INSIDE

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IN FUTURE ISSUES

Eighth Circuit rules on hedge-to-arrive contracts

In two opinions issued the same day, the Eighth Circuit has held that the hedge-to-arrive (HTA) contracts at issue were valid cash forward contracts and were therefore excluded from regulation under the Commodity Exchange Act (CEA), 7 U.S.C. §§ 1-25. *Grain Land Coop v. Kar Kim Farms, Inc.*, No. 98-3217, 1999 WL 1179095 (8th Cir. Dec. 15, 1999); *Haren v. Conrad Cooperative*, No. 98-3803, 1999 WL 1161525 (8th Cir. Dec. 15, 1999). The litigation, which arose during the period of high grain prices in the mid-1990s, pitted several Iowa and Minnesota cooperatives against some of their respective member-farmers in a dispute over whether the HTA contracts between them were enforceable under the CEA.

The CEA requires transactions in commodity futures contracts to occur only under the rules of a board of trade that has been designated by the Commodity Futures Trading Commission (CFTC). However, it exempts from regulation contracts for "any sale of a cash commodity for deferred shipment or delivery." 7 U.S.C. § 1a(11). Such contracts are commonly known as cash forward contracts. In the disputes before the Eighth Circuit, the farmers contended that the contracts were regulated futures contracts while the cooperatives asserted that the contracts were unregulated cash forward contracts.

The contracts at issue in the two cases were materially similar, though the court described only the Grain Land contract in detail. As described by the court, the Grain Land contract required the farmer to deliver a specified quantity and quality of grain to the cooperative at an unspecified time. At the contract's inception, the parties designated a Chicago Board of Trade (CBOT) futures contract price for the grain to serve as a reference point in determining the grain's sale price. The sale price would be CBOT futures contract price, plus or minus the grain's "basis," with the basis being the difference between the grain's futures contract price and its cash price. Though the futures contract price was set at the contract's inception, the basis was not set until the individual farmer elected to set it. If the farmer did do so by a specified time, the cooperative could set the basis and thereby set the grain's sales price.

Because basis can fluctuate, HTA contracts placed "basis-risk" on the farmer. For a fee, however, the farmer could either "roll" the contract into another futures contract period or cancel the contract. Nonetheless, the contract specified that the grain had to be delivered to the cooperative "sometime" for the farmer to collect any gain.

In the mid-1990s, while the contracts at issue were in effect, grain prices rose to the point

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Cotenants claiming by adverse possession

In *Buchanan v. Rediger,* 975 P.2d 1235 (Kan. Ct. App. 1999), the plaintiffs are brother and sister. The plaintiffs' mother became the owner of 157 acres of farmland after the plaintiffs' grandmother died. In 1968, the plaintiffs' mother granted the plaintiffs' father a life estate in the farmland with the remainder to the plaintiffs. The mother died later in 1968, and the father remarried in 1969. In 1977, the plaintiffs' father died survived by his second wife and the plaintiffs. Thus, after the father's death, the plaintiffs' remainder interest became a present possessory interest. The father's second wife died in 1988 leaving her nieces and nephews, the defendants in this case.

While attempting to obtain title insurance for the farmland in 1996, the plaintiffs discovered a 1955 deed conveying the farmland to the plaintiffs' parents as tenants in common. As a result, the defendants claimed that the plaintiffs' father died owning only a one-half interest in the property, and that the plaintiffs only had a remainder interest in one-half of the property. Therefore, according to the defendants, upon the intestate death of the plaintiffs' father in 1977, one-half of his interest passed to his second wife that survived him, and one-half passed to the plaintiffs. Thus, upon the father's death, the plaintiffs owned a three-fourths interest in the real estate. When the father's second wife died in 1988, her one-quarter interest in the tract passed to the defendants.

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that the price of grain for immediate delivery exceeded the futures contract price for a later delivery. In response to this price "inversion," the farmers sold their grain at the cash price and "rolled-over" their HTA contracts. When this happened, the cooperatives, which had hedged their obligations under the contracts by taking a "short" or sell position on the CBOT equal to their HTA buy obligations, experienced losses in their short futures positions. As a result, they were forced to add to their margin accounts. Seeking to stem these losses, the cooperatives took various steps. Grain Land, for example, terminated its outstanding HTA contracts and required farmers to sign new contracts that offered protection to the cooperative against such losses. The farmers who later became litigants against Grain Land declined to sign a new contract.

Though various state law claims were at issue, the central issue was whether the CEA applied to the contracts. Turning first to the CEA itself, the Eighth Circuit found scant guidance in the Act's language for distinguishing an unregulated cash forward contract from a regulated futures contract. A review of the CEA's legislative history was more fruitful, for there the Eighth Circuit found in the fact that regulated futures contracts are not normally settled by the actual delivery of the commodity support for the proposition that it is "the contemplation of physical delivery of the subject commodity that is the hallmark of an unregulated cash-forward contract." *Grain Land Coop v. Kar Kim Farms, Inc.*, 1999 WL 1179095 at *4 (footnote omitted). In light of this proposition, the court commented that "[i]n order to determine whether a transaction is an unregulated cash-forward contract, we must decide 'whether there is a legitimate expectation that physical delivery of the actual commodity by the seller to the original contracting buyer will occur in the future.'" *Id.* (quoting *Andersons, Inc. v. Horton Farms, Inc.*, 166 F.2d 308, 318 (6th Cir. 1998)) (other citations omitted).

