North Dakota Law Review

Volume 48 | Number 3 Article 5

1971

Corporations - Farming Ban - Reasonably Necessary Exceptions

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RECENT CASES

CORPORATIONS — FARMING BAN — REASONABLY NECESSARY EXCEPTIONS—The Secretary of State refused to approve the plaintiff's articles of incorporation because they were in conflict with chapter 10-06 of the North Dakota Century Code. The corporation was being expressly incorporated to conduct the business of farming, and the articles were refused on the ground that the purpose of the proposed corporation was prohibited by law.[1]

The plaintiff brought an action in the district court to compel the Secretary of State to approve the proposed articles. In granting a summary judgment for the plaintiff, the court held that the purpose of the corporation was a valid and legal purpose within the express exception contained in the statute.[2] The district court's decision stated that chapter 10-06 of the North Dakota Century Code prohibits a corporation from holding and farming rural real estate only when such real estate is not reasonably necessary for the conduct of its business.[3] The court reasoned that the owning of rural real estate is not only reasonably necessary, but is an indispensable prerequisite to a corporation engaging in farming.[4]

The North Dakota Supreme Court, in reversing the judgment said, "the prohibition contained in section 10-06-01 [North Dakota Century Code] enjoins the business of farming or agriculture by corporations. Thus, . . . all corporations, . . . except co-operative corporations, 75% of whose members or stockholders are actual farmers residing on farms or depending principally on farming for their livelihood, are prohibited from engaging in the business of farming."[5] *Coal Harbor Stock Farm, Inc. v. Meier,* 191 N.W.2d 583 (N.D. 1971).

Three basic approaches have been utililized by states enacting laws limiting corporate ownership of rural realty. Briefly stated, the three types are: (1) An absolute prohibition;[6] (2) limiting

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1. N.D. CENT. CODE §§ 10-06-01 and 10-19-54 (1960).
   Section 10-19-54 provides that matters set forth in the articles of incorporation shall be in conformity with law, and section 10-06-01 prohibits corporate farming subject to the exceptions provided for in chapter 10-06.
2. Coal Harbor Stock Farm Inc. v. Meier, 191 N.W.2d 583, 586 (N.D. 1971).
3. *Id.*
4. *Id.*
5. *Id.* at 587.
6. KAN. GEN. STAT. ANN. § 17-202(a) (1949), provides that no corporation shall be formed to raise wheat, corn, barley, oats, rye, potatoes, or to milk cows for dairy purposes.

the acreage a corporation may hold;[7] and (3) limiting the corporate holding to an amount *necessary* to accomplish the corporate purposes.[8]

It is this third approach that North Dakota has adopted in their attempt to limit corporate farming. Statutes falling into this third group, allow corporations to hold rural realty which is *necessary and proper*[9] or *reasonably necessary*[10] to the corporate purpose. Oklahoma, which allows a corporation to hold realty which is necessary and proper,[11] was recently faced with a situation similar to that presented in *Coal Harbor*. The Oklahoma Supreme Court, in approving corporate farming[12] predicated their decision on a finding that the legislative intent was to prohibit real estate corporations, not corporate farms.[13]

The ambiguity of the "reasonably necessary exception"[14] clause in chapter 10-06 of the North Dakota Century Code, can be readily observed by a look at the provisions of the chapter.[15] An obvious reaction, prior to *Coal Harbor*, was one of uncertainty.[16]

In upholding the corporate farming ban, the court clarified inferences made in the two prior cases that reached the North Dakota Supreme Court involving the Corporate Farming Act. The

