

# Agricultural Law Update

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## INSIDE

- Unresolved issues in the tobacco quota buyout
- Agricultural law bibliography

*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.*

## IN FUTURE ISSUES

- Conservation easements for agricultural landowners
- Conservation Reserve Program long-term policy

## Federal Register: September 3 to November 11, 2005

**COTTON.** The CCC has adopted as final regulations changing the Extra Long Staple cotton price used to calculate the payment rate from the "average domestic spot price quotation for base quality U.S. Pima cotton" to the "American Pima c.i.f. Northern Europe" price. **70 Fed. Reg. 67342 (Nov. 7, 2005).**

**MEAT, POULTRY AND EGGS.** The FSIS has announced the availability on its web site of information regarding new technologies for use in the production of meat, poultry, and egg products that the FSIS has received and for which FSIS has written a "No Objection" letter. The web site includes brief descriptions of the new technologies in order to increase public and industry awareness of new technologies and foster their use by small and very small plants. **70 Fed. Reg. 60784 (Oct. 19, 2005).**

**ORGANIC FOOD.** The AMS has issued a notice to inform certified organic producers and handlers that the AMS will release the names and addresses of certified operations to the general public. AMS has determined that the Organic Foods Production Act of 1990, as amended, 7 U.S.C. 6501 *et seq.*, authorizes the release of the names and addresses of certified organic producers and handlers under the broad category of information characterized by the 1990 Act as "certification documents." **70 Fed. Reg. 53617 (Sept. 9, 2005).**

**POULTRY INSPECTION.** The FSIS has issued proposed regulations which amend the federal poultry products inspection regulations to provide that turkey slaughter establishments that open turkey carcasses with Bar-type cuts may operate at the maximum line speeds established for J-type cuts, if the establishment uses the specific type of shackle described in the proposed rule. Under the proposed regulation, as under current regulations, the inspector in charge will reduce line speeds when, in his or her judgment, the prescribed inspection procedure cannot be adequately performed within the time available because of the health conditions of a particular flock or because of other factors, including the manner in which birds are being presented to the inspector for inspection and the level of contamination among the birds on the line. **70 Fed. Reg. 53582 (Sept. 9, 2005).**

**SUGAR.** The CCC has issued proposed regulations to provide for an orderly and transparent method of distributing the allocation of marketing allotments to successor mills after growers have petitioned the Executive Vice President, CCC, to transfer their allocation when their mill closes. The proposed regulations use a formula to distribute the closed mill's allocation that will calculate grower shares based on the grower's contribution to the mill's allocation. The proposed regulations also formalize the due date, on the 20th of each month, for the reporting to the CCC on their sugar production. The CCC noted that willful failure to timely file the reports can make a reporter subject to a maximum civil penalty of \$10,000. The proposed regulations also require each reporting entity to have an independent third party verify each company's data submitted to the CCC. **70 Fed. Reg. 53103 (Sept. 7, 2005).**

**TRANSPORTATION.** The CCC has issued a notice to all interested parties regarding additional actions pursuant to the September 20, 2005 announcement to ease transportation issues exacerbated by Hurricane Katrina. The CCC is seeking proposals from interested parties for unloading barges of agricultural commodities located in the New Orleans area to make them available to transport 2005-crop agricultural commodities. Proposals should be submitted November 14, 2005 to be assured of consideration. **70 Fed. Reg. 67410 (Nov. 7, 2005).**

**TUBERCULOSIS.** The APHIS has adopted as final regulations which remove two inconsistent definitions of affected herd under the tuberculosis regulations, 7 C.F.R. § 77.5, 77.20, and add a new definition of affected herd as "a herd of livestock in which there is strong and substantial evidence that *Mycobacterium bovis* exists. This evidence should include, but is not limited to, any of the following: epidemiologic evidence, histopathology, polymerase chain reaction (PCR) assay, bacterial isolation or detection, testing data, or association with known sources of infection." **70 Fed. Reg. 61025 (Oct. 20, 2005).**

The APHIS has adopted as final regulations amending the tuberculosis regulations to remove New Mexico from the list of modified accredited advanced states and adding portions of New Mexico to the list of modified accredited advanced zones, with the remainder of the state listed as accredited-free zones. **70 Fed. Reg. 61226 (Oct. 21, 2005).**

