

APPEALED

FILED  
DEC 16 1992

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF SOUTH CAROLINA  
COLUMBIA DIVISION

ANN A. BIRCH, CLERK  
COLUMBIA, S. C.

Smith Setzer & Sons, Inc.

\* IN RE: PROTEST OF SMITH, SETZER &  
\* SONS, INC.

Plaintiff,

vs.

\* C/A NOS. 3:90-203-21  
\* and 3:90-612-21  
\* (Consolidated)

Hugh Leatherman, Grady  
L. Patterson, Jr., Glenn  
F. McConnell, Luther L. Taylor,  
Jr., Jules J. Hesse, Roy E.  
Moss, Kiffen R. Nanney, Gus J.  
Roberts, and Carol Baughman, as  
officers and members of the  
South Carolina Procurement  
Review Panel, Governor Carroll  
A. Campbell, Jr., Grady L.  
Patterson, Jr., Earle E.  
Morris, Jr., James W. Waddell,  
Jr., Robert N. McLellan, and  
Jesse A. Coles, Jr., as  
officers and members of the  
South Carolina Budget and  
Control Board, division of  
General Services, and James  
J. Forth, Chief Procurement  
Officer for the South Carolina  
Budget and Control Board, a  
division of General Services,

O-R-D-E-R

Defendants.

INTERFERE  
12-17-92

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Plaintiff Smith Setzer & Sons, Inc. ("Smith Setzer") brought these actions challenging the constitutionality of South Carolina's resident vendor and product preference statutes. Because of the operation of the preference statutes, Smith Setzer, a North Carolina corporation, was denied the award of certain state contracts despite being the low bidder. This lawsuit followed and

was tried before me on October 26, 1992.<sup>1</sup> Based on the evidence presented and the arguments of counsel, I find that the challenged laws are constitutional.

#### FACTS

Certain facts have been stipulated. On August 13, 1989, the State of South Carolina, acting through the Division of General Services, issued an Invitation for Bids ("Invitation") on a one-year contract to supply concrete culvert pipe to various state agencies and local political subdivisions within South Carolina. Purchase of pipe under the contract by local political subdivisions was optional. The Invitation declared that the contract would be awarded on a per lot basis, with there being one lot for each of the state's 46 counties. Included in the Invitation were affidavit forms on which a bidder could claim the 2% South Carolina resident vendor preference pursuant to S.C. Code Ann. § 11-35-1520(9)(e) (Law Co-op. 1991) and the 5% in-state product preference provided by S.C. Code Ann. § 1-11-35 (Law Co-op. 1986) and S.C. Code Regs. 19-446.1000 (Cum. Supp. 1991) (collectively the "preference scheme"). The preferences are applied cumulatively; as such, the preference scheme gives a state resident a possible total preference of 7%.

Smith Setzer, a North Carolina corporation, could not claim either preference in submitting its bid. Bids were opened on August 18, 1989; and after application of the preference scheme, Smith Setzer was awarded two lots despite being the low bidder on

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<sup>1</sup> This case was assigned to me on April 13, 1992.

at least 14 lots.

On December 18, 1989, the South Carolina Department of Highways and Public Transportation issued an Invitation for Bids on a contract to supply reinforced concrete culvert pipe to various Highway Department locations. Award was made on a per lot basis. Smith Setzer submitted a bid and was the low bidder on one lot; it was not awarded the contract, however, because of the state's application of the preference scheme.

Smith Setzer exhausted its administrative remedies protesting both contract awards. On this appeal, the cases are consolidated and Smith Setzer asserts a claim under the South Carolina Declaratory Judgment Act, S.C. Code Ann. § 15-53-10 et seq. (Law Co-op. 1976), alleging that the preference scheme violates the United States and South Carolina Constitutions.

#### CONCLUSIONS OF LAW

##### A. Equal Protection Clause Claim.

###### 1. Legitimate Purpose

South Carolina's preference scheme is an example of economic regulation designed to promote domestic business. It does not affect fundamental personal rights or an inherently suspect class such as race, religion, or alienage. Accordingly, Smith Setzer concedes that the preference scheme is presumptively valid and will withstand an Equal Protection challenge so long as the classification drawn is rationally related to a legitimate state interest. New Orleans v. Dukes, 427 U.S. 297, 303 (1976). Smith Setzer, however, contends that promotion of domestic business by

discriminating against nonresident competitors is not a legitimate purpose and, therefore, it violates the Equal Protection Clause. Metropolitan Life Ins. v. Ward, 470 U.S. 869 (1985).

In Metropolitan Life, the Supreme Court struck down, as violative of the Equal Protection Clause, an Alabama statute which granted a preference for domestic insurance companies by imposing a substantially higher gross premiums tax on foreign insurance companies than that paid by domestic insurers. Under the Alabama law, a foreign insurance company could lower its tax rate if it invested in specified Alabama assets and securities. Regardless of the amount of the investment, however, a foreign company could never reduce its gross premiums tax rate to the level paid by a domestic company. Id. at 871-72. The Alabama Supreme Court found that the statute served two purposes: (1) encouraging the formation of new Alabama insurance companies; and (2) fostering capital investment in the state by foreign insurance companies. Id. at 873.