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7. MINN. STAT. ANN. § 500.22(3) (1961):
"[N]o corporation organized for and engaged in any farming operations, shall acquire more than 5000 acres of land."
8. N.D. CENT. CODE ch. 10-06 (1960).
OKLA. STAT. ANN. tit. 18, §§ 1.20(a), (b)(1) (1961).
(a) No corporation of any sort . . . shall, except as herein provided, own, hold, or take any real estate located in this State outside of any incorporated city or town or any addition thereto.
(b) Nothing in this act shall be construed as prohibiting the owning, holding, or taking of:
(1) such real estate as is necessary and proper for carrying on the business for which any corporation has been lawfully formed. . . .
9. OKLA. STAT. ANN. tit. 18, § 1.20(b)(1) (1969).
10. *See* N.D. CENT. CODE §§ 10-06-02, -03, -06 (1960).
11. OKLA. STAT. ANN. tit. 18, § 1.20(b)(1) (1961).
12. Leforce v. Ballard, 454 P.2d 297 (Okla. 1969).
13. *Id.*
14. N.D. CENT. CODE §§ 10-06-02, -03, -06 (1960).
These sections contain "reasonably necessary exceptions."
15. N.D. CENT. CODE ch. 10-06 (1960).
In brief this chapter provides that:
§10-06-01. All corporations, both domestic and foreign, except as otherwise provided for in this chapter are hereby prohibited from engaging in the business of farming or agriculture.
§10-06-02. All corporations must dispose of all rural real estate, except such as is reasonably necessary in the conduct of their business before July 29, 1942.
§10-06-03. All such lands acquired after July 29, 1932 shall be disposed of within ten years, except as is reasonably necessary in the conduct of its business. During the ten year period such land may be used for agricultural purposes.
§10-06-04. Co-operative corporations, 75 percent of whose members live on farms or depend principally on farming are exempt.
§10-06-06. Corporations not disposing of land which is not reasonably necessary . . . shall hold such subject to escheat provisions.
16. *See* McElroy, *North Dakota's Anti-Corporate Farming Act*, 36 N.D. L. REV. 96 (1960). *Contra*, O'Keefe, *The North Dakota Anti-Corporate Farming Act: A Dissenting Opinion*, 41 N.D. L. REV. 333 (1965).

first of these, *Asbury Hospital v. Cass County*,[17] involved a hospital that was a non-profit corporation, organized under Minnesota law. The corporation owned a quarter section of land in North Dakota that had been acquired in 1925. Plaintiff was not in the farming business, but the property was farmed under a lease agreement. In the litigation, the plaintiff sought to establish the importance of the fact that their charter allowed ownership of land.[18] It contended that the requirement that a corporation dispose of rural real estate within ten years, did not apply to any real property that was owned by a corporation which had authority under its articles of incorporatin to own and hold land. The court, dismissing this distinction, held that the corporate farming law applied to non-farming corporations which incidentally owned and farmed rural land. They further held:

> When the statute provides that there shall be excepted from its operation such real estate 'as is reasonably necessary in the conduct of' the business of the corporation, it means such real estate as is *reasonably necessary* for carrying on the business or activity *which the corporation was created to carry on.*[19] (Emphasis added)

It seems implicit in the holding, that the ban would affect corporations expressly organized to farm since the business they would be created to carry on would be in direct contravention of the provision prohibiting corporate farming.[20]

The second case to interpret Chapter 10-06 was *Loy v. Kessler*.[21] This was a quiet title action with the corporate farming law involved as a secondary issue. The defendants contended that the deed was void because a corporation was prohibited from acquiring title to land. In rejecting this contention, the court found that the original act contained a specific prohibition on acquisition of land by a corporation[22] and that this provision was deleted by a subsequent amendment.[23] The court also reasoned that since escheat can apply only to lands in which title is held,[24] the formidable escheat provisions of chapter 10-06[25] was also evidence of the corporation

17. Asbury Hospital v. Cass County, 72 N.D. 359, 7 N.W.2d 438 (1943); Asbury Hospital v. Cass County, 73 N.D. 469, 16 N.W.2d 523 (1944).
18. Asbury Hospital v. Cass County, 72 N.D. 359, 7 N.W.2d 438, 447 (1943). The plaintiff contended that the statute applied only in cases where the owning of property was ultra vires to the corporation. The court held that the statute presupposes that the land was acquired and held lawfully.
19. *Id.*
20. N.D. CENT. CODE § 10-06-01 (1960).
21. Loy v. Kessler, 76 N.D. 738, 39 N.W.2d 260, 270 (1949).
22. N.D. SESS. LAWS 494 (1933).
23. *Id.* at ch. 89, § 1.
24. Loy v. Kessler, 76 N.D. 738, 39 N.W.2d 260, 272 (1949). "Escheat can apply only to lands to which the corporation has acquired title."
25. N.D. CENT. CODE § 10-06-06 (1960).

right to hold title. Based on these two reasons the court in *Loy* held that the act did not expressly prohibit corporations from acquiring title to farm land.

