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IOWA BAN ON PACKER OWNERSHIP OF LIVESTOCK RULED UNCONSTITUTIONAL
— by Roger A. McEowen* and Neil E. Harl**

In Smithfield Foods, Inc. et. al. v. Miller,¹ the Federal District Court for the Southern District of Iowa ruled unconstitutional Iowa’s prohibition against swine processors owning, controlling or operating swine operations in the state.² The opinion is viewed by many as crucial with respect to its potential impact on the maintenance of competition in hog procurement for slaughter, and on the overall structure of the hog industry in Iowa. The key questions that remain after the court’s opinion are whether the case will be upheld on appeal, and whether the court’s opinion will generate additional momentum for federal legislation addressing the issue of packer ownership of livestock.

Anti-Corporate Farming Statutes

For decades, legislatures in states where agriculture plays a predominant role in the state’s economy have expressed concern with corporate involvement in agricultural production activities. Presently, nine states prohibit corporations (with numerous statutory exceptions for certain forms of corporations) from engaging in agriculture to various degrees.³ More 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.

Iowa, through its anti-corporate farming provisions, prohibits unauthorized vertical integration in the cattle and pork sectors.⁴ The Iowa provision makes it “unlawful… for a processor of beef or pork… to own, control or operate a feedlot in Iowa in which hogs or cattle are fed for slaughter.”⁵ The statute excepts cooperatively-owned processors.⁶ Non-exempted corporations, however, may still participate in agriculture by contracting with farmers who own or lease land. But, the Iowa provision, as originally enacted, was designed to restrict a corporate processor’s ability to control all aspects of production. Processors soon realized, however, that they could avoid the reach of the statute by feeding hogs under contract in neighboring states and transporting them to

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Iowa for processing, or feeding them in Iowa and transporting them out of state for processing.

**The Iowa Smithfield Matter**

Smithfield is the nation’s largest pork processor, with more than half of its sows owned by Murphy Farms which, in turn, is wholly-owned by Smithfield Foods. An Iowa corporation, Prestage-Stoecker, financed by Smithfield, contracted with Murphy Farms to buy feeder pigs. The feeders pigs were shipped to Iowa, where Prestage-Stoecker contracted with over 200 Iowa farms to finish the hogs. The finished hogs were then sold to IBP, Inc. for processing. In September of 1999, Smithfield announced its plan to acquire all of Murphy Farm’s capital stock. The Iowa Attorney General challenged the transaction under Iowa Code § 9H.2, and Smithfield modified the transaction. In early, 2000, Stoecker Farms, Inc. was formed as an Iowa family farm corporation. Murphy Farms sold its Iowa-based assets to Stoecker and also assigned its contract with IBP, Inc. to Stoecker. Smithfield then purchased the non-Iowa assets of Murphy Farms, with Murphy Farms providing out-of-state feeder pigs to Stoecker, which contracted with Iowa farms for finishing. The finished hogs were then sold to IBP, Inc. for processing.

The Iowa Attorney General challenged the transaction as a sham. The Iowa legislature amended the law effective July 1, 2004, to tighten the contracting loophole by prohibiting processors from “directly or indirectly contracting for the care and feeding of swine in this state.” The amendment also expanded the exemption for cooperatives organized under Iowa law. The law was further amended in 2002 (again with an effective date of July 1, 2004) to prohibit swine processors from financing swine operations in Iowa or financing a person who, either directly or indirectly, contracts for the care and feeding of swine in Iowa. The 2002 amendment also expanded the definition of “processor” to include an individual who either holds, or within the past two years has held, an executive position in a processor that has direct or indirect control of processing operations valued at over $260 million. Based upon the amended statutory language, the Iowa Attorney General advised Smithfield that it would be in violation of the law as of July 1, 2004, unless they discontinued their operations in the state. In response, Smithfield challenged the constitutionality of the amended Iowa law on “dormant commerce clause” grounds.

**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 the state 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. 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.

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. 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. 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. 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.

**The Court’s “Dormant Commerce Clause” Analysis**

The court opined that the amended version of the law facially discriminated against Smithfield, and was enacted with a discriminatory purpose to eliminate Smithfield from operating in Iowa. The court also found a discriminatory purpose in the amended provision’s exemption for cooperatives organized under Iowa law. The court went on to state that Iowa’s attempt to protect family farmers by restricting vertical integration in the hog industry was disingenuous, did not serve a legitimate state purpose, and constituted nothing more than unconstitutional economic protectionism.

Serious questions can be raised concerning the court’s analysis. Clearly, the test is whether the Iowa provision has an extraterritorial reach that imposes restrictions on packers attempting to own, control or operate a feedlot outside the state of Iowa. It appears that Smithfield can easily avoid the impact of the Iowa law by not attempting to own, control or operate an Iowa feedlot in ways the statute forbids by contracting with producers outside Iowa’s borders. In that event, the Iowa restriction would be constitutional on dormant commerce clause grounds. Similarly, the statute makes no distinction between in-state and out-of-state processors, but prohibits specific conduct by all processors regardless of location. The only exception is for processors organized as a cooperative under the Iowa laws. Importantly, Iowa law provides that a foreign cooperative may be organized under Iowa law as an Iowa cooperative without being physically present in Iowa. Thus, the court’s claim that the legislation discriminates between Iowa and non-Iowa cooperatives seems questionable. To operate in Iowa within the parameters of the law, Smithfield would need to reorganize its business enterprise in the cooperative form. Thus, the law does not prevent the conduct that Smithfield is desirous of engaging in, but merely requires that it be conducted in a specific organizational form with sufficient farmer ownership.

