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Sickening Result

FORUM COLUMN

By Timothy J. Dowling

Salmonella poisoning is back in the news, with federal health officials investigating a nationwide outbreak linked to Peter Pan and Great Value peanut butter, including at least five cases in California. If you think our legal system will hold the responsible parties accountable, think again.

In fact, you might be compelled to foot the bill.

Unless overturned on appeal, a little-noticed Feb. 22 ruling by the U.S. Court of Federal Claims would force taxpayers to pay corporations for the financial inconvenience they suffer from emergency regulations designed to protect the public from unsafe products.

The case, *Rose Acre Farms Inc. v. United States,* (No. 92-710C), arose out of four salmonella outbreaks beginning in 1989 that caused more than 1,000 people to become ill from infected eggs sold by one of the largest U.S. egg producers, Rose Acre Farms.

Most of the victims were sickened by a bread pudding served during a trade convention at Chicago's Hyatt Regency Hotel. Forty-two others fell ill at a wedding reception in Versailles, Ky. Two more outbreaks occurred in Tennessee, where more than 100 people complained of symptoms. Health officials also suspected Rose Acre of being the source of a fifth outbreak in Asheville, N.C.

The victims' fever, vomiting and diarrhea were so severe that hundreds were taken to area hospitals, and some required hospitalization for more than a week. Although salmonella causes many deaths each year, Rose Acre's victims were fortunate enough to recover from their illnesses.

They might feel ill once again, however, when they learn of the claims court's recent ruling in favor of Rose Acre.

Rose Acre brought a "takings" challenge to emergency restrictions imposed by the U.S. Department of Agriculture in response to the outbreaks. For roughly 21 months, USDA required Rose Acre to divert eggs from three of its farms from the table egg market to the less profitable "breaker" market, where the eggs are pasteurized to kill salmonella bacteria and other contaminants and then used for cake mix and similar products. The diverted eggs comprised less than half the total eggs produced by Rose Acre while the restrictions were in effect. The claims court concluded that these protections constituted a taking of the diverted eggs under the Fifth Amendment, and therefore federal taxpayers must compensate Rose Acre $5.4 million, plus interest since 1990 and attorney fees. The award represents the profits Rose Acre allegedly lost due to USDA's public health protections.

The ruling is incoherent as a matter of law and economics.

Rose Acre is one of those rare takings cases that involves actual harm to people, and but for the grace of God, could have involved dead bodies. Courts routinely have denied takings challenges to government actions designed to protect human health and public safety, including development restrictions in flood-prone areas, limits on the sale of cigarettes and alcoholic beverages, and protections against hazardous waste contamination. It is unprecedented for a

takings claimant to succeed in a challenge to government action taken in response to poisonings that sickened more than 1,000 people.

The legal reason these protections are not takings under the Fifth Amendment is that they do not "take" or confiscate property in any meaningful way. At all times, Rose Acre remained free to sell its eggs. USDA simply required it to divert certain eggs produced at the three farms involved in the outbreaks to the breaker market. Once USDA determined the farms were cleaned, disinfected and safe for table egg production, it lifted the restrictions.

In *Lingle v. Chevron*, 544 U.S. 528 (2005), the Supreme Court unanimously held that regulation should be deemed a taking only where it is the "functional equivalent" of an actual expropriation of property. If USDA had expropriated the eggs, Rose Acre would have lost roughly 59 cents per dozen, their value on the table egg market. But by selling to the breaker market, Rose Acre recouped up to 46.6 cents per dozen, and thus the resulting loss was nowhere near the functional equivalent of an actual appropriation.

The Rose Acre court ignored *Lingle's* functional equivalency standard, which *Lingle* called the "touchstone" for regulatory takings liability, and instead focused on lost profits. But lost profits always have been a "slender reed" upon which to base a takings claim, as the court put it in *Andrus v. Allard*, 444 U.S. 51 (1979).

The claims court tried to justify its reliance on lost profits because the challenged protections were temporary. But the Supreme Court disavowed this argument in rejecting a takings challenge to temporary land-use controls designed to protect Lake Tahoe. In *Tahoe-Sierra Preservation Council v. Tahoe Regional Planning Agency*, 535 U.S. 302 (2002), the court ruled that temporary restrictions on development did not work a taking because the land retained substantial value based on future uses. The key to the ruling was retained value, not disruption of short-term profits.

As a matter of economics, the court's ruling fares no better. Its analysis, which turns on what the court called the "diminution in return," rewards inefficient, fly-by-night operations that operate on thin profit margins, while providing little benefit to efficient and well-run firms. Under the court's approach, going from a $1 profit per widget to a $5 loss would be a 500 percent diminution in return, but if a more efficient firm dropped from a $12 profit per widget to a $6 profit (the same $6 loss in absolute terms), the diminution would be just 50 percent.

It makes no economic sense to reward the less efficient firm by enhancing its chances of winning a takings suit by making liability turn on a lost profits percentage. Under the court's fun-with-numbers analysis, the inefficient claimant with smaller initial profits can show an enormously greater diminution in return.

The ruling not only improperly transforms the Takings Clause into a profits protection clause, it also undermines fundamental fairness. The entire egg industry, including Rose Acre, benefits from food-safety protections because they increase consumer confidence. Rose Acre's eggs undoubtedly would lose significant value if USDA refused to respond to salmonella outbreaks, and egg producers would be at greater risk of unfavorable media attention and lawsuits. During the outbreaks, Rose Acre officials expressly relied on the federal government's response to reassure the public. Because the USDA protections generate what the courts call a "reciprocity of advantage" for both the public and the regulated community, courts should be reluctant to require taxpayers to compensate corporations for merely following regulations that redound to their benefit.

The claims court seemed bent on awarding Rose Acre money. In 2003, the court upheld Rose Acre's takings claim largely because it concluded the health protections were overbroad and "inefficient." The U.S. Court of Appeals for the Federal Circuit overturned that ruling because takings analysis does not allow courts to second-guess the wisdom of government action, and it

sent the case back to the claims court for further consideration. Moreover, the 7th Circuit previously rejected a similar challenge to the reasonableness of USDA's regulations under the federal Administrative Procedure Act. Despite having been rebuked on appeal, the claims court continues to devise new theories of liability.

The implications of its latest theory are disturbing. Virtually all public safety protections - from requirements for fire resistant children's pajamas to air quality protections, toy safety standards, and peanut butter recall requirements - reduce profits to some extent. For inefficient firms operating at the margin, the profit loss could be significant. It is ludicrous, however, to insist that taxpayers reimburse a corporation for profits lost due to government action that prevents harm from the corporation's unsafe products.

The Federal Circuit needs to set the claims court straight once again, and in a hurry. Until then, avoid the hollandaise sauce.

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