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Eighth Circuit finds implied cause of action for borrower enforcement of Ag Credit Act of 1987

In *Zajac v. Federal Land Bank of St. Paul,* 887 F.2d 844 (1989) the Eighth Circuit held that the Agricultural Credit Act of 1987 implied a private cause of action for the enforcement of the Act's Farm Credit System "borrowers' rights" provisions. However, that right of action is limited to seeking injunctive relief tailored to secure lender compliance with the procedures prescribed by one or more of the specific "borrowers' rights" provisions. The court expressly disclaimed any right of borrowers to secure judicial review of the merits of lender decisions, such as a decision to foreclose rather than to restructure.

The Eighth Circuit's decision in *Zajac* is squarely at odds with the Ninth Circuit's decision in *Harper v. Federal Land Bank of Spokane,* 878 F.2d 1172 (9th Cir. 1989), in which the contention that the 1987 Act implied a private cause of action was rejected. In light of the split between the two circuits and the importance of the issue to System borrowers and lenders as demonstrated by its recurring nature, it may be assumed that one or both of the two losing parties in the respective cases will seek review by the United States Supreme Court.

In *Zajac,* the implied cause of action issue was presented by the borrowers' claim that they haad been improperly denied the right to obtain an independent appraisal of the lender's collateral at the credit review committee stage of their request for loan restructuring. That right is specifically afforded to borrowers by the Technical Corrections Act of 1988, Pub. L. No. 100-399, sec. 103, 102 Stat. 989, 990 (1988) (codified at 12 U.S.C. sec. 2202(d)(1), (2), and (3)).

(Continued on page 2)

Insider guarantees

In a landmark decision, the Seventh Circuit Court of Appeals has squarely held that creditors holding guarantees from corporate officers and other insiders are subject to the one year reach-back period for preferences under section 547(b)(4)(B) of the bankruptcy code. In *Levit v. Ingersoll Rand Financial Corp.,* 874 F.2d 1186 (7th Cir. 1989), the court held that the express language in sections 547 and 550 of the code permits no other conclusion.

The relevant facts in the case follow a typical business financing pattern. Deprizio Construction Company, over the course of several years, borrowed substantial sums from various lenders. These debts were secured by a lien on the assets of the corporation. In addition, the lenders obtained the personal guarantees of one or more of the corporation's officers and directors. In the year immediately prior to its bankruptcy, the corporation made substantial payments to its lenders, including the lenders whose claims were personally guaranteed. The corporation's Chapter 7 trustee brought adversary proceedings against the lenders seeking to recover payments made more than ninety days but within the year before the filing. The trustee reasoned that the payments made to these outside creditors were "for the benefit of" inside co-signors and guarantors because every dollar paid to the outside creditor reduced the insider's exposure by the same amount.

In affirming the district court's holding with respect to the institutional lenders, the court of appeals looked to several provisions of the bankruptcy code. First, citing section 101(30)(B)(ii), the court recognized that a corporation's officer is an "insider." Under section 101(9), any person with a "claim" against the debtor is a "creditor," and anyone with a contingent right to payment holds a "claim" under section 101(4)(A). A guarantor has a contingent right to payment from the debtor. If a lender holding a guarantee collects from the guarantor, the guarantor succeeds to the lender's entitlements and can collect from the debtor. As a result, according to the court, a guarantor is a "creditor" in the debtor's bankruptcy proceedings.

(Continued on page 2)

After an extensive review of the 1987 Act's legislative history directed at ascertaining whether Congress intended to give borrowers the right to enforce the Act's borrowers' rights provision, including the right to an independent appraisal, the *Zajac* court concluded that Congress had so intended. In reaching that conclusion, the court not only relied on the statements of the Act's Congressional sponsors, but also on the specificity of the borrowers' rights provisions and the lack of any other means of effective enforcement. In particular, the court noted the absence of any specific procedure available to borrowers to seek enforcement by the Farm Credit Administration of those provisions and the absence of any demonstrated activity on the part of that agency to assume such responsibilities on its own initiative.

