

Agricultural Law Issues of Note

Presented by

Allen H. Olson

AGRICULTURAL LAW ISSUES OF NOTE

- I. Tobacco Quota Buyout Issues.
 - A. Tobacco Transition Payment Program enacted as Title VI of the American Jobs Creation Act of 2004, H.R. 4520.
 - B. The Act terminates the tobacco marketing quota and price support loan programs - tobacco is now a free market crop.
 - C. And establishes a transition payment program (buyout) for tobacco quota holders and tobacco producers.
 - D. Quota holders will be paid \$7/lb. for their quota as of the 2002 marketing year.
 - E. Tobacco producers will be paid \$3/lb. for quota they farmed in 2002, 2003 and 2004 based on a complex formula.
 - F. Payments will be made in ten equal annual installments with the first payment to be made between June and September of 2005, the second payment to be made in January, 2006 and the remaining payments to be made in January of each succeeding year.
 - G. Farm Service Agency has published regulations setting forth details of the program at 7 CFR Part 1463.
 - H. Section 1463.109 of the regulations requires that each eligible holder and producer must enter into a contract with the CCC to receive payments. These contracts must be signed by the payment recipients by no later than June 17, 2005. After that date, the holder or producer will lose the right to receive the first payment but may still apply to receive subsequent payments.
 - I. Contracts must be approved by the Farm Service Agency County Committees, but the Committees will not be authorized to approve

contracts until late May or early June.

- J. Tobacco quota has now been abolished, together with any liens that lenders may have had on the quota.
- K. Regardless of what the lien documents say on their face, existing tobacco quota liens do not attach to the transition payments as proceeds or on any other basis.
- L. 7 CFR § 1463.111 makes it clear that transition payments “shall be made without regard to questions of title under state law and without regard to any claim or lien against the tobacco quota, tobacco marketing allotment, or the farm for which a tobacco quota had been established”
- M. The regulations provide that the transition payments may be assigned, but only when there is consideration for the assignment in an amount equal to or greater than the discounted value of the payments subject to the assignment based on a discount rate established by the CCC. New value is required, but this may include the renewal of an existing loan that a lender was under no obligation to renew. The discount rate is to be established under the regulations by adding 200 basis points to the prime lending rate as determined by the CCC.
- N. There are two types of assignments - regular assignments under Section 1463.111 and “successor in interest contracts” under Section 1463.112. Adequate consideration is required in both cases. All payments, including the first payment, may be assigned under Section 1463.111, but only the last nine payments may be assigned through a successor in interest contract under Section 1463.112.
- O. Under Section 1463.111, the recipient may assign all payments, some payments, or portions of payments.
- P. Section 1463.111 assignments must be made on Form CCC-959 (copy attached). The assignment must be approved by the FSA County Committee. This form is available now, but the form for assigning successor in interest contracts will not be available until summer.
- Q. CCC-959 assignments may be filed with the County Offices now, but they will not be effective until approved. Presumably, the assignments will be approved in the order they are received and dated stamped by the County Office. However, the County Offices have not received any specific instructions in this regard, and the regulations are silent on the issue. Make sure that you get the County Office to date stamp a copy for your records at the time you file the assignment. County Committee approval of assignments will likely occur at the same time that the underlying

contracts are approved.

