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Law Center



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Agricultural Contracts and the Leasing of Land

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Contracts and Leases... What are they?

- Essentially both are legally enforceable agreements between two or more parties for the performance of some action or for the exchange of some good.
- Leases are just one of many different forms of contracts

Basic Parts of a Contract:

- Offer
- Subject Matter – at least “reasonably certain”
- Consideration
- Acceptance
- Capacity

Leases

- Leases are a form of contracts that for our purposes of this afternoon deal with the rental of real property that is used for agricultural purposes.
 - Realizing that there are many other forms of leases out there.

Some of the Parties in Leases and Contracts

- ❑ Lessor – also known as the landlord or land owner
- ❑ Lessee – also know as the tenant
- ❑ Lender – usually a bank or credit union, but may be any individual or organization that will lend out money
- ❑ Obligor – the person to whom the duty of the contract is owed
- ❑ Obligee – the person that is obligated to still perform

What are the different types/lengths of leases:

- Tenancy at will
- Periodic Tenancy
- Tenancy for a term of years
- Tenancy at sufferance

Tenancy at will

- Tenancy at will – these can be cancelled by either party at any time, but because of this fact courts do not like to recognize them because they can be used against one of the parties as a weapon “at will”

Periodic Tenancy

- Periodic Tenancy – practically all oral agricultural leases are considered to be this type of lease. The lease is for some relatively short period of time (less than 1 year) and the lease renews itself at the end of the term unless the parties have either given adequate notice to terminate or if they have agreed to end the lease.

Tenancy for a term of years

- Tenancy for a term of years – these are written leases that normally cover more than one year and unlike periodic tenancies they terminate at the end of the lease unless other arrangements are made. The lease contract will usually control most aspects of these leases

Tenancy at sufferance

- Tenancy at sufferance – when one of the above listed tenancies is legally ended and the tenant refuses to depart than a tenancy at sufferance is created.
- The landlord has different options depending upon what state they are in and Arkansas offers several different remedies such as eviction, a fine, or charging double rent.
- This type of tenancy does not last long because either the tenant will leave or eventually a periodic tenancy will come into existence that mirrors the previous agreement

Oral and Written Leases and Contracts

- Are Oral Leases and Contracts even valid?
 - Yes, under certain circumstances.

Oral Leases and Contracts

- ❑ Statute of Frauds
- ❑ A.C.A. § 4-59-101 - (a) Unless the agreement, promise, or contract, or some memorandum or note thereof, upon which an action is brought is made in writing and signed by the party to be charged therewith, or signed by some other person properly authorized by the person sought to be charged, no action shall be brought to charge any:
 - ❑ (5) Person upon any lease of lands, tenements, or hereditaments for a longer term than one (1) year;
 - ❑ (6) Person upon any contract, promise, or agreement that is not to be performed within one (1) year from the making of the contract, promise, or agreement.

- ❑ Also, contracts for the sale of goods that exceed \$500 must also be in writing in order to be enforceable.

What does this mean?

- Oral leases and contracts are valid so long as they may be performed in less than one year (and so long as the goods are worth less than \$500 if it is a contract for the sale of goods).

Examples

- ❑ A verbal agreement to lease land that begins on Jan. 1 and ends on Dec. 31 is perfectly valid. Many oral leases for farmland follow this format.
- ❑ A verbal agreement to perform custom harvesting for this growing season is valid.
- ❑ A verbal agreement to perform custom harvesting for the next three crop years will be invalid (unless some other facts or admissions are made at a late date)

Hypothetical:

- You make a verbal agreement with a painter to paint your house. Such a task can be fully performed in 4 days, but because of weather, a backlog of jobs for the painter to work through, and a lack of available paint that you desire (Razorback or RedWolf red...depending upon your preference) the painter still has not painted your house and it has been more than one year since you made the verbal contract. Is the contract still enforceable?

Answer

- Yes! If the contract could be performed within one year of making it then the oral contract is valid even if they take more than a year to actually fulfill the obligation. Here the facts say that the task could be performed in 4 days which is less than one year.

Exception to the Statute of Frauds:

- ❑ The purpose of the statute of frauds is to have written documentation for important agreements to prove that they actually exist, but there are ways around this doctrine.
- ❑ Common Law remedies (usually equitable remedies) such as Partial Performance and Estoppel may allow a party to enforce an oral contract that exceeds a year if there is some other reason for a judge to rule that it would be unfair not to find that a contract exists.

Examples:

- Making significant capital improvements
- Paying multiple years rent in advance
- Other extreme examples may apply, BUT do NOT rely on this type of remedy if at all possible!