A particularly significant part of the court's opinion was the disclaimer of any willingness on the part of the court to review the merits of System lender decisions, specifically citing as an example a lender's decision to foreclose rather than to restructure a borrower's loan. Although that portion of the opinion was dictum, it appears to be consistent with earlier analogous decisions of the Eight Circuit concerning the scope of review of the denial of FmHA loan applications. *Tuepker v. FmHA*, 708 F.2d 1329, 1332 (8th Cir. 1983) (declining to review the denial of an FmHA loan in the absence of a claim "alleging a substantial departure from important procedural rights, a misconstruction of governing legislation, or some like error, going to the heart of the administrative determination."); *Woodsmall v. Lyng*, 816 F.2d 1241, 1245 (8th Cir. 1987) (declining to review the denial of an FmHA loan because the applicant was not creditworthy on the grounds that the federal courts "are not equipped to undertake such a task, for in these matters we have neither the training nor the experience of an FmHA loan officer.")

Moreover, the *Zajac* court implicitly referred approvingly to previous Eighth Circuit decisions disallowing claims for monetary damages based on alleged breaches by System lenders of the Farm Credit Amendment Act of 1985 by noting that it was not holding that damages were available. *Redd v. Federal Land Bank of St. Louis*, 851 F.2d 219 (8th Cir. 1988); *Mendel v. Production Credit Ass'n of the Midlands*, 862 F.2d 180 (8th Cir. 1988).

Finally, as if to underscore the limited scope of its holding, the *Zajac* court noted that the right of action it was implying from the 1987 Act would necessitate "only limited discovery and pleadings." Thus, it appears that the court crafted its opinion in both its holding and dicta to attempt to reach a result that balanced the interests of System borrowers in obtaining lender compliance with the borrowers' rights procedures prescribed in the Act with the interests of System lenders in retaining the ultimate discretion to make the decisions contemplated by those procedures. In the Eighth circuit at least, substantive judicial review will not be a matter of federal jurisprudence; but rather, if substantive review is available, it will arise out of state law. *See Federal Land Bank of Saint Paul v. Overboe*, 404 N.W.2d 445 (N.D. 1987).

–Christopher R. Kelley,
National Center for Agricultural Law Research and Information

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AALA Editor . . Linda Grim McCormick
188 Morris Rd., Toney, AL 35773

Editorial Assistant Thomas P. Guarino, University of Arkansas, Fayetteville, AR

Contributing Editors Roxana C. Bacon, Bryan, Cave, McPheeters & McRoberts, Phoenix, AZ; Christopher R. Kelley, National Center for Agricultural Law Research and Information; Philip L. Kunkel, Hall Byers, Hanson, Steil & Weinberger, St. Cloud, MN; Drew L. Kershen, Professor of Law, The University of Oklahoma College of Law; Linda Grim McCormick, AALA Editor, Toney, AL; Susan A. Schneider, National Center for Agricultural Law Research and Information; Margaret R. Grossman, Professor, University of Illinois

State Reporter Paul L. Wright, Attorney at Law, Columbus, OH.

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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INSIDER GUARANTEES / CONTINUED FROM PAGE 1

As a result, a payment by the corporate debtor to a lender is "for the benefit of' the inside guarantor under section 547(b)(1) because every reduction in the debt to the lender reduces the guarantor's exposure. Unless one of the exemptions provided by section 547(c) applies, the payment to the lender is avoidable under section 547(b)(4)(B). This section provides that transfers made more than ninety days but less than one year prior to the commencement of bankruptcy proceedings may be set aside by the trustee as preferential.

In addition to holding that institutional lenders with insider guarantees are exposed to a one-year preference period, the court also held that the trustee could recover from the lender any payments made during the expanded preference period which constituted preferences. In so holding, the court relied upon section 550(a), which provides that the trustee may recover from the initial "transferee" or the "entity for whose benefit such transfer was made (i.e., the guarantor)." The only limitation upon the trustee's ability to recover from the lenders is provided by section 550(c), which allows only one recovery.

In reaching its decision, the Seventh Circuit noted that a majority of courts that have considered the issue have concluded that insiders' guarantees do not expose outside lenders to an extended preference-recovery period. And, there are at least two cases pending in other courts of appeals on the same issue. The district court in *In re Robinson Bros. Drilling, Inc.*, 97 Bankr. 77 (W.D. Okla. 1988), appeal pending, No. 88-8089 (10th Cir.), relied upon the district court decision in *Levit* to reach a similar result. However, the district court in *Block v. Texas Commerce Bank*, 1989 W.L. 73228 (W.D. Mo. 1989), appeal pending, rejected the reasoning of the district court in *Levit* and held that the time limit established for insiders was not applicable to a lender who holds an insider guarantee.

