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South Dakota Amendment E Ruled Unconstitutional – Is There A Future For Legislative Involvement In Shaping The Structure Of Agriculture?

— by Roger A. McEowen* and Neil E. Harl**

In *South Dakota Farm Bureau, Inc. et. al. v. Hazeltine*,[1] the U.S. Court of Appeals for the Eighth Circuit upheld the Federal District Court for the District of South Dakota and ruled the South Dakota anti-corporate farming law unconstitutional on "dormant commerce clause" grounds. The opinion is viewed as critical to the future viability of anti-corporate farming restrictions in other states[2] and, more generally, to the ability of state legislatures to shape the structure of agriculture within their borders.

Anti-Corporate Farming Restrictions

Presently, nine states prohibit corporations from engaging in agriculture to various degrees.[3] Recently, consolidation in almost every aspect of the farm economy has further threatened the continued viability of a vibrant, independently owned and widely dispersed farm production sector with the specter of being vertically integrated (largely through contractual arrangements) in the production, processing and marketing functions. Thus, as concentration of agricultural production has accelerated in recent years, legislatures in many of these same states have attempted to legislate protections for the economic autonomy of individual farmers and the environmental health and safety of both the rural and non-rural sectors.

The South Dakota Provision

The South Dakota restriction dates from 1974, and in 1998 South Dakota voters amended the state constitution (known as "Amendment E") to prohibit corporations and syndicates from owning an interest in farmland (with numerous exceptions).[4] Section 21 states:

> "[n]o corporation or syndicate may acquire, or otherwise obtain an interest, whether legal, beneficial, or otherwise, in any real estate used for farming in this state, or engage in farming."

Section 22 exempts "family farm corporations" or "family farm syndicates" as follows:

> "a corporation or syndicate engaged in farming or the ownership of agricultural land, in which a majority of the partnership interests, shares, stock, or other ownership interests are held by members of a family or a trust created for the benefit of a member of that family. The term, family, means natural persons related to one another within the fourth degree of kinship according to civil law, or their spouses. At least one of the family members in a family farm corporation or syndicate shall reside on or be actively engaged in the day-to-day labor and management of the farm. Day-to-day

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labor and management shall require both daily or routine substantial physical exertion and administration."

The plaintiffs, a collection of farm groups, South Dakota feedlots, public utilities and other farm organizations, challenged Amendment E on the basis that it would prevent the continuation of their existing farming enterprises unless those enterprises changed organizationally to come within a statutory exemption. Specifically, several of the plaintiffs feed livestock in their South Dakota feedlots under contracts with out-of-state firms and claimed that Amendment E would apply to their out-of-state contracting parties and hurt economically their South Dakota livestock feeding businesses.[5]

The "Dormant Commerce Clause"

The Commerce Clause of the U.S. Constitution (Article I, § 8, Clause 3) forbids discrimination against commerce, which repeatedly has been held to mean that states and localities may not discriminate against the transactions of out-of-state actors in interstate markets even when the Congress has not legislated on the subject.[6] The overriding rationale of the commerce clause was to create and foster the development of a common market among the states and to eradicate internal trade barriers. Thus, a state may not enact rules or regulations requiring out-of-state commerce to be conducted according to the enacting state's terms.[7]

Historically, dormant commerce clause analysis has attempted to balance national market principles with federalism, and was never intended to eliminate the states' power to regulate local activity, even though it is incidentally related to interstate commerce.[8] Indeed, if state action also involves an exercise of the state's police power, the impact of the action on interstate commerce is largely ignored.[9] Absent an exercise of a state's police power, the courts evaluate dormant commerce clause claims under a two-tiered approach. If the state has been motivated by a discriminatory purpose, the state bears the burden to show that it is pursuing a legitimate purpose that cannot be achieved with a nondiscriminatory alternative.[10] However, if the state regulates without a discriminatory purpose but with a legitimate purpose, the provision will be upheld unless the burden on interstate commerce is clearly excessive in relation to the benefits that the state derives from the regulation.[11] In essence, a state may regulate transactions that occur within its borders,[12] but not those that occur elsewhere.[13]

