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Farmer's Legal Guide to Production Contracts

by

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Dedication

*To my wife Khanh for her love, support
and constant understanding,
especially in the summer of 1994.*

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Of course the observations, conclusions and analysis contained herein are my own, both that with which readers may agree and that with which they may not. Every effort has been made to insure the discussion is accurate, timely and objective, but where it might fall to be such, I accept sole responsibility.

Neil Hamilton
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CHAPTER ONE: INTRODUCTION

There are several reasons why this book was written. First, using production contracts may help you diversify or add more profitable marketing options to your operation. But they also can trigger important legal obligations. Second, the proliferation of grain and hog contracting means more farmers are going to be faced with deciding whether to enter such agreements. Third, until now, few sources of legal information existed about the subject. Fourth, the main goal of the book is to educate producers and attorneys, as well as companies using contracts, about the legal rules and issues that apply. Fifth, the reality of most production agreements is that an inherent imbalance of power and information exists between the parties. In most cases, the company representative asks the farmer to sign a printed form contract with little or no opportunity to negotiate terms. Such imbalances can create the opportunity for unfair advantage in the agreements. This increases the need for farmers to have a resource they can turn to for answers.

Just like a marriage, no one enters a production contract intending to divorce. But farms don't operate under climate-controlled conditions. The impact of weather and disease on quality and prices makes agricultural contracts inherently more volatile than manufactured goods. In the process, they expose growers and contractors alike to risks. You can assume that the companies drafting production contracts have taken time to explore contingencies in the event production doesn't go according to plan. The information in this book is designed to help growers evaluate the legal terms of their contracts, to educate them about their obligations, and to alert them to their standing in the event of quality or payment problems. A good background in these legal issues should help minimize disputes and, in some instances, even improve contract terms.

What Does the Book Cover?

The subject of the book is production contracts for agricultural commodities. One immediate problem is that a good working definition of production contract can't be found in any dictionary. As a result, it is necessary to develop one based on how these contracts work. The following is a legal definition, which covers the vast majority of relations involving production agreements.

An agricultural production contract is a legally binding agreement of a fixed term, entered before production begins, under which a producer either: agrees to sell or deliver all of a specifically designated crop raised on identified acres in a manner set in the agreement to the contractor, and is paid according to a price or payment method, and at a time, determined in advance; or agrees to feed and care for livestock or poultry owned by the contractor until such time as the animals are removed, in exchange for a payment based on the performance of the animals.

Under the agreement, the producer may have no legal title to the crop or livestock but instead is a bailee, and the producer is declared to be an independent contractor and not an employee or joint venture with the contractor.

Elements of a Production Contract

By considering how production-contracting relations operate, it is possible to divide the definition into several main elements:

1. Two parties, the producer and the contractor, make a legally binding agreement.
2. The agreement is for a fixed term, either one crop year or so many production cycles.
3. The agreement is signed or entered into before production begins.
4. The contract calls for either the production of a crop or the care and feeding of animals, on land owned or controlled by the producer.
5. All the animals or all of the crop from a designated number of acres, which may be specifically identified, will be delivered or sold to the contractor.
6. The crops or livestock must be produced or cared for according to the terms of the agreement, to be acceptable.
7. The producer will be paid a set amount at a time according to the agreed schedule or term, which may include premiums or deductions for quality or performance.
8. The producer generally has no legal title to the crop or livestock but is considered to be in a bailment relation with the contractor.
9. The producer is described as an independent contractor rather than an employee, partner or joint venture with the contractor.

The importance of production contracts is they are a unique type of legal agreement that creates a different relationship between the parties. As you can see from the elements listed above, production contracts involve a much greater sharing of both control and risks between the parties than do most traditional marketing tools.

What Makes Production Contracts Different?

Farmers use a rich variety of marketing methods and contract forms for selling crops and livestock, such as:

- *Cash forward contracts*, which involve the sale of a fixed amount of the actual commodity at a set price for future delivery;
- *Marketing agreements*, in which a member of a cooperative agrees to sell all of a particular commodity produced through the organization;
- *Futures contracts*, which involve the sale or purchase of a standardized quantity of a commodity for future delivery on a regulated commodity exchange.

These forms of marketing contracts are important, but they are not the subject of the book. They all differ from production contracts in many key ways. The most important distinctions are that they do not include producing the commodity under the control of another, they do not involve transferring title to the commodity before it is produced, and they may not even necessarily require production or sale of a commodity by the producer. The key is that the three contracts cited above are all forms of marketing arrangements for the commodities produced and owned by the farmer.

In contrast, a production agreement is the sale or production of specified commodities to an identified party under an agreement signed in advance. These distinctions make production contracts a unique and much different form of legal relation than traditional marketing tools.

CHAPTER TWO: THE TREND TOWARD PRODUCTION CONTRACTS

American agriculture has seen a rapid increase in production contracting during the past few years. Long used for the reproduction of seeds, for many vegetable and horticultural crops and for poultry, contracts are now spreading into other commodities, most notably swine and traditional grains. A recent report estimates that over 20% of the country's hogs and pigs are now produced under contract, up from only 2% in 1980. The same report indicates that 7% of both food grain and feed grain production is raised under production or marketing contracts, an increase from less than 2% in 1970.

There are a number of reasons for the trend toward contract production. One is risk management, as everyone involved in agriculture—from producers to the largest food marketers—looks for ways to reduce or manage financial risk. Another is new marketing opportunities, such as the use of corn for ethanol. Perhaps the most important is the revolution in biotechnology that allows companies to custom-design seeds for specific end uses. For example, Pioneer estimates that a com hybrid designed for poultry feeding carries an extra 63 cents to 64 cents per bushel value for broiler feeders.

In recent years several large agricultural supply companies have also begun producing "identity-preserved" or value-added crops like high-oil com destined for poultry and swine feed markets. With such production, companies often contract with growers to produce the varieties for the seed company or the end user. Some observers estimate that by the year 2000 as much as 20% of the nation's com and soybeans could be value-added or identity-preserved crops, which would mean a sharp increase in the use of contracting in grain production. [See Greg D. Horstmeier, "Farming by invitation only," *Top Producer*, February 1993. For a discussion of current national data on contracting in American agriculture, see Patrick M. O'Brien, "*Implications for public policy*" in *Food and Agricultural Markets: The Quiet Revolution*. Schertz and Daft, eds., National Planning Association. 1994.)

Many farmers and companies have greeted "identity-preserved" crops and contract production as the future of agriculture, noting that they will create opportunities for new markets and additional price premiums for farmers. They are, in fact, actually part of a larger trend that has been called the industrialization of agriculture (see sidebar).

CONTRACT PRODUCTION AND THE INDUSTRIALIZATION OF AGRICULTURE

Production contracting is part and parcel of the industrialization of agriculture. Perhaps the best explanation why appears in Thomas Urban's article "Agricultural Industrialization: It's Inevitable" [*Choices*, 4th Quarter, 1991, p.4]. Urban is president of Pioneer Hi-Bred International, the world's largest marketer of agricultural seeds and a leader in contract grain production.

He defines this industrialization as the restructuring of production because greater capital and new technology allow a management system to integrate "each step in the economic process to achieve increasing efficiencies in the use of capital, labor, and technology." He writes: "Production agriculture In· the Western World is now entering the last phase of industrialization—the integration of each step in the food production system. The production is rapidly be-coming part of an industrialized food system."

While not advocating the changes, Urban views them optimistically, noting that they will maximize uniformity and predictability in agricultural production and allow for the branding of food and the marketing of "idently-preserved" products. This is a development that his plant breeders (among others) are actively pursuing. He believes it will attract new capital to agriculture and lead to more rapid adoption of new technologies. He is also optimistic it will create opportunities for agriculture—possibly giving rise to a new kind of family farm, one that is "dependent as much on financial management skills and contract marketing as on production and agronomy know-how." This "super farmer" will respond quickly "to new opportunities to increase income and reduce risk."

But production contracts raise both legal questions and issues of social policy. Will all farmers have access to contracts to raise improved grains, and if so, at what cost? Will contract farming mean new profits for those who raise the crops? What legal risks are associated with production contracts? If "identity preservation" means using production contracts, will this change how we farm? What effect will contracts have on the traditional farm supply and marketing structure? Will they change who buys your crops, how they are priced, and the method of payment? Will they change whether you can save seed to plant next year, or sell some to your neighbors?

Terms to Know

Before discussing the legal and economic issues that arise with production contracts and specialty or "value-added" crops, we should define common terms and concepts, some of which are fairly interchangeable:

Identity preserved refers to crops whose unique characteristics are preserved from the time of production through marketing to processing and consumption. The term is most commonly used with grains, such as those whose altered genetics give them higher values as animal feed. "Identity-preserved" can also mean crops raised under unique production methods. A prime example is Pioneer's "Better-Life Grains" Program, in which contracted growers agree to use no pesticides when growing the grain (see sidebar). To preserve a product's unique traits or value, identity preservation demands significant steps during production, harvesting, storage and processing to segregate the crop from other varieties. Identity-preserved crops are receiving considerable attention in the grain-processing industry. [See Bill Freiberg, "Speakers from the Wet Milling Industry Tell of Their Big Future Demand for I-P Crops," Seed and Crops Industry Journal, February 1993.]

PIONEER TAKES LEADERSHIP IN MARKETING IDENTITY-PRESERVED GRAINS

In 1989, America's largest seed marketer developed its "Better-Life Grains" marketing program for pesticide-free grains. The program illustrates both the idea of identity preservation and the marketing of value-added specialty crops. Under the program, Pioneer contracts with producers who agree to raise crops using seeds provided by Pioneer and following Pioneer's requirements. The company then takes possession of the crop and sells the identity-preserved grain for use by food companies in pesticide-free consumer products. When the products are marketed, the label carries the Better-Life Grains emblem. The most important obligation under the production contract concerns not using pesticides on the crop. Part of the contract reads:

Better-Life Requirements and Certification. The Grower will sign an affidavit attesting that no pesticides have been applied to the soil or crop since the harvest of the previous crop and during the production season or while in storage. The Company will provide the Grower with a detailed list of acceptable and unacceptable practices including isolation requirements. No payments may be made to any Grower until all appropriate certification documents from the Grower have been received and accepted by the [Company].

Grower must provide fifty feet isolation from area treated with chemical pesticides. If this requirement cannot be met with roads, waterways, or crops being raised without chemical application, the Grower will need to work with Pioneer Personnel to measure and flag the isolation area. The Company will not accept soybeans grown on the isolation area.

Testing of the grain for residues of pesticides will be done at the Company's expense prior to delivery by a third party laboratory with which Pioneer has contracted for specialized services. Grain will not be accepted if levels of pesticides are above established governmental standards. The test results will be final.

For agreeing to these conditions, producers receive a premium--in 1994, it came to \$3 a bushel for edible soybeans produced without chemicals. The beans will be sold in Japan for use in tofu and other food products. For a producer, the issues are having access to Pioneer's contract and determining whether the \$3 premium outweighs the significant decrease in yield that might result from raising food-grade beans.

Specialty-crop production generally refers to the production of untraditional varieties such as waxy com, white com, or food-grade soybeans; or it may refer to raising identity-preserved crops. In some cases, it refers to traditional grains that are marketed for untraditional or industrial uses. In any case, the attraction of specialty-grain production is the ability to enter a new or niche market that offers a price premium. Unlike identity preservation, specialty-grain production does not have to be based on unique plant genetics or production methods to result in the unique trait. Instead, entering the specialty-crop market may just depend on the producer's ability to find a buyer who will pay a higher price to guarantee a supply for the alternative use. Grains sold for specialty purposes are sometimes referred to as "product commodities." as opposed to the "grain commodities" sold in the traditional marketplace.

End-use-tailored variety is another way of describing identity preservation. Here, however, the focus is on the plant breeding or genetic engineering that brings added value through a particular crop trait. [See David Wheat and Wade Wilson, "Tailoring Grains for a Perfect Fit" Feedstuffs, May 13, 1991.] High-oil com, with its higher value as an animal feed component, is an example of an end-use-tailored variety. Such developments are bringing new companies into agricultural production. For example, DuPont, which has the rights to several high-oil com varieties, has recently expanded into contract production of com.

Value-added production is a more general and comprehensive term that describes the production of commodities that sell for a price premium. The term can also refer to the marketing of traditional commodities that increases their value or the producer's returns, such as food-grade soybeans or processing com for ethanol. In recent years, there has been much attention given in American agriculture to the search for new uses for traditional grain crops. As part of the 1990 Farm Bill, Congress established the Alternative Agricultural Research and Commercialization Center (AARCC), which has received over \$10 million to fund the research and development of such products.

Composition-based grain marketing is the marketing of commodities based on the value of their various feed components, such as the starch and oil in com. Traditional market grades or standards do not separately value the traits, and the issue of changing the way grains are priced and marketed has received considerable attention over the years. For example, the Iowa Department of Agricultural and Land Stewardship has recently developed a program to promote composition-based grain marketing. The department held a conference on the subject in March 1993, and it publishes an annual catalog about the "Iowa Gold Program." The program provides comparative information on the performance of different com varieties as to the component production, e.g., the percent of corn oil and starch. This information can be used by producers and processors in selecting which hybrids to plant (see sidebar).

VALUING GRAIN FOR ITS COMPONENTS: CONTRACTING OR CHANGING THE PUBLIC MARKET SYSTEM?

The development of alternative methods to value and price grain in the public marketplace will continue to receive increased attention. One reason is producers' concerns about the effect of contracting on price discovery. Composition-based marketing would use publicly discovered pricing mechanisms to make price information and markets available to all producers, just as the current marketing system does.

By contrast, most production contracts "internalize" the pricing mechanism, so the true value of any added traits is not discovered or priced in the public market system. Instead, it is negotiated between the parties. Thus, producers can find themselves at a disadvantage when bargaining with the company that may have developed the genetics and that controls the end-use market. The producer has no way of knowing the real market value of the enhanced product, and is instead offered a fixed premium on a take-it-or-leave-it basis. Because the premium means less of the sales price is available to the company for profits, the company will calculate the premium at the rate that will induce the grower to sign the contract rather than the value of the trait.

Of course, for a public marketing system to function using composition based pricing, it would

Vertical integration in meat production is the most significant factor driving the expansion of contract production in livestock and poultry. For the most part, this occurs in either of two ways. First, companies that began as suppliers expand into production through direct ownership of facilities or through contracts with others to care for and feed company-owned animals. For example, Murphy Farms of North Carolina started as a small feed company but quickly became a major swine producer. Such companies may ultimately decide to complete the vertical integration by expanding into processing and marketing by owning packing facilities, as is now being done by Premium Standard Farms of Missouri. Second, a company that began as a processor or marketer of the commodity may decide to integrate downstream into the production system and control the actual production of the animals. This is the approach used extensively in the broiler industry and by some beef packers. Under either system, the company may decide that all or a portion of the animals it processes and markets will be raised under production contracts with growers, rather than being raised directly by company employees in company-owned facilities.

Legal Significance of the Changes in Production

Regardless of how the process is described, changes in the production and marketing of grains and livestock are exciting developments that may result in new markets, higher prices, price premiums and even new ways of pricing and marketing commodities. Most of the public discussion of contracting focuses on its positive economic benefits. A recent survey by the University of Illinois found that most producers with contract experience were satisfied with the relationship and would continue to use it. [See Robin Hoffman, "*Super Farmers Grab Crop Contracts.*" *Top Producer*. May/June 1992.] Of the 250

farmers surveyed in east-central Illinois, over 30% had at least one production contract. While growers noted the difficulties in satisfying contract terms, such as high quality standards, over 90% of those with contracts said they intended to continue contracting.

But along with the economic benefits and opportunities come new legal issues, such as access to contracting opportunities and their role in spurring concentration of production. These issues will challenge both the farming community and agricultural lawyers. Questions about the fairness of contracts and the economic effects of vertical integration have already triggered public debate and legislative proposals. Critics charge that contracting can reduce farmers to the status of low-wage employees who assume most of the financial risks without the potential for increased rewards. [See Dan Looker. "Hog Feeding on Contract: Safe Money or Servitude?" Des Moines Register, Aug. 15. 1989] Others say the problem is not contracting itself, but bad contracts. As is discussed in Chapter 12, some states, such as Minnesota, have responded by passing laws to regulate the use of contracts and protect producers who enter such agreements. If the new opportunities for specialty grain production and marketing are accomplished primarily through the use of production contracts, then everyone in agriculture has a stake in understanding how they work.

Why Agricultural Companies Use Production Contracts

For the companies involved in developing or marketing commodities such as identity-preserved grains, specialty crops or branded meats, there are a number of reasons to insist on production contracts. The most significant include:

- *Quality control.* Contracts provide control over the production methods, and thus help ensure the commodity's uniformity and quality, making it more suitable for standardized consumer products.
- *Assured adequate supply.* Contracts offer a mechanism to control the quantities and the way crops are marketed to processors and consumers, helping increase the price premiums obtained and prevent oversupplies that may decrease demand.
- *Supply management.* Contracts allow the company to lock in a guaranteed supply to meet potential needs, but do so using pricing arrangements that limit the risk of having to acquire more of a crop than needed. For example, "passed acres" clauses, common in vegetable contracts allow the company not to harvest or purchase the crop even if it meets contract standards. Instead, the producer receives a portion of the contract price from a pool of funds established by a charge on all growers.
- *Marketing-related technology.* Contracts can promote (or require) adoption of related technologies or production methods, some of which may also be marketed by the contractor. Thus, contracting may provide opportunities for economic linkages such as "packages" of seeds, chemicals and marketing opportunities.
- *Intellectual-property protection.* Contracts give the company control over the release of specialized crop genetics that create the added value trait, allowing the contract to serve as an additional form of intellectual-property protection and control the unauthorized reproduction or sale of the crop.

- *Market protection.* Contracts offer a way to preserve confidentiality of marketing arrangements and even the end-user or purchaser. Buyer contracts can be very important with specialty crops, and protecting the identity of the end-user prevents producers from contacting the purchaser directly.
- *Pricing confidentiality.* Contracts that use nonpublic pricing and marketing of commodities allow for concealing the true magnitude of any price premium gained with the special trait. The company can obtain higher profits and limit the producers' knowledge or ability to bargain or negotiate for a larger share of the added value.
- *Reduced risks and higher profits.* Contracts give companies with investments in crop breeding and genetic engineering a mechanism to project their investments and potential returns further down the production process--without having to own the land or production facilities. This allows the company to increase the returns to the investors who funded the research that created the added value. It also allows the company to become more involved in crop production without risking investments in farmland or buildings. With the contract, the producer provides the land, equipment and labor. In addition, because of anticorporate farming laws, many large agricultural companies cannot own or directly control farmland in several Midwestern states.

Taken together, these factors explain why many companies traditionally involved in agricultural sales, such as seed and chemical companies, grain merchandisers and meat processors, are now contracting with farmers for production of commodities. The potential financial returns and the market linkages offer attractive opportunities.

A skeptic might ask, Why own the farm when you can own the farmer and the crop? But most agricultural economists say the rise of contracting is just one factor in the evolution of the food production and marketing sector in the U.S. In their view, consumers are ultimately responsible for the expansion of production contracts, because the agreements are simply mechanisms whereby companies communicate risks and market signals to producers. (See Alan Barkema, "New Roles and Alliances in the U.S. Food System," *Food and Agricultural Markets: the Quiet Revolution*, National Planning Association, 1994.)

Most economists acknowledge the loss of control that contracts can mean for producers, and the role that contracting plays in such trends as the move toward fewer and larger hog farms and reduced marketing opportunities for independent producers. But most players in the agricultural sector appear to have few qualms about the trend toward contracting and vertical integration. Instead, they view it as a positive economic development to make our food system more efficient. While there are policy implications concerning contracting (see Chapter 12), the experience of recent decades shows it is unlikely that public action will be taken to restrict the trend. Deciding whether contracting is a good thing for farmers--or for your operation--is a decision you may have to make in the near future. It is also one you may have to make pretty much alone.

Benefits of Production Contracts: A Form of Risk Management

Farm economists and the media often portray the movement toward contract production as a way to reduce the risks associated with traditional production and marketing. For producers, there are several ways in which this works, including:

- *Reduced financial risk.* Contracts can limit financial uncertainty by providing a guaranteed source of cash flow and reducing the need to borrow money. For example, a young producer who raises hogs on contract does not have to obtain financing to buy the stock; instead, he can make use of his available labor by caring for someone else's animals. Under the contract, the producer is also assured of a steady source of income in the form of contract payments, which may be instable or predictable amounts. By insulating the producer from the market's price swings, the contract may provide more stable income.
- *Access to capital.* Contracts can provide access to capital by helping make the producer a more attractive borrower. If a contract offers a steady source of cash flow, a bank may be more willing to lend money, such as for building a new production facility. In addition, some companies involved in production contracting have available sources of financing for their producers.
- *Access to new technology.* When a producer is interested in raising a new, genetically engineered variety, such as high-oil corn, a production contract with the company owning the patent or variety may be the only way to obtain the seed. Under some contracts, the seed may even be provided at no cost as part of the agreement. The contract may also bring access to higher-value markets along with the new technology and support and advice of the company.
- *Access to new markets.* Contracts can offer access to commodity markets with new sources of demand or higher prices. A grower who wants to produce and market food-grade soybeans for export to Japan will find it difficult to make the contacts and arrangements for such sales. The most likely way to do so will be to sign a production contract with a company that has developed markets in Japan.
- *Higher prices.* Contracts can provide higher prices or price premiums for raising new crops or for using certain production methods. A producer who wants to market organic produce or pesticide-free grain may find that the easiest way to do so is by entering a production contract with a company processing and marketing those foods. It is linkages such as these that make production contracts attractive to companies trying to market specialty crops.

These examples of production contracts' benefits explain why an increasing number of farmers are considering such agreements. They also demonstrate why companies that promote contracting often refer to it as risk sharing between the farmer and the company. By agreeing to raise a particular crop and market it to the company, the producer can make a valuable link that reduces the costs of farming or creates the opportunities for higher returns. Production contracts may offer producers other benefits as well, such as access to the company's agronomic and management expertise and the possibility of unique "crop insurance" programs associated with some forms of guaranteed marketing arrangements.

Risk Sharing or Risk Shifting?

Although production contracts can lead to higher returns and serve as a form of risk sharing, the language in some contracts can make them more a form of risk shifting than risk sharing, with the producer assuming unexpected or new burdens. One rule to keep in mind is that if you are earning higher returns or gaining a benefit under a contract, it is in exchange for something on your part. As an executive at one company has pointed out, the companies are not charities; you earn the benefits you receive (see sidebar).

CONSIDERING THE ECONOMIC RETURNS OFFERED BY CONTRACTS

If a production contract results in greater economic returns, these will be in exchange for something else. Depending on the crop involved and the terms of the contract, the required action-in-contractual terms, the "consideration" by the producer could come in several forms, including:

- Increased production costs associated with contract requirements;
- Reduced flexibility in how to farm;
- Loss of control over pricing and marketing;
- Compensation for lower yields, known as the "production penalty, to that can result if the specialized crop is less productive than traditional varieties. While a premium of \$2 or \$3 a bushel may look attractive, many food grade crops yield significantly less than traditional varieties;
- Compensation for the reduction in the quantity marketed due to the quality standards-that is, not all the crop will be marketable at the price premium;
- Higher-priced inputs, such as special seeds, required under the contract.

The only way a farmer can decide whether a production contract is risk sharing or risk shifting is for him to look at the contract closely. First study the actual language, the legal issues and obligations established, and the nature of the relationship created between the parties. Then try to answer any questions that the proposed contract raises. Consider these common examples of how production contracts may shift additional risks to producers. All the examples have been the subject of recent court cases.

Long-term investments, short-term contracts: Swine and poultry producers who enter contracts often build a new facility to company specifications-usually borrowing a significant amount of money and placing a mortgage on the farmland. But many contracts provide a much shorter contract period than the term of the financing. For example, most broiler contracts are for only one flock of birds. A short-term contract can create serious risks if it is terminated before the building is paid off. The risk is especially real in areas where the contractor is the only party marketing livestock or poultry, leaving no other marketing channel.

Acquisition of specialized equipment: The production of some specialty crops, such as tomatoes, is often done primarily under contract and may require investments in expensive equipment. Producers buy equipment based on the expectation they will raise the crop long enough to pay for the machines.

But almost all vegetable production agreements are for one year, subject to renewal at the company's discretion. This raises the possibility that no new contract will be offered, leaving the farmer with expensive technology that has no use. In a recent lawsuit brought against Heinz, a group of Iowa tomato farmers argued that the company's decision not to renew their one-year agreements was illegal because the growers relied on the company's actions to buy expensive equipment, expecting the contracts to be continued. The case was settled before it went to court, and the terms are confidential.

Flexible quality terms: Production contracts often include extremely detailed terms concerning the quality of the crop or the methods used to produce it. Whether the crop meets these standards is often solely at the discretion of the company. The company can vary its rigor in applying provisions as its needs and market conditions change. Thus, a producer may have raised what appears to be a bumper crop, only to have the price reduced for "quality reasons"- or worse yet, have the company not harvest the crop but instead pay a fixed contract payment. In such cases, there may be few alternative uses or markets for the crop, even if it is released to the grower.

Risk of not being paid: Production contracts are, in many areas, a new form of marketing, with the producer depending on the company to pay for the crop under the terms of the agreement. For a specialty grain producer, the contract may provide that a significant portion of the payment will be made much later after the crop is harvested, even though the producer has given title to the crop to the company. Until the producer is paid, he is an unsecured creditor who is financing the company's operations. If the grain had been sold in normal channels to a licensed warehouse or grain dealer, the producer would be protected by a bond or indemnity fund in case the company went bankrupt. But under many production contracts, the producer has no such protection and must rely on the financial strength of the buyer. As discussed in Chapter 9, many companies contracting for production of grain may not be complying with state grain-dealer laws that require them to obtain bonds.

Risk of loss in performance: In many common forms of production contracts, the producer does not have any legal right or title to the crop while it is being raised. This is designed to protect the company's financial interest in the crop from claims by the producer's creditors, and to protect the intellectual-property rights in the genetic material. With such an agreement, the producer is performing the service of growing a crop for the company, rather than selling the crop. But most contracts also provide that the risk of crop loss, such as by weather or disease, rests with the producer. In other words, if you raise a crop, the company owns it; if you lose it, you owned it and earn no compensation. This form of agreement is a classic example of risk shifting, because it guarantees the company's right to the crop without exposing the company to any of the risks of production.

Whether a production contract is a useful tool or a risky proposition depends on the relationship between the parties, the language of the contract, and the performance of the agreement. You can assume that the company offering you a contract has every intention of performing the agreement and has no interest in a legal dispute arising. But you must also assume that the company received legal advice when it was drafting the contract and that it has protected itself from risks. An important rule to remember is, when in doubt ask questions. You should be aware of your rights and obligations in advance, instead of being unpleasantly surprised later on.

CHAPTER THREE: CONTRACT LAW 101

Contracts are one of the most common legal activities people engage in. Whenever you buy goods, sell a commodity, borrow money, agree to perform a service or hire someone to provide a service, you have entered into some form of contract. Contracts may be simple oral agreements, a one-page document or 10 printed pages of small type, with dozens of different clauses and what lawyers call "boiler plate." They can even be implicit, arising from the parties' conduct. But regardless of the type of contract, there are certain elements of contract law that you must understand because they will be at the heart of any legal effort to interpret your agreement.

To begin with, a contract only applies to the parties who signed it. Although other parties may be affected by it, a contract is enforceable only by the parties to it, and it creates obligations for them only. People are free to enter into any form of agreement or contract they want to, so long as it does not violate existing law or run counter to public policy. Otherwise, you are free to agree to any terms you want, even if the contract is a bad deal for you. Courts may apply certain protections to the parties in a contract, but these protections are the exception, not the rule. Instead, when a court considers contract disputes and whether the agreement was performed or breached, its primary role is to determine the intentions of the parties and enforce their agreement.

Oral contracts are famously difficult to enforce because of the problems in proving the terms that the parties agreed to. In any dispute, it is only natural for each person to remember the terms most favorable to his side. When the parties put the terms of their agreement in writing, they create an independent method for a third party (such as a court) to determine what they agreed to do. For example, in a 1977 Louisiana case, an elderly poultry grower claimed that ConAgra's field representative told him that because of his age, he would not have to insulate his broiler houses to have his contract renewed. The court held that no evidence supported this claim and that all the letters and documents the grower received showed the company had informed him of the need to insulate the houses if the contract was to be renewed [Cooper v. ConAgra, Inc., 340 So.2d 661 (La. Ct. App. 2nd, 1977)].

Courts also follow a rule that the whole contract is to have effect. A North Dakota court resolving a dispute over a sunflower production contract held, "A Contract must be construed as a whole, and every clause, sentence and provisions should be given effect if reasonably practicable" [Red River Commodities, Inc. v. Eidsness (George), 459 N.W.2d 811, 815 (N. D. 1990)]. That is why it is important for you to read and understand all the provisions in a contract.

This does not mean courts will not hear a case alleging an oral contract, but there are legal rules that make them more difficult to enforce. The doctrine known as the "statute of frauds" limits the courts' ability to hear oral testimony about unwritten contracts. State law may even require that certain types of contracts, most notably those involving real estate, be in writing to be enforced (see sidebar).

UNDERSTANDING THE STATUTE OF FRAUDS

The ability of a court (or even the parties involved) to determine whether a contract has been performed depends on the evidence of what they agreed to. A written, signed contract helps resolve doubt and provides the best evidence of the parties' intent-which is why you should always put your contracts in writing. It also provides written terms for the court to interpret or to consider against other contract principles.

To help minimize the need to consider conflicting oral testimony of to evaluate whether the parties' conduct can establish a contract, the statute of frauds was developed. Under this rule, courts can decide that no contract exists unless it is in writing. Under the Uniform Commercial Code (§2-201), the statute of frauds reads In part:

Except as otherwise provided in this section of a contract for the sale of goods for the price of \$500 or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or his authorized agent.

The statute of frauds forwards two important legal theories: 1)"integration," or the presumption that the written contract constitutes the entire agreement (this is sometimes known as the "four corners" of the contract); and 2) "ambiguities," which holds that if the parties intended a special meaning for a term, they would define it in the contract. (Thus, the burden of proof is on the party trying to show the special meaning.) For agreements between merchants, the Uniform Commercial Code provides an exception and allows people who engage in commerce to enter oral agreements and later confirm them in writing. This is what allows an elevator to call another elevator and sell a quantity of grain. The call will be followed with a written confirmation of the agreement. If the other party does not object in writing within 10 days, the contract is established as binding. Courts have recognized exceptions to the statute of frauds that allow parties to try to prove oral agreements, but a party has to establish the right to use an exception.

Still, there are times when parties make oral agreements-for instance, when the parties know and trust each other or when the matter is not considered very important. It is quite common for people to oral modifications to existing legal contracts, based on changing circumstances or subsequent negotiations. In such cases, it will be difficult for the court to determine what the parties agreed to. The most likely form of evidence will be the oral testimony (in law, "parole evidence")of the parties themselves. But oral testimony presents difficulties for the Courts, such as deciding which party's version is more likely to be true. The courts will accept other forms of evidence to help establish that an oral agreement was made, such as the parties' conduct. If both parties' actions indicate they believed a contract existed, the courts can hold that one did.

Another way to distinguish between types of contracts is by studying how the parties' obligations arose. There are express contracts, in which parties agree to certain written terms, and there are implied contracts, in which one party's conduct creates the agreement. Say, for example, that someone comes to your farm to buy a bull, you agree to sell the bull, and the buyer takes him away.

Even if the agreement is not in writing, the conduct of agreeing on the terms and then accepting and removing the property creates the obligation for the buyer to pay for the bull.

Production contracts are usually express written contracts, at least as far as the main elements of the agreement go. Still, claims of subsequent oral modifications or alleged reliance on the other party's conduct occasionally becomes an issue. In the North Dakota case mentioned earlier, the farmer admitted making an oral agreement to sell sunflowers, but he denied having signed a production contract to sell 350,000 lb. of them for 11 ¼¢ a pound or authorizing his son to do so. But the grower had planted the sunflowers and then contacted the company to reduce the contract acres because of a weed infestation problem. The court found that his action of contacting the company under the terms of the agreement ratified the fact that the contract existed [*Red River Commodities, Inc. v. Eidsness*, 459 N.W.2d 811, 814(N. D. 1990)].

Defining a Contract and Its Legal Elements

Based on the ideas discussed so far, a simple definition of a contract could be "an agreement between two or more parties consisting of a promise or a set of promises which the law will enforce or the performance of which the law in some way recognizes as a duty" [Looney and Uchtmann, *Agricultural Law: Principles and Cases* (2nd Ed.), McGraw-Hill, p. 29]. This definition is much simpler than the definition of a production contract set out in Chapter 1. Under common law, American courts recognize five elements as necessary for a valid contract to exist:

1. Legally competent parties
2. A proper or legal subject matter
3. An offer
4. An acceptance
5. Consideration

"Competent parties" and a "legal subject" ensure the integrity of the contracting. By requiring that the parties have the legal capacity to understand and enter the agreement—for example, by requiring that they not be minors or mentally incapacitated—the law ensures that contracts are not used to take advantage of people. By requiring that the subject of the contract be a lawful matter, the law ensures the courts are not used to require or condone illegal conduct. For example, a person who is hired to commit a crime cannot sue for lack of payment.