– Philip L. Kunkel,
Hall, Byers, Hanson, Steil & Weinberger, St. Cloud, MN.

Input sought on 1990 conference

The 1990 AALA annual meeting and educational conference is scheduled for October 5-6, 1990.

The planning committee will soon be selecting topics and speakers.

AALA members with ideas for the 1990 meeting are encouraged to contact Peggy Grossman as soon as possible.

You may mail suggestions to:

Peggy Grossman,
151 Bevier Hall,
905 S. Goodwin,
Urbana, IL 61801,

or call 217-333-1829.

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– Drew L. Kershen, Professor of Law, The University of Oklahoma College of Law

Immigration potpourri: SAWS, RAWS, H2-As and sanctions

by Roxana C. Bacon

Introduction

Since the demise of the Bracero program in 1964, the interplay between U.S. agricultural employers and the Immigration and Naturalization Service (INS) can be described fairly as "intrusive paternalism." Leaving aside the question of whether the heavy hand of the government is justified by employer conduct toward alien labor, it is accurate to state that the government's increasing overseer role is not welcomed by agricultural employers. This brief summary of four different areas in which immigration law and agricultural labor needs collide reflects the uneasy tension between agricultural employers and INS.

SAWS

As part of the last minute politicking which resulted in passage of the Immigration Reform and Control Act of 1986 (IRCA), Pub. L. No. 99-603, 100 Stat. 3360, Congress agreed to include a special amnesty-type benefit for certain workers who had performed seasonal agricultural services in specified crops in specified years. This provision of IRCA is set forth at section 210 of the Immigration and Nationality Act (INA). 8 U.S.C. §1160 *et seq.*

Summary of SAWs

Briefly, the SAWs provision requires the Attorney General to adjust the status to temporary resident of aliens who have (1) resided in the U.S. and (2) performed seasonal agricultural services in the U.S. for a certain number of days. Following the temporary status, and during a specific window of time determined by the alien's dates of qualifying employment, aliens will be adjusted to full permanent resident status (known colloquially as the "green card").

Aliens who worked at least ninety man-days during the twelve months, May 1, 1985 to May 1, 1986, and who meet the residence requirement (an aggregate of six months in the U.S. between May 1, 1985 and November 6, 1986) are known as Group II aliens, and will be adjusted to full permanent resident status two years after the grant of temporary status, or two years after the last day of the application period, whichever is later. Those SAW applicants who met the more restrictive criteria for Group I (more than 90 man-days in each of the three years, beginning May 1, 1983 to May 1, 1986, in qualifying agricultural employment) are eligible to adjust to full permanent status one year after the grant of temporary status, or the last day of the application period, whichever is later.

Workers' legal challenges

There has been the inevitable series of lawsuits challenging many of the SAW provision. The two major challenges, one from the aliens and one from the employers, demonstrate in microcosm the most important theme of the immigration/agriculture universe.

The alien workers have fought through the courts to force INS to accept the reality that most alien migrant workers were truly "undocumented." INS has maintained throughout the suits that the traditional rules of INS adjudication must apply: the burden of proof is on the alien and that burden can only be met by independent, documentary evidence.

In these "documentation" disputes, agricultural employers played an ancillary, but crucial, role. Although IRCA was supposed to require INS to promulgate regulations requiring employers to divulge work records (Conference Report, Rept. 99- 1000, IRCA, p. 96), and imposing penalties on employers for failing to do so, INS failed to address the reluctant employer problem in a timely manner. Indeed, no rule existed until January, 1989 (54 Fed. Reg. 4756), after the December, 1988 end of the SAW application period. As a result, alien workers were often unable to provide any evidence of the qualifying employment except for their own affidavits or affidavits of coworkers.

The pressure on employers not to comply with voluntary requests for records was real. Since most agricultural employers paid alien workers in cash, and most alien workers had no social security numbers (and were ineligible to be issued any), in most cases neither employer nor employee had complied with tax laws. Employers had the most to lose by handing over records that could be used to establish tax violations, and no amount of gentle persuasion was likely to result in such voluntary admissions.

The two major "documentation" lawsuits were both settled in favor of the workers. *United Farmworkers of America v. INS,* Civ. No. S-87-1064-JFM (E.D. Cal. June 15, 1989) affected about 700,000 aliens who filed for SAW status in the twenty-three states covered by the INS Northern and Western regions. This plaintiff class includes approximately seventy percent of all SAW applicants nationwide.

