INSIDE

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IN FUTURE ISSUES

Creditor must prove farm equipment delivered to debtor

The Minnesota Court of Appeals has reversed and remanded a decision that held that a debtor's failure to make the payments required to another farmer in order to obtain a fifty percent ownership interest in certain farm equipment did not give rise to any right in the farm equipment and that the creditor's security interest did not attach in the equipment. *American State Bank of Olivia v. Ladwig & Ladwig, Inc.*, 646 N.W.2d 241, 242 (Minn. Ct. App. 2002). The dispute concerned whether a debtor had acquired a sufficient ownership interest in a piece of farm equipment, a combine, for the bank's security interest to attach. *See id.* The court concluded "that the question of whether debtor acquired a sufficient ownership interest in the combine for [the creditor's] security interest to attach depends on whether the combine was 'delivered' to debtor." *Id.* The court determined that there was a genuine issue of material fact with respect to whether the combine was "delivered" to the debtor. *See id.*

Ladwig & Ladwig, Inc. ("Ladwig") purchased a John Deere 9600 combine with financing provided by John Deere Credit. *See id.* The loan from John Deere Credit was secured using the combine as collateral. *See id.* In late 1991, Ladwig entered into an agreement with Mark and Donna Herickhoff, debtors, which gave the Herickhoffs a fifty percent interest in the combine in return for five consecutive annual payments of $7,148.03, totaling $35,740.15. *See id.* The first payment was due "beginning January 1, 1993, and the same day thereafter annually, with the last payment due Jan. 1, 1997." *Id.*

The Herickhoffs failed to make any payments in 1993, 1994, or 1995. *See id.* In May 1993, they granted a security interest in all personal property, including the alleged one-half interest in the combine to American State Bank of Olivia ("American"). *See id.* at 242-43. In late 1995, Ladwig traded the combine for another John Deere 9600 combine. *See id.* at 242. Ladwig communicated to the Herickhoffs that they could obtain an ownership interest in the new combine if they would make the same five annual payments as under the previous agreement. *See id.* The Herickhoffs agreed and the contract was amended to reflect this new payment schedule. *See id.*

The Herickoffs made two payments, one in 1996 and the other in early 1998, totaling $14,296.06. *See id.* They failed to make any other payments and Ladwig was forced to refinance the combine or have it repossessed by John Deere Credit. *See id.* at 243. Ladwig refinanced the combine through North American Bank of Elrosa. *See id.* The North

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Farmer held not liable for irrigation runoff

In an action brought by a residential developer against a farmer when the developer suffered damages resulting from irrigation runoff from the farmer's operation, the California Court of Appeals has upheld a trial court's entry of summary judgment and its application of § 3482.5 of the California Civil Code, a statute which exempts farming activities from nuisance lawsuits when the requisite elements of the statute have been satisfied. *Rancho Viejo, L.L.C. v. Tres Amigos Viejos, L.L.C.*, 123 Cal. Rptr. 2d 479 (Cal. Ct. App. 2002).

Rancho Viejo, LLC ("Rancho Viejo"), appellant, brought an action against Tres Amigos Viejos, LLC ("Tres Amigos"), respondent, for trespass and failure to contain irrigation water. *See id.* at 483. Tres Amigos responded that its activities were exempted under § 3482.5 of the California Civil Code. *See id.* at 481. Section 3482.5 exempts prescribed agricultural activities from nuisance liability. *See id.*

The parties' predecessor-in-interest owned 500 acres of real property formerly known as the Pope Ranch. *See id.* at 482.Aro und 1984, the Popes prepared a specific plan to divide the property, in which approximately 115 acres, known as the upper property, would be devoted to continued agricultural use. *See id.*

On December 1, 1997, the Popes sold the portion of the Pope Ranch known as the lower property to Rancho Viejo. *See id.* The lower property contained approximately 500 orange

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American Bank of Elrosa paid off the outstanding debt and believed itself to be the only creditor with a security interest in the combine. *See id.*

Between 1993 and 1999, with permission from Ladwig, the Herickoffs used the combine to harvest their crops. *See id.* Ladwig used, stored, and maintained the combine when it was not being used by the Herickoffs. *See id.* In 2000, sometime after the combine had been refinanced, Ladwig communicated to the Herickoffs that the two payments that had been received would be treated as compensation for the use of the combine and that they would no longer have access to the machine. *See id.* Despite this notice, the Herickoffs took the combine in the fall of 2000 to harvest their crops. *See id.* Ladwig notified the sheriff and the combine was returned to Ladwig. *See id.*

The Herickhoffs subsequently defaulted on their loan with American. *See id.* American demanded that Ladwig turn over possession of the combine so that it could be liquidated. *See id.* Ladwig refused to deliver the combine to American. *See id.*

American brought suit to recover the combine from Ladwig, arguing that the interest in the combine had passed to Herickoff despite their failure to make the payments under the contract. *See id.* Both parties filed motions for summary judgment. *See id.* The trial court granted summary judgment in favor of Ladwig, "holding that pursuant to Article 2 of the Uniform Commercial Code ..., Minn. Stat. § 336.2 - 401(3) (2000), the parties could determine by explicit agreement when any ownership interest would pass and that the agreement unambiguously provided that the 50% interest would not pass to the Herickoffs until the required payments were made in full." *Id.* Thus, the trial court held that American's security interest failed to attach to the combine because the Herickoffs did not have an interest in the combine. *See id.* American appealed the trial court's decision to the Minnesota Court of Appeals. *See id.*

American argued that its security interest attached to the combine because "any title retained by Ladwig must be considered a purchase-money security interest and, under article 9 of the UCC, the purchase-money security interest is subordinate to American's security interest because it was not perfected by the filing of a UCC-1 financing statement." *Id.* at 243-44. American relied on *Greenbush State Bank v. Stephens*, 463 N.W.2d 303 (Minn. Ct. App. 1990), to support this argument. *See id.* at 244.