The confusion surrounding North Dakota's Corporate Farming Act[26] after these two cases, is aptly demonstrated by the interpretation given by two earlier writers on the subject. One writer, in an analysis of *Asbury*, indicates that the Corporate Farming Act may not be a ban on all corporate farming.[27] Asbury was a chartered hospital, and there was nothing in its purpose clause to give it power to own, manage or hold real estate of any kind.[28] Its only right to hold land was derived from the general powers given non-profit corporations under the laws of the State of Minnesota. It was in no position to assert that owning rural realty was reasonably necessary to running a hospital.[29]

The article further pointed out that *Loy* expressly held that "a corporation may acquire and hold indefinitely real estate that is otherwise within the prohibited category if it is reasonably necessary in the conduct of its business."[30] The implication of this article is that a corporation, setting forth in its articles of incorporation the purpose to engage in the business of farming, is in a position to assert that owning rural real estate is reasonably necessary, and if so, they may hold the land indefinitely under the decision in *Loy*.

Another writer, after analyzing the same two cases came up with an opposite view.[31] In his opinion, "Corporate farming is under no circumstances allowable."[32] He notes that if *Asbury*, by implication, allowed a corporation to hold and farm rural lands that are reasonably necessary to conduct their non-rural business, this exception applies only to lands acquired by corporations prior to 1932.[33] In *Loy* the court said the reason for the deletion of the prohibition[34] against acquiring real estate was done to permit corporations to pass valid and marketable titles to real estate. Thus there was nothing to indicate the legislature's intent to relax the ban on corporations acquiring and using rural land.[35]

In holding that rural real estate, which is owned by a corpora-

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26. N.D. CENT. CODE ch. 10-06 (1960).
27. McElroy, *North Dakota's Anti-Corporate Farming Act*, 36 N.D. L. REV. 96 (1960).
28. *Id.* at 99.
29. *Id.*
30. *Id.*
31. O'Keefe, *The North Dakota Anti-Corporate Farming Act: A Dissenting Opinion*, 41 N.D. L. REV. 333 (1965).
32. *Id.* at 335.
33. N.D. CENT. CODE § 10-06-03 (1960).
This section explicitly says that lands acquired after July 29, 1932 fall under its provisions. If Asbury allowed a corporation to farm rural lands, it is a logical inference that it applied only to land held prior to 1932.
34. N.D. SESS. LAWS ch. 89, § 1 (1933).
35. O'Keefe, *supra* note 16, at 335.

tion organized for the purpose of engaging in farming or agriculture, does not qualify for the reasonably necessary exception,[36] the supreme court after more than thirty-five years of confusion has settled the question by their decision in *Coal Harbor*. It seems clear that a prospective corporation expressly designed to engage in farming is contrary to section 10-06-01 of the North Dakota Century Code, and as such it should not be allowed to incorporate.[37] By so deciding, the court impliedly found that the legislative intent was to prohibit corporate farming. It is implicit in such a decision, that any future change in the law, relaxing the ban on corporate farming, should come from legislative action and not judicial innovation.

It has been suggested that a corporation need only dispose of all land not reasonably necessary once every ten years, repurchase later, and thereby avoid the escheat provisions.[38] In so doing, it is contended that it is possible to effectively circumvent the corporate farming ban.[39] There is an obvious fault in this reasoning. Since the supreme court has determined the legislative intent to ban corporate farming, a method of circumventing the law resulting in an abrogation of both the spirit and the letter of the law, is a proper place for judicial action. The courts must enforce the spirit, as well as the letter of the law, until the legislature deems it proper to act.

Apparently after *Coal Harbor*, the only way for the farmer to enjoy the basic advantages of incorporation,[40] is to attempt to qualify for the co-operative corporation exception.[41] Since corporate farming is now under no circumstances allowable, this seems the obvious means to achieve the desired result.

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CONSTITUTIONAL LAW—RESIDENCY REQUIREMENTS—EQUAL PROTECTION FOR NONRESIDENT BAR APPLICANTS—Plaintiff brought a class action in Federal District Court seeking an injunction against the enforcement of a state statute requiring bar applicants to es-

36. Coal Harbor Stock Farm, Inc. v. Meier, 191 N.W.2d 583, 588 (N.D. 1971).
37. N.D. CENT. CODE § 10-19-54 (1960) (matters set forth in articles of incorporation shall be in conformity with law).
38. N.D. CENT. CODE § 10-06-06 (1960).
39. Appellants Brief, at 11. Coal Harbor Stock Farm, Inc. v. Meier, 191 N.W.2d 583 (N.D. 1971).
40. N.D. CENT. CODE § 10-15-31 (1960). This section provides for limited liability. For an excellent analysis of the tax benefits *see* Pearson, *The Farm Co-operative and the Federal Income Tax*, 44 N.D. L. REV. 490 (1968).
41. N.D. CENT. CODE § 10-06-04 (1960).