The settlement requires INS to abandon the practices that resulted in discrediting much of the documentation and testimony which the alien applicants submitted to INS to prove their prior work history in agriculture. In addition, INS must now issue any denial notices in sufficient detail so that the aliens will have notice of what they must correct to be approved.

Finally, when INS is relying upon adverse documentary evidence (such as employer letters from contractors or employers which INS believes to be fraudulent) INS must advise the applicants of its reliance on the evidence and give the aliens an opportunity to rebut.

The *UFW vs. INS* settlement, reached in late June, has been implemented by two INS Central office wires to all field offices, one on July 12, 1989 (CO file 1588-C) and the second on July 25, 1989 (CO file 1588-C). In addition to the procedural protections outlined above, the settlement agreement and the INS cables note that employment authorization and a stay of deportation must be offered to all class members whose application is reopened as a result of the settlement, a list of *pro bono* services must be attached to all future notices of intent to deny, and periodic reporting of the results of the implementation must be made to plaintiffs.

The second major "documentation" case concerns the Southern region of INS. *Haitian Refugee Center, Inc. v. Nelson,* 872 F.2d 1555 (11th Cir. 1989) affects approximately 20,000 SAW applications still pending in the INS's Southern region. The Eleventh Circuit upheld the district court's injunction, which required the INS to reopen cases in which:

1. the Service issued defective notices of denial;
2. the INS considered evidence adverse to the applicant without the alien's knowledge; and
3. the Agency adjudicated the application under an incorrect burden of proof.

In addition, the court ordered that:

1. INS had to maintain competent translators in Spanish and Haitian Creole at Legalization offices;
2. SAW applicants must be allowed to present witnesses at their interviews; and
3. INS interviewers must set forth reasons for their recommendations for or against granting SAW status

Roxana C. Bacon is a partner in the firm of Bryan, Cave, McPheeters & McRoberts of Phoenix, Arizona.

directly on their worksheets.

INS Central Office implemented the Eleventh Circuit order by wire to its field offices on June 21, 1989. (CO file 1588).

Employers' legal challenges

The second category of litigation has concerned efforts, primarily by agricultural employers, to expand the definition of "covered agricultural" to make more workers eligible for SAW benefits.

The authority for USDA involvement in this part of IRCA is found in the Act itself. Section 302(a) of the Act (8 U.S.C. §210(h)) directs the Secretary of Agriculture to publish regulations defining "fruits, vegetables, and other perishable commodities" in which field work related to planting, cultural practices, cultivating, growing and harvesting will be considered "seasonal agricultural services," so as to qualify for SAW benefits. After much lobbying, on June 1, 1987, the USDA published its final rule with the key definitions. (54 Fed. Reg. 20372). There was considerable pressure on USDA to expand a narrow, overly technical interpretation of fruits, vegetables, and perishable commodities. Although over 600 comments were filed with USDA, including the Texas Agriculture Commissioner's plea to expand the definition in light of the fact that "64% of Texas' seasonal agricultural workers would not be eligible for SAW legalization under the USDA definition," USDA remained firm, and the definition exclusive.

While a series of lawsuits forced the USDA and INS to expand the definition to include such crops as cotton (held to be a "fruit" under the botanical definition, lettuce seed (a "perishable commodity"), and sod (a "perishable commodity"), the principal crop of contention has been and continues to be sugar cane.

The exclusion of sugar cane from the list was of great concern to some lawmakers and farmworker advocates when it occurred. Many legislators, including House Judiciary Chairman Peter W. Rodino, Jr., complained that the exclusion of sugar cane was a "particularly egregious" evasion of Congress' intent to protect foreign farmworkers. The complaints fell on deaf ears, and litigation ensued.

The approximately 8,000 sugar cane workers who were plaintiffs in the class action *Northwest Forest Workers Association vs. Yuetter*, F. Supp. , Civ. No. 87-1487 (D.D.C. February 28, 1989) fared no better than Rep. Rodino. Their claim for inclusion in the SAW eligible list was eventually denied. The court had first ordered the USDA to reconsider its June 1, 1987 definition excluding sugar cane, and required INS to accept skeletal SAW applications from sugar cane workers. The specific focus of the renewed litigation was whether the USDA's revised definition of "vegetable" (August, 1988), which excluded sugar cane as either a vegetable or perishable commodity, still was arbitrary and capricious, or otherwise legally unacceptable. Relying on the usual deference shown to the Agency's definition of key terms, the district court found that the USDA redefinition of "vegetable" to exclude sugar cane was "adequate and rational."