"Dormant Commerce Clause" Precedent in the Eighth Circuit

In *Hampton Feedlot, et. al. v. Nixon*,[14] the court upheld against a dormant commerce clause challenge provisions of the Missouri Livestock Marketing Law that the state legislature passed in 1999 preventing livestock packers that purchase livestock in Missouri from discriminating against producers in purchasing livestock except for reasons of quality, transportation costs or special delivery times.[15] The law requires any differential pricing to be published.[16] The trial court held the law to be unconstitutional, but the Eighth Circuit reversed. While the court noted that the Act closely resembled an earlier South Dakota law that had been found unconstitutional,[17] the court noted that the Missouri provision did not eliminate any method of sale – it simply requires price disclosure. More importantly, however, the court noted that the Missouri statute, unlike the South Dakota provision, only regulates the sale of livestock sold in Missouri. As such, the extraterritorial reach that the court found fatal to the South Dakota statute was not present in the Missouri statute. The court reasoned that the statute was indifferent to livestock sales occurring outside Missouri and had no chilling effect on interstate commerce because packers could easily purchase livestock other than in Missouri to avoid the Missouri provision. The court also noted that the Missouri legislature had legitimate reasons for enacting a price discrimination statute, including preservation of the family farm and Missouri's rural economy, and an improvement in the quality of livestock marketed in Missouri.[18] Specifically, the court opined that the Missouri legislature had the authority to determine the course of its farming economy and that the legislation was a constitutional means of doing so.

The *Hazeltine* Court's Rationale

In a discussion involving the issue of the plaintiffs' standing, the court in *Hazeltine* cited an Ohio statute that charged out-of-state natural gas vendors at a higher sales tax rate than certain in-state vendors.[19] The court reasoned that the South Dakota livestock feeders contracting with out-of-state firms that were not within an exemption under the South Dakota law were similarly disaffected because of the imminent loss of business if Amendment E were to be enforced. However, the court did not discuss the obvious difference between the Ohio statute and Amendment E. The Ohio statute treated out-of-state natural gas vendors differently from in-state vendors. Amendment E treats *all* businesses operating in South Dakota under the same set of rules, regardless of whether the business is a South Dakota business or an out-of-state enterprise. Under the *Hampton*[20] rationale, the test is whether Amendment E has an extraterritorial reach requiring business transactions conducted in states other than South Dakota to be governed in accordance with South Dakota law, not whether South Dakota businesses are financially injured because of business relations with companies not coming within an exemption to the law. While the court was addressing legal standing on this point, the court was also framing the dormant commerce clause issue. Unbelievably, the court did not make even a single reference to its prior opinion in *Hampton Feedlot*.[21]

The court also provided no analysis on the issue of what entity is actually performing farming operations under the contract feeding arrangements. If the South Dakota feeding operations are making the relevant production decisions under the contracts and are the ones rendering material participation, then it seems highly unlikely that the out-of-state contracting parties could be found to be engaged in farming in South Dakota in a manner that Amendment E prohibits.[22] The court, again without discussing the matter, simply assumed that Amendment E would apply to the contract feeding situations in the case.[23]

Without any analysis of the actual language of Amendment E, the court determined that South Dakota voters had acted with a discriminatory purpose in enacting Amendment E. The court noted that the record contained a substantial amount of evidence on the point.[24] The court also found relevant on the discrimination issue statements of drafters, as well as a statement of a co-chairman of the Amendment E promotional organization that Amendment E was motivated in part by the environmental problems caused by large-scale hog operations in other states.[25] The court called this statement "blatant" discrimination.[26] The court also found indirect evidence of discrimination in that the drafters and supporters of Amendment E had no evidence that a ban on corporate farming

would preserve family farms or protect the environment, and that no economic studies had been undertaken to determine the economic impact of "shutting out corporate entities from farming in South Dakota."[27] Because the court found that Amendment E was enacted with a discriminatory purpose, the state bore the burden to show that it had no other way to advance legitimate state interests. The court held that the state failed to meet its burden.

Implications of the Decision

If left standing, the *Hazeltine* court's opinion raises serious concerns about the analysis of future dormant commerce clause cases in the Eighth Circuit, the doctrine of *stare decisis*, the theory of separation of powers and the ability of states to regulate business conduct within their borders.[28] The court's willingness to ignore its prior opinion in *Hampton Feedlot*[29] and not evaluate the actual language of Amendment E on dormant commerce clause grounds poses difficulty for other states defending against either current or future challenges to anti-corporate farming laws.[30] It would appear at this time, however, that the court is not favorably disposed to anti-corporate farming laws in general, and may also strike down other laws designed to deal with the structural conditions presently facing family farming and ranching operations. The court's opinion represents a complete shift from its opinion in *Hampton Feedlot*,[31] and the court appears to have adopted the modern economic theory of free trade as its framework for evaluating commerce clause cases involving state regulation of business activity.[32] Unfortunately, the court failed to note that the types of production contract arrangements involved in the case have been used in other settings to provide vertically integrated firms with market power and to exclude producers from competitive market outlets for their products.[33]

It is hoped that the Eighth Circuit will reconsider its decision in *Hazeltine* and continue the judicial path laid down in *Hampton Feedlot*.[34]

FOOTNOTES

[1] No. 02-2366, 2003 U.S. App. LEXIS 17018 (8th Cir. Aug. 19, 2003), *aff'g*, 202 F. Supp.2d 1020 (D. S.D. 2002).