As to the method for resolving whether actual physical delivery of the commodity was contemplated, the Eighth Circuit adopted an individualized multi-factor approach used by other courts in HTA and other disputes. In general, the factors considered include "the intentions of the parties, the terms of the contract, the course of dealing between the parties, and any other relevant factors...." *Id.* at *5. More specifically, this approach "scrutinizes each transaction for such characteristics as whether the parties are in the business of obtaining or producing the subject commodity; whether they are capable of delivering or receiving the commodity in the quantities provided for in the contract; whether there is a definite date of delivery; whether the agreement explicitly requires actual delivery, as opposed to allowing the delivery obligation to be rolled indefinitely; whether payment takes place only upon delivery; and whether the contract's terms are individualized, rather than standardized." *Id.* (citations omitted).

Under this approach, the Eighth Circuit held that the HTA contracts at issue were unregulated cash forward contracts, even though they had features that differentiated them from traditional cash forward contracts. In the course of reaching this conclusion, the court noted that the parties were either in the business of producing or receiving grain and that the HTAs bore little resemblance to futures contracts traded on the CBOT in that they were not offered to the general public and were individually negotiated and not standardized.

The court also found that the "roll-over" feature merely postponed delivery and did not negate a delivery obligation altogether. While the cancellation feature in the Grain Land contract could negate delivery, the court observed that the contract provided that no gains could be realized by the farmer unless the grain was delivered. As to both of these features, the court rejected the contention "that a mutually enforceable delivery obligation is necessary to place a transaction outside the reach of the CEA." *Id.* at *6 (citations omitted). Such a "purely contract-based analysis," the court reasoned, "would expand the gravitational pull of the CEA beyond what is suggested by the congressional policies underlying the vague text of [the cash forward contract exclusion]." *Id.* On the other hand, the court found that a contractual obligation to deliver was sufficient to bring the contract within the cash forward contract exclusion, notwithstanding the farmer's lack of subjective intent to deliver the commodity. *Haren v. Conrad Cooperative*, 1999 WL 1161525 at *1.

—Christopher R. Kelley, Assistant Professor of Law, University of Arkansas, Of Counsel, Vann Law Firm, Camilla, GA

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AALA Editor.....Linda Grim McCormick
Rt. 2, Box 292A, 2816 C.R. 163
Alvin, TX 77511
Phone: (281) 388-0155
FAX: (281) 388-0155
E-mail: lgmccormick@teacher.esc4.com
American Agricultural Law Association website: http://www.aglaw-assn.org

Contributing Editors: Roger A. McEowen, Kansas State University; Christopher R. Kelley, University of Arkansas.

For AALA membership information, contact William P. Babione, Office of the Executive Director, Robert A. Leflar Law Center, University of Arkansas, Fayetteville, AR 72701.

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Professors Davis and Pierce also note that the Court is not always consistent in its invalidation of an agency's interpretation of one of its legislative rules. For example, they note that in *Thomas Jefferson University v. Shalala*, 114 S. Ct. 2381 (1994), the Court ruled that "a court can reject an agency interpretation only if an 'alternative reading is compelled by the regulation's plain language or by other indications of the Secretary's intent at the time of the regulation's promulgation.'" 1 *id.* § 6.10 (Supp. 1999). Yet in *Director, OWCP v. Greenwich Collieries*, 114 S. Ct. 2251 (1994), the Court found the regulation interpreted by the agency to be "too vague and ambiguous to support the agency's interpretation," thus, according to Professors Davis and Pierce, making it "difficult, if not impossible, to reconcile the majority opinion in *Greenwich* with the majority opinion in *Thomas Jefferson*." *Id.*

Finally, in the 1999 Supplement to their treatise, Professors Davis and Pierce observe that "[n]umerous circuit courts have distinguished *Stinson* and held that a policy statement [or interpretive rule] does not bind a court if it does not interpret a legislative rule. In that situation, the policy statement has only a potential persuasive effect on a court." 1 *Id.* § 6.2 (Supp. 1999)(citing *United States v. Hill*, 48 F.3d 228 (7th Cir. 1995); *United States v. Mathena*, 23 F.3d 87 (5th Cir. 1994); *United States v. Sparks*, 19 F.3d 1099 (6th Cir. 1994); *United States v. Anderson*, 15 F.3d 278 (2d Cir. 1994); *United States v. O'Neill*, 11 F.3d 292 (1st Cir. 1993); *United States v. Levi*, 2 F.3d 842 (8th Cir. 1993); and *United States v. Hooker*, 993 F.2d 898 (D.C. Cir. 1993).

In summary, therefore, only *legislative rules* have binding effect on private parties, the courts, and agencies. Nonetheless, where an

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Water rights in Wyoming

In *Rennard v. Vollmar,* 977 P.2d 1277 (Wyo. 1999), the parties own adjoining tracts of land that were a single unified tract until being divided in 1973. The plaintiffs' tract was used for farming before 1973, and the plaintiff continued that use. Likewise, the plaintiffs' tract has always been irrigated and received water from an irrigation ditch that originally crossed the entire property, part of which is now the defendants' land. The plaintiffs purchased their tract in order to farm it and intended to irrigate their fields. The sale contract provided that the plaintiffs were to be given written permission for access to all the irrigation ditches for the purposes of cleanup and preventative work. However, no written permission was provided to the plaintiffs, nor was an easement for the ditches included in the deed. The deed containing the property was silent with respect to water rights as well as access to the irrigation ditch.

The plaintiffs experienced difficulty in receiving water as it passed through the defendants' property, and a subsequent investigation revealed that the defendants had placed irrigation head gates on two reservoirs and were taking water from the ditch. The defendants denied the plaintiffs access to the defendants' property for maintenance and use of the ditch, believing that the plaintiffs had no ownership interest in the ditch. The plaintiffs sued for intentional destruction of property, conversion, negligence, and prescriptive easement. The trial court framed the issue as one of whether the plaintiffs had an implied easement in the ditch, and ultimately found that the plaintiffs' use was permissive, that it was feasible for the plaintiffs to build their own ditch, and that no implied easement was intended at the time of the property division.