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

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# Unresolved issues raised by the Tobacco Transition Payment Program (TTPP, also called the 'Tobacco Buyout')

By Theodore A. Feitshans

The Fair and Equitable Tobacco Reform Act of 2004 (the Act) was signed by the President on October 22, 2004. Subtitle A of the Act provides for termination of federal tobacco quota and price support programs, effective for crops after the 2004 marketing year. Subtitle B of the Act provides for transitional payments to be made to tobacco quota holders and producers of tobacco. TTPP payments will be made from June through September of 2005 for the 2005 marketing year, and thereafter in each January of each of the subsequent nine years. Total payments are \$7 per pound for quota holders and \$3 per pound for producers who produced in all three base years (landlords who shared in the risk of production are entitled to part of this payment). Subtitle B also establishes a tax on domestic producers of tobacco products and importers of tobacco products from which transitional payments are to be made. Subtitle C of the Act contains implementation and transition provisions. Issues for which there has been no or only partial resolution include tax treatment of payments, rights of future interest holders, marital rights, interests of prior lien holders, treatment of payments to incompetents, successor-in-interest contracts with other than financial institutions, successor-in-interest holder liability to holders of prior interests, estate planning issues, bankruptcy and insolvency, and even the formula for calculating producer poundage. The tax treatment of payments will not be covered in this article since that topic was covered in the first article in this series that was written by Guido van der Hoeven. (September/October 2005 *Agricultural Law Update*).

Geographically the impact of the Act extends far beyond those states in which program tobacco was produced. Quota holders reside in all fifty states, and in dozens of foreign countries. Producers and importers of tobacco products, subject to the assessments under the Act, are widely dispersed throughout the United States.

The Farm Service Agency (FSA) has generated voluminous guidance and documentation in the process of administering the TTPP. The FSA has established a website devoted to the topic. < <http://www.fsa.usda.gov/tobacco> >.

(For those not familiar with the structure of the U.S. Department of Agriculture (USDA), commodity programs, including the tobacco quota program and the TTPP, are administered by the Commodity Credit Corporation (CCC). The CCC is a government-owned corporation staffed by employees of the FSA.) The North Carolina Cooperative Extension has also established an informational website that provides analysis and additional documentation. <<http://www.tobaccobuyout.cals.ncsu.edu>>.

## Determination of eligibility for quota holder and producer payments

Definitions, including those for producers of quota tobacco and tobacco quota holders, are found in section 621 of subtitle B of the Act. Any "owner, operator, landlord, tenant, or sharecropper that shared in the risk of producing tobacco on a farm where tobacco was produced or considered planted pursuant to a tobacco farm poundage quota or farm acreage allotment" is a producer of quota tobacco for purposes of the Act. An action has been filed in the U.S. District Court for the Western District of Virginia that alleges that the method that CCC has used to calculate producer poundage unconstitutionally exceeds the authority provided by the Act. (*Neese v. Johanns*, Case No. \_\_\_\_\_).

Section 623(a) sets terms for producers of quota tobacco as were set for tobacco quota holders under section 622(a). Section 623(b) requires that each producer of quota tobacco file an application providing adequate proof of that status, and authorizes the Secretary of Agriculture to make an equitable division of contract payments among multiple producers of the same tobacco quota. Section 623(c) provides a mechanism for the Secretary to use in calculating base quota levels. For producers of burley and flue-cured tobacco, this is the effective quota for the 2002 marketing year. Section 622(d) provides that those who produced in each of the marketing years, 2002, 2003, and 2004, shall receive the full producer payment of \$3.00 per pound of quota, over the ten years of the contract period. Producers who did not produce in each of those three years shall have their payments reduced accordingly.