Plaintiffs have appealed the *Yeutter* sugar cane case, and no decision has yet been issued by the Eleventh Circuit. However, in an interesting reversal, INS ordered its offices to accept skeletal "sugar cane" applications, reinstate work authorization for those who had previously filed such applications, and except only those SAW-eligible sugar cane workers who are currently under an H-2A contract. It is not clear whether INS expects reversal at the circuit court level, since it offered no explanation for its August 21, 1989 Central Office wire.

Other than the appellate work left over from the class action lawsuits challenging definitions and procedures, the SAW program is essentially over. It is unlikely that such a statutory beast will ever again be created.

RAWS

Summary of RAWs

The IRCA amendments anticipated an agricultural employer concern that the SAW program would remove many alien workers from agriculture, since their legalization would allow them to move into other, higher paying work. In the event such "urbanization" of the undocumented agricultural work force should occur, IRCA allows additional workers to be admitted under a replenishment agricultural worker program (known as RAW), which would last from fiscal year 1990 through 1993. The agricultural worker shortage in a particular year was to be determined jointly by the Secretaries of Labor and Agriculture. Section 210A(a)(1), 8 U.S.C. §1161A(a)(1).

Unlike SAWs, whose legalization did not require them to remain in agriculture, replenishment workers would receive three years of temporary resident status, but would be required to perform at least ninety man-days of labor in seasonal agricultural labor in each of those three qualifying years. Only upon completion of the requirements would such workers be eligible to apply for adjustment to full permanent resident status.

Need for RAWs in 1990

In mid-summer, 1989, the USDA and DOL told the INS that U.S. growers may need up to 50,000 extra foreign farm workers over the next four years. That estimate provided the go-ahead for INS to issue its interim RAW regulations, which it did by interim final rule. 54 Fed. Reg. 29875, July 17, 1989.

It is unclear how the USDA and DOL arrived at the 50,000 figure. Many farmworker advocates and growers believe the number was concocted with no factual basis, simply to get the RAW program moving. The USDA/DOL early letters, issued in May and June of 1989, avoided predicting a specific number of workers needed, simply commenting that a shortfall "may occur at some time" during the 1990 to 1993 RAW window.

Methodology for RAWs

Putting the horse before the cart, USDA and DOL later proposed methodology for determining the number of RAW workers that might be needed, and hence admitted, in each of the next three fiscal years. The proposed rule, which would add 7 C.F.R. Part 1(e) and 29 C.F.R. Part 503, was published in the Federal Register on August 11, 1989, 54 Fed. Reg. 32985. Comments on the proposed rule were due by mid-September, 1989.

The proposed formula, which is complicated, consists of (1) the need for labor to perform seasonal agricultural services, stated in work days, minus (2) the supply of such labor, also stated in work days, divided by (3) a work day per worker factor, as determined by the Census Bureau. The proposed rule defines relevant terms, such as "work day." It also sets forth the responsibilities of the DOL and USDA to provide information on the supply of and need for agricultural workers. The rule also includes procedures through which additional workers may be requested because of unforeseen shortages and procedures by which agricultural workers may petition for a decrease in the number of work days they must have in order to maintain their temporary resident (RAW) status.

The RAW registration program

Not waiting for formulation of the policy, and moving forward on the 50,000

(Continued on page 6)

number tossed out by USDA and DOL, INS is in the middle of the first RAW registration program. The registration period for RAWs, originally set for September 1 through October 31, 1989, was extended by INS to November 30, 1989. In addition, registration forms (Form I-807) are now available for aliens both inside and outside the U.S.

The interim final regulations create two priority classes. First priority is given to aliens in the U.S. who have performed at least twenty man-days of agricultural work in the U.S. during any twelve consecutive months between May 1, 1985 and November 30, 1988. Second preference is given to aliens outside the U.S. who meet such requirements. Within each of the two priority classes, preference is given to spouses and unmarried children of aliens who have already been legalized under IRCA, whether through its SAW program or any other legalization program. The caveat to the immediate relative preference is that any marriage or adoption creating the claimed family relationship must have occurred on or before November 30, 1988. Finally, the regulations state that aliens who entered the U.S. illegally after November 30, 1988 are ineligible for RAW status.