On appeal, the Wyoming Supreme Court reversed, citing *Frank v. Hicks*, 4 Wyo. 502, 35 P. 1025 (Wyo. 1893), for the rule that a water right becomes appurtenant to the land upon which the water is used, and the ditch, water pipe, or other conduit for the water becomes attached to the land, either as appurtenant or instant to the land, and necessary to its beneficial enjoyment, and therefore becomes part and parcel of the land. Accordingly, the plaintiffs had exclusive ownership of the ditch, and the defendants were not entitled to divert any water from the ditch to their reservoir. In addition, the plaintiff's ownership of the ditch permitted them to enter the defendant's land to maintain and use the existing ditch.

—Roger A. McEowen,
Kansas State University

Animal confinement unit permits in South Dakota

In *Coyote Flats, LLC v. Sanborn County Commission*, 596 N.W.2d 347 (S.D. 1999), in 1997 the defendant received an application from the plaintiff for a special use permit to construct a hog confinement facility that would contain approximately 6,000 hogs. Simultaneously, the defendant attempted to enact new county ordinances to amend the existing county zoning ordinance. The amendments dealt with requirements for animal confinement units. Based on the new ordinances, the defendant denied the plaintiff's permit application. The plaintiff appealed to the circuit court, which struck down the new ordinances as not properly enacted. The court then remanded the permit issue to the commission to consider the application under the existing county ordinance that had been in effect since the early 1970s.

On remand, a hearing before the defendant was held in early 1998, and the plaintiff was again denied the special use permit. The defendant found the proposed facility would create significant odor, and would increase traffic, and that additional trucks would damage roads and cause loss in value of neighboring land. The defendant concluded the facility would be detrimental to the health, safety, and general welfare of the people residing in the area near the proposed site and would be a nuisance. The plaintiff again appealed to the circuit court. The circuit court determined that the defendant's decision was arbitrary and capricious and remanded the case back to the defendant. The court also ordered the defendant to meet as a planning commission and approve the special use permit. The defendant appealed with the issue on appeal being whether the trial court erred in ruling that the defendant's denial of a special use permit was "arbitrary and capricious."

The South Dakota Supreme Court reversed the trial court's decision, noting a near total absence of evidence in the record that would allow the court to label the defendant's findings as arbitrary and capricious. Specifically, the court noted that there was no evidence that the defendant's action was based on personal, selfish or fraudulent motives or on false information. The court also noted that there was substantial relevant evidence in the record to support the defendant's determination. In particular, the proposed facility was to be erected within a township that a heavy population concentration and that roads in the area would be severely damaged from increased large truck traffic. Likewise, adjacent properties would be devalued because of the location of the facility, and the facility would create noxious odors and raise the potential of water pollution.

Two justices dissented on the basis that the defendant's definition of a commercial feedlot was vague in that the ordinance failed to state how many animals were required before an operation was considered a commercial feedlot. As such, the dissent argued, the ordinance could not be uniformly applied.

—Roger A. McEowen,
Kansas State University

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interpretive rule is interpreting a legislative rule, a court will give the interpretive rule "great" deference. This deference may be the same as, or nearly the same as, *Chevron* deference. Consequently, through deference, interpretive rules can have a legally binding effect, notwithstanding the fact that they do not have to be promulgated through the rulemaking processes specified in the APA.

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The plaintiffs claimed full ownership of the real estate under the theory of adverse possession, and the defendants claimed a one-quarter interest in accordance with the 1955 deed. The trial court ruled that the plaintiffs were co-tenants with the defendants and that a co-tenant could not acquire title by adverse possession absent a clear ouster. The trial court also ruled that without knowledge of the co-tenancy the plaintiffs' possession could not be adverse.

The Kansas Court of Appeals reversed, citing a 1905 Kansas Supreme Court case which recognized the possibility that a co-tenant who is granted what appears to be the entire interest in property may hold it adverse to undisclosed co-tenants. The court reasoned that the case was consistent with Kan. Stat. Ann. § 60-503, which allows a claim of adverse possession based upon a good faith belief of ownership of the disputed property for a period of fifteen years. Accordingly, the plaintiffs were awarded title to the tract as tenants in common.

—Roger A. McEowen,
Kansas State University

The legal effects of federal agency pronouncements

By Christopher R. Kelley

Most federal administrative agencies have been given the authority by Congress to make rules that legally bind private parties, the courts, and the agency itself. *See generally* Cornelieus M. Kerwin, *Rulemaking: How Government Agencies Write Law and Make Policy* (1994)(developing the thesis that rulemaking is the single most important function performed by agencies). Not all pronouncements that an agency might characterize or treat as binding "rules" are legally binding, yet federal agencies sometimes treat nonbinding rules as if they were legally binding. Consequently, private parties and the courts often must draw the distinction between nonbinding and legally binding rules. This article offers an overview of the law governing this distinction.

The beginning point for any discussion of federal agency rules is the Administrative Procedure Act (APA). In relevant part, the APA provides that a "rule" is "the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe laws or policy or describing the organization, procedure, or practice requirements of an agency...." 5 U.S.C. § 551(4). As suggested by this definition, unless Congress specifically authorizes otherwise, rules must be prospective in effect, not retroactive. *Bowen v. Georgetown Univ. Hospital*, 488 U.S. 204 (1988). Thus, in general, a legally binding rule "'regulates the future conduct of either groups of persons or a single person; it is essentially legislative in nature, not only because it operates in the future but also because it is primarily concerned with policy considerations.'" Administrative Conference of the United States, *A Guide to Federal Agency Rulemaking* 40 (2d ed. 1991)[*Federal Agency Rulemaking*](quoting *Attorney General's Manual on the Administrative Procedure Act* 14-15 (1947)).