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The sole question before the Supreme Court was whether those purposes were legitimate. Id. at 875. The Court held that under the circumstance of the case, the "promotion of domestic business within a State, by discriminating against foreign corporations that wish to compete by doing business there, is not a legitimate state purpose." Id. at 880. Specifically, the Court found that the effect of the Alabama statute was "to place a discriminatory tax burden on foreign insurers who desire to do business within the State[.]" Id. at 881 (emphasis added). More importantly, the

Court noted that the case did not "involve or question...the broad authority of a State to promote and regulate its own economy. We hold only that such regulation may not be accomplished by imposing discriminatorily higher taxes on nonresidents solely because they are nonresidents." Id. at 882 n.10 (emphasis added).

Metropolitan Life did not change the standard for challenging the constitutionality of economic legislation on equal protection grounds. The test remains an easy one to satisfy--if the purpose of the law is legitimate, it will be upheld so long as there is a rational relationship between the law's classification scheme and its purpose. Id. at 881. Additionally, Metropolitan Life did not hold that encouraging resident industry was a per se impermissible purpose. Rather, Metropolitan Life simply held that a state may not promote resident industry by imposing higher taxes on similar nonresident competitors.

Metropolitan Life is not controlling here and, more significantly, does not render unconstitutional the preference scheme's purpose of promoting South Carolina industry. First, no tax is involved here. Second, the preference scheme does not burden nonresident business. Unlike Metropolitan Life, where nonresident insurance companies had to pay three or four times as much in gross premiums tax as compared to resident insurers, the preference scheme does not increase an out-of-state bidder's cost of doing business in-state. Instead, the purpose of the preference scheme is accomplished by giving resident businesses a slight cost advantage when bidding on state contracts.

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Any burden imposed by the preference scheme is suffered only by the state. This is so because, as is the case here, the preference scheme may sometimes prevent South Carolina from awarding a contract to the lowest bidder. The extra cost is borne by the state, not by the out-of-state bidder. As such, the preference scheme's purpose does not run afoul of the holding in Metropolitan Life because the purpose is not achieved by discriminatorily burdening nonresidents.

Accordingly, this court finds legitimate the preference scheme's purpose of fostering and protecting South Carolina's resident vendors and manufacturers:

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The [preference] statute is designed to protect South Carolina's legitimate interest in directing benefits, generated by state purchases, to the citizens of South Carolina--"the people who fund the state treasury from which the purchases are made and the people whom the state was created to serve." According preference to resident bidders encourages local industry, thus stabilizing state and local economies. The money payable under the contracts is likely to remain within the state and enhance the tax base of state and local government.

Garv Concrete Products v. Riley, 265 S.C. 498, 505, 331 S.E.2d 335, 339 (1985). To pass constitutional muster all that is required is a rational relationship between the classification drawn by the preference scheme and its purpose, and that rational relationship exists in this case.

## 2. Rational Relationship

The classifications established by the preference scheme are between resident and nonresident vendors and manufacturers. As mentioned above, the classifications do not affect fundamental rights or proceed along suspect lines. Therefore, South Carolina

is accorded wide latitude in regulating its economy, and the distinctions drawn by the preference scheme will pass rational basis scrutiny even if they are "made with substantially less than mathematical exactitude." New Orleans v. Duke, at 303.

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In arguing that the preference scheme is not rationally related to its objective, Smith Setzer presented the testimony of Dr. Steven Craig, a University of Houston economist. Dr. Craig testified that in his opinion the preference scheme results in a net revenue loss to South Carolina because the increased cost of procuring goods under the preference scheme outweighs any increase in tax revenue or other economic benefit attributable to the scheme. Accordingly, Smith Setzer concludes that the preference scheme is not rationally related to its objectives and, therefore, violates the Equal Protection Clause.

Even assuming that Dr. Craig's opinion is correct, Smith Setzer's argument fails in a number of respects. First, increasing the tax base is only one purpose of the preference scheme. The burden, however, is on Smith Setzer to negate every conceivable basis which supports the preference scheme. See Madden v. Kentucky, 309 U.S. 83, 88 (1940); see also Minnesota v. Clover Leaf Creamery, 449 U.S. 456, 465 (1981) ("The State identifies four reasons why the classification...is rationally related to the articulated statutory purposes. If any one substantiates the State's claim, we must...sustain the Act."). Smith Setzer has failed to meet its burden of showing that the preference scheme is an irrational and arbitrary way to encourage local industry,

stabilize local economies, and "direct[] benefits, generated by state purchases to the citizens of South Carolina." Gary Concrete, at 339. Second, rational distinctions need not be made with mathematical exactitude. New Orleans v. Dukes, at 303. Accordingly, the preference scheme is not unconstitutional simply because it may not be completely cost efficient. Indeed, South Carolina may find it more important to create or save resident jobs than to always purchase from the lowest bidder. In any event, because the preference scheme, at most, applies to resident bids which are 7% higher than nonresident bids, the scheme is tailored to meet its objectives "without substantially impeding the goal that state purchases be as economical as possible." Gary Concrete, at 339. Third, "[p]arties challenging legislation under the Equal Protection Clause cannot prevail so long as 'it is evident from all the considerations presented to [the legislature], and those of which we may take judicial notice of, that the question is at least debatable.'" Western and Southern Life Ins. v. State Board of Equalization of Calif., 451 U.S. 648, 674 (1981), quoting United States v. Carolene Products, 304 U.S. 144, 154 (1938). Dr. William Charles Gillespie, Chief Economist of the State of South Carolina, testified that South Carolina is a very poor state<sup>2</sup>, and in his opinion the preference scheme saves jobs and creates wealth by protecting small resident businesses. Additionally, Dr. Frank Heffner testified at great length that Dr. Craig's study of the