The next two elements ensure that the parties have agreed to perform some identifiable action. An "offer" is a statement that creates a reasonable expectation in the party receiving it that the party making it intends to enter the contract and assume the corresponding liability. If a company sends you a written contract saying it will pay you \$4 a bushel to grow corn under the terms of the contract, the company has made an offer. The offer provides certainty and definiteness about what the parties are agreeing to do. "Acceptance" occurs when the party takes whatever action is indicated in the offer as necessary to communicate willingness to be bound by the agreement. In most cases, acceptance occurs when both parties sign the written agreement. The acceptance must be timely, meaning it must be done while the offer is effective or before it is revoked or expires. Once an offer has been accepted, the contract is deemed to have been entered and is binding on the parties.

"Consideration" is a legal test requiring that the parties to the contract exchange something of value for the agreement to be enforceable. In a corn production contract, the consideration would be

agreeing to deliver the corn in exchange for the per-bushel price. Consideration takes many forms, it can be agreeing to pay money, to provide goods or labor or to engage in actions, such as caring for someone's livestock.

Once the five elements are satisfied, the contract has been formed. The next step is to follow through on the terms of the agreement, whether painting a fence, selling a bull or raising 40 acres of white corn. At this point, you have the legal right to expect to be paid if you satisfy the terms of the agreement. This is known as "performance." On the other hand, if you fail to perform the agreement in a timely fashion or if you deliver goods that do not meet the specifications, you have "breached" the agreement and may be in "default."

Breach of contract entitles the other party to ask the court for remedies, either by awarding monetary damages or by requiring the party to perform the terms of the contract, known as specific performance. Most written contracts list in detail the actions that must be performed and which events may constitute a breach of the agreement. To determine damages, courts will look at the language of the contract (to see if the measure of damages was set in advance) and at established legal rules for measuring damages in commercial agreements.

Breach of Contract and Damages

Parties to a contract enter an agreement to obtain some improvement in their own situation, and both parties have duties and obligations. For example, a producer who signs the DuPont contract to raise high-oil corn (see Chapter 5) must use his best efforts to raise the largest crop possible and deliver the entire crop to the contractor. On the other hand, the contractor must provide the seed for the crop, pay the grower for the services of raising the crop, and pay the per-bushel premium set out in the contract. If either party breaches the contract, the other party can either use the remedy provided in the contract or go to court and seek a legal remedy. If the breach occurs because the crop is not produced according to the contract, the company can treat the contract as void and not be responsible for making any payments to the grower. If the company refuses to pay the full amount for the services or the premium, the grower must bring legal action to recover these money damages.

Contracts can be breached in part, as when one clause is not followed, or in their entirety, as when the product delivered is not what was contracted for. Consider another North Dakota case, this one involving the sale of wheat to an elevator. The elevator contracted with a farmer to buy spring wheat that it would sell to other growers as seed. But when the other growers planted the wheat, they discovered they had received winter wheat, resulting in no crop being produced. The elevator paid the farmers over \$22,000 in damages and then sued the grower who had sold the wheat for breach of contract. The court ruled that before it could establish whether the farmer owed the elevator any consequential damages, the elevator must prove the farmer knew the wheat was for resale [*Dakota Grain Co. Inc. v. Ehrmantrout*, 502 N.W.2d 234 (N.D. 1993)].

As this case shows, the types of damages that the parties might experience from a breached contract vary with the relationship. For example, if a grower fails to deliver a crop, the contractor may have to reduce its production of the product that the commodity is used in, such as frozen vegetables. Or the company may have to obtain other supplies in the market. If the commodity is a specialized product, such as an identity preserved grain, it may be difficult to find other supplies. Even if supplies are available, they may be much more expensive than the price established in the original contract.

For example, drought cut a Kentucky grower's yields, and he could deliver only 18,700bu of the 35,000bu. of white corn he had contracted to sell at \$3.70 a bushel. The buyer had to purchase the rest at the market price, \$5.54, and withheld almost \$20,000 from the grower's payments for the next year's crop. In court, the grower argued that no damages were due because the drought made it impossible for him to meet the contract. But the court, which ruled for the buyer, held that the contract did not require that the white corn be from the grower's farm. The court also rejected the grower's argument that this understanding was part of an oral agreement between the parties [*Wickliffe Farms, Inc., v. Owensboro Grain Co.*, 39 VCC Rep. Se. 2d 195 (Ky., Ct. App. 1984)]. The case illustrates both the impact of failing to perform a contract and the danger of assuming that promises will be recognized in a later dispute.

An important observation about any alleged breach of a contract is why it occurred. The most common reason contracts are broken is a change in economic circumstances after the contract was formed. In other words, something happened to make the contract a bad deal for one side. As a rule of thumb, most alleged breaches of agricultural contracts occur because of changes in the price and market for the commodity. There have been dozens of cases of claims by grain companies against farmers who sold grain on a forward contract and then failed to deliver. In other cases, growers allege that companies tried to get out of agreements to buy crops because the price dropped (see sidebar).

KANSAS SUNFLOWER CONTRACT BREACHED DURING MARKET INCREASE

In *Tongish v. Thomas d/b/a Northwest Seed*, Tongish had a contract with a local cooperative to grow 160 acres (later modified to 116.8 acres) of sunflower seeds and sell the crop to the cooperative for \$13 a cwt. for large seeds and \$8 a cwt. for smaller seeds. The cooperative had a contract to deliver the seed to Bambino Bean & Seed, Inc., at the same prices as Tongish was to be paid. The cooperative was to receive only a 55¢-a-cwt. handling fee as its profit under the agreement. Once delivery began, a dispute arose because the cooperative was mixing Tongish's high-quality seed with other seed. At the time, the price for sunflower seeds was rising because of weather and other factors. Tongish notified the cooperative he would not deliver any more sunflowers. In May 1989, Tongish sold his remaining seed for \$20 a cwt. But when a dispute arose over who owned the seeds, the new buyer deposited the money with the court to determine who should receive it, and the cooperative sued seeking damages for breach of contract.

In the case mentioned in the sidebar, it is very likely that the rising price of sunflowers was at least a contributing factor in the conflict. Of course, it isn't just growers who are tempted to sell a crop somewhere else when the price changes. The same temptation is there for contractors, though usually in reverse. Consider the following situation.

In *Nuemiller Farms, Inc. v. Cornett* (368 So. 2d. 272), a 1979 Alabama case, a potato grower sued a buyer, alleging that the rejection of nine loads of potatoes based on a claim of dissatisfaction was not in good faith and breached the contract. On March 3, 1976, the parties signed a contract under which the grower was to sell 12 loads of chipping potatoes to the buyer during July and August for \$4.25 a cwt. The grower's crop produced over 20 loads of potatoes, and the buyer accepted three loads without objection. Then the price of potatoes dropped to \$2 a cwt. and the buyer refused further loads, saying

the potatoes would not chip satisfactorily. The grower had the crop tested by a state Extension expert, who reported the potatoes were suitable in all respects.

After the grower sent the buyer a letter demanding performance of the contract, the buyer agreed to try one more load. The seller then bought a load of potatoes from another grower, who was selling potatoes to the buyer at \$2 a cwt. and sent them to the buyer. The buyer claimed dissatisfaction with these potatoes at \$4.25 a cwt., even though they came from the same fields as potatoes he had accepted from the other grower. The seller then offered to buy nine loads from other growers to fulfill the contract, but the buyer refused and noted he could buy potatoes all day at \$2, and he would not accept any more of the grower's potatoes. The grower sued the buyer for breach of contract and damages and won (see sidebar).

WHY PARTIES MAY TRY TO BREAK A CONTRACT

When you think about the market-and weather-related events that can affect the attractiveness of a production contract, you can identify and predict which events may lead to an attempt to end a contract. Considering these events in advance allows you to take steps to minimize the likelihood of a breach of contract.

1. The price for the commodity has increased significantly, creating an opportunity for the grower to sell the goods in the open market for a higher return.
2. The cost of the corn, and the buyer believes there are supplies available in the open market.
3. It has been a good growing year, and the buyer has contracted for the production from more acres than are needed to satisfy demand.
4. The grower did not harvest the quantity specified in his contract.
5. A dispute has arisen over another term in the agreement, and one party does not want to continue to perform agreement.
6. The buyer has failed to pay for of the goods already delivered under the contract.

In any court case involving an alleged breach of contract, two main questions usually arise: Was there a justification for the alleged breach, and if the contract was breached, what damages were suffered? The answers depend on several matters. First, the court studies the language of the contract for a definite answer on the issue of breach. If the contract does not offer one or if it is ambiguous, the court will look to state law to see how similar contractual disputes have been resolved. Once a breach has been established, the court will either apply the contractual provisions concerning damages or apply the rules for measuring damages as established by state law.

Either way, all the states use an important body of law concerning contracts for the sale of goods: the Uniform Commercial Code (UCC) Article 2. First developed in the 1950s to provide greater uniformity and predictability in commercial transactions around the U.S., the UCC is extremely important when determining whether a contract has been breached and what damages should apply. It also provides important guidance on other aspects of contract law. Chapter 4 looks at a number of provisions of the UCC and considers how they may apply to agricultural production contracts.

But before turning to the next chapter, remember these 12 rules.

Hamilton's Twelve Basic Rules of Contracting

Each experience with an agricultural production contract will be unique, depending on the nature of the relationship between the parties, the terms of the contract and the bargaining position of the parties. Still, the discussion and examples set out above help identify a number of common principles to keep in mind. These include the following:

1. Remember the first rule of contracts-whoever wrote the contract took care of himself. There is no reason to assume the contract being offered is fair or that your interests are protected. Although you may trust the company you are dealing with, production contracts are arm's length business transactions and must be considered in this light. This rule is especially important because you will usually be offered written contracts on a take-it-or-leave-it basis and given no real opportunity to negotiate the terms.
2. Read and understand any contract before signing it. Contract terms play a fundamental role in determining the rights and duties of the parties. This book is full of examples of the impact of different contract terms. A good example in understanding the difference between a bushel contract, which commits you to delivering a fixed amount regardless of the crop actually raised, and an acreage contract, which promises delivery of whatever amount, is raised on a designated number of acres. If the terms of a contract are unclear, you need to ask questions until you understand it. In Chapter 9 you will find a list of 15 questions to ask yourself before you sign any contract. You should consider having your attorney review the contract, especially if it involves a sizable portion of your production or involves a long-term relationship or investment. Legal advice is an investment, not a cost, when it resolves confusion and helps you avoid unfavorable economic consequences.
3. Compliance with contract terms is required before the contract is performed. The price premiums you are expecting won't be paid unless the terms of the contract are satisfied. Failure to comply with the contract may subject you not just to lower returns but also to claims for damages, penalties for breach and other legal remedies. Producers who are unable to satisfy a contract requiring delivery of a fixed number of bushels might be surprised to learn they have to enter the market and buy higher-priced commodities to satisfy the contract.
4. Never assume that your failure to perform the contract will be excused. Under certain circumstances, you might think it reasonable to assume the other party will not require you to perform the agreement. Never make this assumption, especially if your failure to perform can be expected to cause the other party damages. If you do not think you will be able to perform or if you would like to amend the terms of the agreement, communicate with the other party rather than surprising them.
5. Know the other party's financial situation and performance history. This knowledge is essential to ensure that you will be paid for what you deliver. This is especially important when the contract calls for the passage of legal title upon delivery or when there is a delay in the payment. In these cases, you become the other party's creditor, and in most situations your claim is unsecured other than by the contractual promise to pay. Before signing a contract, ask

yourself what will happen if the buyer goes out of business or doesn't pay. (The issue of getting paid is the focus of Chapter 7.)

6. Weigh the advantages of the contract in terms of higher prices against any increased costs or risks. While a proposed production incentive, such as a \$2-a-bushel premium for growing a specialty crop, may appear attractive, you must also calculate the real costs and risks of the contract. Remember that the premium is in exchange for something. Perhaps the variety of grain being raised has a significant yield penalty.
7. Proposed contracts are always subject to negotiation. While most production contracts will be printed or typed forms offered on a take-it-or-leave-it basis, you do have the freedom to negotiate. A term that is in writing can still be changed if both parties agree to do so. Of course, your ability to obtain more favorable terms will depend on your market power to negotiate with the company and whether other growers are willing to sign the contract.
8. If there are any changes in the agreement, make sure they are in writing and separately signed by the company representative. The fact that you believe the contract was amended doesn't mean it was. Most contracts specifically provide that the only thing enforceable is what is in writing.
9. Do not rely on oral communications made by the company, either before the contract is Signed or during performance. If what is being said is important to the relationship, be sure it is put in writing, signed by both parties and incorporated as an amendment to the contract. If you cannot get it in writing, be sure to keep copies of any documents, such as letters, payment sheets and checks, that you can use to show what was agreed.
10. Keep good records of your performance. It is always a good idea to keep good records when legal issues are involved. This is especially true in the performance of production contracts. Keep a record of all communication and contact with the contractor, and keep a record of your actions in producing the commodity. If possible, you should keep samples of what was produced and the results of independent quality tests, such as on the germination of seeds or the quality of produce. These records may come in handy in a later dispute over your compliance with the contract terms.
11. Don't hesitate to ask questions when you don't understand what is happening. Remember, you are committing yourself to performing under the terms of the written agreement. If you do not fully understand what the language means or how the procedure will operate, ask questions. The questions should be directed to the company representative or to your own advisers.
12. Stay in touch with the other party to the contract. Communication is important in resolving uncertainty and in preventing misunderstandings. Communicating with the other side about your performance, questions or concerns lets you help build a smooth, productive relationship. When long periods pass without communication, it is possible for circumstances to change and put performance of the agreement in a much different light.

CHAPTER FOUR: THE UNIFORM COMMERCIAL CODE AND PRODUCTION CONTRACTS

When you sign a production contract, you face a variety of legal issues, ranging from time of payment to damages if the contract is breached. Most of these issues are addressed in Article Two of the Uniform Commercial Code (UCC), which applies to contracts for the sale of goods involving more than \$500. Notice that Article Two applies to a contract involving the sale of an item rather than services, such as caring for another party's livestock. Still, the UCC may apply even with service contracts if the contract makes the UCC part of the agreement or if state law applies UCC principles to other types of contracts.

The following questions are among the most common involving agricultural contracts:

1. Does the contract include an implied warranty that the input was "fit for a particular purpose" or was "merchantable"?
2. What happens if you inform the other party that you have no intention of performing an agreement? (This is known as repudiation and notice of anticipatory breach.)
3. If you accept a partial payment when a contract is in dispute, is this an "accord and satisfaction," meaning the matter is resolved?
4. Is the farmer a "merchant" for determining which warranties apply and when contracts must be confirmed in writing?
5. When can oral modifications of contracts be enforced?
6. What measure is used to determine damages when a contract is breached, and when do the parties have a duty to reduce or mitigate the damages?
7. When does the excuse of "commercial impracticability" apply to a contract? Is a crop failure such an occurrence?

Applying UCC Warranties

WHY WE HAVE THE UCC

Historically, contract law has been left to the states, presenting particular problems for interstate commerce. Consider the case of a farmer who sells winter wheat to a grain elevator in another state, which then sells it to a miller in a third state. If a dispute arises over the grain, which state's law should apply? The general rule (unless the parties have agreed otherwise) is the law of the state with the closest relation to the conduct involved—for example, the state where the grain was first sold.

Still, the legal difficulties that can arise with varying state laws are obvious. Early on, the courts recognized that special rules should apply for commercial transactions, especially when between merchants. This history of developing "uniform" and predictable rules for parties in different states led to the creation in the United States of the Uniform Commercial Code. Beginning in the 1950s, this massive undertaking involved the codification of standard legal rules applicable to a wide range of commercial dealings. Today, all 50 states have adopted the UCC, although Louisiana has a special version.

The UCC's different articles apply to various types of commercial arrangements. For example, Article Nine applies to Secured Transactions. If you have ever borrowed money from a bank and signed a security agreement and financing statement, you did so to bring the transaction within the protections of Article Nine.

Whenever you buy something, you expect it to work for the reason you bought it. If the product fails to do what you expect or if it even causes damages when used, you may have a claim for breach of

contract. The legal doctrine that covers these claims is warranty-or a promise the good is of the type and purpose intended.

There are two main types of warranty: a) expressed, as in an advertisement that promises a product will bring certain results, and b) implied, as in an unstated promise that a product will work for the use it is intended. The UCC also gives detailed rules about two types of implied warranties-for merchantability and for a particular purpose [§§2-314 and-315].

The warranty of merchant ability means that when the goods are sold by a merchant, there is a warranty that they "are fit for the ordinary purposes for which such goods are used"-unless the warranties are expressly disclaimed. The warranty of fitness for a particular purpose applies whenever "the seller ... has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods." Thus, there may be an implied warranty for the buyer in every sale that occurs under the UCC.

But sellers can limit warranties with disclaimers that limit the ability of unhappy buyers to claim damages from using the product. Most farmers have seen such disclaimers on the labels of pesticides and seed. For a disclaimer to be effective, however, it must be conspicuous and understandable. There have been many agricultural warranty cases, especially involving claims of damages from defective seeds. Most production contracts for crops include provisions such as this one in Article 7 of the DuPont contract, discussed more fully in Chapter 5:

"DISCLAIMER OF WARRANTY AND LIMITATION OF DAMAGES

DUPONT MAKES NO WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR ANY OTHER EXPRESS OR IMPLIED WARRANTY. NO CLAIM OF ANY KIND, WHETHER OR NOT BASED ON NEGLIGENCE, SHALL BE GREATER IN AMOUNT THAN THE VALUE OF COMMERCIAL SEED IN A QUANTITY COMPARABLE TO THAT QUANTITY OF SEED SUBJECT TO THIS BAILMENT. NEITHER PARTY SHALL BE LIABLE FOR SPECIAL, CONSEQUENTIAL, OR INDIRECT DAMAGES WHETHER OR NOT CAUSED BY OR RESULTING FROM THE NEGLIGENCE OF SUCH PARTY."

This is a classic example of a disclaimer of expressed and implied warranties. It also attempts to limit the damages a farmer can claim. If he can show that the seed was defective, the most he can recover is the cost of replacing the seed-not the damages that might have resulted from not producing a crop,

The company's position is that the farmer didn't buy a new crop under the contract; he just bought the seed to grow a crop, so the seed company should not be liable for these "consequential damages." Some courts have held that such broad exclusions of warranties are not effective, especially when the grower can show that the company was negligent in delivering the wrong seed. But many state courts have upheld disclaimers and damage limitations in defective seed cases (see sidebar). Most courts have rejected other legal theories, such as strict product liability, in the matter of seeds. [For a further discussion of this issue, see J.W. Looney, "Obstacles to recovery in defective seed cases," *Agricultural Law Update*, March 1993.]

**COURT CONSIDERS LIMITATION ON DAMAGES IN SUIT INVOLVING
DEFECTIVE WATERMELON SEEDS**

The case of *Martin Rispens & Son v. Hall Farms, Inc.* [621 N.E.2d 1078 (Ind. 1993)] is representative of the claims made in defective-seed cases. Hall Farms had purchased watermelon seeds from Rispens, a retailer, who had obtained it from Petoseed. Much of the seed was lost due to blotching caused by a defect in the seed. The grower sued both parties, claiming a breach of express warranties and breach of implied warranty of merchantability against Rispens. He claimed that the label on the can described the seed as "top-quality seeds with high vitality, vigor and germination." The retailer's purchase order referred to the seed as "properly fitted for seeding purposes." The defendants claimed that the label on the seed can and the retailer's purchase order both contained limitations on damages for defective seed to the price of the seed.

A lower court held that the farmer was limited to recovering the purchase price because it was an "established industry practice" for seed companies to limit their damages this way, even though the farmer did not know this. On appeal, the Indiana Supreme Court reversed the ruling and sent the case back for further proceedings on several issues, including whether the limitations were actually part of the agreement.

In *Tharalson v. Pzifer Genetics, Inc.* [728 F. 2d 1108 (8 CA 1984)], the court ruled that the attempted disclaimers did not match the express warranties that had been made, and the defective seed was the proximate cause of the farmer's lost crop. But the court upheld the limitation of damages to the cost of the seed.

Giving Notice that a Party Will Not Perform a Contract

An issue that can arise in contracts is the producer's "repudiation" of the contract, giving the company notice of the intention not to perform the contract. For example, the grower might refuse to deliver grains that were forward marketed. Such a case raises questions regarding appropriate damages and the buyer's responsibilities once he knows the grower will not perform the agreement.

A Nebraska Court of Appeals case, *Trinidad Bean and Elevator Co. v. Frosh* [494 N.W.2d 347 (Neb. 1992)], involved a dispute between a Colorado bean buyer that operated an elevator in Nebraska and a farmer. On April 12, 1988, Elmo Frosh contracted with the Trinidad Bean and Elevator Co. in Imperial to sell 1.875 cwt. of edible dry beans. The contract, a forward-pricing agreement rather than a production contract, included two payment options: Option 1 provided for payment of \$16.25 a cwt. on Jan. 15, 1989; Option 2 provided for 50% payment at \$16 a cwt. upon completion of harvest and 50% at \$16 a cwt. on Dec. 1, 1988. The first option would allow the grower to defer income for tax purposes, but both payment options were inadvertently marked on the contract with Frosh. When the contract was reviewed by the Denver office of Trinidad, the company contacted him to determine which payment option he desired so the contract could be processed.

Frosh returned to the elevator in early May 1988 and told them to tear up the contract. At that time, the contract price and market price for drybeans were the same. There was no communication between the parties until Frosh returned to the elevator on Aug. 31, 1988, to make sure the contract

had been torn up. Instead, he learned that the elevator expected delivery. By this time, a drought had pushed the price of beans to almost double their price in May. When Frosh failed to deliver the beans, the elevator sued for the damages it experienced in buying beans at the much higher price. The jury held that Frosh had violated the contract but was not responsible for any damages because the elevator knew in May that he would not perform.

What Frosh did is known as repudiation and "anticipatory breach," meaning he gave the other party notice well in advance of the time of performance that he would not perform under the contract. The issue then becomes the non breaching party's actions following this notice. The Appeals Court affirmed the jury verdict, noting that when the contract was repudiated, there was no difference between the contract and market price.

The court reached this conclusion because UCC §2-713(1) states that the measure of damages following anticipatory breach is the difference between the market price and contract price at the time the buyer learned of the breach. Thus, the elevator could not wait until drought had driven prices higher in August to try to collect from Frosh.

If there is a lesson in this case, it is that a party ending a contract to deliver commodities should make a record of the action and confirm that the other party knows of the decision. For the other party, the lesson is that you must take whatever actions are reasonable at the time to protect your financial interests; do not expect the court to later require the party who breached the agreement to make you whole by paying damages.

When a Contract Is in Dispute, Do Not Accept Partial Payment

Another typical issue concerns a party who cashes a check for part of the amount in dispute under a contract. The legal doctrine known as "accord and satisfaction" may apply to rule that acceptance of the money means the dispute has been settled.

A recent Wisconsin case involving contract production of sweet corn illustrates this doctrine. In *Myron Soik & Sons v. Stokely USA, Inc.* [498 N.W.2d 897 (Wis. App. 1993)], sweet-corn growers brought a class-action suit against Stokely over interpretation of their production contracts. The dispute concerned the amount the farmers received for "passed acres"-crop acres fit for harvest but not taken by Stokely. The contract specified that the growers would be paid for passed acres from a fund created with contributions from growers and the company, based on the total tons of harvested crop. The contract also provided that if the fund could not provide full compensation for unharvested acres, the payments would be prorated. Following harvest, the company notified growers that the fund was insufficient for full compensation and payments would be prorated on a calculation not yet determined. Soon after, a second letter and checks prorating payments at 53.49% were sent to growers.

At this point, the growers sued Stokely, claiming the payments were inadequate; but some of the plaintiffs cashed their checks. Stokely argued that the checks had been calculated under terms of the contract, so that when the growers accepted them, there was an accord and satisfaction of the contract. Stokely argued that the growers who had accepted the checks should be disqualified as plaintiffs in the suit, and the Court of Appeals later agreed.

The Appeals Court concluded there was a dispute at the time the checks were cashed and the letters and correspondence gave growers notice that the checks were meant as full payment for passed

acres. The state of Wisconsin subsequently enacted administrative rules that limit a company's ability to use passed acres clauses (see Chapter 11 for a discussion of these rules.)

When Is the Farmer a Merchant?

What does it matter if you are considered a "merchant" under the UCC? A lot. When a party is considered a merchant under the UCC, a warranty of merchantability applies to the sale of goods. A party who is a merchant might not require a written agreement to be bound to a contract. And most significant of all, a merchant is held to a higher standard of knowledge about commercial law. Some contracts address the issue directly-the DuPont production contract in Chapter 5 includes in its first paragraph language that indicates the farmer is a merchant. But courts around the U.S. are very much divided on whether a farmer is a merchant when selling crops, as the following cases illustrate.

In *Colorado-Kansas Grain Co. v. Reifschneider* [817 P.2d 637 (Colo. App. 1991)], the question was whether the statute of frauds applied so that the oral agreement between the farmer and the company for the sale of grain did not create a contract. The court held that the farmer was a merchant, and thus the written confirmation from the company was enough to establish the contract.

As a merchant, the farmer had 10 days to object to the written notice of confirmation. When he didn't object, the contract became effective. In considering the farmer a merchant, the court cited UCC §2-104(1), which defines the term as:

“a person who deals in goods of the kind or otherwise by the person's occupation holds that person out as having knowledge or skill peculiar to the practices or goods involved in the transaction.”

The court said that if a transaction occurs between merchants, "both parties are chargeable with knowledge or skill of merchants under UCC §2-204(3)." The Colorado court cited cases holding that farmers may be merchants, and wrote, "Today's farmer is involved in far more than simply planting and harvesting crops. Indeed, many farmers possess an extensive knowledge and sophistication regarding the purchase and sale of crops on the various agricultural markets. Often, they are more aptly described as agribusinessmen."

In deciding whether a farmer is a merchant, the court in *Reifschneider* looked at a number of relevant factors, including:

- The length of time the farmer had engaged in selling his product to marketers;
- The degree of his business acumen in dealing with other parties;
- His awareness of the operation and existence of farm markets; and
- His experience with or knowledge of the customs and practices that are unique to the particular marketing of the product he sells.

Courts in Indiana, Michigan, Missouri, Nebraska, Ohio, Illinois and Texas have all determined that farmers may be merchants. But courts in Alabama, Arkansas, Iowa, Kansas, South Dakota and Utah have ruled that farmers do not become merchants simply by selling the commodities they produce. The Iowa Supreme Court ruled that a farmer was not a merchant in *Sand Seed Service, Inc., v. Poeckes* (249 N.W. 2d 663 (Iowa 1975)). In making its decision, the court looked at the farmer's experience-for example, he did not deal in crops on the market but just sold what he raised, he had no business experience, and he had only a high school education.

The Iowa Supreme Court set out a three-part test for deciding when a farmer might be a merchant:

1. The farmer must be a dealer in the goods of the kind involved, or
2. The farmer must hold himself as having knowledge or skill peculiar to the practices or goods involved in the transaction, or
3. He must employ an agent, broker or other intermediary who by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction.

But a few years later, the Iowa court ruled that a farmer might be a merchant, depending on the transaction. In *Dotts v. Bennett* [382 N.W. 2d 85 (Iowa 1986)], the owner of cattle claimed damages when some of the animals died from eating hay purchased from the producer. The case involved two issues concerning UCC warranties applied to the quality of the hay.

First, was the buyer relying on the seller's skill when he purchased the hay, which was later determined to contain mycotoxins that killed several cattle? If so, this might establish the breach of an implied warranty of fitness for a particular purpose. Second, was the seller a merchant for purposes of an implied warranty of merchantability? On the first issue, the court found no evidence of the required reliance on the seller's knowledge and ruled it had been an error to consider the matter. On the implied warranty of merchantability, the court held there was substantial evidence to support the jury finding that the defendant was a merchant of hay for the buyer. The court held that the instructions given the jury on the merchant issue were insufficient, and it sent the matter back to district court.

Making Oral Modifications to a Contract

The question of how to deal with oral "changes" in contracts involves several issues already addressed. What is the effect of "integration clauses"- the provision in the contract that requires changes must be in writing to be effective? And what about the application of the statute of frauds? The law clearly prefers written agreements and will allow parties to enforce integration clauses. Still, there may be ways for a party to claim that a contract has been modified by subsequent oral statements or other actions.

Section 2-202 of the UCC provides for three such theories: "course of dealings," "course of performance" and "usage of the trade." Under these theories, a party can argue that the contract was modified either by a course of conduct between the parties, or because the parties had acted in the same way in a previous agreement, or because such actions are the way things are done in that trade or business. The party trying to establish such claims as the basis for modifying the written terms of the agreement will have the burden of proof (see sidebar).

DISPUTE OVER PAYMENT FOR SMALLER SUNFLOWER SEEDS LEADS TO LAWSUIT

A recent Illinois case involved oral modifications to a grain production contract. In *Neibert v. Schwenn Agri-Production Corp.* [579 N.E. 2d 389 (Ill. App. Ct. 1991)], the Neiberts, Illinois farmers, contracted with Schwenn in 1986 to grow sunflowers on 612 acres. The corporation agreed to supply seed, pesticide and herbicide and pick up the seed from the farmer's storage. In exchange, the Neiberts would raise and harvest the crop and receive 12¢ a pound for seeds larger than 17/54 inch, but no payment for smaller seed.

After four loads of the harvested seed had been picked up, the Neiberts received their first payment and were surprised they were not paid for more of the seed. The company claimed that much of the seed was too small and was being priced at the lower rate. Negotiations between the parties involved the Neiberts' flying to North Dakota for discussions about possible price reforms in the contract. The Neiberts left the negotiations believing the agreement had been modified so they would be paid 10 cents a pound for small seed. Schwenn claimed he agreed only to pay for small seed that had been delivered so far and for the first load following the negotiation meeting.

In October 1986, Schwenn sent a letter to the Neiberts informing them that further deliveries would be paid for under the original contract price with no amendment. Schwenn claimed the Neiberts then said they would not deliver any more seed as of Oct. 26. The Neiberts requested guarantees of payment in November, but Schwenn covered the contracts by purchasing sunflower seeds from other producers.

The Neiberts brought suit in March 1987 against Schwenn for breach of contract; Schwenn countersued, also alleging breach of contract. The trial court found that the Neiberts breached the contract and that the contracts were not modified following the meetings in September. The Neiberts appealed, but the appellate court upheld the lower court's decision that the Neiberts were the ones who breached the contract. The appellate court agreed that any modification needed to be in writing.

The suit also involved the question of the appropriate measure of damages for the Neiberts' breach. Schwenn argued that it had intended to use the seed from the Neiberts to satisfy a sales contract to Dahlgren for one million pounds at 17¢ per pound; When the Neiberts refused to deliver more seed, Schwenn filled the contract with seed raised under contract with other growers. The trial court adopted Schwenn's method for determining damages. This calculation set damages at 17¢ per undelivered pound of seed.

In assessing damages, the appellate court reversed the lower court's findings and looked to the UCC for guidance. The court found that the proper measure of damages was the difference between the cost of covering the breach and the 12¢ per pound to be paid under the Neiberts' contract. The court ruled that Schwenn would have to show what was paid for the seed used to cover the Dahlgren contracts before the damages could be assessed.

The trial court had also included trucking costs and damages from disputes concerning how much seed and chemicals were used. The appellate court disallowed the trucking costs and found that the Neiberts had correctly applied the chemicals and did not owe damages for this. The court also ruled that the Neiberts owed Schwenn for 10 bags of seed that were not used to plant or replant the 612 acres under the contract.

Measure of Damages for Breach

The issue of what measure of damages applies in a breach of contract is not simple, as noted by the court in *Frosh*. The UCC gives buyers and sellers several options for the damages they can seek against a nonperforming party.

When the seller breaches the contract, the buyer has several options. He may cancel the contract and recover as much of the price as has been paid. In addition, he can either "cover" under §2-712 and seek damages for having to acquire substitute goods in the market, or he can recover damages for nondelivery as provided in §2-713.

In addition, when the seller fails to deliver or rejects the contract, the buyer may choose to either 1) recover the goods if they have been identified; or 2) in a case involving unique goods, seek specific performance under §2-716, where by the court will order the seller to deliver the actual goods in question.

The buyer may, after notifying the seller, deduct all or any part of the damages resulting from any breach of the contract from any amount still due under the same contract. This is the idea of set off or withholding. Finally, there are two other important contract provisions relating to damages: the ideas of either liquidated damages or a limitation on damages. A limitation on damages was discussed above in connection with defective seed cases. The idea of liquidated damages is that because it may be difficult to determine the actual damages when a contract is breached, the parties in the contract can agree to a fixed amount of damages. The UCC requires liquidated damages to be "an amount which is reasonable in light of the anticipated or actual harm caused by the breach."

If it is the buyer who breaches the contract, the seller has several options. Under §2-706, he can resell the goods and recover the difference between the contract price and the sales price, plus any incidental damages. Under §2-709, he can also sue the buyer for the full price of goods delivered and not paid for or for goods wrongly rejected. Producers who are having trouble getting paid should contact their attorney to consider the options for recovering the contract price.