Agency rules are the product of agency rulemaking. The APA defines "rulemaking" as the "process for formulating, amending, or repealing a rule." 5 U.S.C. § 551(5). "The object of the rule making proceeding is the implementation or prescription of law or policy for the future, rather than the evaluation of a respondent's past conduct.'" *Federal Agency Rulemaking, supra*, at 40 (quoting *Attorney General's Manual on the Administrative Procedure Act* 14-15 (1947)). This objective and the provision of rulemaking procedures in the APA notwithstanding, the United States Supreme Court has held that agencies are generally free to use their own judgment in determining whether to make new law by rulemaking or by adjudication. *NLRB v. Bell Aerospace Co., Div. of Textron, Inc.*, 416 U.S. 267, 293-94 (1974). The APA, however, distinguishes "rulemaking" from "adjudication." Under the APA, adjudications result in "orders," not "rules." 5 U.S.C. § 551(7).

"Rules" and "rulemaking" are potentially confusing subjects for at least two reasons. First, agencies make rules in several ways. These include "formal" or "on the record" rulemaking under APA §§ 553, 556, and 557; "informal" or "notice and comment" rulemaking under APA § 553; and rulemaking through adjudication. Agencies also announce what they characterize as "rules" by publishing press releases, internal handbooks, and other guidances, the contents of which do not also appear in the *Federal Register*, a process sometimes referred to as "publication rulemaking." Peter L. Strauss, *The Rulemaking Continuum*, 41 Duke L.J. 1463, 1467 (1992)[Strauss](footnote omitted). Agencies often resort to such "publication rulemaking" or "nonrule rulemaking" because of real and perceived delays and difficulties associated with APA rulemaking. Thomas O. McGarity, *Some Thoughts on "Deossifying" the Rulemaking Process*, 41 Duke L.J. 1385, 1393 (1992); *see also* 1 George C. Coggins, *Public Natural Resources Law* § 7.03[2][d] (1990)(discussing the evolution of the USDA Forest Service Manual and the legal status of its contents). When agencies attempt to enforce "rules" made through this form of rulemaking, the distinction between nonbinding and legally binding rules is invariably an issue.

A second source of potential confusion is the common division of "rules" into four categories: legislative rules; general statements of policy; interpretive (or interpretative) rules; and rules of agency organization, procedure, or practice. Although some courts and commentators equate legislative rules with substantive rules, others maintain this synonymous treatment is misleading. *See* Robert A. Anthony, *Interpretive Rules, Policy Statements, Guidances, Manuals, and the Like—Should Federal Agencies Use Them To Bind the Public?*, 41 Duke L.J. 1311, 1321-27 (1992)[Anthony]. Professor Anthony observes that substantive standards can be found in legislative rules, interpretive rules, and policy statements. As discussed below, the latter two categories are not, by definition, legislative rules.

Notwithstanding the fact that rules can be divided into four categories, the APA does not expressly define the differences between legislative rules, interpretive rules, policy statements, and procedural rules. It does not even use the term "legislative rules." Instead, by defining a "rule" as "the whole or part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency," the APA definition of a "rule," "if read literally, is broad enough to encompass virtually any statement an agency might make in any context." 1 Kenneth Culp Davis & Richard J. Pierce, Jr., *Administrative Law Treatise* § 6.1 (1994)[Davis & Pierce](citations omitted). Or, as Professor Anthony notes:

> Issuances encompassed by this definition come in a myriad of formats and bear a myriad of labels: legislative rules, interpretive rules, opinion letters, policy statements, policies, program policy letters, Dear Colleague letters, regulatory guidance letters, rule interpretations, guidances, guidelines, staff instructions, manuals, questions-and-answers, bulletins, advisory circulars, models, enforcement policies, action levels, press releases, testimony before Congress, and many others.

Anthony, *supra*, at 1320 (footnote omitted).

Obviously not every statement an agency might make in any context is a "rule" within the meaning of APA § 551(4). As a practical matter, private parties who deal with federal agencies are concerned primarily, if not exclusively, with rules that have a *legally* "binding effect" on the public, the courts, and the agency. If any statement regarding agency rules can be made with certainty, it is that valid "legislative rules" have that effect. Nonetheless, as previously noted, agencies sometimes treat nonlegislative rules as if they were legislative rules. Professor Anthony characterizes such rules as "spurious rules." Robert A. Anthony, *"Interpretive" Rules, "Legislative" Rules and "Spurious" Rules: Lifting the Smog*, 8 Admin. L.J. 1, 10 (1994)("Such rules have no legal force, but because they are treated as binding by the agency, they are spuriously given the appearance of legal force." (footnote omitted)). Therefore, the determination of whether a "rule" has the legally binding effect of a legislative rule requires distinguishing legislative rules from "spurious rules" and other statements issued by an agency.

Legislative rules

A legislative rule is a substantive rule implementing a statute that the agency is statutorily empowered to make and that is duly promulgated under APA § 553. Professor Anthony would add that the agency also must intend to make a legislative rule, not an interpretive rule or a policy statement. Anthony, *supra*, at 1322 (listing six requirements that must be met by a legislative rule). *See also American Mining Congress v. Mine Safety & Health Admin.*, 995 F.2d 1106, 1109 (D.C.