Terminating Oral Leases:

- 18-16-105. Termination of oral lease of farmlands. – Feb. 19, 2009

The owner of farmlands that are rented or leased under an oral rental or lease agreement may elect not to renew the oral rental or lease agreement for the following calendar year by giving written notice by certified mail to the renter or lessee on or before June 30 that the oral rental or lease agreement will not be renewed for the following calendar year.

- For calendar year leases (beginning Jan. 1 and ending on Dec. 31) the landlord must give the tenant 6 months notice that the lease will not be renewed or the lease will reset on Jan. 1 and go for another year.

Types of Leases

- Cash Rent Leases
- Crop-share Leases
- Hybrid Leases

Cash Rent Leases

- Cash Rent – the tenant is obligated to pay either a fixed dollar per acre amount or a set rent for the entire farm

Cash Rent Leases

- ❑ Lessor is guaranteed a steady stream of income whether or not the tenant's crop makes, if crop prices fall, or if production prices increase (so long as they can collect the money from them)
- ❑ This can be modified in a written contract to take into account about whether or not the tenant's crop makes, if crop prices fall, or if production prices increase by adding a clause that either increases rent in good years or lowers rent in poor years.
- ❑ The tenant generally has more control over the farming operation than with crop-share leases since the landlord is assumed to be interested in the rental payment and not on the farming practices.

Cash Rent Leases, continued

- ❑ “actively engaged in farming” – One issue to remember when dealing with cash leases is that some federal programs and statutes require that an individual be “actively engaged in farming” in order to participate. Cash renting farm land is often NOT considered to meet this standard because the lessor is not subject to the traditional risks associated with farming.
- ❑ Because you are not “actively engaged in farming” (or materially participating) the cash income is not subject to self employment tax and is not considered to be earned income for the purposes of determining how a social security check will be modified if the landlord has already retired.

Cash Rent Leases, continued

- Some Issues to look for:
 - When is rent due? At the beginning of the lease or after harvest?
 - Will the tenant be able to pay the rent if the crop fails? Do you require crop insurance in this event?
 - Do you take out a security interest in the growing crops in order to ensure payment?
 - Because the rent cost is typically fixed the tenant will naturally want to maximize their gain in the short term, usually at the expense of the landlord. Are there any activities that you do not want the tenant to do on the property such as plowing under grass on marginal land, destroying wetlands to increase the amount of farmable land, or allowing other people onto the land for hunting, agritourism, etc...

Crop-share Leases

- Crop-Share – under the standard form of crop-share lease the landlord will typically share in the input costs (seed, fertilizer, fuel, etc...) and provide the land while the tenant will provide labor and the rest of the inputs. After the crop has been harvested the landlord will take between $\frac{1}{4}$ and $\frac{1}{2}$ of the crop in exchange for rent and their share of the inputs.

Crop-share Leases, continued

- ❑ There is a chance for either increased or decreased revenue depending upon the success of the crop.
- ❑ The landlord shares the risks associated with the crop along with the tenant which may satisfy the “actively engaged in farming requirement” of some government programs and statutes.
- ❑ Because the landlord has a stake in the success of the crop the landlord will often retain control over operational decisions or at least share in the decision making process.

Crop-share Leases, continued

- ❑ The operation works much like a partnership (but it is NOT a legal partnership under normal circumstances) in that two parties come together and contribute assets, management, and labor to a business venture and share the benefits and risks associated with it. This means that unlike in a cash rental situation the two parties will have to work with one another!
- ❑ Money collected by the landlord will be subject to self employment taxes and may lower the amount of a landlord's social security check if they are retired

Crop-share Leases, continued

- Issues to look for:
 - Can you work the other party for a significant amount of time?
 - Although you may be able to create a verbal lease you might want a written contract that spells out the rights and responsibilities of each party so that there is no confusion at a later date. Remember that ever contract and lease starts out looking like a great deal or no one would ever enter into them!
 - What kind of farmer is the tenant? If you know that they generally produce poor crops do you want to share in that? Are they “insurance farmers” that intend for their crop to fail every year so that they collect crop insurance...and more importantly, do you have a right to that insurance if it does fail?

Hybrid Leases

- Hybrid – the parties can also choose some combination of cash rent and crop-share leases.
 - There are a number of different models out there, but the usual goal of most of the models is to provide the landlord with some minimum amount of rent (in the form of cash) with a bonus being owed if production is over a certain amount.
 - Because these arrangements are more complex they should always be in writing.