As you can see, the buyer has several options when seeking to recover damages. If he decides to "cover" under §2-712, he must in good faith and without unreasonable delay make a reasonable purchase of substitute goods. The buyer can then recover as damages "the difference between the cost of cover and the contract price together with any incidental or consequential damages," as allowed in §2-715, less any expenses saved by the seller's breach. The fact that a buyer fails to enter the market and "cover" does not prevent him from seeking other remedies.

The buyer may also decide to seek damages under §2-713, known as "market damages." Here, "the measure of damages for nondelivery or repudiation by the seller is the difference between the market price at the time the buyer learned of the breach and the contract price, together with any incidental or consequential damages" provided in §2-715, but "less expenses saved in consequence of the seller's breach."

Under either damage provision, the timing of the breach and the changes in the market price can significantly affect the damages experienced. Contracts are often breached when market conditions change, making performance a bad deal. Typically when the grower breaches the contract, the price is now higher than what was agreed to, and when the buyer breaches, it is lower.

When contract pricing provisions allow for the final price to fluctuate with the market, they give producers opportunities to make the pricing decision and thus reduce the incentive not to perform the

contract for price reasons. Fixed-price contracts, on the other hand, lock the parties into a price determined well in advance and may result in the temptation to breach the agreement and seek higher prices elsewhere. This is always risky conduct.

A recent Kansas case illustrates how the damage provisions apply. Remember *Tongish v. Thomas d/b/a Northwest Seed* [840 P.2d 471 (Kan. 1992)], the dispute over the Kansas sunflower production contract discussed in Chapter 3, the court had to settle a claim for damages by the elevator that did not receive the seed it had expected under the contract. Tongish had contracted to sell the crop to the cooperative for \$13 a cwt. for large seeds and \$8 a cwt. for smaller seeds. After the disagreement arose over payments, Tongish sold his remaining seed for \$20 a cwt. But when a dispute arose over who owned the sunflowers, the new buyer deposited the money with the court to determine who should receive it. The cooperative sued, seeking damages for Tongish's breach of contract.

The district court had to decide whether the damages should be determined by the actual losses-only 55¢ a bushel-or by the difference between market and contract prices. The court found that Tongish had breached the contract, but it awarded the cooperative only \$455.51, the amount the co-op had lost in handling fees for the crop. The Court of Appeals disagreed. It ordered that damages should be the difference between the market price and the contract price as set out in UCC §2-713. The Kansas Supreme Court affirmed the Court of Appeals, ruling that the contract between Tongish and the cooperative obligated the cooperative to take the seeds whether or not it had a market for them. The court held that the majority rule allows for market damages and this rule "encourages a more efficient market and discourages the breach of contracts."

Excuse in Performance and Commercial Impracticability

In any contract there is the possibility that some intervening cause will prevent one party from performing the agreement. Causes can be a government act, such as a grain embargo, a strike by truck drivers, or a natural event, such as flood or drought. And, of course, weather, insects, or disease can play an important factor in determining how much production occurs.

When a crop has already been sold under contract, crop failure raises many important questions. What happens if a flood destroys all the growing crops being raised under contract? If the contract specifies that the crops be raised on those fields, does the flood make the contract impossible to perform? Or must the farmer enter the market and buy the commodity, probably at a higher price, to satisfy the contract?

Many contracts list the types of intervening events or causes that will render the contract void. These clauses are commonly known as Act of God or *force majeure* clauses. Consider the following *force majeure* clause from Frito-Lay's contract to purchase white corn in Illinois in 1994:

In the event of fires, strikes, wars, Acts of God, or events beyond the reasonable control of Producer or Frito-Lay ("Force Majeure") which prevent Producer or Frito-Lay from performance in full or in part of the terms of this Agreement, it is agreed that the failure to perform shall be excused to the extent such Force Majeure has interfered with such performance.

Many producers consider such provisions valuable marketing devices because they can lock in a high price for 100% of their production but be protected if the weather results in a short crop. This type

of flexibility is not possible under normal forward contracting, when the producer commits to deliver a quantity of grain without any protection if weather reduces the harvest.

Whether or not your contract includes such a clause, the UCC incorporates a similar standard into all contracts for sale of goods. Section 2615 includes what is known as the excuse of "commercial impracticability," which provides that:

"nondelivery in whole or in part by a seller ... is not a breach ... under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the nonoccurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid."

But to rely on this section, you must agree to deliver as much of the commodity produced as you can, and you must agree to notify the buyer in a timely fashion about the delay or nondelivery. This provision has a direct relation to weather and the performance of production contracts. Official Comment 9 provides an important further explanation of the law as related to crop production:

"The case of a farmer who has contracted to sell crops to be grown on designated land may be regarded as falling either within the section on casualty to identified goods or this section, and he may be excused, when there is a failure of the specific crop, either on the basis of the destruction of identified goods or because of the failure of a basic assumption of the contract."

Under this comment, the most important question for applying the UCC excuse for performance in production contracts is: Did the contract require the crops to be produced on specific land? In the Kentucky white corn case discussed in Chapter 3, the court said the contract did not specify the acres on which the crop was to be raised and the producer did not have a defense. Many other grain contracts, such as DuPont's contract for high-oil com (set out in Chapter 5), specifically require listing of the fields on which the crop will be raised. This means that if no crop is produced, the grower should be able to claim the UCC §2-615 excuse from performing the contract.

A recent North Dakota case involving a sunflower contract illustrates how the excuse for a crop failure works (see sidebar).

COURT RULES DROUGHT LIMITED AMOUNT OF CROP FARMERS HAD TO DELIVER UNDER CONTRACT

This case, *Red River Commodities, Inc. v. Eidsness (Kelby)* {459 N.W. 2d 805 (1990)}, involves a case that differs from the one discussed before. Kelby contracted to sell 250,000 of sunflower at 11¢ a pound and agreed to plant at least 250 acres in order to do so. But because of drought, he could only deliver 75,084 lb. When the company sued him for the rest, he argued there was an Act of God clause in the contract excusing nonperformance for crop failure. The company admitted there was such a clause, but said the contract required the grower to provide the company with notice by certified mail.

Rather than send a letter, Kelby had told the company's field representative of the pending short crop. The trial court held that the field representative was not an "agent" of the company the notice was ineffective. The Dakota Supreme Court ruled there was substantial evidence that the field representative was an agent of the company and that the company had actual notice of the drought condition. The court sent the matter back to the lower court for further proceedings on the evidence that Kelby had satisfied the contract notice requirement.

Other Excuses for Nonperformance: Unconscionability and Good Faith

There are other excuses that might justify a party's decision not to perform a contract, and other situations when a court will not enforce a contract if the facts justify it. In some cases, intervening events might lead a court to hold that a contract does not need to be performed. In some situations, the terms of the contract or the parties' conduct will lead the courts to determine that a contract is not enforceable or that it has been breached. The two most common reasons are unconscionability and lack of good faith.

Unconscionability is the theory that allows the courts to refuse to enforce unfair or oppressive contracts, even in the absence of fraud or illegality. Unconscionability is a question of law for the court to decide. The term often appears in articles about contracts alleged to be very one sided, and it has been used as a legal claim to attack the fairness of many broiler production agreements (see Chapter 10).

The term is defined in the UCC §2-302, which reads: "If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable event."The official comments to the UCC note that the basic test is "whether in light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract.... The principle is one of the prevention of oppression and unfair surprise ... and not of disturbance of the allocation of risks because of superior bargaining power." To help avoid unfair surprise, the law requires the language of contracts to be clear and precise.

But unconscionability is subject to a number of factors. Court decisions have established the following rules concerning application of the doctrine:

1. Mere unequal bargaining power between contracting parties does not render the contract unenforceable.
2. Even if no "negotiation" occurs between the parties regarding the terms of the contract, that does not render the contract oppressive or unfair.
3. A person has a duty to read the contract before signing it. Failure to do so is no excuse for ignorance of its content.
4. In a commercial setting between experienced parties, courts are less likely to intervene than in a consumer sale. This illustrates how the status of the parties can affect which commercial rules apply, and is one situation in which the issue of whether farmers are considered merchants can be important.

The point of these tests is that you cannot sign a contract without thinking about it (and reading it) and expect the courts to bail you out when the contract is a bad deal. In some instances, such as fraud or a mistake, the court may intervene, but you have the burden of proof to establish that you are entitled to such protection. As a rule, it takes more than just a bad deal to get a court to interfere in your freedom to contract, including your freedom to enter bad contracts.

Good faith is related to unconscionability, but focuses on the performance and enforcement of the contract rather than its formation. In the UCC, it comes up in several ways:

- §1-203 provides that "every contract or duty within this act imposes an obligation of good faith in its performance or enforcement."
- §1-209(19) defines good faith as "honesty in fact in the conduct or transaction concerned."
- §2-103(l)(b) provides that in the case of a merchant, good faith means "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."

Good faith has become an important issue in agricultural production contracts because several states have enacted laws specifying that a duty of good faith applies in production contracts (see Chapter 12). Questions about conduct that violates the good-faith standard have been the subject of many cases. Two agricultural contracting cases illustrate how the standard of good faith is interpreted by the courts (see sidebar).

WHAT CONDUCT VIOLATES A DUTY OF GOOD FAITH?

In *Baker v. Ratzlaff* (564 P. 2d 153), a 1977 Kansas case, a buyer of popcorn brought an action against a grower for breach of contract. In 1973 the producer agreed to raise 380 acres of popcorn using seed provided by the buyer and sell it to the buyer for \$4.75 a cwt., delivered to a plant in Stratford, Tex. The contract provided that the buyer would pay for the popcorn when delivered. If the buyer failed or refused to pay for the popcorn at the time of delivery, the grower had the option of treating the remaining undelivered popcorn as released for sale.

The grower began delivery in early February, delivering a truckload on Saturday Feb. 2 and another on Monday Feb. 4. He received weight tickets but was not paid and did not ask to be paid. The buyer called the grower the next week to ask about future deliveries and was told that an equipment breakdown had slowed their action. Neither party mentioned payment during the discussion. But on Feb. 11, the grower sent the buyer a written notice of termination, treating the contract as breached because of the buyer's failure to pay on delivery. The grower then sold the remaining 1,600,000 lb. for \$8 a cwt.

The buyer sued the seller, claiming that the seller's decision to treat the contract as breached without ever asking for payment or giving any notice was a violation of the good-faith requirements of §1-203. The buyer explained that checks came from the office in Garden City, Kan., not the Texas plant, and that the grower drove through Garden City after delivering the grain. If the grower had wanted payment, he could have stopped in and asked for a check, because the buyer was willing and able to pay for the popcorn. The Implication was that the grower wanted a way out of the of the contract to sell the popcorn at the higher February price.

The district court ruled there was a violation of good faith and awarded the buyer \$52,000 in damages (\$3.25 a cwt. times 1,600,000 lb.- the difference between the buyer's costs in buying popcorn at \$8 to replace what the grower didn't deliver at \$4.75). The Kansas Supreme Court affirmed the ruling, pointing to the grower's failure to demand payment-either on delivery or during subsequent phone calls-and his hasty resale at a price nearly double.

Now consider a case where the action in question was the buyer's - *Nuemiller Farms, Inc. v. Cornett*, mentioned in Chapter 3. In this 1979 Alabama case, a potato grower sued a buyer, alleging that the rejection of nine loads of potatoes based on quality objections was not in good faith and breached the contract.

The parties had signed a contract under which the grower was to sell 12 loads of chipping potatoes to the buyer during July and August for \$4.25 a cwt. By the time of delivery, the Price for potatoes had dropped to \$2 a cwt. The buyer refused further loads, saying the potatoes would not "chip" satisfactorily. The grower had the crop test by a state extension expert, who reported that the potatoes were suitable in all respects.

The jury hearing the case ruled that the buyer had breached the contract and awarded the grower \$17,500 in damages. On appeal, the Alabama Supreme Court ruled that the buyer had violated the good-faith requirement. The court said, "The law requires such a claim of dissatisfaction to be made in good faith, rather than in an effort to escape a bad bargain." The court also noted that because the buyer was a merchant, he was held to reasonable commercial standards. Here the evidence that the potatoes did "chip" satisfactorily weighed against the buyer's claim of rejection.

Commonly Asked Questions About Contracts and UCC Article Two

Q. Can you still be determined to have entered a contract when some of the blanks in the form aren't filled in?

A. Yes. Section 2-204 (3) of the UCC provides that "even though one or more terms are left open, a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy." Section 2-204(1) provides that "a contract for the sale of goods may be made in any manner sufficient to show agreement, including conduct of both parties which recognizes the existence of such a contract." A North Dakota sunflower producer denied having signed a contract to raise and sell 350,000 lb. of sunflowers on 350 acres. But the court held that when the producer notified the company to reduce his acreage because of a weed infestation, he admitted the existence of the contract.

Q. My contract has some specific terms for how it is to be performed, but for several years the company representative and I have used our own procedure. Can the company now force me to follow the written contract?

A. The answer may depend on what aspect of performance is involved. For example, if it was a matter of obtaining permission before treating swine, the course of dealing may control. If the issue is a major matter, such as renewing a one-year contract for another term, the contract probably provides that only the written terms are binding and that no oral agreements or waivers will be effective. But Section 2-208 (1) of the UCC provides for the contract to be altered by what is known as a course of performance. The section reads: "Where the contract for sale involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determining the meaning of the agreement." While your normal practices may not in themselves alter the written agreement, the court can take evidence of the other party's failure to object. The UCC requires that the court try to read the written terms and the course of performance as consistent with each other. Where that is not possible, written guidelines prevail.

Q. My contract includes provisions that I think are unfair and that I didn't have any choice about signing. Does that make it unenforceable?

A. Probably not. Just because you think the contract is unfair doesn't mean a court won't enforce it. The UCC and contract law do provide for claims of unconscionability, but you will have to prove the

contract is so unfair or one-sided that you fit one of the exceptions. The mere difference in the bargaining strength of the parties or the fact that the contract is now a bad deal does not make a contract unconscionable. As for the claim that you didn't have any choice but to sign the agreement, the court might ask why you didn't refuse to enter the agreement.

Q. I didn't read all of the contract before I signed it. Do I have a claim it is not binding?

A. Sorry, Charlie. The law assumes that the parties to a contract have read and understood the agreement before signing it. You will have to come up with a better excuse than this for a court to let you out of the agreement.

Q. My production contract calls for me to make deliveries of grain spread over several months. The buyer is to pay for each shipment on delivery. When I tried to cash the check I received for the last shipment, it bounced. What should I do?

A. The UCC provides helpful rules for sellers who find themselves in this situation. Under §2-609, a party who has reasonable grounds to believe the contract will not be performed may 1) demand assurance of performance in writing, and 2) suspend his side of the bargain until he receives such assurances. Rather than failing to deliver goods and being accused of breaching the contract, you can suspend your delivery and place the burden on the buyer to prove he can perform. You should contact your attorney to see what to put in the letter you send demanding "adequate assurances" (see Chapter 7).

Q. Several years ago I was involved in a production contract that went sour. I didn't get paid over \$10,000 for crops I delivered. But rather than sue, I chalked it up as a lesson in the School of Hard Knocks. Is it too late for me to bring an action now to recover the money?

A. The answer depends on two things: your state's applicable statute of limitations on bringing contract actions and whether the buyer now has any money to pay you. UCC §2-725 provides, "An action for breach of any contract for sale must be commenced within four years after the cause of action has accrued. By the original agreement the parties may reduce the period of limitation to not less than one year but may not extend it."

Some states have enacted different statute of limitations for contract actions. Louisiana allows only one year to bring suit if it is "for damages for the value of the whole or a portion of a crop contracted to be sold, resulting from nondelivery or nonacceptance of the crops, reckoning from the day by which the crops were to have been delivered or accepted, or from the last day of the period, if the crops were to have been delivered or accepted over a period." [See La. R.S. 9:5601(2), as discussed in *Cargill Incorporated v. Suttles*, 606 So.2d 69 (La. App. 3 Cir. 1992).] Generally, it is better to bring a breach-of-contract action soon after the problem has developed. Matters will be fresher in the parties' minds and items that you might need for evidence are more likely to still exist.

CHAPTER FIVE: WALKING THROUGH A PRODUCTION CONTRACT

It's time to look at an actual contract, studying the rights and responsibilities of both parties. Remember, a basic legal rule is that every provision in a contract is considered to have some purpose. Even what may seem like legal mumbo jumbo at first glance will have a reason for being included.

No individual agreement can offer examples of every legal issue that producers will face when signing a contract. But DuPont's 1993 contract for production of Topcross™ high-oil corn is representative of what you may see in the future. The contract is an important one for several reasons. First, it is a classic example of an identity-preserved production relationship in which a specially designed crop is grown for a targeted end use—in this case animal feed (see sidebar). Second, the contract involves a well-respected company and reflects the company's recent decision to become more directly involved in crop production. Third, the contract is extremely comprehensive, presenting most of the legal issues considered in this book. In addition, the contract is one that I can use without fear of exposing anyone's confidential business, since it was used to raise corn on the back forty of my parents' Iowa farm.

DUPONT BEGINS CORN PRODUCTION PROGRAM IN IOWA

In 1993, DuPont Co. announced it was expanding into identity-preserved grain production. The chemical giant constructed a 35,000-square-foot office/laboratory in Des Moines Iowa, and opened a new division DuPont Quality Grains—to contract with producers to raise value-added grains. The company is collaborating with major seed companies to develop corn and soybeans with characteristics. In 1993, the company expected to contract with growers for 25,000 to 30,000 acres of grain. The most important crop being produced so far is high-oil corn, much of which is being marketed directly to poultry producers in Mexico. [See Karol Wrage, "DuPont enters the seed and grain industry," *Seed and Crops Industry*, December 1992; Veronica Fowler, "DuPont lab set for Iowa," *Des Moines Register*, June 4, 1993; and Dale Johnson, "DuPont to start value-added grain market in Iowa," Iowa Farm Bureau Spokesman, June 12, 1993.]

After each section or article of the contract, you will find a discussion of the legal purposes, as well as any important legal questions that are raised. Many of these provisions and questions will also be addressed in the next three chapters. Before you read the comments after each provision, ask yourself what the purpose is, to test your understanding of contract law. As you read the comments explaining the contract, keep in mind how these issues relate to the legal rules discussed in previous chapters.

The Contract

Purpose and parties clause

*DUPONT OPTIUM™ QUALITY GRAINS
AGREEMENT TO GROW TOPCROSS CORN*

This Agreement, made this _____ day of _____, 199_, between _____ whose mailing address (es) (is/are) listed below, (hereinafter "GROWER") and the OPTIMUM™ Quality Grain Group in E. I. DuPont de Nemours and Company (hereinafter "DU PONT"). GROWER and DU PONT are experienced and knowledgeable in the cultivation and business transactions involving corn.

This provision identifies the purpose of the contract and the parties to the agreement. Notice that the language does not include any reference to a sale. Instead, the contract is "an agreement to grow" corn, or a service agreement. The differences between a contract for the sale of a good and one for the hiring of services can be extremely significant in resolving many legal issues. If the contract does not involve a sale, for instance, the question arises whether the farmer ever has any property interest in the crop. A later provision in this contract clearly answers this question: No, he does not.

This clause also specifies the parties to the contract. While the agreement refers to Optimum Quality Grain (OQG), the provision notes that OQG is a division within DuPont. For legal purposes, this means DuPont is not using OQG as a legally independent subsidiary, which could shield DuPont from claims under the agreement.

Also note the last sentence, stating that each of the parties is "experienced and knowledgeable in the cultivation and business transactions involving corn." In this contract, the parties are recognizing each other as merchants. (The importance of deciding whether a farmer is a merchant is discussed in Chapter 4.) In other words, the parties are not relying on the other's advice, but have made their own independent decisions. As a result, they will most likely be held to a higher level of knowledge about commercial law.

Another issue with any production contract is its duration. This contract does not include a provision stating when it will end or how it will be terminated. But the contract specifically deals with an agreement to produce one crop of corn; a court would hold that the contract is implicitly for only one year.

Agreement and consideration clause

In consideration of the mutual promises herein exchanged between DU PONT and GROWER, they agree as follows:

The agreement and consideration clause indicates that the parties have agreed to the terms of the contract. The clause includes the term "consideration," discussed in Chapter 3. In this case, the consideration is that each party agrees to perform the promises contained in the contract.

Right to crop and intellectual-property protection

1. BAILMENT

This is a Bailment contract. The parties agree that the seed, growing crops, pollen, tissues or molecular components, and the harvested crop (hereinafter collectively referred to as TOPCROSS) are owned solely by DU PONT.

- a. GROWER hereby agrees to not give, transfer, or sell TOPCROSS material to any third party without written authorization by DU PONT.*
- b. GROWER agrees to use reasonable efforts to prevent access by third parties to TOPCROSS material.*
- c. GROWER shall return to DUPONT any seed not planted.*
- d. GROWER agrees not to grant or cause to be placed any lien or claim against TOPCROSS material.*

These clauses help establish the type of legal relation between the parties, especially regarding the grower's rights in the crop. The contract specifies that the agreement is a bailment—an agreement in which one party contracts to care for the property of another, but does not obtain any ownership rights in the property even though in his possession.

The most common bailments in agriculture occur when commodities are stored in a warehouse but have not been sold to it. The warehouse may have a claim for the value of the storage, but it does not own the goods or have legal title to them, so a creditor of the elevator could not claim the grain if the elevator went bankrupt.

The reasons for using a bailment are clear from the first clause, stating that the farmer never has any ownership interest in the seed, crops or plant materials raised under the agreement. By preventing anyone else from legally obtaining the identity-preserved seeds from the grower, the bailment works as another form of intellectual-property protection, similar to a patent or variety-protection certificate. Notice that Paragraph (b) also requires the grower to take steps to protect the company's seed from access by others.

Perhaps even more important, this part of the contract specifies that the farmer never has any rights in the crop, so he cannot legally sell it to a third party. Nor can he use the crop for collateral to secure a debt with another party, such as a bank or landlord. This is the specific purpose of Paragraph (d), which helps minimize any legal confusion if a third party does claim ownership of the goods or claims them as collateral to secure a debt. But the issue of who owns the crop can still be important in other situations. (See Chapter 6 for more details.)

Bailment clauses still leave many legal questions unanswered. If the grower never owns the crop, for instance, can it be placed in the federal farm programs? Can the contract extinguish any preexisting legal rights to the crop that a landlord or bank might have under previous agreements or state law?

In 1994, DuPont amended Paragraph (d) of this clause by adding: "GROWER may have a revenue lien placed on the value of the crop, but not have any lien that conveys ownership of the crop to anyone else besides DU PONT." This new provision would let a bank claim a lien for the "value" of the crop for a loan to the farmer, but not claim physical possession of the corn.

Terms and grower's general obligations

2. GENERAL TERMS

GROWER shall use best efforts to produce on GROWER'S fields listed in Exhibit 1 (hereinafter FIELDS) and deliver grain of the highest quality possible from the seed provided by DU PONT to satisfy the specifications in Article 3. GROWER agrees to deliver the total production from the seed to DU PONT or its designee.

- a. GROWER agrees to grow _____ acres of TOPCROSS blend _____ and acres of TOPCROSS blend _____, on land owned, leased or rented by the GROWER as described in Exhibit 1.*
- b. DU PONT or its designee will provide GROWER _____ units of TOPCROSS _____ blended seed, and _____ units of TOPCROSS _____ blended seed. The TOPCROSS seed is a blend of a male sterile hybrid and a pollinator.*
- c. GROWER grants DU PONT and/or its appointed agents free and easy access to the fields to inspect, evaluate and monitor the progress and condition of the crop.*
- d. GROWER agrees to clearly mark and identify the borders of the TOPCROSS and check hybrids. In addition, GROWER must take measures to assure identity of OPCROSS when being planted, grown, harvested, dried and stored so that it is not commingled with common commercial corn. TOPCROSS seed and grain shall be stored in clean and sanitary facilities.*
- e. GROWER will follow the details of the protocol contained in Exhibit 2.*

These clauses set out the terms of agreement and the grower's general obligations. The grower agrees to use his best efforts to raise and deliver high-quality grain from the seed DuPont provides. He also agrees to be bound by the quality specification provisions discussed in the next section of the contract, and agrees to deliver all the crop produced, regardless of quality or amount. The provision includes a number of significant clauses.

Paragraph (a) requires clear identification of the land on which the crop will be raised. This could become a significant issue in a later dispute with another party concerning ownership of the crop. Identification of the land in Exhibit 1 will be important if the weather should limit the crop. Under section 2-605 of the Uniform Commercial Code (UCC), nonperformance because of weather is an implied condition of the contract when crops are to be grown on designated acres.

Notice, too, that the contract is an acres agreement, not a bushel agreement, so the grower has not committed himself to selling a definite amount of corn. (Remember, the contract is not even a sale in the first place.) Instead, the grower will use his best efforts and deliver all the corn raised on the identified acres. But the grower can turn the agreement into a bushels contract if he chooses to use the forward-pricing provision mentioned later, in Article 5 (a).

The acreage language helps answer questions regarding possible crop failure. As long as the producer uses his best efforts, he has no liability to the company even if he raises no crop. But if he doesn't raise a crop, the company, who has already supplied seed at no charge, is also under no obligation to pay him. (Chapter 8 discusses whether federal crop insurance or coverage under farm disaster programs would be available in such a situation.) The only time the grower would be liable for a

crop shortage under this agreement occurs when he chooses the option of forward cash marketing in Article 5(a). If the grower sells a fixed amount before harvesting it, he can become liable for any difference caused by later weather conditions.

Notice that in Paragraph (c) the grower also agrees to give company representatives access to the property to inspect and evaluate the condition of the crop. A unique aspect of many production contracts is that they allow someone to enter your property to evaluate how you are farming. This creates the need for cooperation and for an effective working relationship with the company's field staff.

In Paragraph (d), the grower agrees to take necessary steps to ensure the "identity" of the crop and to keep it segregated from other commercial corn during production, harvesting and storage. Finally, in Paragraph (e) the grower agrees to be bound by the additional requirements in the protocol in Exhibit 2. This is an "incorporation" clause, adding further terms to the parties' legal agreement. The "incorporated" exhibits deal with such matters as crop rotations, isolation of fields and soil fertility. The costs of complying with the various requirements set out here are part of the service the grower is providing in exchange for the price premium in Article 5 (b).

Quality standards, testing and appeals

3. QUALITY SPECIFICATIONS

a. The Specifications are:

Moisture.....15.0% maximum

BCFM.....3.0% maximum

Damage..... 5.0% maximum

Aflatoxin< 20 PPB

Odorcool and sweet

*Contamination.....no more than 1% of corn grain from other
types and no foreign contaminants*

TOPCROSS grain delivered under this contract shall be of merchantable quality, unadulterated and unrestricted from movement in interstate commerce within the meaning of the federal Food, Drug and Cosmetics Act, Environmental Protection Agency tolerances, the U.S. Grain Standards Act and applicable state law.

b. If the moisture, BCFM, and damage exceed the above limits, the corn shall be subject to the discounts or charges set forth by the receiving ELEVATOR (defined below). If the grain is rejected under the ELEVATOR'S discount schedule, the discounts shall be the cost of processing to meet DU PONTS customer's needs.

c. The ELEVATOR'S weights and grades shall govern except that GROWER has the right to appeal any grading by submitting a sample to FGIS at GROWER'S expense for an official grade.

d. A composite sample from each truckload will be analyzed by near-infrared analyzer for oil and protein content.

This part of the contract establishes processes for evaluating the commodity. Paragraph (a) sets gram-quality standards that farmers will usually understand from normal grain marketing. It also incorporates the federal quality standards of the Food and Drug Administration, the Environmental Protection Agency and the Federal Grain Inspection Service (FGIS). If the corn were contaminated, perhaps with aflatoxin, at a level above the federal standard, the grain would not satisfy the contract.

Paragraph (b) includes language concerning grain trade discounts when quality standards are not met. In a typical grain sale, the buyer can either apply the industry's normal discounts and dockages to below standard grain or, if the grain is too bad, can reject it. Because this contract is a service agreement, DuPont already owns the grain, and the company does not have the option to reject it. Instead, the contract provides that if the grain is of a quality to be rejected by an elevator, the discount applied to the grower's final payment will be the cost to DuPont of processing the grain for use by a customer.

Paragraph (c) makes the weights and grades determined by the elevator supreme; however, the grower does have the right to appeal any grading by submitting a sample to the FGIS at the grower's expense. If the FGIS's test result is different than the elevator's, the parties will need to resolve the matter.

Paragraph (d) provides that each separate truckload will be tested for oil and protein content, even though the contract does not include any standard or payment term for these measures. One probable use of such tests would be to determine whether a grower was trying to deliver com that was not in fact Topcross high-oil corn.

Another important aspect of this article is its introduction of a third party into the agreement—the elevator. Apparently, DuPont intends to contract with local elevators to handle the actual transportation and storage of the high-oil com. Article 4 of each production contract identifies the elevator to which the corn will be delivered. Introducing this third party, who may be the one making part of the payment to the grower, adds a new wrinkle to the arrangement.

Delivery term

4. DELIVERY

Delivery shall be made in the month of 199_, and no later than _____ (here in after FINAL DELIVERY DATE) unless DUPONT requires GROWER to store TOPCROSS for delivery after the FINAL DELIVERY DATE. GROWER shall deliver the dried TOPCROSS grain to _____ (hereinafter ELEVATOR), or to such other facility as DUPONT shall direct (additional transportation costs to DUPONTS account) within seven days of DUPONT or ELEVATOR'S notice.

This paragraph establishes when and where the farmer is to deliver the crop. The agreement includes a contract delivery month and also a later date, which is the final date for delivery, although DuPont can extend delivery beyond that date. If the delivery date is extended, the grower will earn storage payments under the terms of Article 5 (b.3). The actual delivery of the com is to be made by the

grower within seven days after he receives the notice for delivery from DuPont or the elevator. The grower is responsible for the costs of delivery, but DuPont will compensate for additional costs if delivery is required to a facility other than the elevator designated in the contract.

Compensation and payment terms

5. FORWARD PRICING, GROWER COMPENSATION AND YIELD GUARANTEE

a. If GROWER prefers, he/she may forward price TOPCROSS grain by contacting the ELEVATOR. The price will be based off of the ELEVATOR'S _____ cash price or basis. If GROWER fails to establish either a flat price or a basis by, 199_, the balance will be flat priced on the close of that date even though delivery may be at some later date. If GROWER fails to deliver sufficient TOPCROSS to satisfy the priced quantity under this agreement, the deficiency will be charged to GROWER'S account at the cash price on the date of delivery, or GROWER may deliver the balance as commercial dent corn.

b. DUPONT or the ELEVATOR will compensate GROWER for performing this contract. The compensation includes three elements: compensation for services; a yield guarantee option; and a storage fee if applicable. In addition to this compensation, DU PONT has reduced GROWER'S costs by supplying the TOPCROSS seed at no cost to the GROWER.

1. The compensation for service will be the price established under Article 5.a, plus a per bushel premium (hereinafter PREMIUM) for TOPCROSS satisfying the specifications of Article 3. The PREMIUM shall be \$0.28 per bushel if GROWER does not elect the yield guarantee option or \$0.23 if GROWER elects the option.

2. At GROWER'S option, DU PONT shall guarantee the TOPCROSS yield at 85% of the GROWER'S commercial check hybrid. GROWER'S election must be communicated to DU PONT by September 1, 1993 or the option terminates.

A. GROWER agrees to measure the TOPCROSS and GROWER check yield through accurate measurement of area and weights of grain harvested and adjusted for moisture. GROWER must notify DU PONT prior to harvest and mutually agree upon the harvest date. Failure to do so prior to harvest will void the yield guarantee.

B. GROWER'S check hybrid shall be as mutually agreed, of comparable maturity to the TOPCROSS and identified in EXHIBIT 1.

C. The location of the check field shall be mutually agreed and identified in EXHIBIT 1.

D. The TOPCROSS and check fields shall be farmed, fertilized and managed identically. Soil samples will be collected at time of harvest.

E. DU PONT will pay GROWER the difference between 85% of the commercial check yield and the TOPCROSS yield for the number of acres of TOPCROSS planted in the FIELD. The price per bushel allowed shall be the average price per bushel paid for TOPCROSS grain delivered. The PREMIUM is not payable on these undelivered bushels.

- 3. Storage and interest will be paid at a rate of one-tenth of a cent per bushel per day on TOPCROSS stored at DU PONT'S request after the FINAL DELIVERY DATE.*
- 4. If GROWER does not own a field, he/she shall indicate the name(s) of the owner(s) on Exhibit 1. Any method of payment other than directly to GROWER shall be indicated on Exhibit 1.*

From the grower's perspective, these provisions are the most obviously important, since they detail the compensation and payment terms. These provisions are also somewhat cumbersome and difficult to understand on first reading. The grower is compensated through a combination of two different methods, set out in paragraphs (a) and (b).

Paragraph (a) involves forward pricing the corn with the elevator. The key issues here are the date the grower chooses to forward price the corn and the amount of crop sold. The grower can decide to do so either before or after harvest, when a definite yield is known. If the grower does not establish either a flat price for delivery, such as through a sale, or a basis date for future delivery prior to a date set in Paragraph (a), the grain will be flat priced on the last date allowed for delivery under the contract. Under the last sentence of Paragraph (a), the grower can be liable for failing to deliver the full amount of priced corn to the elevator. If this happens, either the deficiency is charged to the grower's account at the cash price on the date of delivery, or the grower can decide to satisfy the deficiency by delivering commercial dent corn.