Christopher R. Kelley is Assistant Professor of Law, University of Arkansas and is Of Counsel to the Vann Law Firm, Camilla, GA.

Cir. 1993)(discussing the limited utility of the "intent to exercise legislative power" test for identifying legislative rules). Thus, a "'legislative rule is the product of an exercise of delegated legislative power to make law through rules.'" *Id.* (citation omitted).

A valid legislative rule is binding on private parties, the courts, and the agency. It has the same force and effect as a statute; that is, it has "the force and effect of law." *Chrysler Corp. v. Brown*, 441 U.S. 281, 302 (1979). "This *binding effect* is the chief identifying feature of a legislative rule: its nature and purpose is to alter citizens' legal rights in a decisive fashion." Ernest Gellhorn & Ronald Levin, *Administrative Law and Process in a Nutshell* 315-16 (3d ed. 1990)[Gellhorn & Levin](noting that "to say that such a rule has 'the force and effect of law' does not mean that it is immune from judicial review; courts can entertain challenges to the rule on various grounds"). Nonetheless, while valid legislative rules bind the issuing agency, *United States v. Nixon*, 418 U.S. 683, 694-96 (1974), an agency "may be able to waive them in appropriate cases for the benefit of individual members of the public, at least if the rights of third parties are not prejudiced thereby." Arthur Earl Bonfield & Michael Asimow, *State and Federal Administrative Law* 249 (1989)(citing *American Airlines, Inc. v. Civil Aeronautics Bd.*, 359 F.2d 624 (D.C. Cir.)(en banc), *cert. denied*, 385 U.S. 843 (1966)).

Legislative rules must be congressionally authorized and "reasonably related to the purposes of the enabling legislation." *Mourning v. Family Publications Serv.*, 411 U.S. 356, 369 (1973). "[A]n agency has the power to issue binding legislative rules only if and to the extent Congress has authorized it to do so." 1 Davis & Pierce, *supra*, § 6.3 (citations omitted). Moreover, legislative rules must be consistent with the controlling statute. *Brown v. Gardner*, 115 S. Ct. 552, 554-57 (1995). In other words, legislative rules are subject to challenge on grounds other than the procedures under which they were promulgated.

Unless they apply to a matter exempted under APA § 553(a) and the exemption has not been waived by the agency, legislative rules must be legislatively adopted under the APA. One of the two categorical exemptions in APA § 553(a) is the exemption provided for in APA § 553(a)(2) pertaining to "public property, loans, grants, benefits, or contracts." This exemption would apply to some of the USDA's rulemaking including, for example, domestic commodity program rules and federal crop insurance contracts. For example, in *Rainbow Valley Citrus Corp. v. Federal Crop Ins. Corp.*, 506 F.2d 467, 468-69 (9th Cir. 1974), this exemption was invoked to uphold a 1970 rule adopted without compliance with APA § 553 that reclassified certain lands as uninsurable for federal crop insurance purposes.

The APA § 553(a)(2) exemption no longer applies to the USDA because in 1971 the USDA waived the exemption. 36 Fed. Reg. 13,804 (1971). *See generally Rodway v. United States Dep't of Agriculture*, 514 F.2d 809, 813-14 (D.C. Cir. 1975)(discussing the USDA's waiver of the exemption). As a result, the USDA is "fully bound ... to comply ... with the procedural demands of the APA" when making legislative rules. *Id.* at 814.

Most rulemaking is by "notice and comment" under APA § 553. Although the "notice and comment" requirements of APA § 553 will not apply in some circumstances, such as when "good cause" is demonstrated under APA § 553(b)(B), legislative rulemaking at least requires the giving of notice and an opportunity for public comment. Moreover, all legislative rules must be published in the *Federal Register*. Unless "good cause" is shown under APA § 553(d)(3) or the rule "grants or recognizes an exemption or relieves a restriction" under APA § 553(d)(1), publication must occur thirty days before the rule becomes effective. Legislative rules published as final rules in the *Federal Register* appear the following year in the Code of Federal Regulations.

Unlike legislative rules, interpretive rules, general statements of policy, and rules of agency organization, procedure, and practice do not have to be promulgated under the APA. APA § 553(b)(A) provides that "notice and comment" rulemaking does not apply to such statements. 5 U.S.C. § 553(b)(A). Because such rules are not legislatively promulgated, they are not legislative rules.

Interpretive rules, general statements of policy, and rules of agency organization, procedure, or practice do not have the same legally binding effect as legislative rules. As discussed below, however, interpretive rules may be accorded sufficient deference by the courts to make them outcome determinative. When this happens, it is the court, not the interpretive rule, that imposes the legally binding effect to the contents of the interpretive rule. *See Sims v. United States*, 252 F.2d 434, 438 (4th Cir. 1958)("Administrative interpretations are not absolute rules of law which must necessarily be followed in every instance, but are only helpful guides to aid courts in their task of statutory construction."), *aff'd*, 359 U.S. 108 (1959). While not binding by definition, general statements of policy may have coercive effect as a practical matter. Moreover, rules of agency organization, procedure, or practice can affect parties outside the agency in both insignificant and significant ways. *See Batterton v. Marshall*, 648 F.2d 694, 707 (D.C. Cir. 1980)(observing that "'even office hours ... necessarily require conformity on the part of the public'" (citation omitted)). The discussion that follows defines these categories of agency statements and discusses whether and to what extent they have a binding effect.