RAWs selection

The selection process itself has two stages. First, INS will compile lists of potentially eligible aliens, divided into the two classes for priority consideration. Within the first priority class, those aliens who claim a family-based preference will be randomly selected in a number equal to the shortage number. If more aliens are still needed to meet the shortage number, the next group to be considered will be the rest of the first priority class members who do not have a family preference. They too will be randomly selected. If this number is still not sufficient to meet the shortage number jointly set by USDA and DOL, the same procedure will be followed for the second priority class until, eventually, the shortage number is reached. Finally, the selected registrants will be able to file temporary resident status petitions as RAWs. Those not selected will be retained on the appropriate lists for possible selection later in either the current or future RAW years.

The registration forms are available from all INS offices and from other participating Qualified Designated Entities (QDE's), which are usually social service or other outreach programs. The registration form, which is very simple, must be mailed along with a $10.00 cashier's check to a central INS facility. If the alien is selected through the prioritized, and then random, selection system outlined above, the alien registrant must complete and send a longer petition, with extensive supporting documents and a check for $175.00, back to the central INS processing facility. Following review of that package, INS will grant work authorization and schedule the alien for an interview.

New reporting requirements

Agricultural employers are also subject to new reporting requirements pursuant to a DOL final rule issued on August 25, 1989, which amends 29 C.F.R. Part 502. The basic features of this rule cover how RAWs are to be handled for I-9 form purposes, what wage reports must be provided to RAW workers, what transportation and anti-discrimination rules apply to RAWS, and what alien registration number sequence must be used for RAWs.

In addition, to help provide the raw data for RAWs, the DOL collects information on the number of SAWs employed on ESA reports, which must be filed quarterly.

Editor's note: The discussion of H-2As and Employer Sanctions will appear in next month's *Agricultural Law Update*.

State Roundup

OHIO. *Ohio producer lien bill.* Ohio has enacted an agricultural producer lien legislation. This legislation will enable an agricultural producer to get a superior lien for the value of products delivered to an agricultural product handler. This protection is also extended to agriculture handlers who sell to another handler. The effective date for this legislation is October 26, 1990.

The products identified by the legislation include all fruit and vegetable crops, meat and meat products, milk and dairy products, poultry and poultry products, wool, and all seeds harvested by a producer for sale. Grains are not included because they are covered by the Ohio Grain Indemnity Fund.

Under the Grain Indemnity Fund, producers are reimbursed for a portion of losses experienced as a result of a grain handler's financial failure. Funding is obtained through an assessment charged against each bushel of grain delivered to a grain handler. The fund is maintained and supervised by the Ohio Department of Agriculture.

With the Producers Lien legislation, agricultural producers and handlers may perfect a lien by filing an affidavit in the recorder's office in the county where the product was delivered. The affidavit information includes the name and address of the handler, the lien claimant's name and address, the amount owed, and the date of delivery. To have a perfected lien, it must be recorded within sixty days of the delivery of the product.

Producer's liens have priority over other secured creditors, except wage and salary claims of workers, warehouseman's liens, and amounts owed by the lienholders to the handler that are subject to set off. Where there are multiple producer liens filed, they are given priority by date of filing.

Additional information can be found in Ohio Amended House Bill No. 33. This legislation is codified in sections 1311.55, 1311.56, and 1311.57 of the Ohio Revised Code.

– Paul L. Wright, Attorney at Law, Columbus, Ohio

AG LAW CONFERENCE CALENDAR

Tax Week at Penn State

Dec. 4-8, 1989, J.O. Keller Conference Center, University Park, PA.

Topics include: TAMRA; fiduciary tax returns; government farm program issues; passive losses and farming.

Sponsored by Penn State College of Agriculture

For more information, call 1-814-865-7656.

Penn State Income Tax Institutes

Dec. 4- 5, State College;
Dec. 11-12, Edinboro;
Dec. 12-13, DuBois;
Dec. 13-14, Johnstown;
Dec. 14-15, Danville;
Dec. 18-19, Souderton;
Dec. 19-20, W. Chester.

Topics include: Reporting passive losses; TAMRA review; pensions.

Sponsored by Penn State University Department of Agricultural Economics.

For more information, call 814-865-7656.

1990 Agribusiness Tax Strategies

Dec. 12, 1989, Live on the Continuing Legal Education Satellite Network.

Topics include: Estate planning strategies; § 2032A; tax options for troubled farmers; complying with new reporting requirements.