Some Things to Consider when Drafting Leases (Besides Money)

- ❑ Sustainability of soil and water quality
- ❑ Maintenance of fixed assets on the property
- ❑ Uses of the property
- ❑ Termination of the lease/contract
- ❑ Death of one of the parties
- ❑ Assignment and Subleasing

Sustainability

- Sustainability: protection of soil and water quality so that there is no noticeable degradation of soil or water quality.
- Land is a finite resource and loss of soil through erosion and leaching of nutrients can have severely consequences on the value of land for either sale or rental purposes

Allowed Farming Practices

- row crops – what crops can be grown (cotton every year?), where can they be grown, how much fertilizer and chemicals may be used?
- livestock operations – stocking rate, what species may be kept there
- crop rotation, conservation tillage, no-till farming
- buffer zones around bodies of water, terraces, ponds
- timber stands,
- organic agriculture,
- dedicated wildlife habitat
- Conservation Security Program

Consequences with Neighbors

- If the tenants are allowing erosion to occur than the silt and water must be running onto their land creating a nuisance. This gives rise to potential liability if not while the land is rented than afterwards once the pattern has began

Examples I have witnessed:

- Native prairie grass stand
- Old burial grounds

Maintenance of Fixed Assets

- Most rental property will have some fixed assets that are located on the land and may or may not be used by the tenant.
- The question is: Who has the responsibility of maintaining it?

Houses

- Is the tenant going to live there? If so do they maintain the house or does the landlord?
- May the tenant sublease out the house to someone else without the landlord's consent?
- What if the landlord rents the house to someone other than the tenant that is renting out the farmland? Do the two tenants have to share things such as roads and water supply?

Barns, storage sheds, corrals, etc...

- The tenant has the right to use these facilities if they are located on the property and nothing is expressly stated in the lease agreement.
- What if the tenant makes a substantial improvement to the property such as building a barn or new fences?

Fences

- Is the tenant going to use the fences?
- Whose responsibility is it to maintain them?
 - If the contract says that the tenant has the responsibility to maintain them then the landlord has the right to file a landlord's lien on the tenant's crop if the contract allows for it - *Von Berg v. Goodman*, 109 S.W. 1006 (Ark. 1908).
 - If the contract says that the landlord is responsible for the maintenance of the fences than the tenant may fix the fence himself and charge the landlord for the costs of building the fence, but no other expenses or losses associated with it. *Varner v. Rice*, 1882 WL 1638 (Ark. 1882).
 - In the absence of any express agreement, the tenant is bound to use the premises in a tenant-like manner, and to make the smaller or ordinary, repairs necessary to keep the buildings on the premises wind- and water-tight, such as ordinary repairs to the roofs of buildings, to prevent leakage, and, in the lease of a farm, to make repairs generally, or to keep the fences in ordinary repair. 52A C.J.S. Landlord & Tenant § 819

Fences, continued

- What happens to the posts and wire that the tenant puts into the fence?
 - The general rule is that they stay with the land once the lease is finished and the tenant has no right to either take them out or to demand compensation for them.
 - Consequences?
 - Fences like the ones on Indian leases in Oklahoma

Fertilizing the soil (Is this a permanent asset?)

- The general rule of thumb for who pays on most maintenance and improvement costs is determined by how long the action taken will benefit the property. Things like basic upkeep are usually the responsibility of the tenant while projects that will improve the land for a significant period of time are paid for by the landlord.

Fertilizing the soil, continued

- So what is so special about managing the nutrients in the soil for purposes of leasing land?
 - Is this a short term improvement or a long term one?
 - It's probably in the middle which makes it difficult to assign the cost
 - Many written contracts will contain some phrase about soil nutrients and this is often one cost that is shared by the parties since it has both a short term effect as well as a long term one.
- Dividing the costs can be done a number of different ways.
 - Split the costs 50/50
 - Tenant pays for chemicals that have an immediate effect such as nitrogen while the landlord pays for chemicals that cause continuing benefits such as liming the soil.
 - Various other methods...essentially as many as you can imagine.

Uses of the Property:

- Do you restrict the uses of the property?
- Is the property to be used for agricultural purposes? If so then what kind of uses?
 - Agritourism
 - Bee keeping
 - Ranching
 - Row crops

Uses of the Property, continued

- Will the property be used for hunting?
 - Will the tenant's farming practices disturb the local wildlife?
 - Does the tenant have the right to sublease out the hunting rights?
 - Do you want to try and lease out the hunting rights to someone other than the tenant? To multiple people? What are some of the consequences of doing this?

Assignment and Subleasing

- What are they?
- Can a tenant assign or sublease the property that they are renting to another party without the permission of the landlord?