In *Greenbush*, the creditor claimed that its perfected security interest in the property of the debtor attached to a tractor that was in the possession of a neighbor. *See id.* However, the neighbor in possession of the tractor claimed to be the owner because he had provided part of the purchase price. *See id.* The two neighbors had agreed that the debtor would pay back the neighbor in possession of the tractor and then the debtor would own the tractor outright. *See id.* Until the debt was paid the two neighbors would share the use of the tractor. *See id.* In *Greenbush*, the court characterized the neighbor in possession's interest as a purchase money security interest under Minn. Stat. § 336.9-107 (1988) and priority was determined "'according to the priority in time of filing or perfection.'" *Id.* (quoting *Greenbush*, 463 N.W.2d at 307).

The Minnesota Court of Appeals did not consider the *Greenbush* case analogous. *See id.* It reasoned that the parties were not aligned similarly because in *Greenbush* the purchase money security interest was held by the debtor as the "buyer." *See id.* (citing *Greenbush*, 463 N.W.2d at 305). The court stated that "the agreement between Ladwig

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trees, which Rancho Viejo removed in 1998. *See id.* at 483. Moreover, Rancho Viejo excavated cut slopes into the hills along the boundary line between the upper and lower properties. *See id.* During the course of the excavation, Rancho Viejo encountered water seepage from the upper property on the northeastern portion of the property, and observed water streams and water in canyons on several lots. *See id.*

The upper property consisted of approximately 6,600 avocado trees that had been irrigated by pumping water from wells containing water from the adjacent San Luis Rey River. *See id.* at 482. The well water was saltier than metropolitan water, but the municipal water was unavailable for irrigation. *See id.* Because of the higher salt content of the well water, the avocado grove used a greater amount of water in order to dilute the water's salinity. *See id.* Also, for years, rainwater and natural runoff had flowed from the upper property onto the lower property. *See id.* at 483.

In November, 1998, Tres Amigos purchased the upper property from the Popes and continued to farm the avocado grove. *See id.* Tres Amigos continued irrigating the property in the exact same manner as the grove had previously been irrigated. *See id.* In May, 1999, Rancho Viejo discovered water cascading from the upper property onto its lower property as a result of Tres Amigos' continued irrigation of the property. *See id.* After Tres Amigos refused to take steps to reduce the runoff from its irrigation practice, Rancho Viejo installed an additional subdrain system at its own expense and brought this action seeking damages, as well as injunctive and declaratory relief. *See id.*

The trial court granted summary judgment in favor of Tres Amigos on the ground that § 3482.5 barred Rancho Viejo's cause of action. *See id.* The trial court held that Rancho Viejo failed to establish triable issues as to whether Tres Amigos' activities were (1) agricultural; (2) conducted "consistent with proper and accepted customs and standards as established and followed by similar agricultural operations in the same locality;" and (3) in operation for more than three years. *Id.* n 3. The California Court of Appeals affirmed the trial court's decision. *See id.* at 494.

Rancho Viejo asserted that § 3482.5 was not intended to confer absolute immunity for agricultural activities. *See id.* Rather, Rancho Viejo claimed that the statutory language only afforded protection to agricultural activities that were traditional in scope, such as noise, odors, and dust caused by traditional farming activities. *See id.* The court stated that Rancho Viejo's argument was based on a misunderstanding of nuisance law as well as an overly narrow reading of the statute. *See id.* at 485.

The court determined that the protection afforded to farming under the statute is broadly defined so as to include "any practices performed by a farmer or on a farm as

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and the Herickhoffs contemplated the sale of only a partial interest to the Herickhoffs whereas, in *Greenbush*, the entire interest was transferred to [neighbor in possession] and the entire interest was to revert to [the debtor] if he paid [the neighbor in possession] in full." *Id.* at 245 (quoting *Greenbush*, 463 N.W.2d at 305).

The court explained that the present facts demonstrate that Ladwig's retention of title is more than the retention of a mere security interest due to the fact that Ladwig was to remain a partial owner, even after the partial transfer of ownership to the Herickhoffs. *See id.* The court concluded that an examination of Ladwig's interest as a purchase money security interest was improper and the focus was more appropriately on the provisions of UCC Article 2 addressing the transfer of ownership. *See id.*

The court explained that "the issue of when 'delivery' occurs when only a partial interest in goods is being sold is a novel issue that was not addressed by the parties and has not been discussed in any case that we have found." *Id.* at 246. Under Minnesota law, "for delivery to occur the seller must 'put and hold conforming goods at the buyer's disposition' pursuant to the agreement." *Id.* (quoting Minn. Stat. § 336.2-503(1) (2000)). "Delivery requires that the seller intend to relinquish control over the goods to the buyer by placing them at the buyer's disposal." *Id.* (citation omitted). The court explained that the "general definition of delivery must be modified in the case of the sale of a partial interest, where possession is to be shared even after the transfer of partial ownership." *Id.* This modification is necessary because "the relinquishment of possession by the seller would never be 'complete' or 'unconditional' because the buyer will only receive a partial interest and the buyer's right to share in the possession of the property will always be subject to the condition of the seller's right to share in possession." *Id.*

The court determined that "proof of 'delivery' where the buyer is given only temporary possession requires a showing that such possession is acquired pursuant to an enforceable right of the buyer under the agreement, and is not optional or gratuitous with the seller." *Id.* The court stated that for American to prevail it must prove delivery by showing that "the Herickhoffs hold an enforceable right under the agreement to the annual use of the combine for their harvest." *Id.* at 256-57. The court concluded by stating,

> [w]e agree with the district court's conclusion that the parties explicitly agreed that the Herickhoffs would not have an ownership interest in the combine until they paid in full. But we conclude that such agreement does not control if the combine was delivered. Because there are genuine issues of material fact concerning whether delivery occurred, we reverse the summary judgment for Ladwig and remand for further proceedings consistent with this opinion.
>
> *Id.* at 257.