- R. The regulations also contain provisions for resolving disputes between competing claimants for the same quota payments. These provisions are not particularly well drafted, however. Approval of a contract by the County Committee does not guarantee finality. Rival claimants can challenge payment contracts even after the first payment has been issued and may appeal adverse decisions all the way through the FSA and National Appeals Division administrative appeals system. Litigation is also possible. The dispute resolution provisions are found in Section 1463.109.
 - S. Section 1463.111(e) of the regulations contains an offset provision. Any amounts owed the United States by the assignor can be deducted from a payment before it is sent to the assignee.
 - T. Section 1463.111(f) states that the CCC will report to the IRS any assigned payment as income earned by the assignor.
- II. USDA Office of Inspector General Payment Limitations Abuse Initiative.
- A. Farm program payments are crucial to the economic viability of many farming operations.
 - B. The current farm bill sets dollar limits on the payments that can be received by a farming operation.
 - C. Those limits can be increased by organizing the operation in a manner that qualifies it for multiple payments.
 - D. For example, under the current law, a farming partnership consisting of three individuals and three limited liability companies, where each LLC has two equal members who are also individual partners, can, if set up properly, qualify for six payment limits. This illustrates the operation of the “three-entity rule.”
 - E. However, the FSA payment limitation regulations are extremely complex. To receive the extra payments, a farming operation has to satisfy literally hundreds of rules, many of which are not intuitively obvious. Most FSA County Office employees don’t understand them well. The rules describe not only how the operation must be organized but also how it must operate throughout the year. The best intentioned farmer can easily violate payment limitation requirements, particularly if he or she does not seek competent professional advice.
 - F. Unfortunately, there are also farmers out there who abuse the system and

knowingly collect farm program payments to which they are not entitled.

- G. In 2004, the USDA Office of Inspector General launched an initiative to crack down on fraud, abuse, and improper payments involving payment limitations, disaster payments, and crop insurance (excerpts from the Inspector General's report are attached). This in turn resulted in more Georgia farmers being audited by USDA in 2004 than in any previous year. The audits have focused on 2003 crop year payment limitations compliance but can be expanded to cover prior years as well.
- H. The auditors have required farmers to turn over all of their farm business and financial records. In some cases, the auditors have also interviewed the individuals involved in the operation. The purpose of interviews is often to identify "paper" farmers who are not providing substantial personal labor or management as required by the regulations. Their sole purpose in the operation is to allow the "real" farmer to collect more payments.
- I. Most of these audits have not been completed. A farmer will not be in the clear until he or she receives a letter from FSA stating that the audit has been completed and that no violations have been found. In the case of farm audits, no news is not necessarily good news.
- J. It is quite likely that a number of Georgia farmers will be found in noncompliance as a result of these audits and other investigations by FSA and OIG.
- K. Adverse audit results can have severe consequences. A farmer can be required to refund part or all of the farm program payments received in one or more years with penalties and interest. He can be denied future farm program benefits. In cases involving intentional misconduct, he can be charged criminally and, if convicted, sentenced to prison, fined, and required to make restitution.
- L. In 2004, the Justice Department prosecuted and obtained guilty pleas from a large Mississippi farmer, his brother, and his accountant. The three had created 13 partnerships with 64 corporate partners in order to fraudulently obtain farm program payments. The farmer was sentenced to five years in prison and ordered to repay \$11.2 million. The brother was fined \$5,000 and given two years probation. The accountant was sentenced to seven months in prison and fined \$20,000.
- M. USDA will also catch honest farmers in its enforcement net, farmers who have no fraudulent intent but who nevertheless are not complying with payment limitations rules.

- N. A lender's due diligence in making farm loans should include inquiries as to the number of payment limits for which the farm customer qualifies, whether the customer has been audited by USDA, and the results of the audit.
- O. The payment limitations rules may change. The President's 2006 budget proposals include reducing program payments, eliminating the three-entity rule, eliminating the use of certificates to avoid payment limits on loan deficiency payments, and establishing a single, comprehensive payment limit of \$250,000 per farm for all farm program payments (see attached background article from Washington Post).
- P. Payment limitations and other farm program changes may also be adopted in 2007, the year that the current farm bill expires. These changes would apply in 2008.
- Q. Whatever legislative changes occur, farm program payments will likely remain important to farmers and their lenders, but the nature and amount of those payments could change substantially over time. It is critical that farmers, their bankers, and their lawyers keep up with those changes, both to maximize the payments that farmers receive and to keep farmers in compliance with the rules that accompany those payments.