A tobacco quota holder is "a person that was an owner of a farm, as of the date of enactment of this title, for which a basic tobacco farm marketing quota or farm acreage allotment for quota tobacco was established for the 2004 tobacco market-

ing year." Section 622(a) of the Act authorizes the Secretary of Agriculture "to enter into a contract with each tobacco quota holder under which the tobacco quota holder shall be entitled to receive payments...in exchange for the termination of tobacco marketing quotas and related price support..." Section 622(a) states that "[t]he contract payments shall constitute full and fair consideration for the termination of such tobacco marketing quotas and related price support." The FSA has determined by regulation that life tenants rather than remaindermen, where quota is attached to land subject to a life tenancy, are the 'owners' of the quota for purposes of determining who has the right to sign a TTPP contract and to whom the FSA will make the TTPP payment. (70 Fed. Reg. 17150, 17151, 17160). Nothing in the Act requires that tobacco quota holder owners enter into contracts; however, the refusal to enter into contracts will not prevent the Act from extinguishing the quota held by non-signers. Non-signers will, however, have no right to transitional payments.

Section 622(b) requires that all tobacco quota holders seeking to enter into contracts prove that they are quota holders by filing an application with the Secretary of Agriculture. The February 25, 2005, *Questions and Answers about the Tobacco Transition Payment Program* (TTPP), published by the Farm Service Agency (FSA), indicates that farm ownership as of October 22, 2004, is the determinative factor in deciding who is the eligible quota holder. Nonetheless, the February Fact Sheet states that tobacco quota holders for whom new allotment or quota was established on their farms in the 2003 or 2004 marketing years are not eligible for transition payments.

Section 622(c) establishes the basic quota level for each flue-cured tobacco quota holder established for the 2002 tobacco marketing year as the base year for determining payment levels. All other types of tobacco use production in 2002, 2003, and 2004 to determine the base for setting payment levels. Section 622(d) provides exceptions to section 622(c) where there was an existing contract to purchase all or part of the farm as of the date of enactment, or an agreement to permanently transfer quota as of the day prior to enactment.

## Rights of future interest holders

It is quite common to find tobacco quota and the land associated with it held by

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owners of life estates. Consistent with its position on other commodity programs, the CCC has determined that the life tenant is the 'eligible tobacco quota holder', exclusively entitled to receive payments under the TTPP. (70 Fed. Reg. 17150, 17151, 17160).

An eligible quota holder does not include any other person who: claims a lien, security interest or other similar equitable interest in the farm or in any personal asset of the owner of the farm or a producer on the farm; has a remainder interest or any other contingent interest in the farm or in any personal asset of the owner of the farm or a producer on the farm; or who may have caused any such marketing quota to have been transferred to the farm. (70 Fed. Reg. 17150, 17160).

However, the CCC made no claim of federal preemption. To the contrary it stated, in the explanatory material to the April 4th regulation, the CCC stated that disputes involving these claims must be settled 'privately' without the involvement of either the CCC or the FSA. (70 Fed. Reg. 17150, 17151).

A discussion of the claims of the holders of future interests to TTPP payments would not be complete without a discussion of just what sort of property interest tobacco quota was. For most transfers of land the quota was transferred with it; however, such did not occur in every land transfer. Land transfers occur by deed, registered at the local land office while transfers of quota were registered exclusively with the FSA county office. Although CCC regulations required that any transfer of land be accompanied by a change of ownership in the FSA office, it was not uncommon that this did not happen, especially where the land transfer was intra-family. The CCC implicitly recognized this fact in its regulations governing the TTPP. (70 Fed. Reg. 17150, 17151). For those varieties of tobacco, such as flue-cured, for which the CCC allowed the transfer between farms, an argument can be made that tobacco quota was not real property. Since quota became transferable, judicial decisions addressing this issue are sparse. Obviously, the characterization of tobacco quota has a profound influence upon the rights of holders of future interests. And, to state the obvious, while treatment of quota by federal taxing authorities and courts may be suggestive of how the states should treat quota, that treatment does not likely bind the states.

As to producer payments, holders of

future interests will generally have no claim unless they can show that they shared in the risk of production in one or more of the 2002, 2003, or 2004 crop years.

### **Marital rights**

The marriage relationship may give rise to an interest in tobacco quota. Tobacco quota acquired during the course of marriage will generally be marital property, subject to division upon termination of the marriage, unless a valid prenuptial agreement or marital contract provides otherwise. In most states, tobacco quota acquired before marriage or by inheritance is not marital property subject to equitable distribution. Note, however, that non-marital property may be transformed into marital property by the spouse's contributions to the farm business. Examples of such contributions include paying taxes on the property and repaying loans for which the property was pledged as collateral. The fact that the government's termination of the quota program has converted the tobacco quota to a stream of payments will generally not change its character as marital or non-marital property.