Paragraph (b) details the second method of compensation and notes that either DuPont or the elevator will be the one to compensate the grower for performing the contract. The compensation is based on three components: services, a yield-guarantee option and storage payments if applicable. Note how the contract also reaffirms that the arrangement has reduced the grower's costs of production because DuPont provided the seed.

The compensation for services includes two parts: the price established under Paragraph (a) and a per-bushel premium. The premium is \$0.28 a bushel unless the grower chooses the yield-guarantee option, in which case it is \$0.23 a bushel. The yield-guarantee option as explained in Subparagraph (b.2) protects the grower's production levels at 85% of the yield of a check hybrid. The purpose is to compensate growers in case the Topcross corn produces a significantly lower yield. Under this provision, the grower must choose by Sept. 1 whether to use the yield-guarantee option.

The hybrid used for the yield check must be agreeable to both parties and be identified in Exhibit 1. The grower must farm, fertilize and manage the Topcross and check fields the same. Soil samples can be taken at the time of harvest to verify that this was done. If the grower chooses this option, DuPont agrees to pay the difference between the Topcross yield and 85% of the check hybrid yield. The price is based on the number of acres of Topcross that the grower has under contract times the yield difference, determined at the average price per bushel paid for Topcross corn delivered. The grower earns no premium for the undelivered bushels used to calculate this payment. The average price is apparently based on the amount of corn that the grower delivers, not on the average price for all Topcross corn raised in the year.

If DuPont requires the grower to store corn past the final delivery date established in the contract, DuPont will pay a daily storage fee of 0.1¢ a bushel.

If the grower does not own the fields on which he is growing Topcross corn, he must include the names of the owners in Exhibit 1. If there is any method of payment other than directly to the grower (if, say, a portion is being paid directly to the landlord), he must spell this out in Exhibit 1 as well. This provision is designed to give DuPont notice of other parties who may try to claim a legal interest in the crop or the payments.

But this contract leaves one important question unanswered: When is the payment due? The contract does not specify when the grower will receive any of the payments or what sort of delay may occur between delivery and payment. Because the contract involves a delivery to a grain elevator, it appears normal customs of the grain trade or state laws apply on payment. (Issues concerning getting paid are discussed in Chapter 7.)

Breach of contract.

6. VOID CONTRACT

This Agreement may be voided in the following circumstances:

- a. Location and size of plots shall be mutually agreed upon by GROWER and DUPONT, subject to meeting the rotation and isolation provisions in Exhibit 2. It is the GROWER'S obligation to carry out the protocol, and failure to do so will allow DUPONT to void the contract at its discretion.*
- b. If replanting is necessary, or stand is inadequate as determined by DU PONT, the contract may be voided by DUPONT at its discretion.*
- c. IF THIS CONTRACT IS VOIDED, ALL SEED MUST BE RETURNED AND ALL PLANT MATERIAL MUST BE DESTROYED.*

This article deals with breach of contract and lists the events under which DuPont could decide to treat the contract as being void, or unenforceable. Note that the introductory clause uses the word may. Even if one of these events occurs, DuPont still has the right to enforce the contract. The main reason for DuPont to treat the contract as void would be failure on the grower's part to comply with the growing requirements in Exhibit 2. The provisions in this agreement relate to isolating the crop and rotating fields and are important in ensuring the integrity of identity-preserved production.

Similarly, if the crop is destroyed and the stand has to be replanted, or if the original stand is inadequate, DuPont may treat the contract as being voided. If for any reason the contract is voided, all the seed has to be returned to DuPont and all the plant material must be destroyed. The fact that this clause is in capital letters in the contract indicates that the company wants to be sure the grower reads it. This is another form of intellectual-property protection to guard the company's control over the seed stock.

But what happens if the contract is treated as void, and when might this occur? If the contract is voided, the parties are under no legal obligations and the grower will not be paid for any services. Let's say DuPont does not determine until near harvest that some aspect of the protocol in Exhibit 2 has not been satisfied. Under the contract, the company can decide to treat the contract as void and require the crop's destruction. If so, the grower will have no compensation, will be out the expenses of growing the crop and will lose the chance to grow another crop on that land for the season. These are serious

economic losses. While it is unlikely that this scenario would occur, the contract clearly authorizes such an interpretation.

Disclaimer of warranties

7. DISCLAIMER OF WARRANTY AND LIMITATION OF DAMAGES.

DUPONT MAKES NO WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR ANY OTHER EXPRESS OR IMPLIED WARRANTY.

Under the contract, DuPont is providing seed free of charge. While the contract does not involve a sale and purchase, the grower's production depends on the quality of the seed. In a normal commercial transaction, the UCC would apply several possible warranties, express and implied, as well as merchantability and fitness for a particular purpose. If the seed had some defect that reduced the yield, a grower could try to obtain damages based on the breach of these warranties. The purpose of this clause is to specifically and expressly disclaim any warranties under the contract. Even if the seed does not germinate or set ears, DuPont can claim that the grower has no basis for relief under the contract. While courts may question the effectiveness of disclaimers such as this, it will be hard for a grower to argue he did not see this provision.

Limitations on damages and liability

NO CLAIM OF ANY KIND, WHETHER OR NOT BASED ON NEGLIGENCE, SHALL BE GREATER IN AMOUNT THAN THE VALUE OF COMMERCIAL SEED IN A QUANTITY COMPARABLE TO THAT QUANTITY OF SEED SUBJECT TO THIS BAILMENT. NEITHER PARTY SHALL BE LIABLE FOR SPECIAL, CONSEQUENTIAL, OR INDIRECT DAMAGES WHETHER OR NOT CAUSED BY OR RESULTING FROM THE NEGLIGENCE OF SUCH PARTY.

The second part of Article 7 is designed to place a limit on any potential damages that a grower can claim. Even if a grower does recover damages under the contract, these will be limited to the value of enough seed to replant the fields. This limitation on damages is designed to apply regardless of the legal basis for the claim, including negligence on the company's part.

The last sentence-stating that neither party is liable for any special, consequential, or indirect damages related to the contract relationship means that neither party can try to obtain a large recovery by claiming that some conduct under the contract was the cause of damages. For an example of indirect damages, suppose that the contract was treated as void and the grower could not make a land payment because DuPont failed to pay under the contract. Under this clause, the grower could not allege that DuPont was liable for the loss of the farm or a bankruptcy.

Entirety clause, no oral modifications

8. MISCELLANEOUS.

This Agreement and the Exhibit(s) attached hereto constitute the complete and exclusive statement of the understanding between the parties and supersedes all prior

and collateral representations and agreements by or between the parties hereto. No waiver, depletion, alteration, modification, or amendment of this Agreement shall be valid and binding unless in writing and signed by the parties.

In production-contract disputes, parties frequently claim the existence of additional agreements not included in the written contract. This clause, known as an entirety clause or integration clause, is designed to make the written contract the whole agreement. The language tries to identify and reject all the various bases for other claims. It specifies that any prior agreements are superseded. More important, it says that the only binding provisions are those in writing. Oral modifications or actions that could be relied on as waivers of the contract's terms are specifically rejected, unless they are reduced to writing and signed by the parties.

Successors and assignments

This Agreement shall bind the parties hereto, their heirs, administrators, executors, successors, and assigns.

If the grower dies, the heirs would still be bound to perform the contract, just as DuPont would be if it were sold to another company. The contract can also apparently be assigned to another party by either side.

Choice of law and incorporation of UCC

This Agreement shall be interpreted in accordance with the Uniform Commercial Code as adopted by the state of residence of GROWER.

One issue that always arises in contracts between parties located in different states is which law will apply when the contract needs to be interpreted. This clause, known as a choice-of-law provision, specifies that the Uniform Commercial Code as adopted by the grower's state will be used to interpret the contract. The provision does not say that the law of the grower's state will also be used for issues not covered by the UCC, but this is the most likely interpretation if such an issue arises. Still, because this contract is a service contract rather than sales agreement, it is not clear that Article 2 of the UCC would apply.

Excuse in performance-force majeure

No liability shall result from delay in performance or nonperformance caused by circumstances beyond the control of the party affected.

This clause provides both parties with an excuse for nonperformance when the circumstances are beyond their control. The provision is really a way to incorporate Section 2-605 of the UCC, discussed in Chapter 4.

Designation of address for legal notice

Written notice to DU PONT shall be by personal delivery or by postage paid letter addressed to _____ . Telephone notice shall be given to _____ at _____ .

Because DuPont is a large company, the grower needs to know with whom to deal; this clause instructs the grower how to notify the company. For example, the yield guarantee option requires notice of a selection by Sept. 1. The notice should be given, preferably in writing, in the manner stated in this clause. This prevents any later claim that the notice was not received or was not effective.

Nature of relationships

9. INDEPENDENT CONTRACTOR

GROWER is for purposes of this Agreement an independent contractor and nothing contained in this agreement shall make GROWER an employee or agent of DU PONT or authorize him to act on DU PONT'S behalf.

The legal relationship created between the parties can be one of the most important issues in determining their rights and liabilities in a subsequent dispute. This clause specifically declares the grower to be an independent contractor—neither an employee of DuPont nor an agent acting on its behalf. DuPont's goal here is to prevent other parties from claiming that the company is liable for damages or liability caused by the grower.

Suppose the grower is in an accident with a car while driving a tractor to the field to plant the corn. The injured party might easily be more interested in suing DuPont, because of its “deep pockets,” than in suing the grower. With this clause, DuPont protects itself from a claim of liability. Similarly, the grower cannot claim liability from DuPont for on-the-job injuries. The reason for selecting independent-contractor status is discussed more fully in Chapter 6, but the effect of doing so can be seen in the next clause.

Hold harmless clause, Indemnification and Insurance coverage.

GROWER shall indemnify and hold DUPONT harmless from any and all claims, in any way connected directly or indirectly with GROWER'S operations pursuant to this agreement including GROWER'S use of herbicides and insecticides. GROWER shall carry adequate public liability and property damage insurance.

Here, DuPont is protecting itself from any claims of liability that might arise from the way the grower conducts his operation. Suppose a neighbor sues the grower for negligent application of herbicides, which damaged a soybean crop. Under this clause, even if the neighbor sues DuPont and somehow established a legal link with the grower (which will be difficult, given the independent-contractor status), the grower is obligated to pay the damages for DuPont. This is the idea of “holding them harmless” by indemnifying or agreeing to pay any claims against DuPont.

The clause also requires the grower to purchase "adequate" public liability and property-damage insurance. This reduces the opportunities for someone who is injured but cannot obtain recovery from the grower to seek recovery from DuPont.

Signature clause

IN WITNESS WHEREOF THE PARTIES HAVE EXECUTED THIS AGREEMENT.

E.I. DUPONT DENEMOURS AND COMPANY

GROWER

BY: _____
Authorized Agent

BY: _____
Grower

Address _____

BY: _____
Grower

Address _____

When the parties sign the agreement, they make it legally binding. In contract terms, this is the acceptance provision.

Waiver of landlord lien

NON-OBJECTION BY LANDOWNER(S) including payment under the Agreement as specified in Article 5.d.

The purpose of having landlords sign the agreement is to prevent them from later arguing they had no idea a tenant was raising the crop under contract for DuPont and that they or the tenant arguably had no rights in the growing crop. While the clause does not use the term "waiver," it could be used to make such an argument. This clause appears to contain an error, since the contract does not include a Paragraph (d) in Article 5.

CHAPTER SIX: PERFORMING THE AGREEMENT

Once you understand the common legal Issues Involved In production contracts, you have to apply them to your own operation. By looking at the specific language used in different contracts and

considering court cases that have interpreted similar provisions, it is possible to develop some sound rules of advice and questions to consider regarding your own possible contracts.

The Nature of the Relationship

One important issue in any production contract is the nature of the legal relationship between the farmer and the contractor. The relationship created determines how courts will treat the parties on a variety of legal matters, such as potential liability for damages and disputes over who owns the crop. The answers will be found in either the specific language of the transaction or the actual nature of the relationship that the parties created. The following legal relationships are possible options under production contracts.

Simple contract for sale. In a traditional forward contract, a producer agrees to sell an amount of a commodity at some date in the future. Many production contracts, especially those that do not involve livestock or specially-bred seeds, are simply another form of sales agreement. In general, a forward contract does not call for the parties to share control over production methods and does not contain any additional form of price enhancement based on performance of other contract terms. It is merely an agreement to sell a certain amount of production at a set price and at a given time. The fact that production contracts may go into more detail on performance does not mean they aren't still sales agreements. If they are sales instead of service agreements, Article 2 of the UCC applies (see Chapter 4).

Independent contractor. Production contracts that call for the producer to perform special functions, such as producing an identity-preserved crop or using specific production methods to care for another party's livestock, typically characterize the farmer as an "independent contractor." Consider a 1989 Stokely contract for sweet com:

The Contractor hereby undertakes the production hereunder as an Independent Contractor and not as an employee of the Company. He shall have exclusive possession of the property upon which the crop is grown and shall not be subject to discharge by the Company, who holds no control over him in performance of his contract other than as to the results to be accomplished. He may use such facilities and employ such labor as he desires to carry out this contract, and all persons employed by him for that purpose shall be his employees and not those of the Company.

Another contract that characterizes the producer's status as an independent contractor is Pioneer's Better-Life soybean contract. Paragraph 18, titled "entire agreement," reads:

This Contract represents the full and entire agreement between the parties. The parties agree no change, modification, or alteration of terms and conditions of this Contract shall apply unless the same is in writing and signed by the Grower and the Company. The arrangement shall be one of independent contractors and not one of partnership, employment, joint venture or principal and agent. The Grower agrees to comply with all applicable local, state and federal laws, rules, and regulations.

ConAgra's broiler contract used in Louisiana offers another version of an independent-contractor clause. In it, the parties agree that:

Neither Grower nor his employees shall be deemed or construed to be employees, agents or partners of ConAgra or be entitled to benefits of employees of ConAgra, such as, but not limited to, Workers' Compensation and Unemployment Insurance, and that Grower

is an independent contractor not under ConAgra's direct control nor authorized to represent ConAgra by association, mark, logo, or otherwise.

Companies characterize a grower as an "independent contractor" to avoid many troublesome circumstances and potential liabilities in agricultural production. For example, if you are an independent contractor, you are not an employee subject to worker protection rules and workers' compensation. Instead, you are responsible for complying with various employment and worker protection laws as related to the workers you employ. Because you are also not a joint venture or a partnership with the company, you also cannot claim a share of the profits or make the company liable for your losses.

Often in lawsuits involving the grower's independent-contractor status, someone has been injured on the property and is trying to recover from the deeper pockets of the company (see sidebar).

COURT REJECTS CLAIM POULTRY COMPANY IS LIABLE FOR DEATH OF CHICKEN COLLECTOR

In a 1989 Alabama case, *Spell v. ConAgra, Inc.* [547 So.2d 501 (Ala. 1989)], a mother whose son was electrocuted while removing chickens from a grower's house tried to claim that both the grower and the company were liable for damages. To determine what the relationship between ConAgra and its grower was, the court reviewed the contract, which labeled the grower an independent contractor. On this basis, the court said there was no reasonable inference that the grower was an employee of the company, and the mother therefore could not recover from the company.

But even when production contracts use the independent-contractor status, the actual nature of the relationship might be something different. Courts have established tests to determine when someone is really an independent contractor. Among them: Who provides the inputs, and who bears the risk of loss? If you believe your relationship is really something other than an independent contractor, you should have an attorney consider how the courts would evaluate the relationship using various legal tests. The Internal Revenue Service has also published a list of 20 factors for determining whether an independent contractor or an employee relationship is established. [See Rev. Rul. 87-41, 1987-1 CB296.]

Personal service contract. Under this relationship, a production Contract is considered a contract for personal services, not a sale of goods. An Indiana production contract used by Beatrice/Hunt-Wesson for gourmet popcorn included the following terms:

Grower and Company agree that this agreement is and shall be considered in the nature of a contract for personal services to be performed solely by the Grower and that a major consideration for its execution between the parties has been the Company's reliance upon Grower's expertise and ability to perform according to its terms. As such, this Agreement may not be assigned by Grower for any reason, either in whole or in part, whether by voluntary act or operation of law, except with Company's prior written consent. Failure of Grower to obtain said consent may, at the sole election of Company, be considered a material breach by Grower of this Agreement.

The DuPont contract in Chapter 5 is another example of a service contract, although it also includes an independent-contractor clause. Some courts have treated production contracts for poultry as agreements for the provision of services rather than the sale of goods.

When a contract is for services rather than a sale, the classification can affect the applicability of various UCC doctrines. In *Smith v. Central Soya of Athens Inc.* [604 F. Supp. 518 (N.C. 1985)], the federal court held, "The contracts involved in this action are clearly for services and not for the sale of goods. Plaintiffs were not buyers of the chickens, [but] were paid for the care and housing of the chickens and the production of eggs." The ruling meant the "parole evidence rule" of the UCC did not apply; instead, North Carolina's common-law rules of contracts did. The question then became whether the state's common law of contracts differed from the UCC.

Bailment. This form of legal relationship is often specified in grain production contracts, especially those involving seed production. Remember, a bailment is the legal relationship that exists when someone else is entrusted with possession of your property but has no property ownership in it. Storing grain in a warehouse is a classic example of a bailment. If the warehouse goes broke, its creditors have no right to your grain.

The characterization of a contract as a bailment is not aimed at the party's working relationship, but generally concerns the producer's relation to the seeds or plants being raised. The company providing the seed stock wants the grower to have no ownership rights in the seed used or produced under the contract. Calling the contract a bailment gives the company an additional form of intellectual-property protection to prevent the unauthorized release and multiplication of the seeds. This is why contracts for seed production, called "seedman's contracts," have historically characterized the relationship between growers and seed companies as a bailment (see sidebar).

SEEDMAN'S CONTRACTS

It can sometimes be difficult to find cases answering the unique legal issues created in modern-day production contracts, partly because they are a relatively new development in much of agriculture. But companies have used contracts to control the production of one important type of agricultural product for generations: seeds. The companies have historically contracted with growers to replicate their seed stock for later sale to the public. Whether it is grass seed in the Northwest or hybrid corn in the Midwest, much of it is raised under contract. If you are considering signing a production contract, you might want to ask a neighbor who has raised seed under contract for advice.

Seedman's contracts are also important legally because courts have interpreted the terms of cases. Typically, disputes have involved questions about crop ownership, creditors' claims to the seed, allegations of defective seeds, and quality terms required for payment. Some of the earliest of these cases considered the theory of bailment, such as a 1921 Montana Supreme Court decision, *D. M. Ferry & Co. v. Forquer* [202 Pac. 193]. The court held that seed production contracts were rightfully considered a bailment (rather than an outright sale), even though the seed delivered was not stored but was instead planted and then converted into a new much larger crop of seed.

Several cases have analyzed the bailment theory for legal claims such as breaches of warranties and mortgage foreclosures. Most cases have supported the theory that seed-production relationships

are bailments. But at least one line of court opinions concerning the bailment issue challenges this view. In *Peterson v. Conida Warehouses, Inc.* [575 P.2d 481 (Idaho 1978)], the Idaho Supreme Court had to decide whether a contract between a tenant and a company could transfer a bean crop so that the landlord did not have a right to receive a portion for the unpaid rent. The court held the landlord did have an interest, and reviewed cases concerning seedman's contracts as bailments. In a special concurrence, one judge questioned the wisdom of treating a production contract as a bailment:

I submit it is unrealistic to continue to indulge in the fiction that a bean, which is irretrievably planted in the ground, and whose very existence as a bean ceases as it turns into a plant, may be the subject of bailment, entitling the supplier of the bean to claim all the beans produced from that plant. The parties essentially have entered into a joint venture. With the seed company supplying the bean seeds and the grower, here the Grimms, supplying the land in which the beans may be planted, together with all the labor which goes into planting. Cultivating, harvesting, and hauling to the warehouse. The Idaho court, in our Ferry Co. case, in quoting from the Montana Ferry Co. case came close to the right answer where it spoke of "a share of the net proceeds of the adventure" [36 Idaho at 73, 200 P. at 1067]. Here the grower's share was agreed upon at so much per hundredweight which seems to be what he was to receive for services rendered in the adventure, and not, by any stretch of the imagination, as compensation for storing the beans one inch apart in rows in the ground.

The judge's opinion was not the majority view, but if grain production contracts result in more litigation over claims of ownership, other courts might reevaluate the nature of these legal relationships.

Producers should not be surprised to find that a contract includes several different provisions concerning the relationship being created. Current crop production contracts, even those labeling the grower an independent contractor, may also contain a bailment clause regarding the producer's rights to the seed. For example, DuPont's contract for high-oil com includes both a bailment term for the plant material and an independent-contractor term for the parties.

Joint venture, partnership, and employment. Companies do not want their grain production contracts to be classified in ways that would increase the companies' potential financial exposure or risks. Some of the earliest cases involving agricultural production contracts have dealt with alleged joint ventures. For example, a 1944 New York case, *George W. Haxton & Son, Inc. v. Rich* [267 A.2d 492 (N.Y. S. Ct. App. Div. 3rd. 1944)], involved a fight between a company that had contracted with a grower to raise kidney beans and a creditor of the grower who claimed the crop. The company found itself arguing that the farmer was in a joint venture with it, so it could claim a superior interest in the beans to the creditor's. The court rejected the claim and in reviewing the relationship created under the contract noted:

The chief aim and effect of the contract seems to have been to assure to Haxton the certainty of buying the crop of beans at its own price, provided crop was grown and harvested from the seed it sold to Rich. The latter's participation in the "adventure" only extended to him credit on the sale of the seed and afforded him a sole market for the sale of the crop at a price to be determined by the buyer. Absent from this is any joinder of interest essential to a joint venture. The enterprise remained individual as to each.

However diversified in form and as to subject matter a contract of joint adventure may be, the feature of partnership is a fundamental concept.

The more common reason to claim that a joint venture exists occurs when a grower is trying to force the company either to make additional payments or to pay some liability. But very little case law supports claims that the relationships are joint ventures. So long as the parties do not label their agreement as such and do not hold themselves out as partners, it is unlikely a court would find such a relationship existed.

If production contracts were treated as contracts for employment, joint ventures, or partnerships, potential legal liability could arise from a number of contexts, including:

- Environmental liability, such as related to pesticide use;
- Workers' compensation, unemployment benefits, or other employee protections, both as to the grower and as to other persons employed in connection with the crop, such as the Migrant and Seasonal Farmworker Protection Act;
- Other forms of tort liability, such as for accidents caused by the grower in the performance of the contract;
- Liability for loss of the crop due to warranty issues, claims of defective inputs such as inferior seeds, or reliance on adverse production advice; and
- Control of the property or "engaging in farming." If a contract gives a company control over the production of the crop, or ownership of the crop, it could be seen as being directly engaged in agriculture. This may be illegal under the anti corporate-farming laws of nine Midwestern states.

Production contracts as leases. Another form of legal relationship that can be created under a production contract is the lease of the property involved. While this is fairly unusual, there have been contracts that have been treated as leases. For example in the 1977 Louisiana case *Leachman v. El Dorado Poultry Co.* [342 So. 2d 1224 (Ct. App. La 2nd 1977)], the broiler production agreement was labeled a "Lease Contract and Agreement" under which the grower leased to J-M Poultry a total of six broiler houses and the equipment contained therein for a seven-year period, with an option to renew for an additional four years. A 1961 Wisconsin case involving sweet-com production treated the arrangement as a lease of the farmland. [See *Strong v. Shawano Canning Co., Inc.*, 109 N.W. 2d 355 (Wis. 1961).] And some hog contracts being developed in Minnesota involve long-term leases of the property on which contractors are constructing the buildings.

If your production agreement uses language about leasing, you should remember several things. A lease differs from a typical sales contract because it involves a conveyance of an interest in real estate for a period of time. This conveyance of real estate creates a number of significant issues, such as uses the property can be put to and who has access to it. If a production contract that you encounter is called a lease, be sure to contact your attorney for advice.

Satisfying the Contract Terms

Whenever you are considering a production contract, recognize the changes it can bring to your operation. Remember, before you can claim payment, you must comply with the contract's requirements.

Your access to contracts is the first issue concerning performance. This will depend on which companies are active in your area, what crops you produce, your willingness to conform to the contract terms, and perhaps even the size of your operation. Other factors could include your willingness to make necessary investments in equipment, whether you have an existing business relationship with the contracting company and other added costs associated with the contract. Production contracts for swine and poultry typically require producers to construct new buildings to the contractor's specifications. The requirement of capital investments may not be as significant with grain production, but there can be new requirements for machinery or production methods.

TOMATO GROWERS SUE HEINZ OVER TERMINATION OF CONTRACTS

A group of Iowa tomato growers recently brought suit against Heinz for damages, claiming an alleged breach of a crop production contract. The growers sought damages allegedly caused when Heinz terminated their growing arrangements after they had purchased expensive tomato harvesters. [See *Beachy et al. v. Heinz et al.*, CL. No. C6389-492, in the Iowa District Court for Muscatine County.] The most significant issue in the case, and one that will undoubtedly be the subject of future agricultural contracting disputes, was whether the conduct or oral promises by the company extended the contractual obligation beyond the one-year period specified in the written agreement.

Growers argued they had purchased expensive mechanized tomato harvesters and made other investments in field preparation in reliance on the company's promises. The company argued that the contracts were for only one year and included a clause that made oral statements of no value in interpreting the agreements. The suit was settled in January 1994, and the terms of the settlement are confidential. The settlement means the Iowa courts will not have the opportunity to decide whether the farmers were entitled to rely on the company's actions to extend the contract term. Claims such as this, based on legal theories of promissory estoppel or detrimental reliance, will become more common as contracting increases.

As farmer competition for contracting intensifies, it may become common for companies to market packages of production technologies, including herbicides, seeds and markets, all in the form of one integrated production agreement. This means growers who want to market a crop under a contract may also have to agree to acquire certain inputs from designated parties. Some seed companies, for example, already require growers with a specialty contract to buy 100% of their seed from the company, even on non-contracted acres.

Growing obligations are another issue in grain production contracts because these are usually employed with high-value or specialty-marketed crops. The contracts commonly include specific provisions on production practices. This is especially true in production arrangements such as Pioneer Hi-Bred's Better-Life Grain program, in which the price premium is in exchange for meeting production standards avoiding use of pesticides. (The quality and grower standards of that contract are set out in Chapter 2.)

Grower obligations can also reflect the quality standards incorporated in pricing or acceptance provisions, such as the standards for delivery of food-grade soybeans. The following is an example of a provision for growing obligations, found in a Pioneer contract for the production of alfalfa seed:

The Grower agrees to plant on land with proper crop history, to grow, care for in a good and farm like manner, harvest and transport the seed produced, except as otherwise expressly provided herein, according to the rules and regulations of the Official Certifying Agency; provided, however, that:

A. The Company, at its own expense, shall have the right to enter upon the land, "rogue" and do such work as it deems advisable for the betterment of the crop for seed purposes without any liability for damage, if any, to the crop resulting there from; and further provided that:

B. If at any time the Grower shall, in the Company's opinion, neglect, refuse, or for any other reason fail to carry out his obligations hereunder, the Company may, at the Grower's expense, use any means it deems necessary to properly care for, harvest, and transport the crop and otherwise complete the terms of this agreement.

The issue of grower obligations is in many ways the most significant issue in performing the contract. The question is what the contract requires you to do differently. If it is just a matter of raising a different crop, the contract may have little impact on your farming practices. For example, the grower obligations in the DuPont contract simply require using best efforts to produce a good crop and agreeing to follow the husbandry practices set out in the attached protocol. But as grower obligations become more detailed or as the decision-making and management responsibility shift to the company, compliance may become more significant.

In livestock and poultry production contracts, there are often even more detailed grower obligations than those found in grain contracts. Consider the grower terms from this ConAgra Louisiana broiler contract:

GROWER AGREES TO:

- 1. Provide proper housing, fuel, equipment, water, litter and all labor necessary in properly raising a placed broiler flock to reasonable maturity, as determined by ConAgra.*
- 2. Abide by the management standards regarding feeding, sanitation, farm operation and medication as published in documents for which receipt is acknowledged below and which are hereby incorporated by reference as a part of this agreement.*
- 3. Allow ConAgra to enter Grower's premises at any time for any of the purposes herein set forth.*
- 4. Be present at time baby chicks arrive and assist in the placement of chicks.*
- 5. Reimburse ConAgra for any charges for towing or wrecker service incurred because of inadequate access roads.*
- 6. Be present at time birds are caught.*
- 7. Properly dispose of dead birds and litter as required by the Louisiana Department of Agriculture & Forestry, Office of Animal Health Services.*

8. *Grower shall not, under any circumstances, maintain, keep, grow, house or permit to be present on Grower's premises any poultry, chickens, fowl, turkeys, birds, or guineas of any kind whatsoever, other than birds placed thereon by ConAgra. Provided, however, this provision does not prevent the Grower from engaging in such other farming activities not involving poultry, which does not affect the health and safety of the poultry placed on growers premises by ConAgra.*

As you can see, compliance under this kind of contract may take more effort by the grower and places more restrictions on other activities the grower can undertake.

For a comparison, look at the grower's obligations in the hog-finishing contract used by an Iowa company:

During the term of this agreement, Grower shall:

- A. *Furnish the necessary land, house or houses, equipment, water and other facilities for the proper care and housing of the hogs and for the storage of feed and other materials.*
- B. *Provide such labor and management as is necessary to properly care for the hogs.*
- C. *Keep all records reasonably necessary for the proper and efficient management of the hogs, including death loss.*
- D. *Carry out the instructions of the Supplier's supervisor with regard to the management of the hogs. In the event Grower fails to carry out these instructions, Supplier shall have the right to enter upon Grower's premises to perform those things which Grower has been instructed to do, but which Grower has failed to do. If Grower fails to get the proper production performance with the hogs, Supplier may take over the operation and put its own manager in charge. Any expenses incurred by Supplier in this regard shall be charged to the Grower and deducted from payments owed him pursuant to this agreement.*
- E. *Notify Supplier of any diseases or sickness that any of the hogs may have or have been exposed to.*
- F. *Provide properly maintained roads to the hogs' houses.*
- G. *Supply labor to load hogs onto Supplier's trucks.*
- H. *Comply with such other requirements as Supplier may from time to time designate to Grower as being necessary.*
- I. *Dispose of all manure, waste and dead animals according to State of Iowa regulations.*
- J. *Recognize the security interest of any secured creditor in the animals delivered by Supplier as superior to and having priority over any rights which Producer may have therein; furthermore, Grower agrees to permit any secured creditors of Suppliers to have access to the premises and facilities at all reasonable times for the purpose of exercising any rights, including the rights of inspection and possession, with respect to the secured creditors' security interest.*
- K. *Own no swine, to prevent any other swine from coming onto the premises.*

- L. *Have the facility cleaned, disinfected and ready for receipt of additional hogs from Supplier within seven (7) days from the time the last hog is removed from facility and to notify Supplier that the Grower is ready to accept additional hogs.*
- M. *If the owner does not deliver the requested number of hogs, within seven (7) days of notice of availability, the Supplier shall pay at a rate of ten cents (\$.10) per head short of capacity per day until facility is filled to capacity.*

The growers' obligations under these livestock and poultry contracts are not just definite, they are somewhat restrictive. Notice that under paragraph D of the swine contract, the contractor can take over the facility put its own manager in charge to conduct the operations and charge the costs of doing so back against the grower if the grower does not comply with the provisions. Under both contracts, the growers may not own livestock while under the contract.

Because contracts vary so much in what they require you to do, it is important to read the agreement closely and think about the obligations placed on your farming methods. Some agreements are fairly open; others require you to farm by the book, both literally and figuratively.

You should also evaluate production results under the contract performance terms. Any farmer who hopes to obtain the promised price premiums will have to satisfy the contract-not just production requirements, but also the final standards for the crop. For grains, these standards may be expressed in quality terms; for livestock and poultry, in performance terms such as feed conversion, death loss or pigs weaned per sow.

Thus, contracted crop production introduces the risk that the crop will not be accepted under the contract's quality specifications. If so, the grower will have to look for an alternative market-which might not be difficult if there is an open public market or alternative uses for the crop. But if the crop is a specialty product or has a short marketing life, failure to meet the agreement's quality terms can cause serious problems. The following production clause is from a 1992 seed production contract used by an Iowa company:

The Grower shall furnish food bean crop that meets the following:

- a. *Passed Field Inspection*
- b. *No. 1 Yellow Soybeans -14 PCT Moisture Maximum*
- c. *Free of dirty, green and or moldy seed*
- d. *Free of soil particles on the seed*
- e. *Free from varietal mixtures*
- f. *40 PCT screenings Maximum*
- g. *Free from corn, nightshade, buffalo bur and cocklebur*
- h. *Free from green weed seed and pods that may cause bin spoilage any soybeans not meeting these standards shall be disqualified from all premiums and at Fairview Farms Inc.'s option, be released from this contract or purchased on the local grain elevator price schedule.*

When the crop doesn't meet the contract terms, the outcome depends on the terms of the contract. Under this contract, the grower would lose the claim to any premiums for seed that does not meet the quality standard but would still be able to sell it. In some cases, such as for a protected variety, the company may not want the seed sold for other uses.

