412, *et seq.*

[13] As originally enacted, the EAJA was scheduled to sunset on September 30, 1984. *See* Pub. L. No. 96-481, tit. II, 203, 94 Stat. 2321, 2327 (1980). Congress permanently reenacted the EAJA in 1985. *See* Act of Aug. 5, 1985, Pub. L. No. 99-80, 2(b), 99 Stat. 183, 184-85 (codified as amended at 28 U.S.C. §2414 (d)(1)(B)).

[14] 5 U.S.C. §504(a)(1).

[15] 5 U.S.C. §504(b)(1)(C).

[16] 5 U.S.C. §504(a).

[17] 67 Fed. Reg. 63237 (Oct. 11, 2002).

[18] *See Lane v. United States Department of Agriculture*, 120 F.3d 106 (8th Cir. 1997).

[19] *Id*.

[20] By contrast, the court noted that the USDA's primary argument – that the Immigration and Naturalization Act (INA) of 1952 specifically exempted immigration proceedings from application of the APA – was inapplicable because Section 242(b) of the INA specifically stated immigration proceedings were to be the sole and exclusive procedure for determining the deportability of an alien. *See Marcello v. Bonds*, 349 U.S. 302 (1955) (INA showed clear Congressional intent to exclude deportation hearings from application of the APA).

[21] *Lane v. United States Department of Agriculture,* 120 F.3d 106 (8th Cir. 1997). Importantly, the applicable regulations prohibit ex parte communications between NAD officers or employees and interested persons (7 C.F.R. §11.5), provide for the subpoenaing of evidence and witnesses (7 C.F.R. §11.8(a)(2)), and generally describe a process that is similar to a trial (7 C.F.R. §11.8(c)(5)(ii)). In addition, the regulations state that the party challenging an agency decision bears the burden of proof to establish by a preponderance of the evidence that the agency decision was erroneous (7 C.F.R. §11.8(e)). The regulations also specify that the NAD is independent from all other USDA agencies and offices at all levels (7 C.F.R. §11.2).

[22] No. 05-36172, 2007 U.S. App. LEXIS 20960 (9th Cir. Aug. 31, 2007).

[23] *Lane v. United States Department of Agriculture*, 120 F.3d 106 (8th Cir. 1997).

[24] *Id*.

[25] No. 05-36172, 2007 U.S. App. LEXIS 20960 (9th Cir. Aug. 31, 2007).

[26] *Fairchild Farms, Inc., et al. v. United States Department of Agriculture*, 406 F. Supp. 2d 1132 (D. Mont. 2005).

[27] 120 F.3d 106 (8th Cir. 1997).

[28] *Id*.

[29] *Id*.

[30] 5 U.S.C. §504(b)(1)(C). The court also noted that the legislative history of the EAJA indicated that if the governmental agency takes a position during the adjudication, the adjudication thereby becomes adversarial. H.R. Rep. No. 1434, 96th Cong., 2d Sess. 23, reprinted in 1980 U.S. Code Cong. & Admin. News 5003, 5012. *See also, Mahon v. United States Department of Agriculture*, 485 F.3d 1247 (11th Cir. 2007) (proceedings before the NAD are an adversarial adjudication as stated in §504 of the APA).

[31] 7 U.S.C. §6996(a).

[32] 7 U.S.C. §6997(c).

[33] 7 U.S.C. §6994, 6996.

[34] 7 U.S.C. §6999 specifies that once an agency determination is final, it is reviewable and enforceable by any United States district court of competent jurisdiction.

[35] *Aageson Grain and Cattle, et al. v. United States Department of Agriculture*, No. 05-36172, 2007 U.S. App. LEXIS 20960 (9th Cir. Aug. 31, 2007).

[36] 120 F.3d 106 (8th Cir. 1997).

[37] No. 05-36172, 2007 U.S. App. LEXIS 20960 (9th Cir. Aug. 31, 2007).

[38] Id.

STATE ROUNDUP

PENNSYLVANIA. *Local authority to regulate non-CAO facilities*. Can a Pennsylvania township enforce a stream buffer ordinance requiring a 35 feet vegetative buffer on a non-Concentrated Animal Operation (CAO) farm? Is a township ordinance that requires a 35 feet vegetative buffer for a non-CAO preempted by any Pennsylvania law because it imposes regulation on farm activities that otherwise would not be regulated? Is such an ordinance an "unauthorized ordinance" for ACRE purposes?

Key statutes to consider in answering the questions include Pennsylvania's Nutrient Management Act (NMA) (3 Pa. Cons. Stat. sections 501-522), which applies to concentrated animal operations, or CAO's, and imposes either a vegetated buffer setback of 35 feet or an unvegetated buffer of 100 feet from streams or bodies of water (3 Pa. Cons. Stat. section 507). Pennsylvania municipalities are preempted from adopting or enforcing local ordinances that are inconsistent with or more stringent than the NMA provisions. (3 Pa. Cons. Stat. section 519).

