Pork Production Regulations; Fake Meat; and Tax Proposals on the Road to Nowhere

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Overview

Last week, there were two court major court developments of importance to agriculture. In one, the U.S. Supreme court agreed to hear a case from the U.S. Court of Appeals for the Ninth Circuit involving California's Proposition 12. That law sets rules for pork production that must be satisfied for the resulting pork products to be sold in California. In another development, a federal court in Louisiana held that state's law designed to protect consumers from misleading and false advertising concerning meat products.

The Supreme Court and Pork Production Regulations

National Pork Producers Council, et al. v. Ross, 6 F.4th 1021 (9th Cir. 2021), cert. granted, No. 21-468, 2022 U.S. LEXIS 1742 (U.S. Mar. 28, 2022)

Background. California voters approved Proposition 12 in 2018. The new law took effect on January 1, 2022. Proposition 12 bans the sale of whole pork meat (no matter where produced) from animals confined in a manner inconsistent with California's regulatory standards (largely remaining to be established). It also establishes minimum requirements on farmers to provide more space for egg-laying hens, breeding pigs, and calves raised for veal. Specifically, the law requires that covered animals be housed in confinement systems that comply with specific standards for freedom of movement, cage-free design and minimum floor space. The law identifies covered animals to include veal calves, breeding pigs and egg-laying hens.

The implementing regulations are to prohibit a farm owner or operator from knowingly causing any covered animal to be confined in a cruel manner, as specified, and prohibits a business owner or operator from knowingly engaging in the sale within the state of shell eggs, liquid eggs, whole pork meat or whole veal meat, as defined, from animals housed in a "cruel manner." In addition to general requirements that prohibit animals from being confined in a manner that prevents lying down, standing up, fully extending limbs or turning around freely, the measure added detailed confinement space standards for farms subject to the law. The alleged reason for the law was to protect the health and safety of California consumers and decrease the risk of foodborne illness and the negative fiscal impact on California. Apparently, California believes that existing state and federal law regulating food products for health and safety purposes was inadequate (or the alleged reason for the law is false).

Trial court. In late 2019, several national farm organizations challenged Proposition 12 and sought a declaratory judgment that the law was unconstitutional under the Dormant Commerce Clause.

Note: The Dormant Commerce Clause bars states from passing legislation that discriminates against or excessively burdens interstate commerce. It prevents protectionist state policies that favor state citizens or businesses at the expense of non-citizens conducting business within that state. The clause is dormant because it is not state outright, but rather implied in the Constitution's Commerce Clause of Article I, Section 8, Clause 3.

The plaintiffs also sought a permanent injunction preventing Proposition 12 from taking effect. The plaintiffs claimed that Proposition 12 impermissibly regulated out-of-state conduct by compelling non-California producers to change their operations to meet California's standards. The plaintiffs also alleged that Proposition 12 imposed excessive burdens on interstate commerce without advancing any legitimate local interest by significantly increasing operation costs without any connection to human health or foodborne illness. The trial court dismissed the plaintiffs' complaint.

Appellate court decision. On appeal, the plaintiffs focused their argument on the allegation that Proposition 12 has an impermissible extraterritorial effect of regulating prices in other states and, as such, is per se unconstitutional. This was a tactical mistake for the plaintiffs. The appellate court noted that existing Supreme Court precedent on the extraterritorial principle applied only to state laws that are "price control or price affirmation statutes." Thus, the extraterritorial principle does not apply to a state law that does not dictate the price of a product and does not tie the price of its in-state products to out-of-state prices. Because Proposition 12 was neither a price control nor a price-affirmation statute (it didn't dictate the price of pork products or tie the price of pork products sold in California to out-of-state prices) the law didn't have the extraterritorial effect of regulating prices in other states. The appellate court likewise rejected the plaintiffs' claim that Proposition 12 has an impermissible indirect "practical effect" on how pork is produced and sold outside California. Upstream effects (e.g., higher production costs in other states) the appellate court concluded, do not violate the dormant Commerce Clause. The appellate court pointed out that a state law is not impermissibly extraterritorial unless it regulates conduct that is wholly out of state. Because Proposition 12 applied to California and non-California pork production the higher cost of production was not an impermissible effect on interstate commerce. The appellate court also concluded that inconsistent regulation from state-to-state was permissible because the plaintiffs had failed to show a compelling need for national uniformity in regulation at the state level. In addition, the appellate court noted that the plaintiffs had not alleged that Proposition 12 had a discriminatory effect on interstate commerce and, as such, had failed to plead a Dormant Commerce Clause violation.

Supreme Court grants certiorari. On March 28, 2022, the U.S. Supreme Court agreed to hear the case. The issues before the Court are: (1) whether allegations that a state law has dramatic economic effects largely outside of the state and requires pervasive changes to an integrated nationwide industry state a violation of the Dormant Commerce clause, or whether the extraterritoriality principle is now a dead letter; and (2) whether the allegations, concerning a law that is based solely on preferences regarding out-of-state housing of farm animals, state a claim in accordance with *Pike v. Bruce Church, Inc., 347 U.S. 132 (1970).* In *Pike,* the Court said a state law that regulates fairly to effectuate a legitimate public interest will be upheld unless the burden on commerce is clearly excessive in relation to commonly accepted local benefits.

In the current case, while California accounts for about 13 percent of U.S. pork consumption, essentially no pigs are raised there. Thus, the costs of compliance with Proposition 12 fall almost exclusively on out-of-state hog farmers. In addition, because a hog is processed into cuts that are sold nationwide in response to demand, those costs will be passed on to consumers everywhere, in transactions that have nothing to do with California.