This is one place where the terms of the contract-whether it is a sale or service-become important. If the contract is a sale, the buyer might be able to reject it. But if it is a service, you are being paid for producing the crop, and failure to comply with the quality terms will probably reduce your payment. Consider the DuPont contract: When grain doesn't meet the quality terms, the company can deduct from the grower's payment the cost of conditioning the grain for use by a customer. Under some contracts, the crop may be "released" to the grower for use when it doesn't meet the quality standards. But depending on the crop involved, this release to the grower may not amount to much-especially if the crop is over nature or no other market exists.

Price discounts for poor quality naturally vary with the contract. It is common for a contract to provide that the final price is subject to "discounts applying at the time of delivery," as in the Pioneer Better-Life soybean contract noted above. Keep in mind that the discounts applied within the grain trade can fluctuate during a marketing period.

For example, the discounts applied in the Midwest for low-test-weight corn were much smaller in spring 1993 than at harvest time that fall. The poor growing conditions in 1993 resulted in a great deal of low-test-weight corn, with poorer feed value and less storage life, and this grain was subject to discounts under USDA's grain storage programs. These factors meant grain elevators were less willing to purchase low-quality grain without applying significant dockage. Many elevators limited the amount of poor-quality grain they took in storage by refusing to accept corn below a certain quality.

Cases Involving Satisfying the Contract Terms

Perhaps the best way to consider the legal issues that can arise with performance is to look at several cases illustrating the types of disputes that can arise. One of the most likely disputes occurs when the company claims the crop does not meet the quality terms and will be purchased at a lower price or not at all.

A 1992 Idaho case involving seed corn production provides an excellent example of this type of fight. In *Pline v. Asgrow Seed Co.* [642 P.2d 64 (Idaho App. 1992)], the producer signed contracts to grow 28 acres of Commander seed corn for Asgrow Seed Company. Pline had raised sweet corn before but had not raised seed corn. He raised the corn and delivered it, but after it was processed the company rejected most of it, claiming it failed to meet germination standards and was "unfit for seedmen's use."

Pline rejected the payment the company offered as unacceptable and sued for breach of contract. The trial court found the seed company had breached the contract and awarded Pline \$20,993 in damages. Asgrow appealed, claiming the evidence showed the corn did not meet the contract and the damages were too high. The key provision in the contract concerning the quality of the seed was the following:

Upon or after physical delivery Asgrow may designate the crop or part thereof as unfit for seedmen's use if the germination of the crop or part thereof is less than the Asgrow normally accepted standard for the variety as determined by the official Federal and/or State Testing Laboratory by a test of a properly drawn sample being drawn and submitted by Asgrow within sixty days after receipt of the seed, or if the seeds comprising the crop or such part thereof contain more than twelve percent (12%) of moisture, or if in the judgment of Asgrow, the crop or part thereof is in any other respect

unfit for seedmen's use and cannot be made fit without an unreasonable amount of cleaning or sorting.

Asgrow contended that a preharvest freeze had harmed the seed and that it did not meet the company's "normally accepted standard" of 85% germination. This 85% standard was not in the contract, nor was it communicated to Pline before execution of the contract. At trial, a major issue was how Asgrow had determined the seed did not meet the 85% test. Rather than submit the com to an outside lab for testing, as required in the contract, the company had done the germination tests itself and said the test results ranged from 68% to 85%.

But Pline argued that he had done his own germination tests and had sent seed to the state lab for testing. His results showed germination rates of 91% and 94%. Asgrow claimed the com he submitted for testing was not from his fields and that his home germination tests should not be accepted, but the trial court found Pline's evidence credible. The court used it as the basis for determining that Pline had satisfied the contract and that Asgrow had breached the agreement. On appeal, the Idaho Court of Appeals ruled there was sufficient evidence to support the trial court decision.

The appeal raised another question concerning the measure of damages. The trial court determined that Pline was due \$20,993.25. It reached the figure by taking the number of pounds of corn raised times 25¢ and adding a \$500-per-acre guarantee as provided in the contract. This provision was in a second contract, called a "bailment contract rider," also signed by the parties. It provided:

Asgrow Seed Company guarantees the performance of the attached contract for the production of 3-168 com seed in 1975 to the degree of \$500.00 per harvest acre, plus the compensation per pound as stated in the attached contract.

The above guarantee is not applicable if above crop is lost or destroyed by Acts of God such as wind, freeze, hail, flood or fire. (Heat is excluded.)

This rider specifically guarantees the production of this com. It does not cover excessive crop abuse due to the above listed acts of God.

The trial court interpreted this as a guarantee of a minimum of \$500 an acre for raising seed com and held the seed was not destroyed by an Act of God. Asgrow disputed the purpose of the clause, claiming it was a projection of a possible bonus. The trial court held that the term was ambiguous, and because it was added to the contract by Asgrow the court interpreted it in favor of the grower. This is a good illustration of one of the basic rules of contracts discussed in Chapter 3: Ambiguities in a contract are interpreted against the party drafting them. The Appeals Court held that the trial court had properly interpreted the contract and accurately calculated the damages.

The case is a typical illustration of the issues that can arise in a dispute over performing a contract. It also helps identify several questions to keep in mind, including:

1. If the contract includes undefined standards of terms of the trade, do you know what these are?
2. If the contract requires a party to take a required step, such as testing by an Independent outside body, was it done?
3. If the quality of the crop may be an issue, should you keep samples and have them tested yourself?
4. Is it clear what amount you will be paid under a contract, or is it ambiguous?

5.

Who Has the Burden to Show the Contract Was Breached?

Another issue concerning disputes over compliance is who has the burden of proof to show the contract was breached. Consider the following Minnesota case involving seed-corn production. In *Petersen v. DeKalb Pfizer Genetics* [354 N.W. 2d 887 (Minn. App. 1984)], two brothers decided in 1981 to raise seed corn under contract. Seed was planted on 120 acres and delivered to the company, which paid for the seed in two installments, according to a formula contained in the contract. A dispute arose when DeKalb on its own determined that it would reduce the number of "designated bushels" for calculating the growers' payments.

The company claimed that a hailstorm had struck the county where the corn was grown during the growing year and this entitled the company to reduce the payment 20%. In December 1981 and March 1982, the growers received letters from the company explaining the reductions and including the payments, which were cashed. In March 1983, the growers sued for the difference in payments based on the reduction in the designated bushels.

The trial court awarded damages of \$5,413.71 plus interest for underpayment, ruling DeKalb was not authorized in reducing the payments. On appeal, DeKalb argued that the reduction was appropriate and the acceptance of the payments and delay in bringing suit showed this. But the Minnesota Court of Appeals ruled against DeKalb for one important reason—there was nothing showing that the growers' fields were struck by the hail or that the quality of the corn they supplied was affected.

In legal terms, the court held that before the company could reduce the payment amount, a "condition precedent" had to occur— the yields had to be reduced because of unfavorable growing conditions. But DeKalb admitted at trial that the corn crop in Redwood County in 1981 was greater than in any of the 10 preceding years. Because there was no hail damage to the crop, DeKalb couldn't unilaterally decide to reduce the payments. A good rule to take away from the case is that when a company is trying to reduce the payment you believe you are entitled to, you should have them explain in writing why they are doing so. Then check to see if this is supported in the contract.

Canceling the Contract After the Grower Performs

A final case illustrating disputes that can arise over performance involves an alleged shatter cane infestation. The company argued that the weeds meant it could "release the contract"—meaning it was not responsible for paying the grower for any of the production. Such release provisions are common in seed contracts and can be devastating to the grower because there will be little or no payment after a season of effort. In *Schmidt v. J.S. Robinson Seed Company* [370 N.W. 2d 103 (Neb. 1985)], a Nebraska tenant farmer contracted to raise seed corn. The contract that the parties signed included several provisions allowing the seed company to cancel, including:

Release of acreage. The Company shall have the right to release all or any part of the seed acreage and all or any part of the crop there from prior to delivery if one of the following conditions are met:

- a. In the Company's sole judgment, volunteer corn within or without the seed acreage is excessive, and notice thereof is given to Grower within a reasonable time after the first cultivation thereto:

- b. In the Company's sole reasonable judgment, the prospects for the seed crop are not satisfactory and the Company gives written or oral notice thereof to Grower on or before June 5th of the crop year. The Company shall have the sole right to decide if a stand is good enough to leave for seed production, in which case, such stand, unless thereafter released by the Company, shall be carried through to harvest and Grower shall perform all things required of him in this agreement to produce the best seed crop possible under the circumstances.
- c. At any time prior to delivery the Company determines that the seed crop has been subjected to fire, flooding, ponding, insect damage, shattercane or hail damage to the extent that the crop is killed or been so affected that it should not be used.

If the acreage was released under the contract, the company was not responsible for payment or compensation to the grower. The grower planted the seed corn and cared for it under the direction of a company production manager, who regularly inspected the fields. On July 10, 1980, the producer received notice that the fields were being released due to severe shattercane infestation.

The grower sued the company for breach of contract, and the trial focused on whether the evidence showed the field was suitable for use as seed corn or could be released under the contract. The trial jury rendered verdict for the grower of \$62,924.60, and the company moved to set aside the verdict and moved for a new trial. On appeal, the issues for the Nebraska Supreme Court were whether the trial court was wrong in taking testimony about the condition of the field and whether the buyer had met the burden of showing the field was rendered unfit for seed use.

The court held that the release provisions were a "condition subsequent," meaning that once the grower had performed the contract (raising the corn), the buyer had the burden of proof to show that the release condition (here, the shattercane infestation) was met. The court also held that the release clause included a standard of "reasonableness." The court ruled that under the contract, there was some ambiguity over whether a reasonableness standard was imposed on the company in determining whether to release acreage and refuse to pay for seed delivered. The court turned to a basic rule of contracts to rule in favor of the grower. It cited an earlier case in which it had held, "A contract will be construed most strongly against the party preparing it when there is a question as to its meaning." As a result, the court upheld the jury verdict for the grower.

CHAPTER SEVEN: GETTING PAID

For any producer with a production contract, the most important issue is getting paid. More money—a better return on your investment is the main reason to enter a contract, so anything that reduces your final payment or delays it can greatly affect the success of the venture.

Payment raises a number of important questions with a contract, including: How much will you actually be paid? When will you be paid? Who will be paying you? What are the risks that you won't be paid? Who can claim some or all of your payment? And what can you do to make sure you are paid? The answers naturally depend on your contract and your other circumstances.

How Much Will You Be Paid?

For payment purposes, production contracts can be grouped into three basic categories. The first includes contracts with fixed sale prices. Many vegetable contracts involve the sale of a set amount of the crop at a price established when the contract is entered. The actual, final price may depend on a number of factors set out in the contract, such as the date the crop was planted, the tenderness of the crop harvested, and the variety planted, but the base sales price is set in the contract. With such an agreement, a producer can roughly determine in advance the amount to be paid as influenced by the other payment and quality factors.

The second group of contracts pays a price plus premium. Many grain production contracts, for instance, use the traditional pricing system to establish a base price and then add a premium. Such contracts commonly give the producer flexibility to choose the date on which the base price is set, perhaps by pricing the commodity on the futures market. The contract also identifies any premium the producer is to receive and any bonuses that he can earn based on the quality of crop delivered. The DuPont high-oil com contract analyzed in Chapter 5 uses this sort of pricing approach. So does Pioneer Hi-Bred's 1993 specialty-use soybean contract, Better-Life HP204, which provides:

- I. The Company will pay the grower the base selling price for all bushels delivered basis US # 1 Soybean with market scale of discounts to apply at time of delivery. Grower acknowledges that the Base Selling Price will be equal to the current price quote for the delivery month of choice as quoted by the Company for the location stated above. Call the Pioneer SPP Grain Desk at 1-800-356-0393 for pricing information.
- II. A premium of \$1 .00 per bushel will be paid for the net bushels of clean food grade soybeans.

With these contracts, the grower's final payment depends on his marketing skills and opportunities as well as the contract premiums. The contracts offer a way to market the actual production, such as through forward pricing, and then add whatever premium the contract may provide. The producer's final payment will also depend on the quantity raised. It is important to remember the possible impact that production contracts may have on how much commodity is sold. Two examples of how the final return could be reduced are decreased yield due to low-producing varieties and reductions in the amount of crop that is accepted under the contract's quality terms. (See Chapter 2.)

The third group of contracts pays for the grower's services, as commonly occurs in livestock and poultry contracts. The payment rate is set in the contract, but it factors in a variety of performance figures, such as feed conversion, death loss and fuel use (see sidebar).

PAYMENT PROVISIONS FROM LIVESTOCK CONTRACTS CAN BE QUITE INVOLVED

Because most livestock production contracts use various performance factors to calculate payment, the terms of the agreement can be quite extensive. Consider this payment provision from an Iowa hog-feeding contract:

5. The Grower will be paid four dollars (\$4.00) per head for furnishing labor, utilities, bedding, the facilities and his supervision, including loading and unloading services to be paid within 10 days of arrival of the pigs at his farm. In addition, he will be paid \$.03 a day per head to the time of marketing of the pigs and he will be paid a feed efficiency bonus per animal as follows:

	FEED EFFICIENCY Lbs. feed per pound of grain	BONUS Per head
Herd feed efficiency less than or equal to:	3.4	\$0.50
	3.3	1.00
	3.2	1.50
	3.1	2.00
	3.0	2.50
	2.9	3.00

In addition to those payments Grower will receive a bonus for rate gain of weight as follows:

	RATE GAIN Lbs. per day	BONUS Per head
If the rate of gain is greater than or equal to:	1.55	\$0.25
	1.60	0.50
	1.65	0.75
	1.70	1.00
	1.75	1.25
	1.60	1.50

In addition the Grower will be paid a bonus if the death loss or salable animal loss is as follows:

	DEATH LOSS AND UNSALES % of the inventory	BONUS Per head
Less than or equal to:	1	\$2.50
	2	2.00
	3	1.50
	4	1.00
	5	0.50

All of these bonuses and the \$.03 a day payment will be paid to the Grower after the entire group of hogs has been sold. An unsalable hog is a hog that will not bring at least 50% of the market value for hogs of the market weight, which is 240 lbs. or more. Representatives of the Supplier will have access to the Growers facilities at all times to inspect and count the pigs, to determine death rate, to check on the supply of feed and medication and to determine what additional terms are needed pursuant to the contract. All bonuses under this Paragraph will be computed by the supplier based on records of individual groups.

The records and calculations necessary to determine final payment under these contracts are considerable, so determining what you are due can be a complicated task. Because the actual payment will determine the success of the contract, it is important to be able to decipher payments and settlement sheets when payments are made. Only by knowing how much you should be paid can you determine if you are being paid the wrong amount. If you don't understand how much you are to be paid or why you received the amount you did, ask for further explanation.

When Will You Be Paid?

The timing of payment under a production contract is important for two reasons. First, it will determine when you receive funds that can be used to cover the costs of production. Second, until you actually receive payment, there is always the risk that you might not be paid—one of the greatest concerns that any contract grower has.

To determine when you will be paid under the contract, you should first look at the language of the contract. If the contract is a sale of goods, it will generally call for payment at the time of delivery or at a later date that the parties have agreed to. Consider the timing of payment from a 1994 seed production contract:

Time of payment shall be as follows:

<u>Price Based</u>	<u>On Payment Time</u>
<i>A Harvest Delivery Bid</i>	<i>Nov. 15, 1994</i>
<i>A Current Delivery Bid Within</i>	<i>15 days of delivery date</i>
<i>A Future Delivery Bid.....</i>	<i>15th day of delivery month</i>

Should the Grower fail to select a Chicago Board of Trade price prior to the close of business on June 15, 1995, and notify Fairview Farms Inc. thereof, the price shall be established by the July 1995 Chicago Board of Trade price at the close on June 15, 1995.

If the contract is for services, as most livestock contracts are, the payment will be made after the animals have been delivered and marketed, so that performance can be determined. The following is the timing of payment in a ConAgra Louisiana broiler contract:

Payments will be made by Friday following the week the last kind of such flock is sold. A Grower who sells birds in more than one calendar week will be grouped in the week of his final sale.

Contracts for payment of livestock and poultry are subject to the federal rules on payment, including the prompt-payment and statutory trust protections of the Packers and Stockyards (P&S) Act, as discussed in Chapter 10.

Some contracts are silent on the question of when payment is to be made. For example, the DuPont contract in Chapter 5 never directly answers the question. But every contract includes an implied promise that payment will occur once the terms of the agreement are completed. If the contract doesn't set the date for payment, then fixing the actual date for payment and determining when a payment is late may depend on the provisions in another state law, such as a grain dealer law or the UCC.

Instead of requiring payment on delivery, as state laws may provide for normal grain sales, some contracts allow for installment payments or bonuses paid at later times. Pioneer's Better-Life soybean contract provides:

7. GROWER PAYMENT *Payment (check issued and mailed) for soybeans sold prior to delivery will occur within 10 days after last delivery and acceptance date. Payment for soybeans sold after delivery and acceptance will occur within 10 days after selling date. The payment amount for each payment date shall include the appropriate premiums for the bushels sold. The Company shall have the right to deduct from the first payment any amount the Grower owes the Company for any reason whatsoever. Payment for soybeans grown under the Better- Life program will not be made until all grower certification records are in the Company's possession.*

8. DEFERRED PRICING *If Grower elects to defer pricing beyond the date the grower delivers his grain, he must sign a Price Later Agreement (Credit Sale Agreement).*

The way that a contract alters the timing for payment can have implications under the state's grain-marketing laws, which may place time limits on when payment is to be made. Dealers typically have to pay upon delivery, and the laws may require that buyers obtain fiduciary bonds, which are used to pay growers if the buyer should default.

If the contract alters the timing of payment, it may introduce risks of not being paid. The most common risk is that the producer has transferred title to the grain to the dealer and has only a contract claim for payment. Unless the buyer is licensed under a state's grain-buyer laws, the seller's only legal basis for payment will be the terms of the contract. (State grain-dealer laws, some of which regulate sales under deferred pricing arrangements, are discussed in Chapter 9.)

Who Will Be Paying You?

This should be the easiest question to answer. The party you should be able to expect payment from is the party with whom you entered the contract. But exceptions occur when the contract adds a third party as the actual purchaser or payment agent, or when the contract allows it to be assigned to another party. The DuPont contract discussed in Chapter 5 adds a third party (the elevator), which may be responsible for making some or all of the payments to the grower. If a contract provides for assignment by the buyer without your approval, you may end up being in business with someone you don't know.

What Are the Risks Until You Get Paid?

There are two basic types of payment risk with a production contract. The first involves the performance-related risks discussed in Chapter 6, if hail destroys your crop or heat kills half your chickens, for instance, your payment will be affected.

The second type of risk arises once you have completed your performance of the agreement but before you actually get the money you've earned. Examples include the financial insolvency of the buyer and competing claims for the money from either the buyer's creditors or your own creditors or landlords. If your production contract involves a sale, the main issue concerns the passage of title to the crop and subsequent risks of loss. If the contract involves a service rather than a sale, you have a contract claim for payment for the services you rendered. In either case, if a dispute forces you to sue for payment, the issues will be 1) the evidence you have to support your claim and 2) the legal grounds that may allow your contractor to avoid payment or give a third party a superior claim to the money.

Who has legal title largely defines who takes the risk of loss. If a crop is destroyed while you still own it, the risk of loss is yours. But if the crop has already been delivered to another party and legal title has passed, the risk of loss has also passed. Your contract may contain a provision relating to the passage of title to the crop. If so, the provision is important for purposes of determining who has the right to the crop at that time—a factor that can influence who bears the risk of loss or who can claim a financial interest in the crop.

Consider the following clause from the Stokely contract for sweet corn:

TITLE TO SEED AND CROP: *The title to the seed and the crops grown here from shall at all times be and remain in the Company, and the entire crop, except as herein otherwise expressly provided, shall be delivered to the Company. The Contractor shall not acquire any right, title, or interest in or to the seed furnished him nor the crops grown there from; and his possession of the seed and crop shall be that of a bailee only.*

This provision is similar to the one in the DuPont contract. It operates as both a form of intellectual-property protection and an effort to defeat claims to the crop by a third party.

Some contracts attempt to establish the company's title to the crop while also placing all risk of loss on the producer until the crop is delivered. Consider the Beatrice popcorn contract:

TITLE, RISK OF LOSS: *This agreement is intended and understood by the parties to be effective when signed, and title to the growing popcorn crop shall pass to the Company immediately upon the sowing of the seed. However, until delivery and acceptance by Company all risk of loss, damage or deterioration to the crop shall be borne by Grower, and Grower assumes all responsibility and liability incident to the planting, growing, harvesting, storage, shelling and delivery of the popcorn crop.*

Other contracts do not call for passage of title until delivery but do include provisions allocating the risk of loss. For example, the Fairview Farms contract for food-grade soybeans provides:

RISK AND ENTRY: *Grower assumes all risk of loss of the Food Soybean crop while growing and/or after harvest until such time as Fairview Farms, Inc. takes receipt thereof, Grower permits Fairview Farms, Inc. to take samples from the field or stored crops at any time.*

In these cases, the actual timing of delivery and acceptance will determine when any risk of loss shifts to the company. For that reason, it is important to know when the crop is to be delivered and how

acceptance will be acknowledged by the buyer. On the issue of acceptance by the buyer, §2-607 of the Uniform Commercial Code (UCC) obligates the buyer to pay for the goods once they have been accepted.

But even when the title and risk of loss have shifted to the other party, other events could still prevent you from being paid. These risks might include the bankruptcy of the buyer, the set-off or withholding of your debts by the buyer, or intervening claims against the crop by other parties. These could involve claims of the landlord for rent, if the crop is produced on rented ground, or claims of third-party lien holders, such as banks that might have financed production of the crop.

Who Else Might Claim the Crop or Payment?

Whatever the production contract, companies do not want to become involved in payment disputes involving growers. The companies especially do not want to be in a position where a third party, such as a bank, may be able to establish some type of legal claim to the crops involved in the contract. If a third party can claim possession of the production, the company will not have access to the crop for its own processing or marketing needs. A claim to the commodity might also introduce "leakage" in the company's intellectual-property rights in the crop's genetics. For these reasons, it is common for production contracts to specify that the grower agrees not to grant any legal claims in the commodity to third parties.

Consider this provision in a soybean production contract:

SECURITY INTEREST. *Grower will not grant any security interest of any type in the Soybean Crop and will maintain such property free and clear of all liens, pledges, claims, charges, and all other encumbrances, unless Strayer consents in writing to such security interest or encumbrance. A violation of this paragraph 13 by Grower will entitle Strayer to immediately take any and all action necessary to protect its interest in the Soybean Crop. Grower will be liable for any expenses incurred by Strayer in enforcing of seeking damages for violation of this covenant, including reasonable attorney's fees.*

And this provision appears in Cargill's contract for white corn, used in Kansas in 1993:

Seller warrants that the commodities to be delivered will be delivered free and clear of any and all liens, including but not limited to any lien in favor of the United States for a farm marketing excess penalty.

These provisions are designed to ensure that the producer has clear title to the commodity and can sell it to the contractor. If the contract does not involve a sale, the issue isn't to guarantee that the product is free and clear of claims; it is to prevent someone else from establishing a claim during performance of the contract.

One party most likely to claim an interest in the crop would be the landlord on whose property it is being raised. Consider this provision in Pioneer's alfalfa seed contract regarding the rights of the landlord to the crop:

The Owner's approval of this contract is required when the Grower is not the Owner of the seed field. Therefore, the undersigned, being the Owner(s) of the premises heretofore described, does hereby consent to the foregoing contract and agrees that the rights of the Company under said contract shall be superior to any landlord's

lien or other lien that the undersigned has, or may hereafter acquire, on the alfalfa crop grown on said premises from the stock seeds furnished by the Company.

The bailment provision of DuPont's 1993 contract for high-oil com includes a clause dealing with the rights of third parties: "GROWER agrees not to grant or cause to be placed any lien or claim against TOPCROSS material." The clause was amended in 1994 to permit a "revenue lien," but no claim involving possession of the com. The contract also requires the landowners to sign the contract and allows the grower to grant partial payment directly to the landlord.

But whether such contract provisions effectively limit a landlord's rights depends on the state law giving landlords a lien for rent; it also depends on how other provisions of Article Nine in the UCC are interpreted concerning financing of crops. Contracts that require the landlord to sign the contract and acknowledge the superiority of the company's claim to the crop probably do give the company a better claim to the crop than the landlord has. This does not mean the landlord is not entitled to the rent; he will just have to look to the tenant's other resources.

But when the landlord has not signed the contract or acknowledged the company's right to the crop, the courts may be hesitant to enforce such as contract. In *NBC Leasing Company v. R & T Farms, Inc.* [733 P.2d 721 (Idaho 1987)], an insurance company rented a farm to a tenant who raised grain and potatoes. The farmer obtained seed, fertilizer and other financing to raise the crop from a local input supply company, which filed a security interest in the crop under Article Nine of the UCC. When the crop was harvested, the supplier claimed a priority in the proceeds, and the insurance company sued for its portion as the landlord. The Idaho court had to decide whether the insurance company had a property interest in a portion of the crop that could not be affected by the tenant's agreement with the supplier.

The court ruled that the case was similar to the 1978 case of *Peterson v. Conida Warehouses Inc.*, in which it had held that a bean production contract signed by a tenant was not effective in transferring an interest in the landlord's portion of the crop. The court said that it could not let the tenant farmer subordinate the landowner's interest to a third party and sell the owner's interest in the crop without his permission. This case shows that the effect of a production contract on a landlord's rights will be determined by the particular state law protecting the landlord's interest in rent and crops.

The other parties most likely to claim an interest in crops produced under contract are banks or other creditors of the grower. The issue will most likely arise when the creditor claims an interest in the grower's crops as collateral for an existing debt. Many farmers obtain annual operating financing from banks or other lenders. Typically, the farmer signs a note and a security agreement giving the lender a security interest in the growing crops and other farm assets. The parties also sign a UCC financing statement, which is used to perfect the security interest against other possible lenders so the bank has the first claim or priority in the farmer's collateral.

This process of perfection and gaining priority is what makes the bank willing to lend money to the operation. If the farmer does not pay off the entire loan in one year, the bank has a continuing security interest in the farm collateral, including future crops, until the debt is paid or the security interest becomes unperfected. Anything that could later lessen the priority of the bank's claim to the collateral would make it harder for a farmer to obtain financing and would be opposed by the bank. (This is why it is worthwhile to consider the impact production contracts may have on typical farm financing relations.)

As noted above, many contracts include provisions in which the grower agrees not to allow anyone else to establish a claim or a lien on the crop being raised under the contract. Frito-Lay's white-corn contract used in Illinois in 1994 includes this provision:

Producer represents that Producer has not sold and will not agree to sell Producer's crop to any other person and at the time of delivery to Frito-Lay it shall be free of any crop mortgage, lien, encumbrance or security interest of any kind except as follows: _____ (any Mortgage, lien holder, or beneficiary of any security device shall be hereinafter called the "Secured Party").

But there are real questions about how effectively these contract provisions can limit the rights of other parties-especially when the bank's interest in the crop may already exist. A few cases have directly involved claims by lenders and companies using production contracts, but the cases decided indicate that the legal issues are far from simple.

COURT CONSIDERS WHETHER GROWER'S BANK HAS BETTER CLAIM TO CROP THAN CONTRACTOR

In *Nat'l Bank of Fulton v. Haupricht Bros.* [564 NE 2d 101 (Ohio App. 1988)], the court had to decide whether the seed-corn company or a bank had a better claim to the seed-corn. The case was confusing because it involved several banks and contracts signed by growers in both their individual and corporate status. But the final issues boiled down to whether the bank, which had an existing perfected interest in the farmer's crop, had a superior claim to the seed corn being raised under contract and whether the contract affected the bank's relation with the farmers. The court ruled, "The seed corn was collateral subject to the [bank's] security interest because the [bank's] security interest extended to crops and premises described in the Security Agreement and Financing Statement as supporting collateral crops.

In considering the seed company's contractual claim to the crop, the court noted that the grower's "contract with [the seed company] is irrelevant to determining whether the [bank] had a security interest in the corn. Ascertaining whether the [bank] had a security interest in the corn was simply and solely a matter of determining whether the security interest attached." The court noted that the seed-corn company had not checked any of the financial records to determine whether any lenders had existing financial claims against the grower before it entered the contract. If it had, it would have found evidence of the lender's claim against the debtor and the fields on which the seed was raised. The contract was not effective in limiting the bank's right to the crop.

When contract provisions run into claims by banks to the crop, the results will depend on the state's law and the facts of each grower's financial situation, even if the contract says the grower does not have any rights in the crop or that no other claims to the crop will be recognized. Signing a contract with language to the effect that no other claims are to be allowed might create a claim by the company against the grower for breach of contract or for a remedy if such a later claim does arise. But whether such provisions would be effective against other parties who did not sign the contract is open to serious question.

What Can You Do to Make Sure You Get Paid?

While you can never remove all the risk in a business transaction, you can do several things to minimize your risks of nonpayment. First, you must know who you are contracting with and what the possible financial risks in the contract are. Ask whether the other party is covered by any state or federal law, such as a grain-dealer law or the Packers and Stockyards Act. These laws may require the contractor to be bonded or licensed for your protection. Knowing what you are doing and who you are dealing with goes a long way toward preventing problems.

Second, you should understand what you are agreeing to do under the contract and how this might affect your payment. By thinking about each topic discussed in this chapter, you should be able to answer many of your own questions about your payments.

Third, remember the advice in Chapter 6 about performing the contract. Most payment disputes involve either the amount you should be paid or the validity of an intervening claim to the payment. The amount of payment will depend on your ability to prove the contract was performed. Whether the issue is the germination rate of the seed, the rate of gain of the pig, or the quality of the grain, proving your performance will depend on the factual proof that you make available to whoever will resolve the matter. Good records about how you performed the contract, including samples of the production or the results of any quality tests, can prove valuable in a future dispute.

Fourth, you should identify any laws designed for your protection. These can be especially important if you have performed a contract but have not been paid or have received a payment that was dishonored. Grain-dealer laws and the P&S regulations, which are discussed in two later chapters, can be very important.

Other laws may also offer you some protection, especially if your state has enacted an agricultural producer's lien. This provides growers a legal claim to commodities delivered to another party until they are paid. Minnesota enacted such a law in 1990 [Minn. Stat. §514.945 (1993)]. The lien is valid for 20 days after the commodity is delivered and can be extended if the producer files a lien statement and takes the steps set out in the law. The lien has a higher priority than many other claims to the crop and is designed to make sure producers are paid under their contracts. Ask your attorney if your state has enacted such a law.

Many states also have "agister lien" laws, which give parties who care for and feed another person's animals a claim against them for the value of the services. If you have delivered animals under a contract but have not been paid, you may have a claim for the value of your services-if the contract did not require you to waive such a claim. But before you can use such a lien, you have to know how it applies, how long you have to file the claim, and what priority it will give you to the goods. The answers will vary with the state, the contract and the crop. If you are having trouble getting paid, you should immediately seek legal advice to help you determine your rights and to decide what course of conduct to follow. Delaying action can affect your ability to successfully claim payment.

A final piece of advice on making sure you get paid concerns what you should do when you have good reason to believe the buyer may be unable to perform the contract. Suppose a neighbor has delivered a load of grain under a contract and has received a check that was dishonored. Do you still have to perform your contract, or are you excused? The answer appears in Article Two of the UCC, Section 2-609 provides that a party who has "reasonable grounds" to believe his right to be paid has been impaired can suspend performance under the contract and demand that the other party provide

assurance they will perform. The language of the provision is specific about when reasonable grounds can be used:

- (1) A contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired. When reasonable grounds for insecurity arise with respect to the performance of either party the other may in writing demand adequate assurance of due performance and until he receives such assurance may if commercially reasonable suspend any performance for which he has not already received the agreed return.
- (2) Between merchants the reasonableness of grounds for insecurity and the adequacy of any assurance offered shall be determined according to commercial standards.
- (3) Acceptance of any improper delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.
- (4) After receipt of a justified demand failure to provide within a reasonable time not exceeding 30 days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract.

For a grower, the important guidance of Section (1) is reasonable grounds for insecurity regarding your buyer's performance. Then you can demand adequate assurances of payment, such as evidence of the ability to pay in cash.

The real value of this section is that it can shift the burden of breaching the contract. Rather than deliver the goods and risk not being paid, or stop delivery and risk being in breach, the seller can demand adequate assurance of performance from the buyer. If the buyer cannot provide it, the contract is considered repudiated. It is now the buyer who has breached the agreement, not the seller.

Several cases involving the sale of farm commodities illustrate the application of the section. In *Tappert v. Bunge Corp.* [377 N.E.2d 324 (Ill. App. 9781)], an Illinois farmer had in March 1973 signed three forward grain-sale contracts, each for 10,000bu. of corn for October or November delivery to a grain company. The farmer signed another contract in May 1973. He delivered on one contract and started to deliver on another when a dispute arose over payment. All the contracts were based on phone calls that were later confirmed with signed contracts, as is common in the grain trade. While the company normally made payment once delivery was complete, it did not pay until demanded to do so by the farmer's attorney in late November. After payment was refused on another delivered contract in early December, the farmer ceased delivery and sued the company for the unpaid amount. The company counter sued for delivery of the remaining grain and for damages for having to cover. Apparently, the company failed to pay because the farmer's brother and father had outstanding contracts with the company that they refused to sign. The company was using the delay in payment as leverage against the other family members.