<sup>2</sup> Dr. Gillespie testified that South Carolina ranked second to last nationally in both the creation of wealth and in per capita income.

effects of preferences may greatly exaggerate the true cost of the preference scheme. I find Dr. Heffner's testimony and conclusions more credible than the contrary view. In any event, since credible economists disagree on the benefits of the preference scheme, the question of its utility is debatable. As such, Smith Setzer cannot prevail on its Equal Protection claim. Western & Southern Life, at 674.

This court concludes that the South Carolina legislature rationally could have believed that the preference scheme would promote its goal of encouraging resident vendors and manufacturers. Accordingly, the Equal Protection Clause is satisfied. Id. at 672; Clover Leaf Creamery, at 466.

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B. Commerce Clause Claim.

Smith Setzer also alleges that the preference scheme imposes a substantial burden on interstate commerce and is therefore violative of the Commerce Clause. U.S. Const. art. I, § 8. The Commerce Clause, however, does not restrict a state's action as a free market participant. Wyoming v. Oklahoma, \_\_\_ U.S. \_\_\_, 112 S.Ct. 789, 803 (1992); Reeves v. Stake, 447 U.S. 429, 436-437 (1980); Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 806-810 (1976). As a market participant, nothing in the Constitution prevents a state from favoring its own citizens over others. Id. at 810.

Accordingly, if South Carolina's preference scheme constitutes state market participation, no Commerce Clause analysis is required and the scheme will be upheld. The South Carolina Supreme Court

has previously determined that the state acts as a market participant when it operates the preference scheme:

In the instant matter, the State of South Carolina is acting as a market participant by purchasing reinforced concrete pipe. As a market participant, South Carolina can impose restrictions on itself and not run afoul of the Commerce Clause....South Carolina is preferring its own citizens in the purchasing process--a process which, by definition, vaults South Carolina into the marketplace as a market participant.

Gary Concrete, at 338. This court agrees that, with respect to the preference scheme, South Carolina is a market participant. Therefore, this court finds that the preference scheme does not violate, nor implicate, the Commerce Clause.

C. Due Process Claim.

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Smith Setzer further contends that the South Carolina Procurement Review Panel's refusal to adjudicate its constitutional challenges to the preference scheme constituted a denial of due process. This claim is without merit. First, the review panel could not determine the constitutional issues because the panel lacked the statutory authority to do so. See South Carolina Tax Comm'n v. S.C. Tax Bd. of Review, 278 S.C. 556, 299 S.E.2d 489, 491-492 (1983). Second, Smith Setzer has been afforded a full and fair opportunity to raise the constitutional claims in this court, as well as in the state circuit court. Thus, Smith Setzer has not been denied procedural Due Process. Smith Setzer's substantive Due Process claim also is without merit. The substantive Due Process analysis is virtually the same as the Equal Protection test--that is, whether the challenged law is rationally related to a legitimate state purpose. Williamson v. Lee Optical of Okla., 348

U.S. 483, 487-488 (1955). Accordingly, since Smith Setzer's Equal Protection claim fails, the Due Process claim must also fail. See Clover Leaf Creamery, at 470 n.12.

D. State Constitutional Claims.

In addition to asserting U.S. constitutional violations, Smith Setzer alleges that the preference scheme violates the Equal Protection and Due Process clauses of the South Carolina constitution. S.C. Const. art. I, § 3. The South Carolina Supreme Court, however, has held that the preference scheme does not violate the state's constitution. Garv Concrete, at 338-339. This court agrees.

E. Civil Rights Claim.

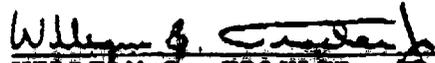
Finally, Smith Setzer alleges a deprivation of constitutionally protected rights in violation of 42 U.S.C. § 1983. As such, Smith Setzer requests an award of reasonable attorney's fees under 42 U.S.C. § 1988. However, § 1988(b) allows only a prevailing party to recover reasonable attorney's fees. As discussed above, Smith Setzer has failed to show any constitutional violation. Therefore, Smith Setzer's civil rights causes of action must fail.

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CONCLUSION

This court holds that South Carolina's resident preference scheme is constitutional. Accordingly, Smith Setzer's request for declaratory relief is denied.

IT IS SO ORDERED.

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WILLIAM B. TRAXLER, JR.  
UNITED STATES DISTRICT JUDGE

Greenville, South Carolina  
December 4, 1992