[2] The opinion takes on even greater significance because many of the states with the major restrictions on corporate involvement in agriculture are located in the Eighth Circuit. See, e.g., Minn. Stat. § 500.24; Mo. Ann. Stat. Ch. 350; Neb. Const. Art. XII, § 1; Iowa Code § 9H; N.D. Cent. Code § 10-06-01.

[3] The states are Iowa (Iowa Code § 9H.1 et. seq.); Kansas (Kan. Stat. Ann. § 17-5901 et. seq.); Minnesota (Minn. Stat. Ann. § 500.24 et. seq.); Missouri (Mo. Ann. Stat. § 350.15); Nebraska (Neb. Const. Art. XII, § 8(1)); North Dakota (N.D. Cent. Code § 10-06.1-02); Oklahoma (Okla. Const. Art. XXII, 2); South Dakota (S.D. Codified Laws § 47-9A-3); and Wisconsin (Wis. Stat. Ann. § 182.001).

[4] S.D. Const. Art. XVII, §§ 21-24.

[5] Two of the plaintiffs feed cattle under contract with out of state firms, one plaintiff raises contract hogs and another raises contract lambs.

[6] See, e.g., Dean Milk Co. v. Madison, 340 U.S. 349 (1951) (holding as unconstitutional a city ordinance prohibiting sale of milk in city unless bottled at approved plant within five miles of city); Hunt v. Washington State Apple Advertising Commission, 432 U.S. 333 (1977) (state statute requiring all closed containers of apples sold or shipped into state to bear "no grade other than applicable U.S. grade or standard" held unconstitutional discrimination against commerce).

[7] See, e.g., American Meat Institute, *et. al.* v. Barnett, 64 F. Supp.2d 906 (D. S.D. 1999) (South Dakota price discrimination statute declared unconstitutional because it applied to livestock slaughtered in South Dakota regardless of where livestock purchased).

[8] See, e.g., Huron Cement Co. v. Detroit, 362 U.S. 440 (1960) (state legislation designed to maintain clean air constituted legitimate exercise of police power allowing state to act in many areas of interstate commerce).

[9] *Id*. A strong argument can be made that Amendment E was also enacted according to the state's police power to protect South Dakotans from adverse health and environmental effects of large-scale, vertically integrated livestock operations. In that event, the impact of the law on interstate commerce would be less of a concern.

[10] See, e.g., Hughes v. Oklahoma, 441 U.S. 322 (1979). But, the plaintiff bears the initial burden of proving discriminatory purpose. *Id*.

[11] See, e.g., Pike v. Bruce Church, Inc., 397 U.S. 137 (1970) (state law prohibiting interstate shipment of cantaloupes not packed in compact arrangements in closed containers, even though furthering legitimate state interest, held unconstitutional due to substantial burden on interstate commerce).

[12] Milk Control Board v. Eisenberg Farm Products, 306 U.S. 346 (1936) (court upheld Pennsylvania price control statute as applied to purchasers of milk in Pennsylvania by a dealer who intended to ship all the milk out of state; Court stated that purpose of statute was "to reach a domestic situation" and that the activity regulated was "essentially local").

[13] Baldwin v. G.A.F. Seeling, Inc., 294 U.S. 511 (1935) (court struck down statute requiring milk purchased out-of-state to not be sold in New York unless out-of-state producers had received New York minimum price); but see Nebbia v. New York, 291 U.S. 502 (1934) (court upheld New York law setting minimum prices paid to milk producers, as applied to purchases by New York retailers from New York producers).

[14] 249 F.3d 814 (8th Cir. 2001).

[15] Mo. Stat. Ann. §§ 277.200; 277.203; 277.212 (2000).

[16] Mo. Stat. Ann. § 277.203(2).

[17] S.D. Codified Laws § 40-15B *et. seq*.

[18] The court found persuasive the testimony of a witness for the state that by providing an incentive for packers to buy livestock on the basis of quality through the grade and yield method, producers would make better genetic decisions, raise better quality animals and earn a better price. The court also noted that, under the current system, larger producers receive premiums for their livestock, giving them an economic advantage over smaller farmers.

[19] An Ohio manufacturing facility purchased nearly all of its natural gas from out-of-state suppliers subject to the higher sales

tax rate, and was held to have standing to challenge the statute because it was financially injured.

[20] 249 F.3d 814 (8th Cir. 2001).

[21] *Id*.