The question of whether TTPP payments arising from producer payments constitute marital property is a more difficult question. The right to producer payments arises from having produced tobacco in one or more of the 2002, 2003, or 2004 crop years. An argument can be made that those years should serve as the basis for determining whether the producer payments are marital property. However, no right to the payments arose until the President signed the Act on October 22, 2004. Prior to that time the producer had nothing. Even after that date the producer had to take the positive step of submitting a contract application by June 17, 2005. Even at that point, no right of action in the producer arose until the government accepted the application, forming a contract with the producer. The contract date is the date upon which the government accepted the producer's application.

Even where TTPP payments are not marital property, the value that the payments represent may be a factor in determining the appropriate division of the parties' marital property. Moreover, the TTPP payments are income includable in income for determining child support and spousal support. Where TTPP payments are marital property, there is a risk of double counting when calculating spousal support. The successor-in-interest con-

tract offers a way of simplifying marital settlements by reducing the stream of payments to a lump sum that can be easily divided. Possibly a direct transfer from one spouse to the other of the right to payments could be effected using the success-in-interest contract. Unfortunately fractional transfers of TTPP contracts are not permitted. If a successor-in-interest contract to make a direct transfer between spouses is contemplated, it may be necessary to complete the transaction prior to the final decree of divorce because it is an unresolved issue whether the CCC would still consider ex-spouses to be family members eligible to execute a successor-in-interest contract. Careful review of the tax consequences of such a transaction is essential prior to execution of any such a transfer.

No tobacco quota holder or producer is required to take TTPP payments. However, the quota holder or producer's failure to sign a contract with the CCC on a timely basis could be evidence of voluntary suppression of income.

### **Interests of prior lien holders, bankruptcy and insolvency**

In some respects, interests of prior lien holders are analogous to holders of future interests. Much turns on how tobacco quota is characterized; however, prior lien holders may have greater rights because liens can encompass personal property, even if after-acquired, as well as real property. To date, one decision, *In re: Evans* (Case No. 04-03288-8-JRL (Bankr. E.D.N.C. April 15, 2005)), has addressed the question of the rights of prior lien holders in TTPP payments. The debtors were tobacco farmers who filed for relief under Chapter 11 of the U.S. Bankruptcy Code on April 22, 2004. The decision in *In re: Evans* was not appealed.

The debtors in *In re: Evans* were eligible for both producer and quota holder payments. Judge Leonard held that the tobacco quota was valuable property of the estate, and that the TTPP quota holder payments were proceeds and therefore part of the bankruptcy estate. In a footnote, Judge Leonard characterized tobacco quota as a species of real property running with the land.

As to the producer payments based upon the 2002 and 2003 crop years, Judge Leonard held that the 'risk of production' was simply the measure that Congress used for determining eligibility for payments, and that the risk of production in 2002 and 2003 had no value as of the

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commencement of the action. Since it had no value as of the commencement of the action, the TTPP producer payments based upon the risk of production in 2002 and 2003 were not proceeds and not part of the bankruptcy estate. Judge Leonard found that the bankruptcy estate bore the risk of loss associated with the 2004 crop year. As such, the bankruptcy estate, under 11 U.S.C. §541(a)(7), acquired whatever the risk of loss provided. The court determined that the TTPP payments based on the risk of loss in the 2004 crop year were part of the bankruptcy estate.

The court in *In re: Evans* found that FETRA evinced no intent by Congress to preempt state law under which prior liens were created. The regulations state, “[t]his final rule preempts State laws that are inconsistent with its provisions, but the rule is not retroactive.” (70 Fed. Reg. 17150, 17157). The court held that the rules determining to whom TTPP payments are to be made were adopted for administrative ease and not intended to affect the underlying rights of the parties. To summarize the decision, quota holder payments were part of the bankruptcy estate, subject to preexisting liens, the producer payments based upon the risk of production in 2002 and 2003 were not part of the bankruptcy estate, and the producer payments based upon the risk of production in 2004 were part of the bankruptcy estate, but not subject to preexisting liens.