At trial, the issue was whether this conduct was reasonable and whether it gave rise to sufficient grounds for the producer to use §2-609 and demand adequate assurance of payment. The trial court held that Bunge's action was a wrongful refusal to pay and the farmer was justified in suspending his performance on the other contracts. The Illinois Court of Appeals affirmed the ruling, holding that when the farmer delivered grain and no payment was forthcoming, "certainly reasonable grounds for insecurity arose with respect to Bunge's future performance." The court said it was reasonable to treat all the contracts together as an "ongoing arrangement" and not consider each separately. As a result,

the company's failure to respond to the farmer's demand by providing adequate assurance of performance meant it had breached the contract, and the farmer was released from performance. In practical terms, it probably meant he could then sell his grain at a higher price and Bunge could not collect damages from him.

But anyone who relies on §2-609 should get the advice of an attorney on the contents of the demand letter and the way to send it. For example, the UCC requires that the demand be in writing. If you don't put it in writing, you run the risk of it not being effective (see sidebar).

COURT RULES THAT TELLING TRUCK DRIVER “NO MORE SHIPMENTS” DOESN’T SATISFY §2-609

In *Scott v Crown* [7 UCC Rep. 2nd 464 (Colo. App. 19880)], a Colorado farmer contracted in February 1983 to sell 16,000 bu. of No. 1 wheat to Crown Co. for April Delivery. The contract required shipment in full before payment was due. A \$ 2,000 advance payment was made, and all the wheat was to be delivered by March 13, 1983, with a final payment of \$49,000 due on April 13,1983. On March 1, 1983, the farmer executed several additional contracts to sell wheat to the buyer and began delivering under them. During this period, the seller’s banker informed him that the buyer was not the “best grain trader” and told the seller to contract the Department of Agriculture for information on the buyer. When the seller did so, he learned there was an active complaint against the buyer concerning payments to other farmers. The next day, when one of the buyer’s trucks came to take another load of grain, the seller refused to deliver any more. Instead, he told the driver that his attorney had instructed him not to load any more grain until he talked with Mr. Crown to “settle some questions.”

The seller and his attorney testified that they tried to contact the buyer by phone several times but were unsuccessful. The next communication was a letter from the buyer in late March in response to the seller’s refusal to deliver more grain. The buyer denied having breached the contracts, noting that they called for full shipment prior to payment, and warned the seller he was breaching the contracts by refusing to deliver, which might lead to damages if the buyer was forced to cover. In early April, the buyer followed up with a letter to the seller in which he canceled the contracts. It was only after this letter that the seller sent a letter from his attorney citing §2-609 and demanding full performance for the previously delivered grain.

Later in April, the seller sued for payment in full for the delivered grain. The buyer claimed there were no reasonable grounds for the seller to deem himself insecure about performance. The trial court held that reasonable grounds did exist, and the appeals court affirmed. But the court went on to hold the seller’s attempt to demand adequate assurance was defective. Rather than send a letter, as required by the UCC, the seller had instructed the buyer’s truck driver and did not send a letter until two weeks after suspending performance.

The court said that in some cases an oral request may be sufficient, but here it was not. No subsequent patten of interaction between the buyer and seller demonstrated that the buyer knew the seller was demanding assurance. The letters from the buyer during March and early April indicated that he thought the seller was refusing to perform the contract. Even the content of what the seller told the truck driver was not adequate under §2-609. Rather than demand assurance of payment, the seller said he was suspending delivery until he got a few questions settled.

The court also noted that a demand for performance assurances can’t be used to force a modification in the contract. Here, the seller agreed to full shipment before payment, meaning he accepted the risk of payment. Even when his attorney did send a demand for assurance, he asked for more than the contract allowed by requesting immediate payment for delivered grain, when the contract provided for delayed payment. As a result, the court held that the farmer did not have the right to suspend performance and demand adequate assurance. Instead, his conduct resulted in an anticipatory breach that gave the buyer the right to cancel the contracts and resort to the buyer remedies provided in the UCC. The case was remanded to the trial court to determine how much the farmer owed the buyer.

If you think you need to use §2-609 to demand assurance of performance, contact your attorney and be sure you do it right. If you don't, you might make matters worse by being the one who breached the contract. Another provision of the UCC provides a remedy when you discover the buyer is insolvent. Section 2-702(1) provides:

Where the seller discovers the buyer to be insolvent he may refuse delivery except for cash including payment for all goods theretofore delivered under the contract, and stop delivery under this Article (Section 2-705).

If the party cannot pay in cash, there is a mutual rescission of the contract. However, using this section presents the risk that you may incorrectly conclude the buyer is insolvent and then be held to have breached the contract by demanding cash payments. It may be wiser to use §2-609 to demand adequate assurances. This way, if the other side can't meet the assurances, he will be forced to breach the contract. This may even put you in a better position for the remedies you can recover. These are issues to discuss with your attorney if the case arises.

CHAPTER EIGHT: RESOLVING DISPUTES

Thousands of farmers have had excellent results with production contracts, finding them profitable and advantageous for their operations. But not all. As the many cases cited in this book indicate, disputes can arise and agreements can go sour.

The cause of a dispute can range from weather to miscommunication to market changes to just bad personal relationships. Possibly the most common reasons are contract terms that producers find inherently difficult to meet (see sidebar).

ARE THERE TIME BOMBS IN YOUR CONTRACT?

Certain types of contract provisions are loaded with the potential to cause problems—they may be time bombs in the making. You do not have a bad contract just because it includes one or more of these provisions, but if it does, you should ask yourself more questions about how the relationship will work

1. Does a “passed-acres” clause let the company decide not to harvest or accept otherwise suitable crops?
2. Do any provisions let the company decide late in the growing season to release the crops from the contract without liability for any payment?
3. Does the contract specify the standards for measuring your performance or require you to “farm by the book,” or does it bind you to undefined standards of “good husbandry”?
4. Can the company make deductions in your payments that not based on your actual performance, such as 3% death loss applied to all contracts?
5. Are there unfunded obligations, such as commitment that you will satisfy all state environmental compliance rules?
6. Do any “incorporation” clauses obligate you to satisfy other laws that you know little about, such as migrant-and seasonal-worker protections?
7. Must you transfer title to the crop without having any way to protect a security interest in the crop until you are paid?
8. Will there be long delays before you are paid the final amounts due?
9. Can the company assign performance of the agreement to another company without notice or your approval?
10. Does the contract obligate you to resolve disputes using mandatory arbitration without the opportunity to present your dispute to a court or jury?
11. Will the contract be interpreted under the laws of another state or require disputes to be resolved in another jurisdiction?
12. Does the contract require you to waive the protection of any laws or procedures you might otherwise have?
13. Does your livestock or poultry contract limit the delay between new batches of animals?
14. If you make expensive capital investments to get the contract, are these protected by a long-term agreement or other limitations on termination?

(See Laura Sands, "Time bombs in your contracts: what you don't know about your specialty-crop contract could hurt you," Top Producer. Mid-February 1994.)

When a dispute does develop, four basic issues have to be decided: 1) What the parties agreed to in the contract; 2) whether either party breached the agreement in some way; 3) what law will apply and where the dispute will be heard; and 4) what procedure will be used. The first two issues, which can be the heart of any dispute, have been discussed in previous chapters. This chapter will focus on the two procedural issues-which will have a direct effect on the outcome of the dispute.

Which State Has Jurisdiction?

Even with the Uniform Commercial Code (UCC), the states can differ in how they resolve specific legal questions. So an important factor in any dispute will be deciding which state's law applies and where the dispute will be resolved. Most contracts answer these questions in several clauses-the choice-of-law, incorporation-of-law and entirety clauses.

Production contracts generally spell out the location for resolving disputes and the law to be used. Not surprisingly, the provisions usually designate the home state and county of the company writing the contract as the place for bringing legal action regarding the contract. (In legal terms, this is known as selecting a home forum or venue.) Usually, the provisions will also select the law of the company's home state as the law to be used for resolving disputes. For example, the Beatrice popcorn contract includes the following provision:

CHOICE OF LAW/JURISDICTION: *This Agreement shall be construed and performed under the laws of the State of Indiana. The courts of Indiana, County of White, shall have exclusive jurisdiction over the parties in any action relating to the subject matter or interpretation of this Agreement.*

ConAgra's Louisiana broiler contract contains this clause:

All actions and proceedings with regard to this Agreement, including arbitrations here after provided, shall be exclusively filed, heard and resolved in Union Parish, Louisiana, for the purpose of jurisdiction and venue.

Frito-Lay's 1994 purchase agreement for white com in Illinois stated:

THIS AGREEMENT SHALL BE GOVERNED BY THE LAWS OF THE STATE OF TEXAS.
This Agreement is entered into, performable at and payable from Dallas County, Texas, and venue for any action based on this Agreement shall rest solely in Dallas County, Texas.

Finally, consider this provision from Cargill's 1994 seed-com contract used in Illinois: *"This Agreement shall be interpreted according to the laws of the State of Minnesota."*

Choice-of-law and jurisdiction clauses give the company several advantages if a dispute arises. They let the company choose its home turf and a body of law that its lawyers know well. They can also force the grower to leap significant hurdles, such as traveling to another state and hiring a local attorney to pursue legal action. In addition, if your state provides special protections or rules in certain types of contract disputes, the choice of law from a different state may mean you cannot claim the local protections. But the reverse can also be true. The Cargill contract used in Illinois incorporates the law of Minnesota. This may be fortunate for Illinois growers because Minnesota has adopted extensive legal protections for contract production. Without the contract term, Illinois growers would not have the benefit of the Minnesota law (see sidebar).

WHICH LAW APPLIES WHEN THE CONTRACT DOESN'T SAY?

Parties from different states are free to decide which state's law will apply to their contract. But occasionally, a production contract does not include a choice-of-law clause, leaving open the question of which state's law will apply to any dispute. The UCC's §1-1 05 favors the law of the jurisdiction bearing a reasonable relation to the transaction—in most cases, the state where the contract is to be performed. This issue can be particularly important if the two states in question have adopted different versions of the UCC on the issue in dispute.

Consider the situation in *Dunavent Enterprises, Inc v. Ford* [294 so.2d 788 (Miss. 1974)]. A Mississippi cotton grower contracted to sell all the cotton he would raise on 1,600 acres to a Tennessee company. The weather prevented the farmer from planting all 1,600 acres, but he delivered all the cotton from the 1,250 acres that he did plant. He claimed protection under §2-615 of the UCC (see Chapter 4), claiming commercial impracticability due to crop failure. The company argued that because the contract was signed in Tennessee, it should be interpreted under Tennessee law. At that time, Tennessee had not adopted the force majeure provisions of §2-615, so the farmer's excuse might not be valid.

But because the contract did not specify that Tennessee law would apply, the trial court had to decide the issue. It held that the law of Mississippi, the state where the cotton was to be grown, harvested, delivered, should apply. The Mississippi Supreme Court affirmed the ruling and noted that the farmer's situation was exactly the sort for which the crop-failure protection of §2-615 was designed.

Another provision that appears in virtually every production contract is the entire-agreement clause, providing that the written contract is the entire agreement between the parties. The clause exists to prevent growers from using oral modifications or other evidence to argue that the terms of the agreement have been modified. The "integration" clause in the 1992-93 waxy-corn contracts used by the Farmers Cooperative Company of Aurelia, Iowa, reads:

This agreement constitutes the entire understanding between the parties here to. Except as set forth elsewhere herein, neither Buyer nor Seller has any authority to alter, modify or assign this agreement or any part here of without the prior written consent of the other party. No such alteration or modification shall be effective unless in writing and signed by the parties hereto. Any assignment made without such consent shall be null and void and of no effect. This agreement shall bind each of the parties hereto, their heirs, administrators, executors, successors and assigns.

Integration clauses such as this one are enforceable and relate directly to the issues of the statute of frauds and oral modifications discussed in Chapter 4.

Many production contracts also include provisions regarding which other laws apply to the agreement. These clauses can range from an agreement requiring the grower to comply with all environmental laws and worker protection requirements to the statement that the contract will be interpreted under the terms of the UCC. For example, under the ConAgra broiler contract used in Louisiana, the grower agrees to "properly dispose of dead birds and litter as required by the Louisiana

Department of Agriculture & Forestry." The DuPont contract for high-oil corn includes the following sentence in Article 8:

This Agreement shall be interpreted In accordance with the Uniform Commercial Code as adopted by the state of residence of the GROWER

The Cargill white-corn contract used in Kansas in 1993 included the following incorporation clause:

Seller further warrants that neither the commodity nor the shipment of such commodity shall be in violation of any and all other federal, state and local laws, regulations or ordinances. If commodities are adulterated, whether by aflatoxin or by other adulteration under any applicable laws, or the commodity or its shipment is in violation of any other clause of this provision Seller shall be in breach of this Contract, shall indemnify Buyer from all costs, damages, and losses, whether arising out of Seller's negligence or strict liability and Buyer may take advantage of any and all remedies given under the terms and conditions of this Contract or under federal, state and local laws.

In some cases, these incorporation clauses may even obligate the grower to comply with laws that would not normally apply to a farming venture (see sidebar).

NATIONAL GRAIN AND FEED ASSOCIATION RULES MAY APPLY TO GRAIN SALE CONTRACTS

Many grain-industry contracts have a provision incorporating the rules of the grain trade. For example, the "Purchase Confirmation and Contract" that Cargill used in 1993 for white corn in Kansas included a box at the top of the first page and read: "Rules Subject to:" Typed into the box was "NGFA."

The provision means that the rules of the National Grain and Feed Association, the main voluntary trade organization of the grain industry, are part of the contract. If a dispute arises over a matter such as quality testing or the discount to apply, the company can argue that the issue will be resolved through the trade rules. This use of industry standards to resolve matters is common between merchants and members of the trades and is endorsed by the UCC.

The main problem for a producer is that he probably has no idea what these rules provide. In fact, one main effect is that the NGFA has established an arbitration system for resolving disputes. The Cargill contract also provides the following:

The parties both agree that the sole remedy for resolution of all disagreements between parties arising under this contract shall be arbitration proceedings under the NGFA Arbitration Rules (or under the Rules specified on the front of this contract, if different). The decision and award determined by such arbitration shall be final and binding on both parties.

For a copy of the NGFA booklet Trade Rules and Arbitration Rules, write to the NGFA at 1201 New York Ave., N.W., Suite 830, Washington D.C. 20005; or call 202-289-0873

Some incorporation clauses are brief and may have little effect on the parties' obligations. But others can have a significant effect, adding obligations to the agreement. An example of an extremely detailed incorporation clause is found in the Beatrice popcorn contract:

EMPLOYMENT STANDARDS: *Grower agrees all popcorn contracted herein was or will be grown in accordance with the applicable provisions of Sections 6, 7 and 12 of the Fair Labor Standards Act of 1938, as amended, and the regulations and orders of the United States Department of Labor issued under Section 14 thereof, and agrees whenever applicable, to comply with §202(l) to (7) inclusive, Of Executive Order No. 11246, as amended by Executive Order No. 11375, and regulations there under, the provisions and regulations of the Occupational Safety and Health Act, and §503 of the Rehabilitation Act of 1973, and all other applicable regulations, including Affirmative Action for Handicapped Workers, 41 CFR§60-741.4, and Affirmative Action for Disabled Veterans of the Vietnam Era, 41 CFR §60-250A, and Public Law 95-507, Utilization of Small Business Concerns and Small Business Concerns Owned and Controlled by Socially and Economically Disadvantaged Individuals, as the same may be amended from time to time, and all of which are hereby incorporated by reference as though fully set forth herein. Grower agrees that he will furnish the Company with written certification of such compliance either ten (10) days after final delivery, prior to final payment hereunder, or at any other time during the term hereof when requested by the Company.*

This provision appears to be included to comply with the federal governments purchasing requirements. Unfortunately, most farmers don't know what the laws require, or even how to find out-raising a question about the effect of the grower's promise of compliance and certification. But such detailed incorporation clauses illustrate how grain production Contracts can bring on obligations of uncertain magnitude for farmers.

A close look at these contracts shows that various other clauses can appear, including:

- *Severability.* The clause states that if a court should find part of the contract illegal or otherwise invalid, the rest of the contract can still be enforced.
- *No waiver.* If the parties through conduct or oral agreement change or waive the enforcement of some term of the contract, such as by accepting late delivery on one occasion, they do not reform the contract to waive the original term.
- *Attorneys' fees.* Many production contracts provide that if the company must spend money on legal fees to enforce the contract, the grower will be responsible for paying the fees.
- *Assignment.* Some production contracts include a provision that prevents the grower from assigning or transferring responsibility for performing the contract to another person.

The ConAgra broiler contract used in Louisiana provides:

Grower may not transfer nor assign his/her rights, duties, and/or obligations pursuant hereto, without the prior written consent of ConAgra

Ways to Resolve Disputes

No doubt the best way to resolve a dispute is to avoid it in the first place. Understanding your contract and maintaining open communications with the company can go a long way to avoiding surprises. But when problems do develop, the parties must consider their options whether to go along with whatever has happened or to fight over the alleged breach of the agreement.

Usually, the parties will try to resolve their dispute through negotiations, with or without the help of attorneys. The vast majority of legal disputes in the U.S., even those that end up in court, are

ultimately resolved when the parties find a negotiated settlement. So the first rule of addressing a dispute is to try to negotiate a resolution. When parties do so, they usually save time and money; they end up with a healthier relationship (perhaps one that can continue); and they maintain control over their own business arrangements. But when negotiations fail or are not worth pursuing, the parties must decide what other approaches to follow to resolve the dispute.

If you decide to pursue formal legal resolution, you still have to decide which procedure to use. The most common options are litigation, mediation and arbitration. If you are bringing the action, you may have control over which procedure to use. The only limitations occur when the contract or state law requires certain procedures for resolving disputes. If the other party to the contract brings the action, you might not have a choice but to defend or respond in that forum.

The most common formal method for resolving legal disputes is to file a lawsuit in a local state court based on an alleged breach of contract. The aim of litigation is to bring the legal matter before a judge or jury authorized to decide which party has acted legally. If one party has filed an action for breach of contract, all the legal principles and rules discussed in Chapters 3 and 4 will come into consideration; other legal issues discussed in the previous chapters may also arise. Court cases can be lengthy, complicated and expensive. The success of any case depends on the agreement involved, the conduct in question, the quality of the evidence that can be presented, the state law on contractual issues and the damages that can be proved to have occurred.

If you end up in court, you will of course need to contact an attorney and pay for representation and advice. In most instances, each side will bear its costs in a breach-of-contract action. You should not expect that you can make the company pay for your costs in bringing suit—even if you win. Recovering legal costs is more the exception than the rule, so you must recognize that your costs will reduce the amount of the final judgment you may get from the court. If you are considering suing for an alleged breach of contract, it is important to discuss with your attorney how you will place a fair and reasonable value on the damages you may recover. You may find that the amount involved does not justify bringing a court case.

Alternative Dispute Resolution

Litigation is only one way to resolve a legal dispute. In recent years, there has been increasing interest in alternative dispute resolution (ADR). In fact, many production contracts include ADR provisions, and some state laws encourage their use. The two main forms of ADR for producers are mediation and arbitration.

Mediation requires the parties to meet and discuss their differences with a trained mediator, a neutral party who works with the parties to reach a solution. The mediator does not act like a judge in resolving the matter or imposing a legal decision, and instead helps the parties identify options for resolving their differences without going to court. The idea is that mediation may be more effective in resolving matters because it helps restore communications after the relationship has broken down. Under most state laws, the parties divide the cost of mediation.

Mediation may offer a quicker and much less costly way to resolve a problem than litigation. But it is important to recognize that mediation will not always work. The mediator does not have the authority to order the parties to take certain actions or to force them to agree. If mediation does not result in an agreement to settle, the parties may still sue.

Many producers are familiar with mediation because it received considerable attention as a way to resolve agricultural credit conflicts in the 1980s. Several states have adopted mandatory mediation for different types of agricultural disputes. In 1990, Iowa became the first state to require mediation in disputes involving livestock production contracts. Under the law, a farm resident or other party may request mediation of a dispute involving "the performance of either person under a care and feeding contract, if both persons are parties to the contract" [Iowa Code §654 B.1 (2) (a)]. The term "care and feeding contract" is defined as "an agreement, either oral or written, between a farm resident and the owner of livestock, under which the farm resident agrees to act as a feeder by promising to care for and feed the livestock on the farm resident's premises." The Iowa law makes mediation mandatory—courts cannot hear such cases until the parties present a release obtained from the mediation service.

Several other states have promoted mediation by enacting laws to regulate contracting (see Chapter 12). For example, Minnesota Code §17.90 -.98, enacted in 1991, establishes a number of requirements for all "agricultural contracts," including:

A contract for an agricultural commodity between a contractor and a producer must contain language providing for resolution of contract disputes by either mediation or arbitration.

Similarly, a 1994 Kansas law, which authorizes swine production contracts by corporations and packers, requires that all swine production contracts "contain language providing for resolution of contract disputes by either mediation or arbitration."

The second major form of ADR important in production contracting is arbitration. As a way to resolve a dispute, arbitration is closer to litigation than to mediation because it will result in a final legal decision determining the rights and obligations of the parties. But rather than take the dispute before a judge or jury, the parties take it before an arbitrator or panel of arbitrators with expertise in resolving commercial disputes of the type involved. The parties to the dispute present the facts of their matter and make their legal arguments based on the contract and the law that governs the relationship. The arbitrators then issue a ruling. Arbitration is considered less costly than litigation because the procedure usually takes less time. Each party is generally responsible for paying its share of the costs.

Some forms of arbitration let the parties take a further appeal of the arbitrator's decision to the courts. In this case, arbitration is just one more step in trying to resolve the matter. But in other cases, the ruling may be final binding arbitration, meaning the parties cannot appeal the dispute to a court and are bound by the decision of the arbitrators.

Whether a matter must be submitted to arbitration, and whether arbitration is final, will depend on several factors. First and most important is whether the contract obligated the parties to use arbitration. Arbitration clauses are becoming increasingly common. For example, the Cargill white-corn contract used in Kansas in 1993 specified:

The parties both agree that the sole remedy for resolution of all disagreements between parties arising under this contract shall be arbitration proceedings under the NGFA Arbitration Rules (or under the Rules specified on the front of this contract, if different). The decision and award determined by such arbitration shall be final and binding on both parties.

But a second factor may determine whether contract provisions requiring arbitration are enforceable under state law. Each state has a law concerning the use of arbitration and determining

how arbitration agreements will be enforced. Most of these laws recognize that written agreements requiring parties to submit controversies to arbitration are valid and enforceable, unless grounds exist under state law for not doing so. One of the grounds may be that the requirement of binding arbitration is unfair.

For example, the Iowa law on arbitration [Iowa Code §679A 1(2)(a)] provides that language requiring arbitration is not enforceable if it is in “*a contract of adhesion.*” This sort of contract is basically one in which the party had no ability to alter or negotiate the terms. No Iowa court has yet said whether a production contract requiring arbitration is a contract of adhesion. There may be cases interpreting your state law on arbitration that provide guidance on these issues (see sidebar).

COURT RULES GROWERS MUST GO THROUGH ARBITRATION EVEN THOUGH OTHER GROWERS WON

One state court case involving arbitration of a production contract is *Amdahl v. Green Giant Co.* [497 N.W.2d 319 (Minn. App. 1993)], which involved several lawsuits by vegetable growers. Under the production contracts the growers signed in 1981, they were given the option of taking a fixed price or participating in a futures program. In the futures program, the grower’s compensation for their vegetables was tied to the price of field-corn contracts on the Chicago Board of Trade. Under the contract, each producer received a partial fixed payment in the fall of 1981, the Schedule A payment. The second payment, Schedule B, was due in June 1982 and was to be determined by the success of the futures trading. The futures program proved to be a disaster for many of the growers who chose the option. Declines in the price of field corn led to substantial losses for many growers; most received less than what they would have if they had chosen the fixed-price option. Some lost so much money that they owed the company a refund when it came time for the second payment in June 1982.

Green Giant tried to collect the losses it experienced by deducting the sums owed from the Schedule B payment, or by demanding and receiving repayment from growers, or by initiating arbitration as required under the contract. Green Giant arbitrated the contract with a group of growers, and the arbitrator ruled for the growers, saying the contract precluded Green Giant from recovering losses beyond the size of the Schedule B payment.

Another group of growers sued in federal court, alleging breach of contract and claiming that the first arbitration decision was binding on them, meaning they didn’t have to go through new arbitration. The dispute went before several federal and state courts before the Minnesota Court of Appeals resolved the matter. It held that the first arbitration did not preclude the company from relitigating the issue with growers who were not part of the original proceeding. The court held the parties had to go through new arbitration on the matter.

Most legal observers consider alternative dispute resolution to be an important legal reform that makes it easier to resolve disputes. As a result, people are promoting arbitration and mediation clauses in different agreements. But it is important to recognize that alternative dispute resolution, especially arbitration, can be a defensive technique used by companies to minimize the growers' ability to obtain relief in the courts.

Companies might favor using arbitration rather than face litigation for several reasons. First, the company can control the arbitration procedure by including it in the contract, even detailing where it will occur. The arbitration clause can also incorporate special rules of law or practice, such as those of the NGFA, noted above. While the company may be familiar with these rules and procedures, most growers will not be. In addition, arbitration may be less expensive than a full-blown lawsuit, but growers will still need to hire attorneys and pay the costs of the arbitration panel. For example, a Mississippi poultry grower who was trying to sue his contractor, Wayne Poultry, discovered he would have to pay arbitration fees and expenses of almost \$10,000 to get his case heard.

The contract can try to make arbitration the final decision in a case. Even if the clause is not enforceable, the arbitration clause will require growers to go to the expense and trouble of arbitration before being able to go to court. And the awards granted in arbitration are generally less expensive than in court actions. Arbitrators generally have no authority to award large punitive damages for acting in bad faith. In contrast, several recent lawsuits involving poultry contracts have resulted in the growers' receiving multimillion-dollar awards of punitive damages.

Arbitration may also let companies avoid judicial rulings concerning the legal effects of contract provisions. By avoiding dangerous legal precedents, contractors can limit the filing of "copycat" suits by growers who feel they were similarly injured. All these reasons may help explain why there has been an increase in the defensive use of arbitration clauses by contractors (see sidebar).

POULTRY COMPANY INCLUDES DETAILED ARBITRATION CLAUSE IN NEW CONTRACTS

Consider the following provision for a ConAgra 1993 Louisiana broiler contract, which was added after the state legislature almost adopted a requirement of mediation or arbitration:

All claims between Grower and ConAgra arising out of this Agreement shall be submitted to arbitration. The following procedure shall apply:

- (a) Either party may demand arbitration in writing within ten (10) days after the alleged claim was known or reasonably should have been known. Such demand shall include the name and address of the arbitrator appointed by the party demanding arbitration.
- (b) Within ten (10) days after such demand the other party shall name an arbitrator and notify the other party of the name and address.
- (c) The two arbitrators shall within ten (10) days request a panel of seven (7) to be designated by the American Arbitration Association, one of whom shall be selected as the third arbitrator. The party requesting arbitration shall make the first challenge/strike from the panel of seven. The third arbitrator shall serve as chair of the proceedings.
- (d) All arbitrators shall be persons having knowledge of and experience in the broiler production industry.
- (e) Either party may demand arbitration in writing within ten (10) days after the alleged claim was known or reasonably should have been known. Such demand shall include the name and address of the arbitrator appointed by the party demanding arbitration.
- (f) Within ten (10) days after such demand the other party shall name an arbitrator and notify the other party of the name and address.
- (g) The two arbitrators shall within ten (10) days request a panel of seven (7) to be designated by the American Arbitration Association, one of whom shall be selected as the third arbitrator. The party requesting arbitration shall make the first challenge/strike from the panel of seven. The third arbitrator shall serve as chair of the proceedings.

- (h) All arbitrators shall be persons having knowledge of and experience in the broiler production industry.
- (i) Each party shall bear his own arbitration costs and expenses, and the costs and expenses of the third arbitrator shall be shared jointly and equally between the parties.
- (j) The arbitration hearing shall be held at the venue provided herein and at least twenty (20) days notice of the hearing date, time and location shall be provided by the parties.
- (k) The arbitrators selected shall hear the evidence and testimony offered by both parties, and the arbitration hearing shall be concluded within ten (10) days unless otherwise ordered by the arbitrators, and the arbitrators will make a majority decision within a reasonable period of time. Both parties shall be allowed a period of time to submit post-hearing briefs within a period of time designated by the arbitrator acting as chairperson. An award rendered by a majority of the arbitrators appointed pursuant to this Agreement shall be final and binding on all parties unless the finding is arbitrary or capricious. Such judgment or award rendered by a majority of the arbitrators may be entered by either party in any courts as herein provided having jurisdiction.
- (l) The parties stipulate that the provisions hereof shall be a complete defense to any suit, action, or proceeding instituted in any Federal, State or local court of before any administrative tribunal with respect to any controversy or dispute arising during the period of the Agreement and which is arbitrable as herein set forth. The arbitration provisions hereof shall, with respect to such controversy or dispute, survive the termination or expiration of this Broiler Growing Agreement.
- (m) Nothing herein contained shall be deemed to give the arbitrators any authority, power, or right to alter, change, amend, modify, add to or subtract from any of the provisions of this Broiler Growing Agreement. All matters pertaining to such arbitration shall be in accordance with the Louisiana Arbitration Law, LSA R.S. 9:4201, et seq., unless otherwise provided in this Agreement

This clause, while clearly establishing a mechanism to resolve contract disputes, also shows how arbitration can be used to provide a serious limitation on the types of legal remedies that a grower might otherwise have.

If a contract includes use of arbitration for resolving disputes, you should ask yourself a number of questions about the potential effect:

1. Is the use of arbitration mandatory, or do you have the option to choose another method, such as mediation?
2. How many arbitrators will there be?
3. Who will choose the arbitrators?
4. Which arbitration rules will be used—those of the American Arbitration Association, state law, or a trade association such as the NGFA?
5. Where will the arbitration be held?
6. Who is responsible for paying the costs of the arbitration?
7. Will you need an attorney for the arbitration proceeding?
8. Is there a limitation on the issues the arbitration can address?
9. Is the result of the arbitration binding, or can you appeal the decision to a court?

10. Is the arbitration clause enforceable?

Twelve Questions to Consider if a Dispute Arises

If a dispute arises over a production contract, you should evaluate the merits of your case and the likely arguments you can make. These questions can help you decide what possible claim you might have:

1. Was the contract signed by both parties?
2. Was the negotiation to enter the contract actually completed, i.e., was there a meeting of the minds, or were the discussions incomplete?
3. Is the language of the agreement clear and precise, or are there ambiguous terms?
4. Can the contract be attacked as unconscionable?
5. Was the contract between business people in a commercial setting or more like a consumer transaction?
6. Was the agreement altered by any oral promises or conduct, and were these relied on?
7. Did the other party perform the contract in good faith?
8. What damages occurred because of the breach of contract?
9. Were the damages foreseeable to the other party or the consequences of your own situation?
10. How did you limit the damages once the contract was terminated?
11. What does the contract provide for resolution of disputes?
12. What efforts have you made to resolve the dispute?

CHAPTER 9: GRAIN PRODUCTION CONTRACTS

Every agricultural sector that uses production contracts faces its own legal issues. For grain producers, these often focus on who owns the crop under contract. Like custom operators, growers under contract may fail USDA's at-risk tests, potentially complicating eligibility for farm programs or crop insurance claims. Laws written to protect farmers' payments with grain dealers may not be fully adapted for production contracts. Meanwhile, plant breeders are challenging "brown bagging" and other practices they believe infringe on their intellectual-property rights. But because production practices are changing faster than our legal system, many gray areas remain.

Production Contracts and Farm-Program Participation

Production contracts for grain raise various questions about participating in federal farm programs. The regulations that determine a producer's eligibility for price-support loans, for instance, require that a producer "have a beneficial interest in the commodity that is tendered to the CCC for a loan, loan deficiency payment, or purchase" [7 CFR §121.5(c) (1) 1993]. This means that when a grower has already passed the title or ownership of the crop to another party under a production contract, the question arises whether the grower still has enough "beneficial interest" to be eligible for farm programs. The ASCS rules include the following test:

A producer shall not be considered to have divested the beneficial interest in the commodity if the producer retains control of the commodity, including the right to make all decisions regarding the tender of such commodity to CCC for price support, and the producer:

(i) Executes an option to purchase whether or not an advance payment is made by the potential buyer with respect to such commodity if the option to purchase contains the following provisions:

"Notwithstanding any other provision of this option to purchase, title; risk of loss; and beneficial interest in the commodity, as specified in 7 CFR part 1421, shall remain with the producer until the buyer exercises this option to purchase the commodity. This option to purchase shall expire, notwithstanding any action or inaction by either the producer or the buyer, at the earlier of: (1) The maturity of any Commodity Credit Corporation price support loan that is secured by such commodity; (2) the date the Commodity Credit Corporation claims title to such commodity; or (3) such other date as provided in this option." or

(ii) Enters into a contract to sell the commodity if the producer retains title, risk of loss, and beneficial interest in the commodity and the purchaser does not pay to the producer any amount or any incentive payment amount to enter into such contract except as provided in part 1425 of this title [emphasis added].