The court seemingly downplayed the rationale of the state in enacting restrictions on vertical integration in pork processing in Iowa. The United States Court of Appeals for the Eighth Circuit (the court that will hear the appeal in this case) has noted that preservation of the family farm and the rural economy are legitimate reasons for state legislation. Also, the rationale for such legislation has been well documented. Likewise, the preamble to Iowa Code § 9H.2 states that the purpose of the law is “... to preserve free and private enterprise, prevent monopoly, and protect consumers.” That would appear, under the Eighth Circuit test, to be a legitimate state interest.
What Does the Future Hold?

A ban on packer ownership of livestock has been proposed at the federal level and has passed the U.S. Senate on two occasions.22 If the Iowa court’s opinion is upheld on appeal, it could undermine existing ownership bans in other states, and forestall additional states from attempting to pass similar laws. Also, the opinion could increase pressure to pass federal legislation banning packer ownership.23

In any event, the court’s decision is important for the future structure of agriculture and what state governments can do, if anything, to help shape that structure.

FOOTNOTES

1 No. 4:02-cv-90324 (S.D. Iowa Jan. 22, 2003). The U.S. District Court for the Southern District of Iowa (Pratt, J.) entered an order on January 30 granting the state’s request to stay the opinion in the case until the case is finally decided on appeal.

2 Iowa Code § 9H.2.


5 Id.

6 Id.

7 Murphy Farms also furnished Prestage-Stoecker with all necessary supplies and employees.

8 In early 2002, the Iowa District Court held the formation of Stoecker was valid and that neither Smithfield nor Prestage-Stoecker had violated Iowa Code § 9H.2.

9 Iowa Code § 9H.2(B)(1)(B).

10 Iowa Code § 9H.1 (19)(b).

11 See, e.g., Dean Milk Co. v. Madison, 340 U.S. 349 (1951) (holding as unconstitutional a city ordinance prohibiting the sale of milk in the city unless it had been bottled at an approved plant within five miles of the 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 the state to bear “no grade other than applicable U.S. grade or standard” held an unconstitutional discrimination against commerce).

12 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 the livestock was purchased).

13 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).

14 Id. A strong argument can be made that the Iowa legislature, in amending Iowa Code §9H.2, was also acting pursuant to its police power to protect Iowans from adverse health and environmental effects of large-scale, vertically integrated hog operations owned or controlled by packers. In that event, the impact of the law on interstate commerce would be less of a concern.


16 See, e.g., Pike v. Bruce Church, Inc., 397 U.S. 333 (1977) (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).

17 Iowa Code § 9H.2.

18 The court made much of statements during the 2002 legislative session of the bill’s sponsor, Senator Stewart Iverson, that the legislature would attempt to amend § 9H.2 in response to a court decision permitting Smithfield to finance an Iowa-based hog producer.

19 See, e.g., Hampton Feedlot, et. al. v. Nixon, 249 F.3d 814 (8th Cir. 2001) (Missouri livestock price reporting law upheld as constitutional because statute indifferent to live hog sales occurring outside Missouri and packers could easily purchase livestock other than in Missouri to avoid the impact of the provision).

20 See Hampton Feedlot, et. al. v. Nixon, 249 F.3d 814 (8th Cir. 2001)(upholding against dormant commerce clause challenge a state livestock marketing law).


22 An initial version was introduced as an amendment to the 2002 Farm Bill, S.1731, 107th Cong. (2001). An amended version passed the Senate in February 2002. S. 1731 (amended) (amendment S.A. 2837). On the first day of the 108th Congress Senator Grassley (R-IA) reintroduced a slightly modified version of the packer ban.

23 See comments of Senator Grassley, Des Moines Register, Jan. 24, 2003, p. 1D.

TAXATION OF LIVESTOCK COMPENSATION PROGRAM PAYMENTS

By Roger A. McEowen*

In the fall of 2002, the USDA announced the creation of the Livestock Compensation Program (LCP) designed to provide financial assistance to those livestock producers suffering from extreme drought in certain parts of the country. Signup began on October 1, 2002, with the program available to those in counties that received primary disaster designation due to drought in 2001 or 2002, as well as those in counties that had disaster designation requests pending as of September 19, 2002, that were subsequently approved.

The amount of payments under the program is based on standard feed consumption data for each eligible type of livestock (beef cows, dairy cows, stockers, buffalo and beefalo, sheep and goats), with the payment rate set at $18.00
per animal consuming unit. The animals must have been owned for 90 days or more before and/or after June 1, 2002.

Reports have surfaced that LCP payments are not subject to income tax. Unfortunately, there is no specific statutory exclusion for disaster payments. Apparently, the belief that LCP payments are not taxable is based upon a belief that LCP payments constitute welfare. While various types of disaster payments made to individuals have been excluded from gross income under a general welfare exception, see, e.g., Rev. Rul. 98-19, 1998-1 C.B. 840, that exception only applies if the payments are made under legislatively provided social benefit programs for the promotion of the general welfare. Indeed, in Rev. Rul. 76-144, 1976-1 C.B. 17 and Rev. Rul. 75-246, 1975-1 C.B. 24 the IRS addressed the general exception from income for welfare benefits received by individuals from governmental units under legislatively provided social benefit programs. However, in the rulings, IRS noted that payments under governmental programs that represent compensation for lost wages or lost profits are includible in gross income. For instance, under I.R.C. § 85, the exception from income for welfare benefits is made inapplicable to unemployment compensation. In addition, the legislative history of I.R.C. § 139(b)(4) states that the exclusion does not apply to payments that are in the nature of income replacement. I.R.C. § 139(b)(4) codifies the general welfare exception for payments to individuals in connection with a qualified disaster.

Consequently, there is little doubt that LCP payments constitute income replacement and are, therefore, subject to income taxation in the hands of the recipient.

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