Assignment and Subleasing, continued

- ❑ If there is no agreement to the contrary than the default rule is that the tenant is generally is free to either assign or sublease property that they are renting without the permission of the landlord, however the tenant may still be liable if the person to whom they lease it to either breaches the lease or fails to pay rent
- ❑ This can create a very difficult situation for the landlord!
 - What do they know about the new tenant?
- ❑ Rules concerning assignment and subleasing are state specific so to be safe the landlord should prohibit them in the written lease.

Death of a Party

- ❑ What happens when either the landlord or the tenant dies?
- ❑ Usually nothing changes! The estate of the decedent (usually their family) will continue the lease until it runs its course.
- ❑ Most contracts (including leases) remain relatively unaffected by the death of one of the parties.
 - The exception is for contracts that involve a personal service since those depend on the individual to perform some special service.

Death of a Party, continued

- Why?
- Would it be fair to throw out a tenant if the landlord dies one day? What about the crops that are growing on the property? What if the tenant actually lives there as well?
- What if the tenant is the one to die? A lease for a house may be cancelled, but often the tenant's family will need some time to figure out what is going on with the estate and if any changes need to be made.

What about crops that remain unharvested at the end of the lease?

- ❑ Unless the contract says otherwise the tenant has no right to harvest crops after the termination of the lease even if unforeseen occurrences such as the weather prevent the harvest. *Huckaby v. Walker*, 217 S.W. 481 (Ark. 1920)
- ❑ Many other states make some provisions for the harvesting of crops after the termination of a lease so long as it is reasonable.
 - If the landlord gives the tenant the required notice of termination before June 30 and the tenant waits until the second week of September to plant winter wheat for harvest in July of the next year than a court will probably not be too sympathetic to the tenant.

Termination of the Lease/Contract:

- ❑ What kind of lease is it? Term of Years or Periodic Tenancy?
- ❑ Tenancy at Will – either party can cancel it whenever they want to
- ❑ Term of Years – these leases simply expire at the end of the term without any notice being necessary
- ❑ Periodic Tenancy – these can be month to month or year to year, however in most agricultural leases they are assumed to be year to year.
 - Under the Common Law either party must give 6 month's notice to terminate a year to year periodic tenancy.

Termination of the Lease/Contract, continued

- ❑ Breach of Covenant:
- ❑ If the landlord or tenant breaks one of their promises in the lease agreement or farms in a wasteful manner is there a right to terminate the lease?
 - Generally No, unless the state specifically creates such a right or the lease contract allows for it. The normal remedy is to sue just like with a breach of contract and either get damages or an injunction against further waste.
 - Courts may make allowances in certain cases where the tenant or landlord's actions are so severe that they warrant termination, but this is rare.

Termination of the Lease/Contract, continued

- ❑ Breach of Contract:
- ❑ Very similar to the breach of a covenant in a lease, but instead of just one portion of the lease being broken, the violation here is severe enough that the contract itself is broken.
- ❑ Can you stop performing if the other party breaches the contract?
 - Sometimes you can, but only if the breach warrants your nonperformance as well. Minor problems arise in contracts all of the time and courts realize the fact that the world isn't perfect.
 - In the case of a minor problem the party that is in the wrong may have to pay damages to the other party to offset their losses from the breach; however if the contract can continue on than both parties should carry on with the contract.

Termination of the Lease/Contract, continued

- The problem that often arises in these cases is where you entered into a contract for a long period of time (such as in lease for a term of years) and something happens which causes you to want to get out of the lease.
 - Crop values skyrocket, land closer to home becomes available to rent or buy, but you are tied up in the current lease, etc...

Termination of the Lease/Contract, continued

- You/They want out of the lease so you/they “make a mountain out of a mole hill”
- This is the worst scenario because not only do they probably never breach the lease by their conduct, but now you will breach the contract instead (since you probably believe that the contract has been rescinded by now) and you will be the one paying the damages.

Termination of the Lease/Contract, continued

- What is the point?
 - Don't just assume that a contract or lease has terminated because it may just be your wishful thinking

Termination of the Lease/Contract, continued

- Can the lease or contract be cancelled?
- If the parties agree to cancel the lease or contract than this is often enough to cancel the lease or contract.
 - This is probably the best and most common way that the parties can end a contract

Websites with free lease forms and resources

□ Iowa State Extension

- <http://www.extension.iastate.edu/wright/news/leaseforms.htm>

□ University of Illinois – Farmdoc

- <http://www.farmdoc.uiuc.edu/pubs/Legal.asp?Subsect=Acquiring&Subclass=Lease>

□ Arkansas?

Thanks for Attending

- ❑ I'll be around the rest of the day to answer questions if I can...Please ask and I'll answer if I'm able to.
- ❑ Much of this information can be found on the National Agricultural Law Center website at <http://www.nationalaglawcenter.org/>
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