Chapters 6 and 7 noted that some production contracts try to limit the grower's legal claim to the commodity-typically, by providing that the grower has no legal interest in the crop. The DuPont contract for high-oil com (see Chapter 5) is a good example of such an agreement, stating: "*The parties agree that the seed, growing crops, pollen, tissues or molecular components, and the harvested crop (hereinafter collectively referred to as Topcross) are owned solely by DuPont.*"

Does this mean that producers who sign similar contracts are not eligible for the farm programs? USDA and ASCS have not ruled that a typical grain production contract violates the beneficial interest rules so that a producer is not eligible for payments. But compare the language in the ASCS rules on beneficial interest with many production contracts' provisions regarding title to the crop, and you will see why the question is a legitimate one.

In fact, some observers believe that USDA may be developing new guidelines on "beneficial interests," possibly to be proposed by 1995. If so, producers will need to be aware of USDA's plans for applying the test to production contracts. When farm-program participation, such as the opportunity to receive deficiency payments, is part of a producer's calculation in entering a contract, he will have to determine whether the contract's terms relating to risk of loss, passage of title, and timing and method of payment leave him with enough beneficial interest to be eligible.

While it is too early to tell how USDA may act on this matter, a recent ASCS decision on seed-corn production in 1994 provides some indication of the agency's thinking. When reviewing claims for disaster assistance, the agency concluded that several seed production contracts, which included provisions for minimum payments or earning guarantees, had to be reconsidered in determining whether the producers experienced losses that could be compensated under disaster-relief programs. The issue concerned whether the producer bore any risk of loss to the crop under contract. This review led to reconsideration of the eligibility of producers for assistance.

In spring 1994, seed-corn producers in Illinois who had signed contracts with Cargill received a letter from the county ASCS office that included the following:

Dear Producer: The Illinois State ASCS Committee has reviewed the 1994 seed corn contracts for Cargill Hybrid Seed Inc. It is the determination of the State Committee that producers of 1994 seed corn for Cargill Hybrid must include Cargill Hybrid on the 1994 Wheat and Feed Grain contracts. Cargill has been informed of this determination.

At the earliest convenience, please stop at the office to revise your 1994 contract. If you have questions regarding this matter; please do not hesitate to contact the office.

ASCS officials have indicated that they sent the letters after determining that the contract's use of commercial corn averages for part of the payment effectively removed some of the producers' financial risk in raising the crops. Under ASCS field guidelines [5-PA(Rev. 10) Amend 1, page 8-425, Par 931 A and B], the agency determined that Cargill's name needed to be added to the contracts. In past years, agency officials have routinely reviewed contracts used by cotton and rice companies to ensure producers retained sufficient risk of loss and beneficial interests to meet farm program rules.

Crop Insurance: Do You Have an Insurable Interest?

Another issue for many grain producers considering a production contract is their ability to obtain crop insurance. In legal terms, the question is whether a producer retains sufficient "insurable interest." One main court case ruled in favor of producers; *Parks v. Federal Crop Insurance Corporation*

(FCIC) [416 F. 2d 833 (7 CA 1969)]. The issue was whether six Indiana farmers who had raised hybrid seed corn under contract with DeKalb were eligible for insurance payments on losses experienced in 1965.

The federal district court and FCIC ruled that the seed-corn growers were not producers under the law and did not have an insurable interest for federal crop-insurance purposes because their contracts guaranteed them a price and they didn't own the crop. The federal Court of Appeals reversed the lower court's ruling and said the farmers were growers for purposes of FCIC. The court also ruled that while the seed-corn contract included certain price guarantees, the producers' ultimate payment depended on how much corn they raised. The producers did suffer a financial loss because of the damage to the crop by drought. The court held that this was an insurable interest, even though the producers might not have had title to the crop.

Grain Dealer Protections and Credit Sales

The most important issue facing a grower marketing grain under a production contract is the risk of not getting paid. Risk arises when there is a time lag between grain delivery and payment. Is the grower financing the buyer's operation, and if so, what type of security interest or other legal protection does the grower have to ensure getting paid?

Some of the most important legal protections here are state grain dealer laws regulating the activities of those who buy grain from producers. The laws typically provide for payment upon delivery or demand by the grower, unless the sale is some form of deferred-pricing arrangement. The laws also typically require buyers to be licensed and to obtain bonds, which are used to pay growers if the buyer defaults. Some states, such as Iowa, place liens on the assets of grain dealers in favor of unpaid sellers.

But if the contract alters the timing of payment, the producer may have transferred title to the grain to the dealer and may have only a contract claim for payment. The following provision from Missouri's law is representative of how the laws work:

In general, a person licensed as a grain dealer shall make payment of the agreed-upon purchase price to the seller of grain upon delivery or demand of said seller or his authorized agent, unless a written grain purchase contract or valid deferred payment contract shall provide otherwise [Vernon's Ann Mo. Stat. §276.461 (1) (199311)].

Two things are necessary for a state's grain-dealer law to apply: First, the buyer must be regulated as a grain dealer and subject to the payment requirement; and second, the transaction must involve the sale of grain. Keep in mind that some production contracts—such as DuPont's for high oil corn—treat the transactions not as sales but as payment for services. In these cases, there is some question whether the state grain-dealer laws apply. In addition, most grain-dealer laws specifically exclude deferred pricing or credit sale transactions from coverage. Many production contracts specifically include the producer's agreement to delayed payment or a price-later system.

There is also the question whether the contractor considers himself to be a grain dealer and has obtained a license. Consider the definition of a grain dealer from the Illinois Grain Dealers Act:

Any person engaged in the business of buying grain from producers thereof for resale or for milling or processing. A producer of grain buying grain for his own use for

seed or feed shall not be considered as being engaged in the business of buying grain for resale or for milling or processing [225 ILCS 630/1(1994)].

The fact that a company does not consider itself a grain dealer would not prevent the state from ruling it is one, but the fact that a company does not have a license or a bond would limit your ability to seek payment in case of a default.

Based on a review of many grain production contracts, it appears that some of the companies that contract for specialty-crop production do not believe their activities require them to be licensed as grain dealers. Consider the warning, printed in boldface and capital letters, on a soybean production contract used in Iowa:

NOTICE TO SELLER OF FINANCIAL RISK

THIS CONTRACT CONSTITUTES A VOLUNTARY EXTENSION OF CREDIT.

THIS CONTRACT IS NOT COVERED BY ANY GRAIN BUYER'S BOND.

This clause warns the grower that until he receives payment, he is an unsecured and unprotected creditor of the buyer. This contract suggests that the company believes it is not a grain dealer and is under no obligation to make payment on delivery, obtain a state grain dealer's bond or make contributions to the state's grain indemnity fund, used to compensate unpaid sellers. Whether state officials would come to the same conclusion is uncertain. The issue may be especially important to specialty-grain buyers who operate without licenses, because laws such as Iowa's make it a serious crime to buy grain without obtaining a grain dealer's license [Iowa Code §§203.3(1) and 203.1 1(2)].

The risk of nonpayment may not be significant when dealing with a well-known company such as Pioneer or DuPont. But producers who sell specialty crops to small or new firms should consider their possible financial risks. If you contract to raise and sell grain to a company, you should definitely ask the company whether it is licensed as a grain dealer under state law. Producers should also consider taking precautions, such as those discussed in Chapter 7, to ensure they will be paid for the grain after they have delivered it.

Intellectual-Property Rights and Crop Production Contracts

The trend toward contract grain production is directly related to the development of improved plant genetics to produce high-value crops for special uses. There is also a direct correlation to the availability of intellectual-property-right protections for agricultural crops. Companies that are spending millions of dollars on new crops want to protect their financial investments in their creations and claim rights further along the production chain. That is why chemical companies are entering grain production by opening subsidiaries engaged in contract production.

Companies can extend protections over new plant genetics several ways. They can own or rent land and raise the crop themselves, although this is costly and even illegal for some companies in many Midwestern states. They also can sell the seed to farmers and then buy back the production in the open marketplace for further distribution, although they will risk losing control over the specially tailored genetics. When farmers can save the seed and replant it, the company loses some of its ability not just to sell the seeds but also to capture the added value. Any open sale of the improved seed may also reduce the extra value itself, unless the public marketplace provides a way to value the additional traits.

In this case, poultry growers who buy high-oil corn might get a better feed ingredient, but without having to pay anyone for the improvement. The companies can also contract with farmers to raise the crops and to then sell the crops exclusively to the company for further marketing. This is, of course, the use of production contracts.

To protect their interests in both the improved genetics and their ability to maximize the financial gains from the products, companies will use whatever laws are available. The laws that are most directly applicable are those protecting intellectual-property claims in seeds and plants. The U.S. is the most advanced nation in applying the full range of intellectual-property protections to living materials, including plants.

INTELLECTUAL-PROPERTY PROTECTIONS FOR SEEDS IN THE U.S.

U.S. plant breeders have several ways to protect their interest in a new variety including:

Plant-variety protection certificates. Plant breeders of new sexually reproducing varieties may claim “breeders’ rights” under the Plant Variety Protection Act [7 USC §§2321-2883]. This approach is most commonly used for cross or self-pollinating crops such as wheat and soybeans.

“Plant patents.” Plant breeders and companies who develop or find asexually reproducing plants—those reproduced using cuttings or scions of the original, such as fruit trees—can claim a “plant patent” under the 1930 Plant Patent Act [35 USC §§ 161-164]. This act, the first legal protection for plant breeders, was influenced by the experience of famed plant breeder Luther Burbank, who found it difficult to reap commercial rewards for his inventions.

Utility patents on plant varieties. The newest, and in some ways the most controversial, protection for new plant creations is utility patents, so called to distinguish them from “plant patents.” Under a 1985 decision of the U.S. Patent Office, *Ex Parte Hibberd* [227 U.S. P.Q. 442 (B.P.A.I. 1985)], a plant breeder may obtain a utility patent on a new plant variety. The Patent Office’s decision to allow the patenting of plant varieties followed a 1980 U.S. Supreme Court decision approving patenting of living organisms that are developed by genetic engineering. Hundreds of these patents have been issued for plant varieties. The most extreme applications of plant patents are the recent decisions to grant *Agracetus*, a Madison, Wis.-based subsidiary of W.R. Grace, separate patents for “all genetically engineered” cotton and soybeans.

Trade secrets on hybrids. In addition to these formal mechanisms, plant breeders have more informal ways to protect their inventions. For example, breeders of hybrid seed corn use the law of trade secrets to protect the identity of their parent lines from other breeders and maintain control over the production of their hybrids. Because of the hybrid nature crop, farmers cannot save seed for planting and obtain the same results. The self-protecting nature of hybrids is one reason that seed companies have experimented for years in hybridizing other crops, such as canola, cotton, wheat and soybeans. With the exception of canola, the efforts have been largely successful. In recent years, there have been several highly publicized lawsuits involving seed companies fighting over the ownership of parent lines of hybrid corn.

Companies may also protect their intellectual property through contractual arrangements, with the producer agreeing not to save or sell any of the harvested crops as seed. Some companies in the soybean business do not use the Plant Variety Protection Act; instead, contractual provisions let the companies use breach-of-contract claims in local courts to enforce their ownership of the seeds. The

contractual claims concerning seed ownership are included on the label when the seed is sold or appear on the back of the purchase agreement (see sidebar).

IOWA SOYBEAN COMPANY USES PURCHASE AGREEMENT TO PROTECT SEEDS

A good example of an ownership clause is the sales agreement used by an Iowa seed producer. The front of the bill of sale provides, "Terms on the reverse side are a part of this Agreement. Read Carefully." The back of the agreement lists several detailed provisions on matters such as limitation on warranties and a notice of required arbitration. The provision on intellectual property reads:

STINE SEED COMPANY PURCHAS AGREEMENT

Supplier represents and Purchaser hereby acknowledges that Supplier is engaged in the business of developing and supplying for sale various varieties of seeds. Supplier has a substantial investment in the development and production of Stine Brand Seeds and in the use of subsequent production of the Stine Brand Seeds herein sold. Supplier has expended substantial effort in developing a market for Stine Brand Seeds. Supplier has existing contractual relationships with other purchasers and growers for the sale of Stine Brand Seeds and expectations of additional contracts for the sale of Stine Brand Seeds in the future.

In consideration of the foregoing and in consideration of the Stine Brand Seeds herein sold, **Purchaser hereby acknowledges and agrees that the production from the Stine Brand Seeds herein sold will be used only for feed or processing and will not be used or sold for seed, breeding or any variety improvement purposes.** Purchaser acknowledges Supplier's proprietary interest in the use of subsequent production from the seeds herein sold, and agrees it would be a violation of this agreement to allow subsequent production of the seed herein sold to be used to create a seed variety or seed product from said production, which may be used for seed purposes by individuals or entities other than Stine Seed Company. Purchaser agrees and acknowledges that any use of Stine Brand Seeds which is forbidden by this agreement will constitute a misappropriation of the personal property of Stine Seed Company, and will therefore result in a breach of the agreement. Purchaser agrees that Supplier may bring an action in Dallas County, Iowa, to recover damages as a result of the breach of this agreement, along with reasonable attorney fees and costs associated with any action commenced in regard thereto.

Purchaser agrees and acknowledges that any use of Stine Brand Seeds forbidden by this agreement will damage Supplier's legitimate expectation of future sales of seed, and any use of Stine Brand Seeds in violation of this agreement will constitute an attempt to intentionally injure or destroy Supplier's prospective business expectations in future sale of Stine Brand Seeds.

Purchaser agrees and acknowledges that any use of Stine Brand Seeds in violation of this agreement will cause a substantial damage to Stine Seed Company, and that if subsequent production of the seed herein sold is used to create a seed variety or seed product a substantial damage to Stine Seed Company for all seed varieties or seed products thereby created will be caused. This agreement shall not limit any other rights, legal or equitable, that the Supplier has but

Under this contract, growers have no right to save any seed for future plantings. This limits the farmer's rights to save seed for next year's planting if the seed is protected under the Plant Variety Protection Act. Restrictions on saving crops for future seed use are also commonly found in specialty-crop production contracts. The following clause is from an Iowa company's contract with farmers to raise specialty soybeans:

No Sales to Third Parties. *Grower acknowledges that [company] has a valuable proprietary interest in the Parent Seed and Seed Crop. Grower agrees that he will not use for seed except under this agreement, nor sell to or permit any other person to use for seed any of the Parent Seed or Seed Crop. Grower acknowledges that the [company's] legal remedies for the event of any actual or threatened breach of this covenant, in addition to any other right or remedy which [company] may have, shall [include] specific enforcement of this covenant through injunctive or other equitable relief.*

Some production contracts provide that the grower never has any ownership in the seed planted on the farm. Bailment provisions, which grant no ownership rights to the growers, were discussed in Chapter 6. For example, Pioneer's contract for alfalfa seed provides, in part:

III. Stock Seed

A. *The Grower agrees to accept, as a bailee, stock seed of___, for seeding at the rate of___pounds per acre.*

B. *The Grower agrees to return all unused stock seed to the Company within two (2) months from the date of receipt by the grower.*

VII. General Terms

B. *Title. The Grower agrees:*

1. *That the stock seed furnished, the plant life produced and all seed grown under this agreement are and at all times shall remain the property of the Company,*

2. *That he will not use or sell nor permit any other person to use or sell for seed any of the crops produced from the stock seed furnished by the Company.*

3. *That he will not allow any of the vegetative cuttings or plants from the stock seed to be removed from his fields or control, except with express written consent of the Company, and further*

4. *That he will not commit any act permitting any other party to obtain possession of the seed in anyway whatsoever except as provided for hereunder.*

Such intellectual-property protections appear most often in grain and seed contracts, but they can also be found in contracts for the production of livestock or purchase of breeding stock (see sidebar).

INTELLECTUAL-PROPERTY CLAUSES MAY ALSO APPLY TO SWINE

Traditionally, many livestock producers have obtained replacement breeding stock by selecting and retaining young females for future breeding. For livestock producers, this is the equivalent of farmer-saved seed. But increasingly, companies are including contract provisions that prohibit producers from using any of the offspring from the companies' high-quality genetics for further breeding purposes. Consider the following provision for the Camborough Total Herd Contract (CAMC) used by the Pig Improvement Company (PIC), one of the nation's largest providers of improved swine genetics.

Customer agrees:

- To buy _____ Camborough gilts for the complete initial stocking of the herd and _____ Camborough gilts (minimum 33% replacement) per year for all herd maintenance requirements and to use these gilts as parent animals in said customer herd only.
- To buy _____ PIC terminal boars for initial stocking and _____ PIC terminal boars (minimum 1 boar/50 sows) per year for herd maintenance.
- To sell only for slaughter all progeny of animals of the animals purchased.
- Not to sell or transfer to other ownership or premises the progeny of the purchased animals for breeding purposes or permit any other party to use the progeny for breeding purposes.
- To give PIC the right to examine herd production records to verify compliance with this sale and use restrictions at all reasonable times after reasonable notice by PIC.

In a later clause, the contract provides;

This contract is in effect from the date of execution for a period of twelve (12) months beginning ___ and ending ___. ALL RESTRICTIONS ON SALE, TRANSFER OR USE FOR BREEDING PURPOSES, AND THE RIGHT TO EXAMINE CUSTOMER'S PRODUCTION RECORDS TO VERIFY COMPLIANCE THEREWITH SHALL SURVIVE EXPIRATION OF THIS CONTRACT FOR TWENTY-FOUR (24) MONTHS AFTER DELIVERY OF THE LAST ANIMALS SOLD UNDER THIS CONTRACT.

The effects of these provisions are clear. You cannot save or sell any of the offspring for breeding purposes. You also grant PIC the right to inspect your production records to determine whether you have been diverting any of the offspring from slaughter markets for use as breeding stock. The contract is silent about the remedies the company can seek when a producer violates this clause, but the obvious answer would be a breach-of-contract action requesting damages for the value

How Intellectual-Property Protections Affect Farmers

From the grower's perspective, the most important issue in these legal protections is the way they affect what producers can do with the commodities they raise. Can you legally save seed from one crop year and plant it in another? Can you save protected seed and sell it to other farmers? What happens if you violate the law?

The answers depend on the crop and the pertinent law. With hybrids, there is little a farmer can do about saving or selling saved seed because it won't breed true. But when seed is sold under a contract that restricts its future use or sale, the question is whether the contract is enforceable. While a

search of lawsuits found no cases concerning the clauses, there is a presumption that such voluntary contractual agreements would be binding if taken before a court. The enforceability may depend on whether the buyer was aware of the provision and whether the courts would for some other reason find it illegal.

The most important legal questions relate to seeds protected under the Plant Variety Protection Act (PVPA) or under "patents." The PVPA gives developers of novel plant varieties an 18-year patent-like protection and creates a system for them to protect their innovations from infringement. Since passage in 1970, over 2,000 PVPA certificates have been issued. The act is easy to use, and plant breeders can complete the applications for a PVPA certificate without the services of a patent attorney. The act has played a significant role in increasing private seed-breeding activities in the U.S.

An important part of the PVPA is the exemptions it contains. The most important are an exemption for "bona-fide research" on protected varieties and a farmer exemption that gives farmers the right to "save seed" for future uses, and in some instances to sell saved seed to other farmers. In recent years, the farmer exemption, also known as the crop exemption, has become controversial. Seed breeders claim that farmers are able to purchase PVPA-protected seed, raise a crop and then sell significant amounts to other farmers as seed, thus unfairly appropriating the research of the breeder and "stealing" the market.

Farmers' practice of saving and selling first-generation protected seed is commonly called brown bagging. It occurs fairly often, even if it is not publicized, in areas that raise sexually reproducing crops such as wheat, soybeans and cotton. The potential financial impact of brown bagging on seed research cannot be denied. For example, in 1990 Pioneer Hi-Bred decided to stop breeding hard red winter wheat in Kansas because of financial losses. Statistics show that in 1989 only 8% of acres planted with Pioneer's variety 2157 were actually sold by Pioneer; the rest had been brown-bagged by other growers.

Because of incidents like this, the American Seed Trade Association (ASTA) has led efforts to limit the farmer exemption by allowing the saving of seed for planting on the farm-but prohibiting the sale of saved seed to other farmers. An ASTA official recently stated, 'The number-one priority in ASTA is amending the PVPA.' In August, 1994, Congress enacted an amendment that would make it illegal for a farmer to sell any saved seed to another person. But the new amendment applies only to newly certified varieties. This means that seed breeders' main avenue for defending their legal rights in PVPA-protected seed will still be to bring suit when they believe producers have illegally infringed their rights.

The controversy over "brown bagging" was whether the PVPA placed a reasonable limit on the amount of seed a farmer can save and sell to other farmers or whether the provision was a wide-open exception to the plant breeder's rights. Section 2543 formerly read, in part, that:

It shall not infringe any right hereunder for a person to save seed produced by him from seed obtained, or descended from seed obtained, by authority of the owner of the variety for seeding purposes and use such saved seed in the production of a crop for use on his farm, or for sale as provided in this section: Provided, that without regard to the provisions of §2541(3) of this title it shall not infringe any right hereunder for a person, whose primary farming occupation is the growing of crops for sale for other than reproductive purposes, to sell such saved seed to other persons so engaged, for reproductive purposes, provided such sale is in compliance with such State laws governing the sale of seed as may be applicable.

The new amendment strikes the "provided" clause.

There have been few enforcement actions under the original act, and even fewer have reached the federal courts, limiting the opportunities for courts to interpret the exemption. But one Seed Company in particular, Asgrow, aggressively enforced its rights under the PVPA, bringing over 20 actions across the country. The most important brown-bagging case recently arose in Iowa and is now being considering by the U.S. Supreme Court (see sidebar).

U.S. SUPREME COURT TO RESOLVE IOWA BROWN-BAGGING CASE

The case of *Asgrow Seed Co. v. Winterboer* [982 F. 2d 486 (C.A. Fed. 1992) rev. 795, F. Supp. 915 (N.D. Iowa 1991)] pits one of the nation's largest seed breeders against a farm family from Iowa. The facts in *Winterboer* provide a dramatic illustration of the stakes involved in brown-bagging cases.

The Winterboers do business under the name DeeBee's Farm and Seed. Asgrow alleged that its investigation found the Winterboers were brown-bagging Asgrow seeds by harvesting and selling the seeds in nondescriptive brown bags, saying there were "just-like" Asgrow's varieties. The Winterboers did not dispute that Asgrow was the owner of a novel variety protected under the PVPA, or that they had sold progeny of the novel variety-over 10,000 bu. in 1991. Instead, they argued that because the majority of the soybean crop (over 80%) was sold for other than reproductive purposes, they fell within the farmer exemption for saved seed.

The federal judge district court in Sioux City granted Asgrow's motion for summary judgment and granted the request for a permanent injunction against the Winterboers' selling any of the seed except for saved seed as defined by the court. Congress had not intended to give farmers an unrestricted right to sell seed, the court said. It concluded that the "exception allows a farmer to save, at a maximum, an amount of seed necessary to plant his soybean acreage for the subsequent year." Assuming soybeans are planted at a rate of 1 bu. to the acre; the court said that if a farmer could reasonably expect to plant 1,500 acres of the protected variety in the subsequent crop year, the maximum amount of seed that could be classified as "saved seed" would be 1,500 bu.

The Winterboers appealed the decision. In December 1992, the Appeals Court reversed the district court's ruling and remanded the case for further proceedings [*Asgrow Seed Company v. Winterboer*, 982 F. 2d 486 (C.A. Fed., Dec 21, 1992)]. The Appeals Court held that the "crops exemption" is subject to certain statutory limits found in § 2543 but not a quantitative limit, or "ensuing crop" limit as devised by the district court. The Appeals Court identified these limitations:

- The crops exemption only applies when the seed being saved, used or sold has been obtained by authority of the owner of the variety for seeding purposes;
- Sales can be made only to other farmers;
- The "primary occupation" of both the seller and buyer of the seed must be "the growing of crops for sale for other than reproductive purposes;" and
- The selling farmer remains subject to infringement under §§2541 (3) and (4) of the act concerning either "sexually multiplying the novel variety as a step in marketing, or using the novel variety in producing (as distinguished from developing) a hybrid or different variety."

The court determined that the crop exemption must be applied on a novel variety basis for each crop, meaning “buyers or sellers of brown-bag seed qualify for the crop exemption only if they produce a larger crop from a protected seed for consumption (or other nonreproductive purposes) than for sale as seed.” The test means that a court “must determine the amount a farmer grows for sale to consumers and the amount of crops a farmer grows for brown-bag sales to other farmers.” If the farmer sells more of a variety to consumers than to other farmers as seed, the farmer qualifies under the section to buy or sell saved seed.

In April 1994, the U.S. Supreme Court agreed to review the Appeals Court rule in *Winterboer* (case no. 92-2038) and will rule sometime in 1995 on the extent and nature of the farmer exemption to the PVPA. The court’s decision will be important because farmers may still save and sell seed from previously certified varieties.

Opportunities in Grain Production Contracts: Watch the Bottom Line

As marketing opportunities for such crops as identity-preserved grains increase, more growers will have occasion to consider such contracts. For many producers, the reason will be additional economic benefits offered by contracts. But producers will need to carefully evaluate whether the contracts are in fact profitable. Some Illinois white-corn growers have discovered that as the premiums offered by companies have declined, white-corn production has been less profitable than traditional field corn.

Conversely, some companies have had to increase their premiums for specialty crops to have sufficient supplies to meet demand. For example, Pioneer’s Better-Life Grains program increased the premium for food grade soybeans to \$3 a bushel in 1994, up from \$2 in 1993. By pushing a pencil on what they can expect to earn under contract, grain producers will be in a better position to evaluate any additional costs and risks associated with the agreement. They should also inventory their possible legal concerns about how their grain production contract will work (see sidebar).

FIFTEEN QUESTIONS TO ASK YOURSELF ABOUT YOUR GRAIN PRODUCTION CONTRACT

To understand your rights and obligations under a production contract and identify potential legal risks, ask yourself these 15 questions about any contract you may be considering signing. If you are comfortable with the answers, you should have little concern. But if you cannot answer the questions, you should consider asking the representative of the company you have been dealing with, and you should consider calling your attorney for advice. If neither can answer your questions, you might want to think twice about the wisdom of entering the contract.

- 1. What am I agreeing to do?** Am I selling someone a crop or contracting for my services in raising a crop for someone else? How does the contract affect my ability to farm the way I want to? How long does the agreement last and how is it terminated?
- 2. What is the nature of the legal relationship being created?** Am I an independent contractor, is this a service contract, am I an employee or joint venturer with the company? Can there be any liability between us?
- 3. What is the delivery date if the contract is a sale?** Is it a fixed date? If not, who determines the date?

4. **How much will I be paid under the contract?** Is it a fixed amount? Do I understand how the payment or premiums will be calculated? What discounts or quality bonuses might apply, and who determines them?
5. **When do I get paid?** If the payment date is a fixed date, how long are the potential delays, and can any debts I owe the company be deducted from it?
6. **Is the contract for a fixed amount of crop or the production from specific acres?** Will I have to buy other commodities to satisfy the contract if something cuts my yields?
7. **What happens if there is a crop failure or for some other reason I don't produce the crop or can't complete the contract?** Does the contract include an Act of God clause excusing weather or disease problems?
8. **When does title to the crop pass?** Is it at the time of planting, at harvest, at delivery or at payment? Do I ever have legal title to it?
9. **How will the contract affect my obligations to other parties?** Will the contract affect the rights of the bank that financed the crop or my landlord's rights?
10. **What legal protection do I have to be sure I get paid?** What happens between the time the crop is physically delivered and I get my cash? Is my buyer bonded? Am I protected by any federal or state laws, or am I an unsecured creditor of the company? Am I confident the company has the financial resources to perform the contract?
11. **What contract terms must I satisfy before performance is complete?** Who determines if I have complied with them, and is the decision reviewable?
12. **What restrictions are placed on the sale or use of the crop if it is not purchased under the contract?** Can I sell it to someone else? Can it be used for seed? Does the buyer have to release his claim before I can use it?
13. **How will any disputes be resolved?** Does the contract require mediation or arbitration? Are court appeals allowed and if so, where? Which state laws apply to the agreement?
14. **Are there provisions of the agreement I still don't understand?** Am I relying on anything, such as oral promises, not in written agreement?
15. **Does anything in the contract allow the company to alter its terms or to end the relationship after it has begun or after I have performed?** Can I be sure the crop will be purchased and I won't be left holding it?

CHAPTER TEN: LIVESTOCK PRODUCTION CONTRACTS

Perhaps no other sector of agriculture has seen greater interest in production contracts than the livestock and poultry industries. Today, the 30-year trend toward contract production and vertical integration in poultry is virtually complete. According to USDA, more than 90% of the broilers in the nation are now raised under production contracts, and similarly high rates occur for other types of poultry as well.

The same trend has begun in swine production. The percentage of hogs and pigs raised under contract increased from 4% in 1980 to over 20% in 1990 according to some estimates. Some experts expect the contract-production figure to reach 50% in the next decade.

Many pork producers may soon consider whether a production contract is right for their operation. They will need to know what questions to ask about a contract and their relationship with the company involved. Because broiler growers probably have more experience with production contracts than any other group of producers, their track record can provide valuable lessons in what contracting may bring.

How Livestock Contracts Are Unique

Livestock or poultry contracts differ from those used in other commodities in several ways, illustrating why livestock contracts may raise particular legal questions.

1. The contracts do not involve the sale of commodities; instead, they create some other form of legal relationship, such as service contracts. Typically, the grower provides the land, building, fuel and labor, while the contractor provides the animals, feed, medicine and management. The contractor, not the grower, owns the animals.
2. Payment under livestock contracts is generally related to animal performance, such as feed conversion, rate of gain or the number of young weaned.
3. Livestock contracts generally require significant investments in fixed capital assets such as land, buildings and equipment.
4. The length of livestock contracts can vary greatly. Many broiler contracts are for only one flock; other contracts are for longer than just one production cycle.
5. The contracting company generally maintains more control over the grower's production methods, often through inspections by field representatives and required compliance with company production manuals.
6. Animal health comes into play and can be a significant factor in performance.
7. Many issues concerning environmental compliance not present with crop production arise. Most notably, these include animal-waste management and the disposal of dead animals.
8. Livestock contracts are often used where no other marketing or contracting opportunities exist. The producer may be locked into the existing contract relationship, regardless of how well it is functioning.

Each of these points can generate a number of important legal issues. For example, performance payment clauses can be complicated and difficult to understand, raising the question

whether a producer or grower is being paid fairly. And the need for substantial investments raises the issue of what protection a grower has if the contract is terminated before the buildings are paid for.

Legal Developments May Prompt Changes to Poultry Contracting

Before studying some of the specific issues that arise with these contracts, we should consider several legal trends that may play an important role in shaping the future of livestock contracting in the U.S.

The past three years have seen an explosion in producer lawsuits involving poultry contracts. Several lawsuits have resulted in multimillion-dollar damage awards to growers, usually when it was found that contractor employees intentionally defrauded growers, such as by misweighing birds and feed (see sidebar). These cases could begin to play a more Significant role in defining the rights and obligations of both the grower and the contracting company, and are important in understanding livestock contracting.

ALABAMA POULTRY GROWERS RECEIVE \$14 MILLION VERDICT BASED ON FRAUD IN WEIGHING

Contract production and the treatment of growers by poultry integrators were major issues in the Alabama case of *Braswell v. ConAgra Inc.*, 936 F. 2d 1169 (11 Cir. 1991). In the lawsuit, Braswell and other contract growers alleged fraud and breach of contract by ConAgra employees for deliberately misweighing trucks and thus paying growers less than they were entitled to. A Federal District Court jury awarded the plaintiffs \$4.55 million in compensatory damages and \$9.1 million in punitive damages. The judge reduced the compensatory damages by almost \$112,000 but awarded \$1.6 million in prejudgment interest on the compensatory damages. On appeal, the Eleventh Circuit Court of Appeals affirmed the decision and damage award. The case represents one of the largest financial recoveries ever received in a production-contract case.

In a similar case in Mississippi, in state district court, six growers received over \$16 million in damages against Wayne Poultry, owned by Continental Grain. That decision is now on appeal.

The growers' success in the Braswell and Mississippi lawsuits has spawned a rash of new cases. [See Charles Johnson. "Ruffled feathers: littered with problems: the poultry industry can teach us plenty about contract production," *Farm Journal*, May/June 1994.] In late 1994, courts in the Southern states were considering more than a dozen major cases dealing with the lights of poultry growers and allegations of misconduct by contractors.

This increase in litigation has occurred partly because some poultry growers are organizing more aggressively and standing up for their legal rights. In addition, several grower-oriented attorneys and legal-action groups are becoming more involved in cases on contracting issues. Organizations such as the Rural Advancement Fund International (RAFI) in Pittsboro, N.C., and Farmers' Legal Action Group (FLAG) in St. Paul, Minn., have played a leading role in helping organize and educate growers.

The lawsuits being filed naturally differ from one another with the facts and the contract involved. But they share a number of common claims, issues and themes, including the following:

1. Early contract termination, before the investments in buildings were paid off;
2. Company requirements for additional improvements, at the grower's expense;
3. Manipulation of the quality, quantity or cost of inputs such as birds and feed;

4. Company knowledge that contracts were unprofitable;
5. Under weighing of poultry and feed;
6. Failure to make payment, which can lead to an administrative action:
7. False rankings under the system that the companies use to pay growers and terminate contracts:
8. Retaliation against growers by terminating contracts for complaining and/or organizing:
9. Alack of local competition, resulting in local monopolies;
10. Grading problems related to payment factors, such as number of condemned birds.