Pennsylvania also enacted a law to resolve disputes between townships that regulate agricultural activities and farmers who are subject to these regulations. Under this law, known as the Agriculture, Communities and Rural Environment Act, or ACRE, (3 Pa. Cons. Stat. sections 311-318) a key term is "unauthorized" ordinance. If a local ordinance is unauthorized, the local township may face action by the state Attorney General to enjoin enforcement of an unauthorized ordinance.

ACRE defines an unauthorized ordinance as:

> [a]n ordinance enacted or enforced by a local government unit which does *any* of the following:
>
> (1) *Prohibits or limits a normal agricultural operation unless the local government unit*: (i) has *expressed or implied authority under State law* to adopt the ordinance; and (ii) is *not prohibited or preempted under State law* from adopting the ordinance. (Principal examples of restrictions on local government include the Nutrient Management Act, the Protection of Agricultural Operations from Nuisance Suits law (The Right to Farm Law, 3 Pa.C.S. section 951-957), the Agricultural Security Area law (3 Pa.C.S. sections 901-915) and the Municipalities Planning Code (MPC, title 53 Pa.C.S.. section 10600 et seq.).
>
> (2) Restricts or limits the *ownership structure* of *a normal agricultural operation*. 3 Pa. C.S. 312 (emphasis added).

A third statute to consider is the zoning enabling law, 53 Pa. Cons. Stat. section 10101 et seq., known as the MPC, which has several key sections that affect local authority to limit agricultural operations. These include:

Section 10603(b): Under this section zoning ordinances are authorized to permit, prohibit, regulate, restrict, or determine a variety of land uses in the community. Zoning ordinances may not, however, regulate activities of commercial agriculture to an extent that is greater than the regulation found in the Agricultural Security Area Law, the Protection of Agricultural Operations from Nuisance Suits and Ordinances Act, and the Nutrient Management Act. In the case of the Nutrient Management Act, the limits on zoning authority apply regardless of whether any agricultural operation within the area to be affected by the ordinance is a concentrated animal operation as defined by the Act.

Section 10603(h): This section provides zoning ordinances shall encourage the continuity of development and viability of agricultural operations. Ordinances may not restrict agricultural operations or changes to or expansions of agricultural operations in areas *where agriculture has traditionally been present*, *unless* the agricultural operation will have a direct adverse effect on the public health and safety. Nothing in the amended section requires a municipality, however, to adopt a zoning ordinance that violates or exceeds the provisions of the Nutrient Management Law, The Agricultural Security Area Law, or the Protection of Agricultural Operations From Nuisance Suits and Ordinances Law.

Since the farm is not a CAO the Nutrient Management Act does not apply and a Nutrient Management Plan (NMP) is not required. But, does the township restriction violate some other limit on local government authority?

Under the last sentence of MPC section 10603(b) cited above, the NMA restrictions apply to test the township's authority even if the facility does not need a NMP because it is not a CAO. Is the language of section 10603(b) *an express or implied authorization to the local community* to exercise authority over a non-CAO to the same degree as CAO's are regulated? Can the last sentence of MPC section 10603(h) be read as an authorization to local communities to regulate agriculture, of any size or type, in ways that are consistent with other laws. Is community action taken under these rules "authorized" even if applied to an activity that otherwise escapes regulation?

None of the recent decisions that interpreted ACRE or the MPC have touched this question of local authority to regulate non-CAO facilities. That means the issue is ripe for disagreement and will ultimately be resolved in court. Other unanswered questions remain, such as, "Is the section 10603(h) prohibition on restrictions where agricultural use has historically been present an express statement that negates any section 10603(b) or 10603(h) authorization?"

To the non-CAO farmer, is giving up a 35 feet buffer a major imposition to avoid soil erosion? In today's environment where every bushel of corn is worth more than it has been for many years that may be true. Lost farm income potential is also likely to be the heart of the disagreement in terms of how these laws are interpreted.

—John C. Becker, Penn State University

MONTANA. *Supplier's lien*. The debtor obtained loans from a bank and granted security interests in all farm property, including crops growing and to be grown on the farm. The bank perfected the security interests. The defendant supplied beet seeds to the debtor that were used to raise a crop of beets. The defendant claimed a priority agricultural supplier's lien on the crop. The bank argued that the defendant's lien was not perfected because the defendant did not provide the debtor with a billing statement, as required by N.D. Cent. Code § 35-31-02, that included a notice that if the amount due to the defendant was not paid, a lien could be filed against the crop. The court found that no such billing statement was provided to the debtor; however, the court held that the supplier's lien was perfected because the defendant had substantially complied with the lien requirements since the debtor had actual knowledge that the supplier's lien could be filed if no payment was made. *Stockman Bank of Montana v. AGSCO, Inc.*, 727 N.W.2d 742 (N.D. 2007).