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incident to or in conjunction with those farming operations, including preparation for market, delivery to storage or to market, or delivery to carriers for transportation to market." *Id*. The court stated that Rancho Viejo could not reasonably argue that irrigation was not an agricultural activity or operation. *See id*.

The court further determined that the legislative intent was contrary to the narrow reading of the statute that Rancho Viejo asserted. *See id.* at 488. In a letter in support of the statute, Assemblyman John Thurman stated:

> [Assembly Bill] AB 585 is an important step toward eliminating suits by individuals who have moved to a new housing development "in the country" and find the long-established farm bordering their back fence offends their senses. Suits against agricultural operations for dust, wind machine or tractor noise, livestock or poultry smells *and other things commonly associated with the operation of an agricultural enterprise* are becoming more prevalent as urban development reaches out to meet agricultural areas. AB 585 will stop this dangerous cycle by allowing agriculture to operate without undue pressure from urbanization. Keeping agricultural land in agricultural use is the goal.

Id. at 488. (Emphasis supplied.)

The court read the letter from Assemblyman Thurman to indicate that the legislature sought broad protection for traditional farming practices performed in conjunction with long-standing commercial operations when neighboring properties are developed into residential or urban use. *See id*. The court further opined that irrigation is an ongoing operation in commercial farming generally, and was regularly conducted in the instant case according to the undisputed testimony of Tres Amigos' witness, and that such irrigation practices fell within the literal language of the statute. *See id.* at 489.

Rancho Viejo also argued that § 3482.5 was inapplicable in the instant case because it was enacted to protect farmers who were innocent victims of urbanization and to stem the removal of land from agricultural uses where residential development moves in next door to a longstanding activity. *See id.* at 490. Rancho Viejo asserted that a farmer should not be immunized when the farmer profits from urban development on his land yet also seeks to protect his continued agricultural activity. *See id*.

The court disagreed and held that Rancho Viejo was cognizant of the fact that the upper property was still agricultural in nature, and yet Rancho Viejo took steps to begin mass urban development of the lower property. *See id*. Moreover, Rancho Viejo removed the orange trees and initiated excavation on the lower property, ultimately changing the condition of the lower property. *See id*. The court stated that Rancho Viejo failed to contradict with any competent evidence that its nuisance cause of action did not accrue until it graded the slopes below Tres Amigos' avocado grove. *See id*.

Importantly, Rancho Viejo failed to establish that Tres Amigos changed the watering practices of the upper property that had been in place since at least 1982. *See id.* The court determined that Tres Amigos' irrigation practices were customary and accepted because Tres Amigos met its burden of producing competent and admissible evidence establishing the customary character of its irrigation methods through its witness. *See id*. at 492. Rancho Viejo's expert witness failed to offer competent and admissible evidence to the contrary. *See id.* at 493. Therefore, the court determined that Tres Amigos' irrigation activities were not unreasonable because its practices were accepted and customary. *See id.* at 494.

Finally, the court ruled that Tres Amigos fell within the exemption of the statute because the farm had been in operation for more than three years. *See id.* at 491. The court explained that the statute cannot be read to permit developers to enjoin a long-established farming operation as a nuisance simply because the farm was purchased and operated by a new owner. *See id.* Rather, the court held that § 3482.5 was predicated on the duration of the agricultural operation, not the duration of the farmland's ownership. *See id.*

The court concluded that Rancho Viejo failed to establish any genuine issues of material fact to indicate that § 3482.5 should not apply to the irrigation practices of Tres Amigos. *See id.* at 494. Therefore, the California Court of Appeals affirmed the decision of the trial court. *See id.*

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District court rules Iowa ban on packer ownership of livestock unconstitutional

By Anne Hazlett

In recent years, the domestic livestock industry has undergone a rapid increase in the level of concentration both through consolidation of small and medium-sized operations and vertical integration. Operating in a depressed farm economy with consistently low livestock prices, many producers have grown increasingly concerned about the effect that this industry transformation is having on their ability to access a competitive marketplace. In particular, some livestock operators have expressed concern about "captive supplies," a term generally referring to animals that are owned or committed to a packer more than fourteen days prior to slaughter. They believe that packers are using captive supplies to manipulate market prices.[1]

One remedy suggested to address the problem of captive supplies and the perception of its impact on market transparency and accessibility is to limit the ability of packers to own or substantially control livestock. Several states have enacted restrictions on packer ownership of livestock to address producer concerns.[2] On January 22, 2003, the United States District Court for the Southern District of Iowa ruled that an Iowa statute that forbids pork processors from directly or indirectly owning, operating or controlling pork production in the state is unconstitutional. *Smithfield Foods, Inc., et al. v. Thomas J. Miller*, 2003 U.S. Dist. LEXIS 915 (S.D. Iowa, Jan. 22, 2003). As debate on this issue begins to brew in the 108th Congress, this ruling is significant in that it raises the question of whether a federal law is necessary to realize the proponents' intentions.