#### Treatment of payments to incompetents

The FSA-211 is the power of attorney form required by FSA when another person has been designated by the recipient of program benefits to sign papers for that recipient. As a tool for managing the affairs of one physically or mentally unable to manage their own affairs, the FSA-211 is useless because by its own terms it is rendered not in force by the “incompetence or incapacitation of the undersigned grantor”. A separate durable power of attorney or appointment of a guardian is required to manage the TTPP business of a person who is incompetent. FSA will not automatically accept the durable power of attorney of a person who is incompetent.

It refers these documents to the USDA’s Office of General Counsel (OGC) for a determination of whether the document will be honored.

Given the extensive publicity generated by FSA and the state extension and other organizations in quota tobacco states, however, it is likely that a few quota holders, and, perhaps even a few producers, primarily among those who are incompetent failed to meet the June 17, 2005 signup deadline to receive the first payment. FSA’s February 2005 Fact Sheet,

*Tobacco Transition Payment Program (TTPP)*, indicated that sign-up will be available from March 14 to June 17, 2005, and that this will be “the final and only opportunity to receive Federal payments related to tobacco production.” FSA softened its position in its April 4, 2005 *Federal Register* notice, in which it reserved the discretion to extend this deadline. (70 Fed. Reg. 17150, 17164). FSA also stated that late applicants would, in any event, receive all payments made after the late contract application is accepted.

It is, therefore, incumbent upon producers or quota holders who have not submitted a contract application to do so with all due speed. Although FSA has issued no guidance as to the circumstances under which it will exercise its discretion to accept late contract applications, applicants or their representatives would be well advised to document the causes of their tardiness and request late acceptance of their application. The representative of an incompetent quota holder or producer would certainly want to fully document how the incompetency of the applicant prevented a timely application. In the event that FSA makes an adverse determination, the Act provides for appeal first to the county committee and then to the National Appeals Division (NAD), in a procedure very familiar to practitioners who handle disputes with the FSA. Adverse decisions of the NAD may be appealed to the appropriate federal district court.

#### Successor-in-interest contracts

Section 624 of the Act requires the Secretary of Agriculture to permit producers and quota holders to transfer their right to payment to a financial institution in return for a lump sum payment from the financial institution. By notice and request for comments published in the *Federal Register* on June 27, FSA gave notice of the procedure and form that it anticipated using for successor-in-interest contracts. (70 Fed. Reg. 36919). Form CCC-962, Tobacco Transition Payment Program Successor-in-Interest Contract, has been made available through county offices and the FSA website. Form CCC-962 has already been revised several times. The successor-in-interest contract requires in Part A, identification of the original contract, identity and contact information for the transferor, and the transferor’s signature and date signed; in Part B, identity and contact information for the successor-in-interest, the successor-in-interest’s signature and date signed, and the TTPP Account Number (obtained by registering with CCC using Form CCC-963); and in Part C, information needed for immediate transfer to a subsequent successor, if any, if not this section is left blank. In Part D, the parties

indicate the means by which they wish to be notified of contract approval. Part D includes instructions for submission of the Form CCC-962.

By signing the successor-in-interest contract, the transferor warrants that the contract identified in Part A is a valid TTPP contract, that no assignment of any future payment has been made, and that the transferor is not indebted to the federal government. The successor-in-interest contract is silent as to the rights of third parties in TTPP payments under state law. If the analysis in *In re: Evans* is ultimately adopted by other courts, then financial institutions that have executed successor-in-interest contracts may be protected from preexisting liens only to the extent that the law of the state where the contract arose (presumably the location of the quota and the production of the tobacco) protects the purchaser of a contract from preexisting liens. The limited preemption that the April 4<sup>th</sup> rule provides, as discussed above, would not likely provide any protection from preexisting liens.

Successor-in-interest contracts may be used for transfers to other than financial institutions in three limited circumstances. These circumstances are limited to “contract transfers between family members[,] contract transfers between a TTPP contract holder and a person who purchased tobacco quota or allotment before October 22, 2004, when quota was put on a farm not owned by the purchaser[, and] contract transfers because of death of the original contract holder.” (FSA Notice TB-1172 (9-28-2005)). These transfers are exempt from the minimum payment provisions applicable to registered financial institutions. (70 Fed. Reg. 17150, 17165).