Sponsored by Continuing Legal Education Satellite Network and others

For more information, call 1-800-669-1625.

Ag Law Update

Jan. 18, 1990. Telephone CLE.

Topics include: Government programs; farm economics; farm credit; income taxation; farm business planning; and estate and gift taxation.

Sponsored by: ABA Section of General Practice; AALA; and USDA Cooperative Extension Service.

For more information, call 312-988-5648

Environmental Law

February 15-17, 1990, Hyatt Regency, Washington, D.C.

Topics include: SARA, RCRA, TSCA, NEPA, Clean Water Act developments and underground water developments.

Sponsored by the Environmental Law Institute and the Smithsonian Institution.

For more information, call 1-800-CLE-NEWS or 1-215-243-1630.

Recent bankruptcy decisions

Recent Chapter 12 bankruptcy litigation has produced interesting caselaw in the area of the eligibility standards for obtaining Chapter 12 relief. The most basic challenge to eligibility concerns the nature of the debtor's business, that is, whether it is a "farming operation" for purposes of Chapter 12 relief. The bankruptcy case of *In re Sugar Pine Ranch*, 100 Bankr. 28 (Bankr. D. Ore. 1989), dealt squarely with this issue, holding that a business that consisted primarily of the harvesting of timber was an integrated farming operation for purposes of Chapter 12 eligibility. The court noted many similarities between the debtor's sustained yield harvest methods and traditional crop farming. These similarities, combined with the fact that the debtor also had a small cattle operation, led the court to conclude that an integrated farming operation existed. The debtor was, therefore, found to be eligible for Chapter 12 relief.

In addition to requiring the existing of a "farming operation," Chapter 12 also requires that at least fifty percent of the debtor's income be derived from such farming operation. 11 U.S.C. § 101(15) (1988). Although obviously closely related to the definition of "farming operation," this requirement has produced its own line of cases, which focus on whether a specific type of income can be characterized as farm income.

In this context, the characterization of cash rental income has been debated. The courts, however, remain split. Some have followed the stringent rule set forth by the Court of Appeals for the Seventh Circuit in *In re Armstrong*, 812 F.2d 1024 (7th Cir. 1989). According to *Armstrong*, cash rent, because it is not connected to the inherent risks of farming, is not farming income. In contrast, other courts have rejected the mechanical disallowance of cash rent, arguing that the court must look to the "totality of the circumstances." *In re Rott*, 73 Bankr. 366 (Bankr. D. N.D. 1987).

This issue, whether rental income constitutes income from a farming operation for purposes of Chapter 12 eligibility was addressed in three recent bankruptcy cases. In the case of *In re Coulston*, 98 Bankr. 280 (Bankr. E.D. Mich. 1989), the court found a "totality of the circumstances" test to be most equitable, citing *In re Rott*. In so doing, the court specifically rejected the *Armstrong* approach. Articulating its own test, the *Coulston* court stated that the characterization of cash rent should be based upon the full range of circumstances surrounding the leasing of the land. The court stated that it must look "both backward and forward in time," that is, at the debtor's history in farming, why the leasing was necessary, and whether the farmer intended to farm in the future. Applying this standard, the *Coulston* court found the cash rent at issue to be income from the farming operation.

Similarly, a Missouri bankruptcy court also rejected the *Armstrong* rule and found cash rent to be farm income for purposes of Chapter 12 eligibility. *In re Vernon*, 101 Bankr. 87 (Bankr. E.D. Mo. 1989). There, the court surveyed the factors considered in other non-*Armstrong* cases and applied these factors to the debtor's rental arrangement. In addition to the history of the debtor's operation and his future intentions, the court also looked to the relationship between the debtor-landlord and the tenant. Applying these factors to the debtor's situation, the court found the rental payments to be income from farming.

The debtors in a recent Florida bankruptcy case were not so successful, however. *In the Matter of Morgan Strawberry Farm, L.D.*, 98 Bankr. 584 (Bankr. M.D. Fla. 1989). In this case, the court held that under either the *Armstrong* test or the totality of the circumstances test, the debtor's leasing activities did not result in income from farming operations. In addition to finding a straight cash rental arrangement, the court found no participation in the farming operation and no evidence of an intention to ever return to farming. On this basis, the court held that the debtors were ineligible for Chapter 12 relief and dismissed the case.

