

The “Material Participation” Test

^{3/4}by Neil E. Harl* and Roger A. McEowen**

The authors of the Sparks report are critical of the Connor-Carstensen-McEowen-Harl paper¹ for not providing a “bright line” test for “control” in the proposed statute and raise all manner of questions about the meaning of the passage in the proposed legislation defining “control” in terms of packer involvement in the production process “to such an extent that the producer is no longer materially participating in the management of the operation with respect to the production of livestock...”² The authors of the Sparks study are also critical of the authors of the McEowen-Carstensen-Harl paper³ for not providing more analysis of the amendment’s “safe-harbor” provision on material participation. However, the McEowen-Carstensen-Harl paper was written and circulated several days before the so-called material participation safe-harbor was added to the amendment.

A. General

The criticism demonstrates a fundamental lack of understanding of the role of legislation and the relationship of legislation to administrative law by the authors of the report and by those who were advising the authors. Congress, wisely and commendably, has generally resisted such efforts to provide highly detailed and specific “bright line” tests, particularly when Congress has legislated with respect to issues relating to the structure of the economy or a specific sector or subsector. As examples—

- Undoubtedly the most venerated statute impinging upon economic activity in the United States, the Sherman Act of 1890, often referred to as the “charter of economic freedom,” which led to major structural changes in the economy, contains not one phrase that could be construed as a bright-line test. That act refers to “...every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce...”⁴ Moreover, the act refers to “attempt to monopolize” and to “conspire with any other person or persons, to monopolize.”

That legislation has stood the test of time and has provided the necessary statutory framework for numerous price fixing cases, cases alleging attempts to monopolize and intent to monopolize, all without highly specific language in the statute. Indeed, the vitality of the Sherman Act has been its careful construction of a legal framework for evaluating economic questions of structure.

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¹ Connor, John, Peter C. Carstensen, Roger A. McEowen and Neil E. Harl, *The Ban on Packer Ownership and Feeding of Livestock: Legal and Economic Implications*.

² 7 U.S.C. § 192(f), amending Packers and Stockyards Act of 1921.

³ McEowen, Roger A., Peter C. Carstensen and Neil E. Harl, *Proposed Legislative Ban on Packer Ownership of Livestock Mischaracterized by Economists*.

⁴ Sherman Act of 1890, Sec. 1, 26 Stat. 209 (1890), 15 U.S.C. §§ 1-8.

- The Clayton Act of 1914⁵ provided the first statutory framework for challenging mergers without mention of the four-firm concentration ratio, the Herfindahl Index or other “bright-line” test. The statute simply specified that mergers were proscribed that might “substantially lessen competition or tend to create a monopoly.” That language, with only minor amendments, continues to serve as the basic framework for evaluating proposed mergers.

- The Federal Trade Commission Act of 1914⁶ refers to “unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce.” That language hardly qualifies as a “bright-line” test.

- The Packers and Stockyards Act of 1921, a very broad regulatory statute,⁷ makes it unlawful for any packer, live poultry dealer or handler, market agency, or livestock dealer “to engage in or use any unfair, unjustly discriminatory, or deceptive practice...”⁸ Again, that hardly measures up to a “bright-line” test.

- The Capper-Volstead Act of 1922, another statute designed to alter the economic playing field,⁹ authorized producers to act collectively except where “the price of any agricultural commodity is unduly enhanced thereby...”¹⁰ It is likely that some critics probably raised an objection and argued for a bright-line test then. Wisely, the Congress did not follow what would certainly have been viewed as unwise advice.

The Congress in respecting the constitutional separation of powers, grants to the Executive Branch of Government the rule making power as well as the general enforcement power of such statutes, with authority to publish and to make final detailed implementing regulations. Indeed, it is widely understood that the Congress is not well-advised to enact highly detailed (and necessarily rigid) “bright-line” tests in this or any other area of the law.