Meat Labeling Law Unconstitutional

Turtle Island Foods SPC v. Strain, No. 20-00674-BAJ-EWD, 2022 U.S. Dist. LEXIS 56208 (M.D. La. Mar. 28, 2022)

Background. In 2019, Louisiana enacted the Truth in Labeling of Food Products Act ("Act"), with the Act taking effect October 1, 2020. Among other things, the Act prohibits the intentional misbranding or misrepresenting of any food product as an agricultural product via a false or misleading label; selling a product under the name of an ag product; representing food product as an meat or a meat product when the food product is not derived from a harvested beef, port, poultry, alligator, farm-raised deer, turtle, domestic rabbit, crawfish, or shrimp carcass.

The LA Dept. of Ag and Forestry (LDAF) developed rules and regulations to enforce the Act with fines of up to $500 per violation per day but had not received any complaints nor brought any enforcement actions against anyone. Indeed, the LDAF determined that plaintiff's product labels complied with the law.

The plaintiff produces and packages plant-based meat products that are marketed and sold in LA and nationwide. Plaintiff's labels and marketing materials clearly state that its products are plant-based, meatless, vegetarian or vegan, and accurately list the products ingredients. After the Act passed, the plaintiff refrained from using certain words and images on marketing materials and packages and removed videos from its website and social media to avoid prosecution under the Act.

Trial court decision. The plaintiff sued, challenging the constitutionality of the Act on the grounds that the Act violated its freedom of commercial speech. The plaintiff claimed it would be very expensive to change its labeling and marketing nationwide. The trial court determined that the plaintiff had standing because "chilled speech" or "self-censorship" is an injury sufficient to confer standing, and that the plaintiff had demonstrated a "serious intent" to engage in proscribed conduct and that the threat of future enforcement was substantial.

On the merits, as noted, the plaintiff asserted that its conduct was protected commercial speech (both current and future intended) that the Act prohibited. The trial court noted that commercial speech is not as protected as is other forms of speech. To be constitutional, the government speech (the Act) must be a substantial governmental interest, advance the government's asserted interest and not be any more excessive than what is necessary to further the government's interest. The trial court determined that the Act was more extensive than necessary to further the state's interest. While the interest in protecting consumers from misleading and false labeling is substantial, the defendant failed to establish that consumers were confused by the plaintiff's labeling. Thus, the Act failed to directly advance the State's interest and was more extensive than necessary to further that interest. The trial court also determined that the defendant failed to show why alternative, less-restrictive means, such as a disclaimer would not accomplish the same goal of avoiding consumer deception/confusion. The trial court held the Act unconstitutional and enjoined its enforcement.

"Greenbook" Released

On March 28, the White House released the details of its $6 trillion budget for the 2023 fiscal year (October 1, 2022 – September 30, 2023). That same day, the Treasury released the Greenbook, its explanations of the revenue proposals. Many of the provisions are those that were proposed in 2021, but did not become law. Here's a brief rundown of the provisions of most significance to farmers and ranchers:

- Top individual rate to 39.6 percent on income over $400,000 ($450,000 for married couples;
- Corporate rate goes to 28 percent (87 percent increase on many farm corporations);
- Raise capital gain rate to 39.6 percent on income over $1 million;
- Capital gain tax on any transfer of appreciated property either during life or at death;
- Partial elimination of stepped-up basis – if to spouse, then carryover; transfer of appreciated property to CRAT would be taxable;
- Transfers of property by gift or at death would be a realization event (eliminates the fair market value at death rule);

- Trust assets must be "marked-to-market" every 90 years beginning with any new trust after 1940. The rule would be the same for partnerships or any other non-corporate owned entity. In addition, no valuation discount for partial interests, and a transfer from a trust would be a taxable event. Exclusion of $1 million/person would apply. Any tax on illiquid assets could be paid over 15 years or the taxpayer could elect to pay the tax when the property is sold or is no longer used as a farm (in that event, there would be no 15-year option);
- All farm income (including self-rents) would be subject to the net investment income tax of 3.8 percent;
- A minimum tax would apply to those with a net worth over $100 million;
- Long-term capital gains and qualified dividends taxed at ordinary income rates for taxpayers with taxable income exceeding $1 million;
- Grantor-Retained Annuity Trusts (GRATs) must have minimum term of 10 years. This would eliminate the use of a "zeroed-out" GRAT; also, the remained interest in a GRAT at the time of creation must have a minimum value for gift tax purposes equal to the greater of 25 percent of the value of assets transferred to the GRAT or $500,000. In addition, there would be limited ability to use a donor-advised fund to avoid the payout limitation of a private foundation;
- Any sale to a grantor trust is taxable and any payment of tax of the trust is a taxable gift;
- Limitation on valuation discounts (related party rules);
- R.C. §2032A maximum reduction would increase to $11.7 million (from current level of $1.23 million);
- Trust reporting of assets would be required if the trust corpus is over $300,000 (or $10,000 of income);
- Elimination of dynasty trusts;
- Carried interest income would become ordinary income;
- No basis-shifting by related parties via partnerships;
- Limitation of a partner's deduction in certain syndicated conservation easement transactions;
- R.C. §1031 exchange deferral would be limited to $1 million;
- Depreciation recapture would be triggered on the sale of real estate, which would eliminate the maximum 25% rate;
- Elimination of credit for oil and gas produced from marginal wells;
- Repeal of expensing of intangible drilling costs;
- Repeal of enhanced oil recovery credit;
- Adoption credit refundable, and some guardianship arrangements qualify; and
- Expand the definition of "executor" to apply for all tax matters.

The provisions have little to no chance of becoming law, but they are worth paying attention to.

Conclusion

There's never a dull moment in agricultural law and tax.