Background

Smithfield Foods, Inc. ("Smithfield") is the largest pork processor and hog producer in the world. *Id.* at 5. Based in Virginia, Smithfield currently holds a twenty-one percent share in the daily capacity of United States' processors. *Id.* Much of this dominance is a result of the company's vertically-integrated business model whereby it owns both hog production operations and pork processing facilities. *Id.*

In September of 1999, Smithfield announced its intent to acquire the capital stock of Murphy Farms, Inc. ("Murphy Farms"). *Id.* at 7. Murphy Farms had no processing interests at the time of the acquisition. *Id.* The transaction included $80 million for the purchase of Murphy Farm's Iowa-based assets. *Id.*

On the day after Smithfield's announcement, the Iowa Attorney General sent Smithfield a letter challenging the transaction as a violation of Iowa Code § 9H.2. *Id.* At the time, that provision prohibited a pork processor from contracting for hog care and feeding in Iowa if it ultimately slaughtered those hogs. *Id.* Because its hogs were eventually processed by IBP, Inc., Smithfield maintained that the acquisition would not violate the state law. *Id.* Even after Smithfield modified the purchase, however, the Iowa Attorney General filed a suit in state court against the company alleging a violation of § 9H.2 because he believed that the transaction would give Smithfield, a processor, control over the Murphy Farms hog production facilities in Iowa. *Id.* at 7-8.

In January of 2000, Stoecker Farms, Inc. was formed as a family farm corporation under Iowa law. *Id.* at 8. On that very same day, Randall Stoecker resigned his position as an executive in Murphy Farms and invested $10,000 in the new company. *Id.* at 9. Smithfield loaned the rest of the initial investment in the business. *Id.*

Within a month, Murphy Farms rehired Stoecker to manage its Midwest operations outside of Iowa. *Id.* Murphy Farms then sold its Iowa-based assets to Stoecker Farms. *Id.* In addition, Murphy Farms assigned its contract with IBP to Stoecker. *Id.*

Following this transaction, Smithfield bought the non-Iowa assets of Murphy Farms. *Id.* In this arrangement, Murphy Farms provided out-of-state feeder pigs to Stoecker Farms which contracted with Iowa farmers for finishing and sold the hogs to IBP for processing. *Id.* In light of Smithfield's ownership interest in Murphy Farms, the Attorney General amended its petition to challenge the formation of Stoecker Farms and its subsequent transactions as a sham. *Id.*

In the spring of 2001, William Prestage, a former member of Smithfield's board of directors, purchased a fifty-one percent interest in Stoecker Farms. *Id.* Stoecker Farms was then renamed Prestage-Stoecker Farms, Inc. *Id.* This purchase was also challenged by the Attorney General in its action against Stoecker Farms as an attempt to get around the limits of § 9H.2. In February of 2002, the state court held that the formation of Stoecker Farms was not a sham and that neither Smithfield nor Prestage-Stoecker Farms was in violation of the state law. *Id.* at 9-10.

During the course of this action, the Iowa General Assembly made several changes to § 9H to take effect July 1, 2004. *Id.* at 10. In 2000, the law was amended to prohibit any processor from "directly or indirectly contracting for the care and feeding of swine" in Iowa. *Id.* The amendment specifically defined "contract for the care and feeding of swine" as "an oral or written agreement between a person and the owner of swine, under which a person agrees to care for and feed the owner's swine on the person's premises." *Id.* (quoting Iowa Code § 9H.1(6A)). Further, the amendment expanded an exemption from the ban for Iowa cooperative associations to include cooperative corporations organized under the state law. 2003 U.S. Dist. LEXIS 915 at 10.

Two years later, the 2002 General Assembly passed additional amendments to § 9H. *Id.* In those legislative actions, it expanded the prohibition on activities by processors in Iowa to ban financing of anyone who "directly or indirectly" contracts for swine care and feeding in the state. *Id.* at 11 (citing Iowa Code § 9H.2(b)(1)(b)). The amendment banned processors from directly or indirectly receiving the net revenue derived from Iowa-based swine operations or activities by those who contract for swine care and feeding in the state. 2003 U.S. Dist. LEXIS 915 at 11 (citing Iowa Code § 9H.2(b)(1)(d)). It also expanded the definition of a processor to include an individual who holds, or held within the past two years, an executive position in a processor entity that has direct or indirect control of processing operations valued at over $260 million. 2003 U.S. Dist. LEXIS 915 at 11 (citing Iowa Code § 9H.1(19)(b)). Finally, the amendment raised the penalty from a total fine of $25,000 to a possible fine of $25,000 per day. 2003 U.S. Dist. LEXIS 915 at 11 (citing Iowa Code § 9H.3(2)(a)).

When the Iowa Attorney General advised Smithfield, Prestage-Stoecker Farms and Murphy Farms, LLC[3] (hereinafter "plaintiffs") that they would be subject to suit and penalties of up to $25,000 per day under the amended statute if they continued their operations after July 1, 2004, they challenged the law in federal court. 2003 U.S. Dist. LEXIS 915 at 2, 12. Naming Attorney General Miller in his official capacity, the plaintiffs brought an action under 42 U.S.C. § 1983 asking the court to declare § 9H.2 an unconstitutional infringement on interstate commerce. *Id.* at 2.