B. The important question is how accurately the proposed language reflects Congressional intent as to packer “control” over livestock.

1. The language prohibits packer involvement in the production process “...to such an extent that the producer is no longer materially participating in the management of the operation with respect to the production of livestock...”¹¹ That proposed amendment states forthrightly that packers would be precluded from dominating the production process to such an extent that a producer is no longer participating materially in management. Stated in a slightly different fashion, the Senate bill would, if enacted in its proposed form, be properly interpreted as precluding contracts or other arrangements that reduce the producer to a mere laborer with no involvement in management or a level of involvement in management that is not material.

⁵ 38 Stat. 730 (1914), 15 U.S.C. §§ 12-27, 29 U.S.C. § 52.

⁶ 38 Stat. 717 (1914), 15 U.S.C. §§ 41-51.

⁷ 42 Stat. 159 (1921), 7 U.S.C. §§ 182 et seq.

⁸ 7 U.S.C. §§ 192(a), 213(a).

⁹ 7 U.S.C. §§ 291-92.

¹⁰ 7 U.S.C. § 292.

¹¹ 7 U.S.C. § 192(f), amending the Packers and Stockyards Act of 1921.

2. The term “material participation” has a long history in agriculture as well as in other sectors of the economy. Each time the Congress has visited or revisited this area, the legislation enacted has used language sparingly—

a. In 1956, Congress enacted an amendment to Section 1402 of the Internal Revenue Code to enable farm landowners to participate in the social security program. The amendment simply referred to “material participation” by the landowner in the production of agricultural or horticultural commodities. Regulations subsequently adopted by the United States Treasury have provided detailed guidance for that particular application of the term.¹²

b. In 1986, Congress, in enacting the passive loss rule, made it clear that the guideline should be more demanding than merely “material participation” and so defined “material participation” on a basis which is “(A) regular, (B) continuous, and (C) substantial.”¹³ Again, the Congress signaled that the test should be more demanding *in the setting of passive losses* and the regulations and cases have reflected that Congressional enactment.

C. For the proposed language, the passage communicates clearly that the administrative agency with the rule-making power is expected to develop implementing regulations but the message is that producers’ involvement in management *must not be diminished below a “material” level.*

History has shown that greater specificity by the Congress would be unwise and imprudent and would diminish the life of the provision. Moreover, it is the role and responsibility of the Executive Branch, not the Congress, to provide detailed, implementing guidance for such provisions.

The language employed communicates, as has been done before, how the rule is to differ from the “material participation” rule used in other settings and for other purposes. The proposed provision would be in the tradition of legislation leveling the economic playing field dating back to the Sherman Act of 1890.

Just as the language in the Sherman Act, Clayton Act and other enactments since has demonstrated, divestitures have been ordered, mergers have been challenged and halted and those convicted of price fixing have been sentenced to incarceration and substantial fines and civil penalties on the basis of something less than a “bright-line” test in the basic legislation.

Greater specificity is neither desirable nor recommended at the legislative level.

It is noted that Iowa¹⁴ (as well as Minnesota,¹⁵ Nebraska¹⁶ and South Dakota¹⁷) have state-level bans on packer ownership of livestock. The Iowa provision for example imposed a ban several years ago making it unlawful for a processor of beef or pork “to own, control or

¹² Treas. Reg. § 1.1402.

¹³ 26 U.S.C. § 469(h)(1).

¹⁴ Iowa Code § 9H.2 (2001).

¹⁵ Minn. Stat § 500.24(3)(2001) (Minnesota takes the position that livestock feeding is engaging in farming and thus is covered by the corporate farming statute).

¹⁶ Neb. Rev. Stat. § 54-2602.

¹⁷ S.D. Const. Art. XVII, §§ 21-24.

operate a feedlot in Iowa which hogs or cattle are fed to slaughter.” That language, while providing even less of a “bright-line” test, has not caused problems in Iowa, a leading livestock feeding state, particularly in hogs.