[22] For a discussion of the issue of packer ownership and control of livestock through contractual relationships and the effort, at the federal level, to ban packer ownership of livestock, see McEowen, Carstensen and Harl, "The 2002 Senate Farm Bill: The Ban on Packer Ownership of Livestock," *7 Drake J. of Ag. L. 267* (2002).

[23] It is noted, however, that had the court analyzed the issue and determined that the out-of-state companies were engaging in farming in South Dakota under the contracts, the issue would have remained as to whether Amendment E discriminated against these businesses by treating them in a more disadvantageous manner than in-state businesses.

[24] For example, the court noted that the "pro" Amendment E statements compiled by the Attorney General informed voters that without passage of Amendment E, "[d]esperately needed profits will be skimmed out of local economies and into pockets of distant corporations," and "Amendment E gives South Dakota the opportunity to decide whether control of our state's agriculture should remain in the hands of family farmers and ranchers or fall into the grasp of a few, large corporations." The court claimed that these statements were "brimming with protectionist rhetoric."

[25] Why the court found statements of intent relevant to the discrimination issue without examining the content of the language of Amendment E is not explained.

[26] However, state legislation designed to maintain clean air has been held to constitute a legitimate exercise of the state's police power allowing the state to act in many areas of interstate commerce. See, e.g., Huron Cement Co. v. Detroit, 362 U.S. 440 (1960).

[27] The court failed to mention the numerous exemptions under the South Dakota provision.

[28] It is noted that South Dakota is expected to file a petition for rehearing with the court.

[29] 249 F.3d 814 (8th Cir. 2001).

[30] The state of Iowa presently has an appeal pending with the Eighth Circuit involving the state's ban on packer ownership of livestock. Smithfield Foods, Inc. *et. al*. v. Miller, 241 F. Supp.2d 978 (S.D. Iowa 2003). Most of the states with major anti-corporate farming laws are located within the Eighth Circuit.

[31] 249 F.3d 814 (8th Cir. 2001).

[32] Indeed, the court cited *H.P. Hood & Sons v. DuMond, 336 U.S. 525 (1949)*, where the Court stated that "the vision of the Framers was that every farmer . . . shall be encouraged to produce by the certainty that he will have free access to every market in the Nation."

[33] For a discussion of these issues see, McEowen, Carstensen and Harl, note 22 *supra*; Stumo and O'Brien, Antitrust Fairness vs. Equitable Unfairness in Farmer/Meat Packer Relationships, *8 Drake J. of Ag. L. 91* (2003); and Carstensen, Concentration and the Destruction of Competition in Agricultural Markets: The Case for Change in Public Policy, *2000 Wis. L. Rev. 531* (2000).

[34] 249 F.3d 814 (8th Cir. 2001).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

GENERAL

DISCHARGE. The plaintiffs operated a dairy farm and had purchased feed from the debtor under the recommendation of a nutritionist employed by the debtor. The plaintiff filed a lawsuit for damages to the cows resulting from improper formulation of the feed by the nutritionist. While the lawsuit was pending, the debtor filed for Chapter 11. There was some dispute as to whether the plaintiffs received proper notice of the bankruptcy proceedings, and the plaintiffs failed to file a claim in the bankruptcy case. The debtor's plan provided that "administrative trade claims" would be paid as in the normal course of business without necessity of the creditor filing a claim. A discharge was granted in the Chapter 11 case. The plaintiffs sought further prosecution of the lawsuit and the debtor filed for summary judgment based on the discharge of the claim in the bankruptcy case . The plaintiffs argued that the lawsuit was an "administrative trade claim" which was not discharged. The trial court granted the summary judgment, holding that the plaintiffs' lawsuit was not an administrative trade claim because the plaintiffs had liability insurance to cover their claim. The appellate court reversed, holding that the existence or non-existence of liability insurance was irrelevant to whether the lawsuit was an administrative trade claim. The case was remanded for a ruling on whether the plaintiffs' suit was an administrative trade claim. The appellate court noted that administrative trade claims include tort claims because such claims are an ordinary cost of doing business. **Fieber's Dairy, Inc. v. Purina Mills, Inc., 331 F.3d 584 (8th Cir. 2003)**.

The debtor had given a creditor a packet of financial materials as part of a request for an extension of credit on a farm loan. The materials included a list of equipment owned by the corporation wholly-owned by the debtor. Some of the equipment was not owned by the corporation but was owned by the debtor and the debtor's brother who farmed separately. However, the financial materials also included a depreciation schedule which was not consistent with the list of equipment. No tax return was required from the debtor by the creditor. During the application period, the corporation was in the process of reorganizing by distributing the debtor's brother's