In December of 2002, the plaintiffs filed a motion for summary judgment in which they argued that the Iowa law discriminates against out-of-state interests by its terms and in its intended effect. *Id.* at 21. Further, they challenged § 9H.2 as an extra-territorial regulation of interstate commerce. *Id.* at 40. Granting summary judgment in favor of the plaintiffs, the United States District Court for the Southern District of Iowa held that the Iowa law is unconstitutional on its face, in its intended purpose and as applied to the plaintiffs under the United States Constitution. *Id.* at 41.

Analysis

In evaluating the plaintiffs' claims, the court began with a review of its dormant

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commerce clause jurisprudence. *Id.* at 15. The Commerce Clause of the United States Constitution provides that "Congress shall have the power... to regulate Commerce... among the several States." *Id.* (quoting U.S. Const. art. I, § 8). The United States Supreme Court has long recognized that this provision not only grants Congress the authority to regulate commerce among the states but also directly limits the power of states to discriminate against interstate commerce. 2003 U.S. Dist. LEXIS 915 at 15. This negative reciprocal of the Commerce Clause has been termed the dormant commerce clause. *Id.*

The dormant commerce clause prohibits an individual state from enacting regulatory schemes that impose economic protectionism by burdening out-of-state competitors to benefit in-state economic interests. *Id.* at 15-16. When reviewing a dormant commerce clause challenge to a state policy, the court engages in a two-part analysis. *Id.* at 16. First, the court must determine whether the challenged measure discriminates against out-of-state interests. *Id.* Discrimination may occur in one of three forms. *Id.* The text of the statute may facially discriminate against foreign interests. *Id.* Or, a statute may be facially neutral but have a discriminatory purpose. *Id.* at 17. Lastly, the statute may be facially neutral but have a discriminatory effect. *Id.* If the court finds that the state statute is discriminatory, the act is subjected to a strict scrutiny analysis whereby the policy is doomed unless the state can prove that the regulatory scheme was enacted to protect an important state interest and that it had no other non-discriminatory means to address the issue. *Id.*

When the court finds that the challenged policy is not discriminatory or the state is able to successfully justify the discrimination, the analysis moves to a second phase. *Id.* at 18. There, the court weighs the state's interest against the burden the statute places on interstate commerce. *Id.* "Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." *Id.* (quoting *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970)).

Applying this analysis to Iowa Code § 9H.2[4], the plaintiffs pointed to the exemption for Iowa cooperatives, foreign cooperatives that contract with Iowa cooperatives, and foreign cooperatives that have an Iowa cooperative in their membership as support for their allegation that the Iowa law expressly discriminates against interstate commerce. 2003 U.S. Dist. LEXIS 915 at 22. Plaintiffs contended that under the exemption Iowa cooperatives are free to conduct business in precisely the same manner as that which would subject their companies to fines of up to $25,000 per day. *Id.*

Beyond facial discrimination, the plaintiffs further argued that § 9H.2 was enacted with a discriminatory intent, purpose, and effect. *Id.* at 23. In making their case, the plaintiffs placed heavy emphasis on comments made by Iowa Senate Majority Leader Stewart Iverson, Jr. in a newsletter that was published and distributed on the same day Senator Iverson introduced the most recent version of § 9H.2 in the General Assembly. *Id.* In that document, Senator Iverson explained that "in response to a recent Iowa court decision that let's [sic] Smithfield Foods finance an Iowa-based hog producer, the Iowa Senate will consider legislation this week to protect farmers from large meatpacking firms." *Id.* Plaintiffs maintained that this declaration clearly demonstrates that Iowa amended § 9H.2 with an intent and purpose to effectively exclude Smithfield and other out-of-state interests from the Iowa pork industry. *Id.*

In addition, the plaintiffs pointed to an advertising supplement for "Iowa 2010: A Strategic Planning Initiative," a comprehensive plan for Iowa's future that was compiled by Iowa Governor Thomas Vilsack. *Id.* at 23-24. The supplement stated in part:

> Agriculture is the soul of Iowa, but its long-term growth rate is less than half the rate of other industries. The reliance on traditional agricultural commodities and markets will shrink as the forces of an integrated world economy continue a 30-year downward spiral of raw commodity prices. Research suggests this will be especially true for food prices as production rates increase in emerging market countries. Open markets for commodity crops will diminish in favor of highly integrated systems driven by consumer demand. While dramatically altering the face of traditional farming practices, these changes provide a unique opportunity for Iowa to reinvent agriculture and its role in feeding the world.

Id. at 24 (quoting Iowa 2010- The New Face of Iowa: Embracing Iowa's Values-Shaping Iowa's Future, 4 (2000 advertising supplement)). It also expressed a goal of making Iowa "known as the consumer-driven life science capital of the world, aligning producers with consumers, diversifying the agricultural economy and increasing farm income." 2003 U.S. Dist. LEXIS 915 at 24-25. Plaintiffs contended that these two themes in the Iowa 2010 document evidenced the fact that Iowa realized the economic benefits of a vertically-integrated pork industry and amended § 9H.2 to preserve those benefits for Iowans alone. *Id.* at 25.

Finally, the plaintiffs argued that the Iowa Code actually codifies an overall public policy directive that advocates discriminatory regulatory schemes such as Iowa Code § 9H.2. *Id.* In passing the Iowa Agricultural Industry Finance Act, for example, the General Assembly found that "this state is in a period when the economic structure of agriculture and the production, processing and marketing of agricultural products is undergoing a period of rapid transformation." *Id.* (quoting Iowa Code § 15E.203(1) (1998)). The Legislature then stated an intent to ensure that Iowa capture the greatest benefit from the opportunities created during this period and directed that state resources be used to assure: (1) that the majority of the wealth created by Iowa agricultural productivity is retained in the state, (2) that local agricultural producers are provided with an opportunity to acquire a majority ownership interest in Iowa agricultural ventures promoted under the new law, and (3) that Iowa becomes a world model for agricultural producer-based vertical cooperation. 2003 U.S. Dist. LEXIS 915 at 25-26 (quoting Iowa Code § 15E.203(2)).