Rules of agency organization, procedure, or practice

Rules of agency organization, procedure, or practice are usually collectively referred to as "procedural rules." Jeffrey S. Lubbers & Nancy G. Miller, *The APA Procedural Rule Exemption: Looking for a Way To Clear the Air*, 6 Admin. L.J. 481, 482 n.10 (1992)[Lubbers & Miller]. Though a convenient collective description, "the term 'procedural rule' has no clear definition." *Id.* at 482 (footnote omitted).

The procedural rule exemption from compliance with the rulemaking procedures of APA § 553 "has generally covered matters such as agency rules of practice governing the conduct of its proceedings and rules delegating authority or duties within an agency." *Federal Agency Rulemaking, supra*, at 49. In addition to covering matters such as the time period for competing railroads to file applications responding to proposed mergers, *Lamoille Valley R.R. Co. v. ICC*, 711 F.2d 295, 328 (D.C. Cir. 1983), the exemption has been held to cover agency instructions, guidelines, and procedures, including relatively specific standards for determining what kinds of activities would result in enforcement reviews under the Medicare program's peer review organization program, *American Hosp. Ass'n v. Bowen*, 834 F.2d 1037, 1043-52 (D.C. Cir. 1987).

> In essence, the exemption:
> requires agencies and courts to distinguish between procedural rules and substantive rules. There are many rules that are easy to categorize, e.g., a rule specifying the time limit for filing a response to a complaint is procedural, while a rule imposing a new binding obligation on regulatees is substantive. Unfortunately, however, there are many rules that can as easily bear one characterization as another.

1 Davis & Pierce, *supra*, § 6.4. As the District of Columbia Circuit recently confessed, "we have struggled with the distinction between 'substantive' and 'procedural' rules...." *JEM Broadcasting Co., Inc. v. FCC*, 22 F.3d 320, 326 (D.C. Cir. 1994). *See also* 1 Davis & Pierce, *supra*, § 6.4 ("There are scores of lower court opinions that apply the procedure substance distinction to a wide variety of agency rules that are difficult to classify. They form an untidy body of law that defies accurate summary treatment. Given the inherent difficulty of the enterprise, the boundary between substantive rules and procedural rules

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is likely to remain murky.").

Courts have developed various tests for determining whether a rule is a procedural rule but none of these tests has been universally accepted. If there is a rule of thumb, it may be that "[t]he likelihood that a regulation will pass muster as 'procedural' is in direct proportion to its insignificance." Gary J. Edles & Jerome Nelson, *Federal Regulatory Process: Agency Practices and Procedures* § 4.2II (2d ed. 1994).

One test "depends simply upon whether [the rule] addresses some sort of agency procedure." Lubbers & Miller, *supra*, at 485 (citing as an example *Southern California Edison Co. v. Federal Energy Regulatory Comm'n*, 770 F.2d 779 (9th Cir. 1985)). This test, however, "is unhelpful because substance can be masked as procedure." *Id.* at 489. Recognizing this, other courts have used a "substantial impact" test. *Id.* at 485 (citing as an example *National Motor Freight Ass'n v. United States*, 268 F. Supp. 90 (D.D.C. 1967)(three-judge panel), *aff'd mem.*, 393 U.S. 18 (1968)). This test focuses on the magnitude of a rule's impact, not on the impact's nature. At some "undefined level," the rule becomes subject to APA § 553. *Id.* at 485-86.

The District of Columbia Circuit has looked to whether a particular rule "'encodes a substantive value judgment or puts a stamp of approval or disapproval on a given type of behavior.'" *Id.* at 486 (citing *American Hospital Ass'n v. Bowen*, 834 F.2d 1037, 1047 (D.C. Cir. 1987)). As that Circuit recently indicated, an aspect of that test examines whether the rule changes "*substantive standards*." *JEM Broadcasting*, 22 F.3d at 327 (emphasis in original). More broadly, the court observed:

> Our oft-cited formulation holds that the "critical feature" of the procedural exception "is that it covers agency actions that do not themselves alter the rights or interests of parties, although it may alter the manner in which the parties present themselves or their viewpoints to the agency." ... "Of course, procedure impacts on outcomes and thus can virtually always be described as affecting substance, but to pursue that line of analysis results in the obliteration of the distinction that Congress demanded." ... The issue, therefore, "is one of degree," and our task is to identify which substantive effects are "sufficiently grave so that notice and comment are needed to safeguard the policies underlying the APA."

Id. at 326-27 (citations omitted).

The District of Columbia Circuit's approach has been characterized as "problematic" because "[c]ourts have either not engaged in useful analysis or they have used the test in a way that could effectively eliminate the statutory distinction between procedural and substantive rules." Lubber & Miller, *supra*, at 489. For its part, the now-defunct Administrative Conference of the United States (ACUS) recommended as follows:

> In determining whether a proposed rule falls within the statutory exception for rules of agency "procedure or practice," agencies should apply the following standard: A rule is within the terms of the exception when it both (a) relates solely to agency methods of internal operations or of interacting with regulated parties or the public, and (b) does not (i) significantly affect conduct, activity, or a substantive interest that is the subject of agency jurisdiction, or (ii) affect the standards for eligibility for a government program.

Id. at 496 (quoting ACUS Recommendation 92-1, 1 C.F.R. § 305.92-1)(footnote omitted defining "program" to include "those involving benefits, contracts, licenses, permits, and loan guarantees")).

Policy statements

A general statement of policy is neither legally binding on the public or the courts nor judicially enforceable against an agency. In other words, it does not establish a "binding norm." *Pacific Gas & Electric Co. v. FPC*, 506 F.2d 33, 38 (D.C. Cir. 1974). Instead, a *general statement of policy* states how the agency intends to use its lawmaking power in the future but does not attempt to bind anyone immediately." Gellhorn & Levin, *supra*, at 318. *See also Federal Agency Rulemaking*, *supra*, at 58 ("Policy statements are issued by an agency to advise the public prospectively of the manner in which the agency proposes to exercise a discretionary power in subsequent adjudications or through rulemaking. Often policy statements are issued to guide agency personnel in administering laws, and sometimes they are addressed to the public." (footnote omitted)).