—Robert P. Achenbach, Jr., AALA Executive Director

MONTANA. *Ditch rights*. The plaintiff's ranch was originally part of a single family ranch that was split to provide separate ranches for three sons. When the ranch was split, each parcel received a portion of the total water rights and portion of the ditch rights such that each parcel could be flood irrigated. The defendant purchased one of the parcels with the ditches but some of the ditches did not extend beyond the defendant's parcel. The defendant filled in these ditches because they were not used to convey water for any irrigation, and the plaintiff filed suit, claiming that the plaintiff's interest in these ditches prevented the blocking of the plaintiff's ditch right. The court held that the deed conveying the original ranch to the three sons was ambiguous as to the extent of the ditch rights conveyed to each parcel as to the ditches contained on the defendant's parcel. The evidence showed that the filled-in ditches were not used for conveying water for the irrigation systems but only assisted the irrigation by increasing the moisture in the land around the other ditches which did convey the irrigation water. The court held that the deed dividing the original ranch did not convey a ditch right in these supporting ditches because these ditches did

Cont. on page 7

Federal roundup/Cont. from page 3
App. LEXIS 19820 (8th Cir. 2007), *aff'g*, 2006 U.S. Dist. LEXIS (D. Neb. 2006).

WORK. The plaintiffs were chicken processing plant workers who were required to wear protective clothing while working. The plaintiffs argued that the defendant employer violated the Fair Labor Standards Act for failing to pay the workers for the time spent putting on and taking off the protective clothing over the course of a work day. The evidence showed that the amount of time spent donning and doffing such clothing varied from six to 13 minutes a day. The trial court had given the jury instructions as to the definition of work as something which required exertion, which included consideration as to whether the clothing was cumbersome or heavy or required concentration for donning or doffing. The appellate court remanded the case, holding that the instruction was improper because the proper test for the definition of work was whether the activity was controlled or required by the employer and was pursued for the benefit of the employer. *De Asenico v. Tyson Foods, Inc.*, 2007 U.S. App. LEXIS 21289 (3d Cir. 2007), *rev'g and rem'g*, 2006 U.S. Dist. LEXIS 33411 (E.D. Penn. 2006).

HERBICIDE. The plaintiff was a cotton grower and planted cotton seed with a planter that applied herbicide directly after the seed was planted. The herbicide was manufactured by the defendant. After some heavy rains, the cotton crop showed signs of damage and most of the crop had to be destroyed and replanted with soybeans. Some acres were not destroyed, and the portion with herbicide had yields of less than half of the yields produced on acres on which no herbicide was applied. The plaintiff sued for damage to the cotton crop, alleging negligence, breach of express warranty, misrepresentation, breach of implied warranty of merchantability, breach of implied warranty of fitness for particular purpose, and strict liability. The defendant moved for summary judgment on all claims, arguing that limited warranties on the herbicide limited the recovery to the value of the herbicide and the herbicide was not shown to have been defective. The court held that summary judgment on the negligence and misrepresentation claims was not appropriate because the plaintiff demonstrated sufficient evidence that the herbicide was properly applied as directed by the defendant and that the damage was caused by the herbicide. The court granted summary judgment on the strict liability claim because the plaintiff did not provide any evidence that the herbicide was supplied in a defective condition that rendered it unreasonably dangerous. The court also granted summary judgment on the breach of warranty claims because the plaintiff failed to show that the herbicide contained any warranty language and the disclaimer language on the herbicide was effective to disclaim any warranty. *Nichols v. American Cyanamid Co.*, 2007 U.S. Dist. LEXIS 56063 (E.D. Ark. 2007).

WETLANDS. The plaintiff owned farm land through which a creek flowed, creating several oxbows, horseshoe shaped curves of land. The plaintiff had asked the local Natural Resources Conservation Service office to make a wetlands determination as to the oxbow land but called off the inspection. The local office learned that the plaintiff had started to fill the oxbow land and made an inspection of the oxbows. The local office determined that the oxbows contained wetlands because of the presence of hydric soil, hydrology of wetlands, and hydrophytic vegetation. The plaintiff ignored the warnings of the local office and completed the filling in of the oxbows. The NRSC office cited the plaintiff for filling in of wetlands in violation of the law and the plaintiff appealed the decision. At all stages of the appeal, the plaintiff argued that the NRCS failed to properly document the wetland characteristics of the oxbows as required by agency manuals and failed to demonstrate that the oxbows could not have been used for cultivation before the filling took place. The court held that the NRCS properly relied on its personnel to inspect the land and such expert determinations were sufficient to support the finding that the oxbows were wetlands. The court held that the burden was on the plaintiff to show that the oxbows were cultivatable before the filling and that the filling did not change the character of the land. *Clark v. USDA*, 2007 U.S. Dist. LEXIS 46341 (S.D. Iowa 2007).