With this evidence, the Plaintiffs asserted that the intent and effect of § 9H.2 is to eliminate Smithfield from doing business in Iowa and allow only Iowa cooperative associations or regional cooperatives with at least one such Iowa entity as an owner contracting with Iowa residents to benefit from the vertical integration business model. 2003 U.S. Dist. LEXIS 915 at 27. Plaintiffs believed that Iowa is using § 9H.2 to ensure that only Iowans can practice Smithfield's vertically-integrated business model in Iowa. *Id.* Therefore, since the statute discriminates against out-of-state entities facially, in effect and in purpose with no justification beyond economic protectionism, it should be struck down as a per se violation of the dormant commerce clause. *Id.*

In defense of its policy, Iowa offered several arguments to refute the Plaintiffs' claims of facial discrimination. First, Iowa maintained that § 9H.2 does not facially discriminate because the law makes no distinction between in-state and out-of-state swine processors. *Id.* Rather, the law applies universally to all processors. *Id.* Second, Iowa asserted that § 9H.2 does not discriminate between Iowa and non-Iowa cooperatives for purposes of the exemption because it did not require that non-Iowa cooperatives be physically present in Iowa in order to be organized under Iowa law. *Id.* at 27-28. Third, the State argued that the unique treatment of cooperatives is widely recognized in federal laws exempting agricultural cooperatives from antitrust, tax and securities provisions. *Id.* at 28.

With respect to purpose, Iowa contended that the stated purpose of § 9H.2 is "to preserve free and private enterprise, prevent monopoly, and also to protect consumers." *Id.* Plaintiffs have failed to prove that the Legislature had any purpose other than that which it put into the text of the statute. *Id.* at 28-29. In making this argument, Iowa argued that the court must adhere to the state's established standards

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of statutory construction which require the court to give the language of the statute its plain and rational meaning where the terms are unambiguous. *Id.* at 29. Because the express statement of purpose in § 9H.2 is unambiguous, the court's inquiry may extend no further. *Id.* Specifically, the court may not consider any evidence of discriminatory legislative intent imbued in Iowa 2010 or Iowa's Agricultural Industry Finance Act. *Id.* Iowa maintained that if the court restricts its inquiry to the unambiguous terms of § 9H.2, there is no evidence of a discriminatory legislative intent, purpose or effect. *Id.*

After "careful consideration" of the parties' positions, the court concluded that § 9H.2 unconstitutionally discriminates on its face, in its purpose and in its effect. *Id.* at 30. As to facial discrimination, the court first defined the term "discrimination" in the context of commerce clause considerations to mean "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Id.* (quoting *Hampton Feedlot v. Nixon*, 249 F.3d 814, 818 (8th Cir. 2001)). In this case, the state has narrowly tailored its prohibitions to cast a wide net around the plaintiffs' economic activities while reserving the same opportunities for Iowa entities. 2003 U.S. Dist. LEXIS 915 at 30.

In reaching this conclusion, the court rejected Iowa's assertions that its law is facially neutral because it does not require a business to be present in Iowa to take advantage of the cooperative exemption and because it applies to all entities other than cooperatives. *Id.* at 30-31. The court stated that a cooperative organized under Iowa law is an Iowa entity regardless of where the entity is physically located. *Id.* at 31. It then explained that the fact that § 9H.2 applies evenhandedly to all Iowa and out-of-state interests other than cooperatives is not a saving grace for the law. *Id.* "[A] showing that the State favors only in-state cooperatives over all other business entities does nothing to obviate the fact that the statute blatantly protects the rights of Iowans to engage in conduct forbidden to out-of-state entities such as plaintiffs." *Id.* When a law clearly prohibits out-of-state businesses from conducting their activities in a particular manner and then expressly exempts in-state entities from the very same restrictions, there can be no mistake that the policy treats in-state and out-of-state interests differently. *Id.*

Further, the court rejected Iowa's argument that agricultural cooperatives often enjoy differential treatment under federal law than do other business entities. *Id.* at 32. There, the court chided Iowa for overlooking one important consideration: Congress has the power to regulate interstate commerce and to discriminate among different entities in matters of interstate commerce. *Id.* Because the dormant commerce clause precludes the state of Iowa from exercising the same power, the fact that several areas of federal law provide a different standard for cooperatives is irrelevant. *Id.*

Beyond facial discrimination, the court also determined that the Iowa General Assembly enacted § 9H.2 with a discriminatory intent and purpose. *Id.* at 35. In so doing, it dismissed Iowa's contention that the statute's clear and unambiguous statement of purpose precludes any further inquiry into legislative intent. *Id.* Quoting the Eighth Circuit's decision in *Waste Systems Corp. v. Minnesota*, 985 F.2d 1381 (8th Cir. 1993), the court noted that when considering the purpose of a challenged statute, the court is not bound by the name, description, or characterization given by the legislature. *Id.* To the contrary, the court must determine for itself the practical impact of the law. *Id.*