Once a pronouncement is determined to be a general statement of policy, two principles follow: (1) The policy statement can be adopted without compliance with APA § 553, and (2) the policy statement is not legally binding. The more difficult issue, however, is determining whether a pronouncement is a general policy statement. This issue most often arises in the context of a pronouncement that has not been promulgated in compliance with APA § 553. In this context,

> the proper question ... is not whether the policy document *is* a legislative rule. Rather, the proper question is whether the nonlegislative document *should have been* issued as a legislative rule in the circumstances. The key to that question is ...: *Did the agency intend the document to bind? Has the agency given it binding effect?* If the answer to either of these questions is "yes," the document should have been issued as a legislative rule.

Anthony, *supra*, at 1327.

As Professors Davis and Pierce observe, determining whether an agency pronouncement has a binding effect is not always easy. Courts will examine, but not necessarily follow, an agency's representations concerning the intended effect of a pronouncement. *See* 1 Davis & Pierce, *supra*, § 6.2. Whether the result of sloppiness or the product of strategic choice, an agency may use ambiguous or inconsistent language (such as variously using "must" and "should"), thus leaving uncertainty over the pronouncement's intended effect. Nonetheless,

> [t]he beauty of the "binding effect" test lies in its ability to frustrate agency attempts to use ambiguity to further illegitimate strategic goals. A court may interpret an ambiguous statement as binding or not binding, but the agency cannot have it both ways. If the court concludes that the agency statement is binding in some important respect, it will hold that the statement is a "rule" that can be promulgated only through the use of rulemaking procedures and that is potentially reviewable to the same extent as any other rule. If instead the court concludes that the statement is a general statement of policy, courts will not permit the agency to give its statement binding effect on members of the public.

1 *id.* § 6.2.

Although not *legally* binding, general statements of policy may, as a practical matter, have a coercive effect. That is, "[t]o the extent that an agency possesses significant discretionary power over a class of regulatees or beneficiaries, many are likely to 'comply' 'voluntarily' with an agency's 'nonbinding' statement of its preferred policies." 1 *id.* § 6.2.

Interpretive rules

Strictly defined, "an *interpretive rule* differs from a legislative rule in that it is not intended to alter legal rights, but to state the agency's view of what existing law already requires." Gellhorn & Levin, *supra*, at 317. "[T]he courts do not treat interpretations as making new law, on the theory that they merely restate or explain the preexisting legislative acts and intentions of Congress." Anthony, *supra*, at 1324 (footnote omitted). Rules that make "new law" are not interpretive; rather, they are legislative and must have been promulgated as legislative rules before they can be given binding effect. "Rules have been found to make 'new law,' and thus to be legislative, where they fill a statutory gap by imposing a standard of conduct, create an exemption from a general standard of conduct, establish a new regulatory structure or otherwise complete an incomplete statutory design." *Federal Agency Rulemaking, supra*, at 62 (citing Michael Asimow, *Nonlegislative Rulemaking and Regulatory Reform*, 1985 Duke L.J. 381, 394).

The distinction between legislative and interpretive rules has been characterized as "fuzzy." *Avoyelles Sportsman's League, Inc. v. Marsh*, 715 F.2d 897, 909 (5th Cir. 1983). Nonetheless, the District of Columbia Circuit recently offered the following reconciliation of its case law:

> Accordingly, insofar as our cases can be reconciled at all, we think it almost exclusively [is] on the bases of whether the

purported interpretive rule has "legal effect", which in turn is best ascertained by asking (1) whether in the absence of the rule there would not be an adequate legislative basis for enforcement action or other agency action to confer benefits or ensure the performance of duties, (2) whether the agency has published the rule in the Code of Federal Regulations, (3) whether the agency has explicitly invoked its general legislative authority, or (4) whether the rule effectively amends a prior legislative rule. If the answer to any of these questions is affirmative, we have a legislative, not an interpretive rule.

American Mining Congress v. Mine Safety & Health Admin., 995 F.2d 1106, 1112 (D.C. Cir. 1993). With regard to the fourth criteria, the court noted:

A rule does not, in this inquiry, become an amendment merely because it supplies crisper and more detailed lines than the authority being interpreted. If that were so, no rule could pass as an interpretation of a legislative rule unless it were confined to parroting the rule or replacing the original vagueness with another.

Id.

Professors Davis and Pierce have praised the guidance offered by the *American Mining Congress* criteria. They maintain, however, that "[t]he second criterion—publication in the Code of Federal Regulations (CFR)—should not be used in any attempt to distinguish between a legislative rule and an interpretative rule...." 1 Davis & Pierce, *supra*, § 6.3 (Supp. 1999).

A note of caution: Not all rules that "interpret" are interpretive rules. Legislative rules can be "interpretive." The distinction between a legislative rule that interprets a statute or another rule and an interpretive rule is found in the definition of a legislative rule—that is, the agency has the statutory power to make the rule and it exercises that power in compliance with APA § 553. As noted above, unlike legislative rules, "[i]nterpretive rules do not require notice and comment...." *Shalala v. Guernsey Memorial Hospital*, 115 S. Ct. 1232, 1239 (1995); *see also Hoctor v. United States Dep't of Agric.*, 82 F.3d 165, 167 (7th Cir. 1996)("There are no formalities attendant upon the promulgation of an interpretive rule, but this is tolerable because such a rule is 'only' an interpretation."). This exemption for interpretive rules from compliance with APA § 553 is "to allow agencies to explain ambiguous terms in legislative enactments without having to undertake cumbersome proceedings." *American Hospital Ass'n v. Bowen*, 834 F.2d 1037, 1045 (D.C. Cir. 1987).