In a somewhat unusual case, a family farm corporation was found ineligible by a California court in *In re Garako Farms, Inc.*, 98 Bankr. 506 (Bankr. E.D. Cal. 1988). There, the court applied the totality of the circumstances test even though income from the farming operation was not specifically at issue. The court used the test to find that the corporate debtor was not of the type that Congress intended to protect by the Chapter 12 legislation. Although the family member who was the majority stockholder in the debtor-corporation had supervision over, and some participation in, the farming operation, and clearly, there was a farming operation based upon the test usually applied to income, the court found that the family did not "conduct the farming operation" for purposes of Chapter 12 eligibility. This confusing analysis may have stemmed from the court's concern that the farm corporation had originally been set up to develop a pension and profit-sharing plan and was managed by a dentist with an active practice. On this basis, the court found the debtor ineligible and dismissed the case.

In summary, eligibility issues in Chapter 12 bankruptcy cases remain a risk to farmers with unconventional farming operations. Although it is likely that a court will apply a "totality of the circumstances" test to these issues, the use of this test does not necessarily indicate the court's willingness to bend the rules to allow eligibility.

– Susan A. Schneider, Staff Attorney, National Center for Agricultural Law Research and Information

Federal Register *in brief*

The following is a selection of matters that have been published in the *Federal Register* from October 2, 1989 to November 6, 1989:

1. CCC; Disaster Payment Program for 1989 crops; final rule; effective date 10/2/89. 54 Fed. Reg. 40369.

2. CCC; Dairy Export Incentive Program; notice. "CCC will pay exporters the agreed upon bonus through the issuance of generic certificates redeemable for CCC owned commodities." 54 Fed. Reg. 43186.

3. CCC; Emergency Livestock Assistance; final rule; effective date 11/30/89. 54 Fed. Reg. 43941.

4. EPA; Cancellation of pesticides for nonpayment of 1989 registration maintenance fees; notice. 54 Fed. Reg. 42936.

5. APHIS; Swine identification; proposed rule; comments due 12/19/89. 54 Fed. Reg. 43065.

6. FmHA; Limitation to the redelegation of authority to approve debt settlements and releases of liability in connection with voluntary liquidations; effective date 10/1/89–9/30/90. ". . . reduces State Directors approval authority not to exceed $1,000,000. All debt settlements/release of liability cases in excess of $1,000,000 must be submitted to the National Office for approval by the Administrator." 54 Fed. Reg. 43840.

7. FCIC; General crop insurance regulations; high-risk land exclusion option; final rule; effective date 10/24/89. 54 Fed. Reg. 43272.

8. USDA; Semi-annual regulatory agenda; Fall 1989. 54 Fed. Reg. 44408.

Single copies of the Federal Register for $1.50 per issue can be ordered by calling 202-783-3238.

– Linda Grim McCormick

Agricultural Law Update

219 New York Avenue
Des Moines, Iowa 50313

ADDRESS
CORRECTION REQUESTED

AMERICAN AGRICULTURAL LAW ASSOCIATION NEWS

Report on the Annual Conference

More than 200 practitioners, educators, government officials, industry representatives, and guests met in San Francisco November 3-4, 1989 at the American Agricultural Law Association's Tenth Annual Meeting and Education Conference.

Over 50 speakers addressed a wide range of topics including international agricultural trade, agricultural labor law, marketing of fruits, vegetables and tree nuts, farm finance and credit issues, managing agricultural soil and water resources, and agricultural cooperatives.

Phillip L. Kunkel delivered the presidential address on Rural America.

Friday's luncheon address was delivered by Dr. Gordon C. Rausser on Agricultural Policy Alternatives for the 1990's.

James B. Dean was awarded this year's "Distinguished Service Award."

George R. Massie reported that the he AALA Job Fair, held concurrently with the Annual Meeting, served 38 applicants and ten law firms and employers.

Margaret R. Grossman is the Association's President-elect. Donald B. Pedersen, Fayetteville, Arkansas, assumed his duties as President. Joining the Board are newly elected members Sarah Vogel and Ted. E. Deaner.

Retiring Board members are Linda A. Malone and Kenneth J. Fransen. We wish to thank them for their dedicated service to the organization.

Tom Lawler announced the winners of the Student Writing Competition. Barbara Hoekstra won first place and Thomas E. Jurgensen won second place, out of fourteen entries.

Next year's Annual Meeting will be held October 5-6, 1990, at the Marriott City Center, in Minneapolis, MN.