Looking at the evidence provided by the plaintiffs, the court stated that no evidence could offer more direct proof of the General Assembly's intent in amending § 9H.2 to specifically discriminate against Smithfield than Senator's Inverson comments prior to introducing the legislation. *Id.* at 36. Moreover, the advertising supplement for the Iowa 2010 plan clearly illustrates the state's recognition of the current trend towards a more vertically-integrated agricultural industry and its desire to keep the benefits of this evolution in Iowa. *Id.* And, the Iowa Agricultural Industry Finance Act reiterates that Iowa public policy seeks to ensure "that the majority of wealth created by agricultural productivity is retained in this state." *Id.* (quoting Iowa Code § 15E.203(2)). When viewed individually, none of these facts conclusively demonstrate that the Iowa Legislature had a discriminatory purpose in enacting the amended § 9H.2. 2003 U.S. Dist. LEXIS 915 at 36. Nevertheless, when considered collectively and in conjunction with the terms of Chapter 9H, the "undeniable" conclusion is that the General Assembly amended the statute with a discriminatory purpose to achieve a discriminatory effect in violation of the Constitution. *Id.* at 37.

Having concluded that § 9H.2 discriminates against interstate commerce on its face, in purpose and in effect, the court then considered the statute under a strict scrutiny review. *Id.* at 37-38. Under that framework, a state statute violates the Commerce Clause unless the state can demonstrate that the policy "serves a legitimate local purpose unrelated to economic protectionism and that the purpose could not be served as well by nondiscriminatory means." *Id.* at 38 (quoting *Cotto Waxo Co. v. Williams*, 46 F.3d 790, 794 (8th Cir. 1995)). Here, Iowa maintained that its stated purpose of § 9H.2, "to preserve free and private enterprise, prevent monopoly, and also to protect consumers," is a legitimate local purpose and not economic protectionism. 2003 U.S. Dist. LEXIS 915 at 38. Expressing its sympathies with Iowa's attempt to protect its family farmers, the court rejected this stated purpose as disingenuous, concluding: "The evidence makes clear that the State enacted § 9H.2 with an eye towards nothing more than protecting local economic interests from out-of-state behemoth Smithfield Foods." *Id.*

Furthermore, the court stated that the proffered statement of purpose does nothing to protect § 9H.2 from a Commerce Clause challenge. *Id.* at 38-39. The vision of our founders in enacting the Commerce Clause was to protect the ability of each citizen in our country to freely access every market in the nation, both as a consumer and a producer. *Id.* at 39. Thus, by claiming to "preserve free and private enterprise, prevent monopoly and also to protect consumers," Iowa purports to promote precisely the sort of discriminatory scheme against which the Commerce Clause was conceived. *Id.* Finding no justifiable explanation for the discrimination inherent in the text, purpose and effect of § 9H.2, the court declared the statute null and void and ordered Iowa to strike the law from its books.[5] *Id.* at 41.

Implications

While limited to Iowa, the *Smithfield* decision has far-reaching implications to the extent that it highlights a larger national debate over the structure of agricultural production and legislative attempts to ensure that independent producers can compete with agribusiness in food production. During the development of the 2002 Farm Bill, this issue took center stage in the legislative debate when the Senate-passed farm bill contained a provision authored by Senator Tim Johnson (D-SD) that would have prohibited packers from owning, feeding or controlling livestock for more than fourteen days prior to slaughter. *See* H.R. 2646 as amended on Senate floor, § 1043, 107th Cong. (2002). Producer-owned cooperatives and entities owned by such cooperatives which slaughter less than 2 percent of the livestock slaughtered in the United States were exempted from the ban. [6]

While the Johnson provision was not included in the final legislation, it sparked significant interest in and discussion about the issue of concentration in the agricultural sector. Today, this dialogue has quickly resurfaced. Within six weeks of passage of the new farm bill, the Senate Agriculture Committee held a hearing to review the proposed packer ban. *Hearing on Banning Packer Ownership of Livestock Before the Senate Comm. on Agriculture*, 107th Cong., July 16, 2002. The following month, the Senate Judiciary Committee held a field hearing in Sioux Falls, South Dakota to address the question of whether meat packers are abusing market power at the cost of livestock

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producers. *Ensuring Competitive and Open Agricultural Markets: Are Meat Packers Abusing Market Power?, Hearing Before the Senate Judiciary Committee*, 107th Cong., Aug. 23, 2002. And, in late August, the House Agriculture Committee mailed questionnaires to over fifty industry, producer, and academic interests to solicit their perspectives on the current state of livestock markets. This information will be used to lay the foundation for future hearings looking at concentration in agricultural markets.

On January 7, 2003, Senator Charles Grassely (R-IA) introduced S. 27, a bill amending the Packers and Stockyards Act to make it unlawful for a packer to own, feed, or control livestock intended for slaughter. S. 27, 108th Cong. (2003). To date, co-sponsors include Senators Mark Dayton (D-MN), Michael Enzi (R-WY), Tim Johnson (D-SD), Patrick Leahy (D-VT), Byron Dorgan (D-ND) and Tom Harkin (D-IA). On the House side, Representative Leonard Boswell (D-IA) has indicated he is looking for co-sponsors for a bill similar to the Grassley measure and expects to introduce this legislation in the coming weeks. Jerry Perkins, *Iowans Push for Packer Ban at Federal Level*, Des Moines Register, Jan. 24, 2003, http://www.desmoinesregister.com/business/stories.html.