—Robert P. Achenbach, AALA Executive Director

State roundup/Cont. from p. 6
not convey any irrigation water. The court noted that the supporting ditches had not been used for many years as part of the irrigation efforts. *Wills Cattle Co. v. Shaw*, 2007 Mont. LEXIS 368 (Mont. 2007).

—Robert P. Achenbach, Jr., AALA Executive Director

INTERFERENCE WITH BUSINESS RELATIONS. The plaintiffs operated a worm farm and obtained permission from a nearby dairy to take their manure. The defendants complained to the dairy about the practice, claiming that the worm farm created too many flies. The dairy refused to let the plaintiffs remove manure after the defendants complained. The plaintiffs had their operation inspected twice by the state which found the operation properly operated and free of flies. The dairy still refused to provide the manure and the plaintiffs' farm ceased operation for lack of manure. The plaintiffs sued the defendants for tortuous interference with business relations. The dairy owner provided an affidavit describing the events and the affidavit did mention the complaints made by the defendants but also stated that the denial of access to the manure had several other reasons not tied to the complaints, including the added trouble of stopping work to load the manure, the sloppy handling of the manure by the plaintiffs and lack of any benefit to the dairy because the amount of manure was insignificant to the total amount produced by the dairy. The affidavit also stated that the defendants had withdrawn their complaint. The court noted that the evidence included some testimony from the dairy employees that there was some problem with flies on the plaintiffs' property. The court held that the trial court's grant of summary judgment to the defendants was proper because the plaintiffs failed to show that the manure agreement was terminated merely because of the defendants' original complaints and the complaints were made with the intent to damage the plaintiffs' business. *Bateman v. Gray*, 2007 Miss. App. LEXIS 595 (Miss. Ct. App. 2007).

—Robert P. Achenbach, Jr., AALA Executive Director

SALES AND USE TAX. The plaintiffs operated a farm on which two pole buildings were located, one an indoor arena and stalls 60 by 200 feet in size and the other approximately 1,000 square feet in size. The plaintiff contended that the buildings were exempt from tax under Or. Rev. Stat. §307.397 as agricultural buildings. The court noted that Section 307.397 applied only to machinery, equipment and tangible personal property and held that the pole buildings were not machinery or equipment. The court also noted that Or. Rev. Stat. § 307.030(1) defined real property as land and "all buildings, structures, improvements, machinery, equipment or fixtures erected upon, above or affixed to the land." In addition, the exemption provided by Section 307.397 applied only to frost control systems used in agriculture; trellises used for hops, beans or fruit or for other agricultural or horticultural purposes; hop harvesting equipment, oyster racks, trays, and stakes; or equipment used for the fresh shell egg industry. The court held that the Section 307.397 did not apply to the two pole buildings which were included in the real property tax valuation of the farm. *Gardner v. Multnomah County Assessor*, 2007 Ore. Tax LEXIS 136 (Or. Tax Ct. 2007).

—Robert P. Achenbach, Jr., AALA Executive Director

First Class Mail
U.S. POSTAGE
PAID
Des Moines, Iowa
Permit No. 5297

6292 N.E. 14th Street
Des Moines, IA 50313

AMERICAN AGRICULTURAL
LAW ASSOCIATION

AALA Membership Survey

In an effort to improve membership benefits, the AALA membership committee has created an online survey that gives members a chance to let us know about how members feel about their membership in the AALA. You can access the survey from the AALA web site home page (the first page after the "enter" page). You will need to log on in order to take the survey but responses will be anonymous.

2007 Annual Conference

It's less than three weeks before the 2007 Annual Agricultural Law Symposium at the Westin San Diego Hotel (formerly a Wyndham hotel) in sunny downtown San Diego, CA, October 19-20, 2007. Mark your calendars and plan a trip to enjoy the sights (Gaslight District), sounds (sea gulls and trolley bells), animals (San Diego Zoo and Seaworld) and sunshine. The program has been posted on the AALA web site with a registration form. If you would like extra copies of the conference brochures to distribute in your area, please let me know by e-mail. Special note: The room block expired on September 17, 2007, and the rooms are available at the Westin only at the regular retail rate.

Early registration at the conference will be available at the second floor conference area from 6pm to 8pm.

Robert P. Achenbach, Jr,
AALA Executive Director
541-485-1090
FAX 541-30208169
RobertA@aglaw-assn.org