The binding effect of interpretive rules

Interpretive rules, as such, are not binding on private parties or the courts, nor are they judicially enforceable against the agency. However, "[a] court may choose to give binding effect to the position taken by an agency in an interpretative rule, but it is the court that provides the binding effect of law through its process of statutory interpretation; the agency's interpretative rule serves only the function of potentially persuading the court that the agency's interpretation is correct." 1 Davis & Pierce, *supra,* at § 6.3. *See also Federal Agency Rulemaking*, *supra*, at 65 ("An agency issuing an interpretive rule (i.e., an interpretation which merely reminds parties of existing law or interprets a statute without creating new rights and duties) may well intend that its interpretation bind its own personnel, and it may expect compliance from regulated individuals or entities. Nonetheless, the agency cannot expect the interpretation to be binding in later proceedings; because it does not have the force of law, parties can challenge the interpretation.").

When a *legislative rule* "interprets" an ambiguous statute that the agency has been delegated authority to implement, the agency's interpretation is binding on a court if it offers a "permissible construction of the statute." *Chevron v. Natural Resources Council, Inc.*, 467 U.S. 837, 842-43 (1984). When the interpretation is found in an *interpretive rule*, not a legislative rule, a different degree of deference applies: "a court is not required to give effect to an interpretative regulation. Varying degrees of deference are accorded to administrative interpretations, based on such factors as the timing and consistency of the agency's position, and the nature of its expertise." *Batterton v. Francis*, 432 U.S. 416, 425 n.9 (1977) (citations omitted). *See also* Davis & Pierce, *supra*, at § 6.3 ("Both Congress and the courts have long recognized... that 'interpretive rules,' exempt from the notice and comment procedure by APA § 553, do not have binding effect on citizens or on courts. Thus, the *Chevron* test does not apply to interpretive rules.").

The deference accorded to interpretive rules, sometimes called "*Skidmore* deference" based on *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944), is weaker than the "*Chevron* deference" accorded to legislative rules that interpret. In *Skidmore*, the agency had not been given the power to make legislative rules. Hence, the agency could not make rules that were legally binding on a court. Professor Davis and Pierce describe the distinction between *Chevron* deference and *Skidmore* deference as follows:

[T]he judicial deference to be accorded a legislative rule [*Chevron* deference] is a strong form of deference attributable to the fact that the agency is exercising legislative power granted it by Congress using the procedures Congress authorized for that purpose.... *Skidmore* deference is not based on the institutional legitimacy of the agency pronouncement; an interpretative rule cannot have binding effect because Congress has not authorized any agency to issue an interpretative rule with binding effect. *Skidmore* deference is based solely on common sense. A court should consider adopting the position taken in an agency interpretative rule because there are reasons to believe that agency positions are wise and correct.

1 Davis & Pierce, *supra*, § 6.3 (noting also that "[t]he *Skidmore* opinion states that deference due interpretative rules is based solely on their potential power to persuade").

Notwithstanding the rule that interpretive rules interpreting statutes are not binding on the courts, Professors Davis and Pierce note that "an interpretative rule binds federal courts when it explains or interprets a legislative rule unless the interpretative rule is inconsistent with the legislative rule, violates the Constitution or a federal statute, or is plainly erroneous." 1 *id.* § 6.3 (relying on *Stinson v. United States*, 113 S. Ct. 1913 (1993)). As more often stated, an "administrative interpretation is controlling unless plainly erroneous or inconsistent with the regulation. 1 *id.* at § 6.10 (relying on *Bowles v. Seminole Rock Co.*, 325 U.S. 410 (19945)). Underlying this principle is the notion that "[t]he agency typically is in a superior position to determine what it intended when it issued a rule, how and when it intended the rule to apply, and the interpretation of the rule that makes the most sense given the agency's purposes in issuing the rule." 1 *id.* at § 6.10.

Professors Davis and Pierce are critical of *Stinson* because the non-legislatively-issued administrative "commentary" in which the interpretation was found did not claim to have binding effect: "The *Stinson* Court held... that courts must give the commentary greater authoritative effect than the [agency] claimed for it.... That part of the reasoning seems wrong." 1 Davis & Pierce, *supra*, § 6.10 (citation omitted). On the other hand, they suggest that *Stinson* can be interpreted "merely as a reaffirmation of long-standing principles," including the principle articulated in *Udall v. Tallman*, 300 U.S. 1 (1965). 1 *id.* § 6.10.

Udall v. Tallman stands for the proposition that courts must give "great" deference to an agency's interpretation of its own regulations. "The classic statement of the rule is the 'plainly erroneous' standard: if the language of a regulation is ambiguous, a court must accept an administrative construction of it that is not 'plainly erroneous or inconsistent' with the language of the regulation." Russell L. Weaver, *Judicial Interpretation of Administrative Regulations: An Overview*, 53 U. Cin. L. Rev. 681, 722 (1984) (footnote omitted). *See also* Russell L. Weaver, *Challenging Regulatory Interpretations*, 23 Ariz. St. L.J. 109 (1991). In this regard, as Professors Davis and Pierce note, "[a]n interpretation of a rule inconsistent with the language used by the agency in a legislative rule fails to satisfy the requirement that citizens have adequate notice of permissible and impermissible conduct." 1 Davis & Pierce, *supra*, § 6.10.

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