As the debate on this issue begins to brew in the 108th Congress, proponents of a ban believe that the *Smithfield* decision will create support for a prohibition at the federal level. In an interview with the *Des Moines Register*, Senator Grassley said: "I think the court decision will help. This court case says that if you are to have a packer ban, you have to have it imposed nationally by Congress and not by the states." *Id*. Similarly, Representative Boswell responded: "The court's decision will stir up support. We're going to push for a packer ban as much as we can." *Id.*

Back in Iowa, leaders of the Republican-controlled Legislature have indicated they are still assessing the court decision but hope that Congress will provide a national solution. *Id.* Also voicing support for a national ban on packer ownership, the Democrat leaders are further calling for immediate legislative action at the state level to revise the Iowa ban in a way that will pass constitutional muster. *Id.* Iowa Attorney General Tom Miller has said that he will appeal the Court's ruling to the Eighth Circuit Court of Appeals. *Id.*

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[1] Some producers believe that when packers own or contract for livestock supplies prior to fourteen days before slaughter they are able to purchase fewer animals from the spot market which results in reported prices that do not accurately reflect prices paid for a majority of livestock. Jerry Heykoop, Congressional Research Service, Livestock: A Proposed Ban on Ownership and Control by Packers, 1 (2003) (hereinafter "CRS Ownership Ban Report). They feel that this reduction in price transparency puts them at a disadvantage relative to the packers because contract prices are typically tied to spot market prices. *Id.*

[2] *See* Cal. Food & Agric. Code §18381 (Deering 2001); Neb. Rev. Stat. § 54-2604 (2001); Iowa Code § 9H.2 (2002).

[3] Formed in 2001, Murphy Farms, LLC is the successor in interest to Murphy Farms, Inc. 2003 U.S. Dist. LEXIS 915 at 5. At present, Murphy Farms, LLC owns almost half of Smithfield's sows. *Id.* Murphy Farms, LLC is wholly owned by Smithfield. *Id.*

[4] In its present and pertinent form, Iowa Code § 9H.2 reads:

9H.2. Prohibited operations and activities—exceptions

The purpose of this section is to preserve free and private enterprise, prevent monopoly, and also to protect consumers.

1. Except as provided in subsections 2 through 4, and section 9H.2A, all of the following apply:

b. For swine, a processor shall not do any of the following:

(1)

(a) Directly or indirectly own, control, or operate a swine operation in this state.

(b) Finance a swine operation in this state or finance a person who directly or indirectly contracts for the care and feeding of swine in this state.

For purposes of subparagraph subdivision (a) and this subparagraph subdivision, all of the following apply:

(I) "Finance" means an action by a processor to directly or indirectly loan

money or to guarantee or otherwise act as a surety.

(II) "Finance" or "control" does not include executing a contract for the purchase of swine by a processor, including but not limited to a contract that contains an unsecured ledger balance or other price risk sharing arrangement. "Finance" also does not include providing an unsecured open account or an unsecured loan, if the unsecured open account or unsecured loan is used for the purchase of feed for the swine and the outstanding amount due by the debtor does not exceed five hundred thousand dollars. However, the outstanding amount due to support a single swine operation shall not exceed two hundred fifty thousand dollars.

(c) Obtain a benefit of production associated with feeding or otherwise maintaining swine, by directly or indirectly assuming a morbidity or mortality production risk, if the swine are fed or otherwise maintained as part of a swine operation in this state or by a person who contracts for the care and feeding of swine in this state.

(d) Directly or indirectly receive the net revenue derived from a swine operation in this state or from a person who contracts for the care and feeding of swine in this state.

(2) Directly or indirectly contract for the care and feeding of swine in this state.

However, this subparagraph does not apply to a cooperative association organized under chapter 497, 498, 499, or 501, if the cooperative association contracts for the care and feeding of swine with a member of the cooperative association who is actively engaged in farming. This subparagraph does not apply to an association organized as a cooperative in which another cooperative association organized under chapter 497, 498, 499, or 501 is a member, if the association contracts with a member which is a cooperative association organized under chapter 497, 498, 499, or 501, which contracts for the care and feeding of swine with a member of the cooperative who is actively engaged in farming.

Iowa Code § 9H.2 (2002).

[5] Having found § 9H.2 to unconstitutionally discriminate against interstate commerce, the Court saw no need to address Plaintiffs' extra-territorial effect challenge. 2003 U.S. Dist. LEXIS 915 at 40.

[6] Supporters of the Johnson measure contended that by limiting packers' ability to manipulate the market the ban would improve farmers' ability to access livestock markets. CRS Ownership Ban Report at 5. In their opinion, banning packer ownership and control of livestock would force packers to compete against each other on the spot market which would in turn raise the prices ultimately received by producers. *Id.* In lobbying for support, these groups frequently expressed concern about the pace of vertical integration and the loss of open markets. *Id.* They warned that the end result of this transformation will be a market of several large companies and few, if any, independent producers. *Id.*

In contrast, opponents of the ban argued that this measure would reverse many of the efficiency gains that have come though closer alliances between packers and producers. *Id.* This system has enabled packers to lock in a reliable supply of consistent product, to add value and to meet demands from retailers who want forward pricing long before delivery to order to improve their business planning. *Id.* Opponents of the ban further contended that the legislation would disrupt supply chains by making risk management and production contracts for livestock illegal. *Id.* The ban would hurt the domestic livestock industry's competitiveness both here and abroad because it would not apply to foreign livestock interests who will take advantage of the economic efficiencies offered by vertical integration. *Id.* at 5-6. Lastly, opponents expressed concern that the ban would cause massive asset divestitures by companies which would in turn flood the market with livestock and other assets as packers restructured their operations to be in compliance with the new law. *Id.* at 6.