#### Estate planning issues

In the event of the death of the quota holder, section 622(f) provides for transfer of the right to receive payments to the quota holder’s surviving spouse, or, if there is none, to the quota holder’s estate. This provision does not appear to preempt state law governing intestacy, transfers by will, and prenuptial agreements by transferring the right to payment to the surviving spouse. As the court held in *In re: Evans*, this provision appears to be primarily for the administrative convenience of the CCC. Nonetheless, the issue remains open and subject to interpretation. For those with a state-law claim based on a will, a prenuptial agreement, or the law of intestacy, there are practical barriers to obtaining the money from the party to whom the CCC makes the payment if that party is not willing to voluntarily relinquish the funds. Section 623(e) is identical to section 622(f) in setting terms of succession in the event of the death of the pro-

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ducer of quota tobacco. USDA's October 6 press release (Release No. 0415.05) and the related FSA notice (FSA Notice TB-1172 (9-28-2005)) have provided some clarification and readers are referred to those documents.

For estates that receive TTPP contracts, the availability of successor-in-interest contracts to transfer interests in the contracts to the beneficiaries should be very helpful. This will avoid what some had earlier feared, the necessity of holding the estate open to receive the payments.

#### **Tobacco manufacturer and importer assessments**

The TTPP is paid from funds generated through an assessment on producers and importers of tobacco products. The FSA published its Final Rule, *Tobacco Transition Assessments*, in the *Federal Register* on February 10, 2005, [70 Fed. Reg. 7007 - 14] setting assessments for domestic manufacturers of tobacco products and importers of tobacco products.

#### **Disclaimer**

*Information provided here is for educational purposes only. Nothing herein constitutes the provision of legal advice or accounting services. Quota holders and tobacco producers should contact their legal advisers, tax practitioners and other professional advisers relative to their circumstances in regards to these issues.*

*Editor's note: This article is a companion piece to the In Depth article, entitled "Tobacco quote buyout tax considerations", by Guido van der Hoeven, appearing in the September/October 2005 issue of the Agricultural Law Update, pages 4-7, 10-11,*

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*If you desire a copy of any article or further information, please contact the Law School Library nearest your office. The National AgLaw Center website < <http://www.nationalaglawcenter.org> > <http://www.aglaw-assn.org> has a very extensive Agricultural Law Bibliography. If you are looking for agricultural law articles, please consult this bibliographic resource on the National AgLaw Center website.*

*- Drew L. Kershen, Professor of Law, The University of Oklahoma, Norman, OK*

*Report from Executive Director*

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**UPDATE BY E-MAIL.** If you have not already switched to the e-mail version of the Update, I urge you to use the membership renewal form to change your subscription to the e-mail version. This will save the association a considerable amount of expense in reduced printing and postage costs. In addition, if you had an e-mail subscription now, this issue of the Update would have been in your e-mail box at least a week before you read this. If you would like to see a sample PDF file of the e-mail Update, please send me an e-mail at [RobertA@aglaw-assn.org](mailto:RobertA@aglaw-assn.org) and I will send a sample file.

#### **CONFERENCE HANDBOOK ON CD.**

Again this year, we are offering CD-ROMs of the printed materials from the 2005 conference. The CDs also contain the archives of the Update from 1999-2005. Just send me an e-mail and I will send one to you with an invoice for \$45.00.

As always, I look forward to hearing from all members about suggestions for improving your membership benefits. Happy Holidays to all.

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## AMERICAN AGRICULTURAL LAW ASSOCIATION NEWS

### *Report from the Executive Director*

**MEMBERSHIP RENEWALS.** The new year rapidly approaches and that means that it is time to renew your membership to the AALA. Membership renewal packets should be arriving shortly and I urge everyone to return their membership dues promptly to avoid unintentional interruption in your Update subscription and other member benefits. Recent graduates should notice the membership category of "new professional" for \$60 for members who are within three years, as of January 1, 2006, of graduating from a college or law school.

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