{Adapted from Randi Ilyse Roth, "Contract farming breeds big problems for growers, "Farmers' Legal Action Report, Winter 1992, Vol. 7, #1.}

Whether or not growers obtain some form of recovery through litigation depends on their ability to convince a court or jury that some illegal action or conduct violating the terms of the contract has occurred. Various principles of contract law-such as the preference for reliance on written contracts and the role of the statute of frauds in making it difficult to prove oral modifications-all can play important roles in cases over the alleged breach of grower contracts. Making and winning a case on a grower's contract is not an easy proposition. Still, as the court decisions indicate, with the right facts and the assistance of informed counsel, some growers may have winnable cases.

Of course, companies involved in poultry contracting note that the vast majority of growers are pleased with the terms of the contracts. They say recent lawsuits represent a few isolated incidents, not general industry practices. They also point out that they have a stake in the growers' financial success and want to maintain sound working relations for the benefit of both parties,

Recently, several large integrators have taken steps to improve communication with growers. For example, Tyson completed a survey of all its growers to determine their satisfaction with the current contracts and relations. Wayne Poultry made several changes in its contracting system, such as not including employee growers in rankings with independent growers. Finally, to prove the popularity of poultry contracts, the companies point to their waiting lists of people who want to become growers.

Poultry Growers Form National and State Organizations

Successful grower organizations at the state and national levels are the second recent important development in poultry contracting. The groups aim to increase growers' bargaining power and obtain fairer and more profitable contracts. Most significant is the recent formation of the National Contract Poultry Growers Association. In his famous article about the industrialization of agriculture, Pioneer Hi-Bred President Thomas Urban predicted that producers might organize, much as urban workers did in unions, to receive greater protections and better economic returns. In many ways, the development of poultry growers' organizations proves Urban's prediction (see sidebar).

WILL POULTRY GROWERS UNIONIZE?

An important development influencing poultry growers' legal clout has been the recent formation of the National Contract Poultry Growers Association (NCPGA). This group along with state-based grower groups has provided members a stronger voice in dealing with contractors and has given members the confidence and knowledge that come from sharing common experiences. Much of this comes by way of the group's monthly newsletter, the *Poultry Growers News*.

The NCPGA has actively promoted growers' rights and has helped introduce legislation in North Carolina, Oklahoma, Alabama, Mississippi, Florida, and Louisiana. It has disseminated information and advice about contracting matters and has helped growers obtain lower-priced inputs such as insurance and equipment. It has also directed producers to attorneys with experience in grower claims.

The NCPGA's growth into an economic and political force will undoubtedly affect the actions of contracting companies. For more information about the NCPGA you can contact John Morrison, The Executive Director, at P.O. Box 824, Ruston, LA 71273 or call 800-259-8100, fax 318-251-2981. [Charles Johnson, "Uproar in the chicken house," *Farm Journal*, February 1994; Robert H. Brown, "Contract poultry growers begin nationwide organizing," *Feedstuffs*, Sept. 7, 1992; and Steve Marberry; "Poultry growers suing contractors, organizing for clout," *Feedstuffs*, Jan. 18, 1993.]

What Laws Protect the Right of Growers to Organize?

One very important federal law offers some protection to growers trying to organize: the Agricultural Fair Practices Act (AFPA) of 1967 [7 USC §§2301-2305]. Congress passed the AFPA to protect the right of farmers and ranchers to form associations that would enable them to bargain for better prices and terms with handlers and processors.

The act prohibits a number of practices for "handlers," who include persons engaged in "contracting...with...producers with respect to production or marketing of any agricultural product "The act focuses on prohibiting handlers from discriminating against producers or intimidating them because they organize or join grower associations. But the Act does not require a company to contract with any particular grower or grower organization.

The act was used as grounds for a suit in federal court when Florida poultry producers claimed Cargill had terminated their poultry contracts because of their efforts to organize other Florida growers. The Justice Department helped represent the growers, claiming the AFPA had been violated (see sidebar).

COURTS HOLD FLORIDA POULTRY GROWERS' CONTRACTS MUST BE REINSTATED

One of the first cases applying the AFPA to poultry growers who organize was *Baldree v. Cargill, Inc.* [925 F. 2d 1474 (11th Cir. 1991), affirming 758 F. Supp. 704 (M.D. Florida 1990)]. The Florida Poultry Growers Association and the U.S. Department of Justice sought a preliminary injunction forcing Cargill to reinstate its grower's agreement with Arthur Gaskins, president and organizer of the association.

The federal district court granted the preliminary injunction. It found there was a substantial likelihood that the Grower's Association and the Department would show that Cargill terminated the agreement to prevent Gaskins from supporting the association and to hamper the association's claim against Cargill-and the Cargill had done so without economic justification in an unfair and unjustly discriminatory and deceptive practice. The court cited the Packers and Stockyards Act and the Agricultural Fair Practices Act as authority for its decision. The decision was affirmed by the Eleventh Circuit.

The underlying dispute concerned a lawsuit that Gaskins had filed against Cargill, alleging various forms of fraudulent practices, such as misweighing. [See Charles Johnson, "Equity in the Pecking Order: A Chicken Rebel Ruffles Feathers in His Fight for Contract Rights," *Top Producer*, February 1994.]

The best way to discuss the legal issues related to livestock production contracts is to consider the language used in representative contracts and to look at some of the cases in which disputes have occurred.

Grower Obligations Under Production Contracts

The most important provision of any production contract is the section describing what obligations a grower will undertake in order to be paid. The following is the grower obligation section from a broiler contract used by ConAgra in Louisiana:

GROWER AGREES TO:

- 1. Provide proper housing, fuel, equipment, water, litter and all labor necessary in properly raising a placed broiler flock to reasonable maturity, as determined by ConAgra.*
- 2. Abide by the management standards regarding feeding, sanitation, farm operation and medication as published in documents for which receipt is acknowledged below and which are hereby incorporated by reference as a part of this agreement.*
- 3. Allow ConAgra to enter Grower's premises at any time for any of the purposes herein set forth.*
- 4. Be present at time baby chicks arrive and assist in the placement of chicks.*
- 5. Reimburse ConAgra for any charges for towing or wrecker service incurred because of inadequate access roads.*
- 6. Be present at time birds are caught.*
- 7. Properly dispose of dead birds and litter as required by the Louisiana Department Of Agriculture & Forestry, Office of Animal Health Services.*

8. *Grower shall not, under any circumstances, maintain, keep, grow, house or permit to be present on Grower's premises any poultry, chickens, fowl, turkeys, birds, or guineas of any kind whatsoever, other than birds placed thereon by ConAgra. Provided, however, this provision does not prevent the Grower from engaging in such other farming activities not involving poultry, which does not affect the health and safety of the poultry placed on Grower's premises by ConAgra.*

This clause gives you a good idea of the restrictions and obligations commonly found in broiler contracts. Besides providing the necessary production inputs and labor (Paragraph 1), and agreeing to abide by the management standards (Paragraph 2), the grower is granting many other broad rights to the contractor while assuming serious responsibilities. Among these are the right of the company to inspect the premises at any time, a restriction on raising any other poultry on the premises, and a promise to properly dispose of all dead birds and litter according to state law. When you compare these obligations with those commonly found in grain production contracts, it is easy to see why livestock contracting relationships can be considered much more restrictive.

Similar grower obligations are found in most swine contracts, whether for the production of feeder pigs or the finishing of hogs. The following lists the grower's obligations in Iowa a hog-finishing contract:

During the term of this agreement, Grower shall:

- A. *Furnish the necessary land, house or houses, equipment, water and other facilities for the proper care and housing of the hogs and for the storage of feed and other materials.*
- B. *Provide such labor and management as is necessary to properly care for the hogs.*
- C. *Keep all records reasonably necessary for the proper and efficient management of the hogs, including death loss.*
- D. *Carry out the instructions of the Supplier's supervisor with regard to the management of the hogs. In the event Grower fails to carry out these instructions, Supplier shall have the right to enter upon Grower's premises to perform those things which Grower has been instructed to do, but which Grower has failed to do. If Grower fails to get the proper production performance with the hogs, Supplier may take over the operation and put its own manager in charge. Any expenses incurred by Supplier in this regard shall be charged to the Grower and deducted from payments owed him pursuant to this agreement.*
- E. *Notify Supplier of any diseases or sickness that any of the hogs may have or have been exposed to.*
- F. *Provide properly maintained roads to the hogs' houses.*
- G. *Comply with such other requirements as Supplier may from time to time designate to Grower as being necessary.*
- H. *Dispose of all manure, waste and dead animals according to State of Iowa regulations.*
- I. *Recognize the security interest of any secured creditor in the animals delivered by Supplier as superior to and having priority over any rights which Producer may have therein; furthermore, Grower agrees to permit any secured creditors of Suppliers to have access to the premises and facilities at all reasonable times for the purpose of exercising*

any rights, including the rights of inspection and possession, with respect to the secured creditors' security interest.

- J. Own no swine, to prevent any other swine from coming onto the premises.*
- K. Have the facility cleaned, disinfected and ready for receipt of additional hogs from Supplier within seven (7) days from the time the last hog is removed from facility and to notify Supplier that the Grower is ready to accept additional hogs.*
- L. If the owner does not deliver the requested number of hogs, within seven (7) days of notice of availability, the Supplier shall pay at a rate of ten cents(.10)per head short of capacity per day until facility is filled to capacity.*

This clause shows that swine contracts can also include rather expansive promises on the part of the growers. For example, the provision of Paragraph D would allow the contractor to take over the grower's operation if there was a dispute over compliance with the production standards. Paragraph G is a rather open-ended promise to provide the company with whatever other supplies they designate as "necessary."

Contractor Obligations Under Production Contracts

Now let's consider what the contracting companies promise to do under the arrangements. The following is the contractor-obligations clause from a ConAgra contract used in Louisiana in 1993:

CONAGRA AGREES TO:

- 1. Deliver__ baby chicks, more or less, to Grower.*
- 2. Furnish all feed, vaccine and medication necessary for the care and raising of said birds.*
- 3. Load and haul the flock to market.*
- 4. Maintain records of each Grower's account.*
- 5. Furnish copies of chick delivery tickets, feed tickets, medication tickets, live weight tickets, USDA condemnation certificate, settlement sheet and weekly ranking Sheet to all Growers in the payment comparison.*
- 6. Pay Grower on the following basis:*
 - a. The cost per pound of each flock delivered to the plant during the same week shall be determined by adding the cost of chicks placed at twelve cents (12¢) each, feed used at the price of seven cents (7¢) per pound, and medication priced at ConAgra's cost. This total cost is then divided by the net pounds produced to arrive at a net cost per pound for each flock.*
 - b. An average net cost per pound for all flocks sold that week is calculated in the manner using the same cost factors.*
 - c. Net pounds are determined by calculating the total pounds from first weight (net truck weight) less condemnation allocated as follows: All whole birds condemned for disease and 50% of all condemned parts will be charged to Grower. All birds condemned for contamination, over scald, cadavers and other plant causes will be charged to ConAgra.*

Whole bird condemnation will be calculated by multiplying the number of whole birds condemned by the average weight of that lot.

- d. Growers whose net cost per pound equals the average net cost per pound for the week will receive the base rate of 4.00 cents per net pound. All other Growers will be compensated as determined by the number of points of cost below or above average, as per the schedule set out below.*
- e. Flocks which are determined by ConAgra to be a catastrophic flock such as fire, storm, suffocation, etc., shall be eliminated from comparison of average weekly cost per pound and paid 3.25 cents per pound. ConAgra decisions will be final as to whether a flock is eliminated from the comparison.*
- f. Payments will be made by the Friday following the week the last kind of such flock is sold. A Grower who sells birds in more than one calendar week will be grouped in the week of his final sale.*
- g. ConAgra reaffirms the right of Grower to witness the weighing of all vehicles containing birds obtained from Grower's farm and encourages Growers to do so.*

The company's obligations are primarily to provide the birds and other promised inputs and to pay the grower after the birds have been weighed and processed.

The contractor obligations from the hog-feeding contract used by an Iowa company are somewhat similar:

1. Supplier agrees to deliver to Grower feeder pigs to be housed, fed and cared for by Grower in accordance with the terms of this agreement.
2. Title to the hogs shall at all times remain with the supplier. Grower shall have no right, title of interest whatsoever therein and have no right to sell or encumber hogs, wither voluntary or involuntary.
3. During the term of the agreement as defined below, Supplier shall:
 - a. Furnish feed, vaccines, and medication necessary to raise the hogs to marketable size.
 - b. Provide a supervisor who shall make regular calls on the Grower's farm to advise on the management of the hogs and to act as Supplier's representative with Grower.
 - c. Be solely responsible for the hauling away and selling of the hogs when they reach marketable size and for all expenses incurred in connection therewith.

Determining How Much the Grower Will Be Paid

Articles on livestock contracting, especially broiler contracts, often refer to the issue of payment. Many growers complain that even when they can estimate how well the animals performed, they don't know whether the contract was profitable until they receive the settlement sheet.

One reason is that livestock contracts include a series of different performance factors. Compensation systems can involve calculations of per-day payment, rate-of-gain payments, feed-

conversion-efficiency bonuses, fuel-efficiency bonuses, death-loss deductions, and deductions for condemnation of animals. Many companies use grower ranking systems when calculating the final settlement. Under these systems, companies compare the growers on performance and then use the rankings to provide payment incentives and to determine which growers' contracts will be ended for consistently below-standard performance.

The payment provisions for a broiler contract and those for a swine feeding contract (see schedules in Chapter 7) both suggest how complicated the final settlements can be—and why there can be misunderstandings and disputes over the amounts earned. Furthermore, many growers complain about their lack of involvement in the calculation of their payments. They argue that the weighing and measuring of the inputs and birds, the determination of the animals' performance and the calculation of the final settlement are all under the complete control of the contracting company.

While there is no reason to assume the company's calculations are untrustworthy, some growers feel there are too many opportunities for the companies to "adjust" the numbers if they want to. Several lawsuits have involved situations where local company employees were found to be doing just that. Other growers who have had disputes with contractors believe the contractors use their control over the calculations to penalize "troublemakers."

Length of the Contract and How It Can Be Terminated

It usually takes a substantial investment in buildings and equipment to raise poultry or livestock on contract. In fact, it is not uncommon for all the contract growers in a local area to have investments equal to or larger than the companies have in the processing plants and feed mills. A typical broiler house in the South can cost \$60,000, and many growers build several. A typical confinement facility for feeding swine in the Upper Midwest can cost over \$100,000. Because these investments are large, and are generally made with borrowed money, one of the most important aspects of the contract is the length of the agreement.

The length of any contract should be specified. In the broiler industry, the common length of a contract is one flock ("flock to flock"), or about seven weeks. In this instance, the company could decide not to renew and the producer would have little advance warning and few options for challenging it. Not surprisingly, contract length has been an issue for many of the contract grower organizations and has been included in several state legislative proposals.

One view is that the length of the contract should at least match the time it would take to pay off the loans on the investment in buildings and equipment. In 1993, after the Louisiana legislature almost enacted grower protection legislation, ConAgra did in fact begin offering a 10-year contract option to its broiler growers in the state. But this is definitely the exception to the rule in poultry contracting.

In swine contracting, many companies are offering contracts for several "turns" or batches of swine. The number of turns may range from four to 10. The length of other contracts may be expressed in years. In either situation, a legal issue that can arise concerns the amount of time that can elapse between turns. For example, when will the next batch of pigs arrive.

For the companies, the benefits of short-term contracts are obvious. First, it increases their flexibility when deciding which growers to use and also how much production to have in place. If market conditions require the company to reduce the number of animals placed, it has the option of not

renewing some contracts. The use of a ranking system for compensation creates a mechanism for terminating producers who are arguably the poorest performers.

In addition, the use of short-term contracts offers the companies considerable control over the growers' actions. One reason that it took more than 20 years for contract poultry growers to organize may be the fear many growers have that their contracts will not be renewed if they question the contractors' practices. Short-term contracts also provide the companies with a considerable amount of leverage, allowing them to insist that growers agree to new contract terms and adopt new technologies. A common complaint among growers is that when they are close to paying off their buildings, the company's request new investments in more modern feeding, ventilation or watering equipment. Growers must agree to make the new investments to retain the contracts. Current growers are always made aware the companies have a waiting list of new growers who want to build facilities to begin contract production. The threat that new growers may get the contracting opportunities imposes restraint on current growers.

The poultry companies, for their part, reject many of these explanations for short-term contracts. They argue that they have a great interest in their growers' performance and profitability and want them to succeed. The companies also note that they are in an extremely competitive business, with narrow profit margins, and must be able to revise contract terms and production methods to remain profitable. Some companies also say that growers have not expressed interest in long-term contracts because of concerns about being locked into inflexible payment terms.

Protections to Ensure Livestock Producers Are Paid

The most important issue in any production contract is making sure the producer gets paid for the goods or services provided. This can be especially true with livestock contracts where the income from the agreement maybe the most significant source of farm income in the operation. To understand the protections for producers it is important to look at several laws, most importantly the provisions of the federal Packers and Stockyards (P&S) Act.

The Packers and Stockyards Act was passed in 1921 to protect the integrity of the nation's meat and livestock markets and promote fair trade practices in the livestock and meat-packing industries. The law prohibits packers from engaging in a number of practices concerning livestock, meats, meat food products and livestock products in unmanufactured form. Among the prohibited practices are the following:

1. Using unfair, discriminatory, or deceptive practices;
2. Giving unreasonable preference or advantage, prejudice or disadvantage to any person or locality;
3. Selling to or buying from another packer so as to affect the supply, thereby restraining commerce or creating a monopoly;
4. Doing anything that would result in manipulating or controlling prices, creating a monopoly, or restraining commerce; and
5. Conspiring to apportion territory or sales, to manipulate prices, or to aid another in any of the specified unlawful acts [7 USC §192(a)].

One of the major provisions of the act concerns financial protections for producers. After a 1976 case in which a packer's financier took priority over the claims of unpaid sellers, Congress amended the act to

require "prompt payment" and established a statutory trust provision for the benefit of unpaid sellers [7 USC §§192-196, 228b (1988)]. Under the act, a packer is obligated to hold money in trust for the benefit of unpaid sellers unless the packer's average annual purchases do not exceed \$500,000. (7 USC §196 (b)). A packer is defined as:

Any person engaged in the business (a) of buying livestock in commerce for purposes of slaughter, or (h) of manufacturing or preparing meats or meat food products for sale or shipment in commerce, or (c) of marketing meats, meat food products, or livestock products in an unmanufactured form as a wholesale broker, dealer, or distributor in commerce [7 USC § 191].

Livestock are defined as "cattle, sheep, swine, horses, mules, or goats--whether live or dead" [7 USC § 182].

Does the Packers and Stockyards Act Apply to Poultry Growers?

In 1987, Congress extended the act's protections to poultry growers through the Poultry Producers Financial Protection Act (7 USC §181 et seq). This act extends the prohibition on "unlawful practices" to live poultry dealers, and it imposes the prompt-payment requirement and the statutory trust protections for growers. A poultry grower is defined as "any person engaged in the business of raising and caring for live poultry for slaughter by another, whether the poultry is owned by such person or by another; but not an employee of the owner of such poultry" [7 USC §182(8) (emphasis added)].

The act also applies to "poultry growing arrangements." defined as "any grow-out contract, marketing agreement, or other arrangement under which a poultry grower raises and cares for live poultry for delivery, in accord with another's instructions, for slaughter" [7 USC §182(9)]. A "live poultry dealer" means "any person engaged in the business of obtaining live poultry by purchase or under a poultry growing arrangement for the purpose of either slaughtering it or selling it for slaughter by another..." [7 USC §182 (10)].

Live poultry dealers and handlers are also covered under the act and subject to the trust provisions [7 USC §197 (1988)]. The act protects farmers who actually raise poultry, including chickens, turkeys, ducks, geese and other domestic fowl [7 USC §182(6)]. But a corporate poultry dealer, operating under a growing arrangement, could also be considered a poultry grower and reap the benefits of the trust as well [In re Roxford Foods Litigation. 790 F. Supp. 987 (E.D. Cal. 1991)].

What Types of Court Cases Have Been Decided Under the P&S Act?

There have been many cases under the act; several recent ones address the issue of who is a packer and whether the actions are covered under the act. For example, an Arkansas court held that a purchaser and marketer of meat in a manufactured form (already processed, packed and suitable for resale) was a packer under the act. [See *U.S. v. Jay Freeman Co., Inc.*, 473 F. Supp. 1265 (E. D. Ark. 1979).] The court reasoned that the act's language "in an unmanufactured form" referred only to "the last antecedent phrase or word...." Thus, "unmanufactured form" applied only to livestock products, so marketers of meat and meat food products were no longer exempt from the act's provisions.

Similarly, courts have interpreted "packer" to include grocery-store chains that prepare meat products for resale. [See *Safeway Stores, Inc. v. Freeman*. 244 F. Supp. 779 (D.C. 1965). See also *Peterman v. U.S. Department of Agriculture*, 770 F.2d 888 (10th Cir. 1985). In this case, a meat-locker type of operation in which the buyer prepared meat products as a meat retailer was considered a packer under the act.] However, a livestock company that purchases cattle for resale or for the "ultimate" purpose of slaughter may not be considered a packer [*St. Paul Fire and Marine Insurance Co., Inc. v. Idaho Bank and Trust*, 708 F. Supp. 285 (D. Idaho 1989)]. In this case, the buyer was not preparing or marketing meat products; the purchases were only for resale, not for slaughter. The livestock company was only a "dealer" under the act, not a "packer" that must comply with the statutory trust.

The law is administered by the Packers and Stockyards Administration in Washington and at 12 regional field offices (see sidebar).

ADDRESSES FOR CONTACTING THE PACKERS AND STOCKYARDS ADMINISTRATION	
Producers who want to obtain more information or file a complaint should use these addresses:	
HEADQUARTERS	
3039 South Agriculture Building 14 th and Independence Ave. SW Washington, D.C. 20250 202-447-7051	
REGIONAL OFFICES	
Atlanta, Ga (covering Ala., Fla., Ga., S.C.) Room 338 1720 Peachtree Street, NW Atlanta, GA 30309 404-347-4845	Lancaster, Pa. (CT, ME, MA, N.H., N.J., N.Y., Pa., R.I., Vt.) 1860 Charter Lane, Suite E Lancaster, PA 17601 717-299-6324
Bedford, Va (D.C., Del., Md., N.C., Va., W.V.) Turnpike Road Box 1027 Bedford, VA 24523 703-982-4330	Memphis, Tenn. (Ark., La., Miss., Tenn.) Suite OM-37, Box 06 7777 Walnut Grove Road Memphis, TN 38119 901-577-7676
Denver, Colo. (Colo., Mont., N.M., Utah, Wyo.) 307 Livestock Exchange Building Denver, CO 80216 303-294-7050	Omaha, Neb. (Iowa, Neb.) 909 Livestock Exchange Omaha, NE 68107 402-221-3391
Fort Worth, Tex. (Okla., Tex.) 8A36 Federal Building 819 Taylor Street Fort Worth, TX 76102 817-334-3286	Portland, Ore. (Alaska, Ida., Ore., Wash.,) 9370 SW Greenburg Road Suite 311 Portland, OR 97223 503-221-2687

Indianapolis, Ind.
(Ill., Ind., Ky., Mich., Ohio)
434 Federal Building
46 East Ohio Street
Indianapolis, IN 46204
317-336-6424

Kansas City, Kan.
(Kan., Mo.)
12351 West 96th St.
Lenexa, KS 66215
912-236-2355

Sacramento, Calif.
(Ariz., Calif., Hawaii, Nev.)
9550 Micron Ave.
Suite D
Sacramento, CA 95827
916-551-1142

South St. Paul, Minn.
(Minn., N.D., S.D., Wis.)
208 Post Office Bldg., Box 8
South St. Paul, MN 55075
612-290-3876

How Can Producers Obtain the Packers and Stockyards Act Protections?

Producers must remember several things if they want to be protected by the P&S system. First, they must determine if the transaction in which they are involved is covered under the law. Perhaps the best way to determine this is to file a complaint with the Packers and Stockyards Administration and have them advise you about coverage. P&S complaints can be divided into three general areas:

1. *Payment problem*, which deal with the right to be paid promptly and the right to receive payments protected by the statutory trust fund assets;
2. *Other unfair and deceptive practices*, which may involve allegations such as misweighing or terminating of a contract for complaining about payment: and
3. *Monopoly practices*, which relate to anti-trust-related claims.

The prompt-payment rules for packers and dealers require payment of the full amount of the purchase price before the close of the next business day following the transaction unless the parties expressly agree otherwise. An agreement waiving the prompt payment requirement must be in writing and not be procured by deceptive practices. Attempts to delay payment maybe treated as an unfair practice under the act.

For live-poultry dealers, full payment must be made to the seller-grower either a) before the close of the next business day following the purchase, if it is a cash sale, or b) by the close of the 15th day following the week in which the poultry is slaughtered in the case of poultry obtained under a growing arrangement.

The dates for payment are important because the grower must file a timely complaint with the P&S in order to preserve the right to be paid from the statutory trust assets. The P&S and the poultry company must receive your written complaint within 30 days after you had the right to be paid. So first determine the day you had the right to be paid, and then add 30 days. Your complaint must be filed by that date for it to be valid. If you received a check for payment and the check was later dishonored, you must file your complaint within 15 days of the notice of the check being dishonored.

A complaint can be filed with the appropriate regional P&S office, where it will be investigated and passed on to Washington if further action is required. The complaint may even result in an administrative action by the government against the company. Producers may file anonymous complaints about company practices.

In addition, producers may bring their own civil lawsuits alleging violations of the act, even though they have not filed an administrative action (see sidebar).

LEGAL RESOURCES AVAILABLE TO GROWERS WANTING MORE INFORMATION ON P&S ACT

Producers who want additional information about Packers and Stockyards Administration programs have several options. Besides contacting the P&S field offices listed above, they can contact several organizations for information. For example, there is an excellent series of articles written by Randi Ilyse Roth, an attorney with the Farmers' Legal Action Group, St. Paul, Minn. The articles reprinted from *Farmers' Legal Action Report* (1992), include:

- a. Making Complaints Under the Packers and Stockyards Act
- b. Contract Farming Breeds Big Problems for Growers
- c. How Much Did Your Birds Really Weigh?
- d. Are You Being Paid the Right Amount?
- e. Breeding Change-Legislative Remedies for Contract Growers

FLAG can be contacted at: 1301 Minnesota Building, 46 E. 4th St., St. Paul, Minn. 55101, or call 612-223-5400.

Another excellent source of information is the National Center for Agriculture Law Research and Information, at the University of Arkansas School of Law, Fayetteville, Ark. 72701 (phone: 501-575-7646). In January 1994, the center published a series of producer bulletins on "Legal Aspects of Livestock Production and Marketing," by J.W. Looney. Be sure to request Producer Bulletin No. 35, *Regulation Under the Packers and Stockyards Act*, and Producer Bulletin No. 36, *Producer remedies in Sales of Livestock or Poultry to Packers: Prompt Payment and the Statutory Trust*.

Are There State Versions of the P&S Act?

A number of states have enacted similar laws covering intrastate transactions. The Minnesota Packers and Stockyards Act, for example, places reporting requirements on packers and stockyard owners. Packers and grain and feed businesses with annual sales of more than \$10 million are required to keep a separate account for transactions related to contract feeding of hogs, cattle or sheep. The account may be audited at any time by the commissioner of agriculture. They must also include in their annual report to the commissioner of agriculture "a copy of each contract a packer has with a livestock producer and each agreement that will become part of the contract that a packer has with a livestock producer for the purchase or contracting of livestock."

Producers who are contemplating signing contracts to raise livestock or poultry should seriously consider seeking legal advice first. The number of issues that might be related to these contracts and the financial risks and obligations commonly associated with them are too significant for anyone to enter such an agreement lightly (see sidebar).

TWELVE QUESTIONS TO ASK ABOUT YOUR LIVESTOCK CONTRACT

The preceding discussion illustrates a number of important legal issues related to contract production of livestock. To help you determine if such a contract is right for your farm, ask yourself the following questions:

1. How long is your contract, and how can it be determined?
2. Does the contract protect your ability to pay off the investment you made in the operation?
3. Do you have the right to reject animals you feel are unhealthy?
4. Is your contractor licensed with the Packers and Stockyards Administration, and is your transaction protected under P&S rules?
5. If you are responsible for complying with environmental rules for livestock waste handling and disposal of dead animals, does the company provide financial assistance for the costs?
6. Are company employees also raising animals, and are the employees ranked with you for compensation?
7. Do you respect the knowledge and experience of the company's field representative who supervises your operation?
8. Do you have flexibility to acquire necessary inputs locally, or does the company control where they are acquired?
9. If you produce grain, will the company purchase any of it for use in feeding the animals?
10. Do you receive copies of all weight-tickets and settlement sheets used to calculate your performance?
11. Do you understand the factors used to calculate your compensation under the contract?
12. Do you think you have been paid accurately?

CHAPTER ELEVEN: VEGETABLE PRODUCTION CONTRACTS

Contracting is common in vegetable production for many of the same reasons it is in other crops: secure, stable supplies for buyers (canners and marketers in this case) and established markets for sellers. Often vegetable producers are well organized in marketing cooperatives that bargain for the terms of marketing contracts signed with major processors. But vegetable production is spreading into some areas where it hasn't traditionally been found. For vegetable growers, the important questions in contracted production are what happens when bad weather affects harvest, what protections ensure that growers are paid and what restrictions apply to production practices.

Pricing and Payment Terms

Most vegetable contracts involve sales of the produce by the grower to either a buyer or shipper. Some involve guaranteed shipments of so many pounds a week, but most are based on acres of production. For payment purposes, they normally use fixed prices, applying premiums or discounts based on the quality of the crop. Negotiated prices that are fixed in advance are common for some crops that do not have a public marketing system. A 1991 contract for pea beans used by Joseph Campbell Co. in Ohio set the price term of the contract as follows:

The price, delivered, per net cwt. of pea beans shall be:

(a) the quantity of cwt. of "Sound Beans" In the load (as such term is defined in United States Standards for Beans effective June 4, 1982), reduced, in case of loads which grade more than 18.0% moisture, by the applicable "percent Shrink" for the load as shown on the attached Schedule A;

multiplied by,

(b) \$19.00 per cwt. less the following deductions (if any) for the following conditions:

(1) Deduction for Cost of Drying;

(2) Deduction for Picking Charge to Remove Damaged Beans;

(3) Deduction for Removal of Corn, Soybeans and Contrasting Classes of Beans.

(c) Buyer will deduct, and pay to the Michigan Bean Commission, Grower's \$0 per cwt. assessment.

Vegetable contracts can use other sorts of compensation, of course. In the following contract for green and red cabbage, the shipper agrees to pay the grower a fixed payment of \$1,700 an acre for raising 80 acres of cabbage. The contract provides:

THIS AGREEMENT made and executed this _ day of _ 1992, between __, __, California, herein designated as GROWER, and __, Pasadena, California, herein designated as SHIPPER.

WHEREAS, Grower agrees to farm approximately 80 net acres of cabbage in __, California for Fall 1992.80 acres Fall cabbage (70 acres green, 10 acres red)__, California harvest dates as follows:

November 2.....15acres (green)

November 510acres (red)
November 9.....15acres (green)
November 16.....20acres (green)
November 23.....20acres (green)

WHEREAS Shipper agrees to purchase 100% of the total above crop as set forth in Exhibit I-A. Exhibit I-A (Planting Schedule) will be provided by Grower with Shipper's designated blocks as soon as possible to Shipper.

IT IS AGREED

1. Grower agrees to plant, grow and bring all of said cabbage crop to maturity on the real property described on Exhibit I-A attached hereto, and agrees to use all of the payment hereafter provided in growing of said crop and will otherwise do everything necessary to grow said crop in a good farmer-like manner; agrees to indemnify Shipper and save it harmless from any and all claims, demands, suits, damages or causes of actions which may arise out of growing said crop, and agrees that Shipper liability herein under is limited to the payment of said installments as and when they fall due.
2. In the interest of growing the best crop possible, grower agrees to take all reasonable steps to keep growing crop free of pests, insects, parasites and other harmful organisms.
3. The costs will be \$1,700.00 per acre for a total due Grower of \$136,000. Shipper agrees to pay Grower the cost in installments as set forth on attached Exhibit B.
4. Grower shall carry all necessary liability insurance and workmen's compensation insurance for all persons performing service upon the land and in connection with the growing of the crop.
5. Shipper shall carry all necessary liability insurance and workmen's compensation insurance for all field men, harvesting crews, truck drivers, and all persons performing services upon the land in connection with the harvesting of the crop.
6. Shipper will be solely responsible for the harvesting, packing and sales of said crop, and agrees to indemnify Grower and save it harmless from any and all claims, demands, suits, damages or causes of action of creditors or other persons which may arise out of sales of said crop and agrees that Grower liability hereunder is limited to the growing of said crop as agreed in section one.
7. Grower will grant Shipper unrestricted entry to harvest said cabbage crop. In the event of adverse field conditions, caused by rain, Grower agrees to provide at harvest caterpillar and wheel tractors at reasonable customary hourly rates which will be paid by Shipper.

This simple, straight forward agreement between the parties is free of boiler plate and pages of fine-print provisions. The contract does not answer a number of legal questions, such as what happens if there is a crop failure or how disputes will be addressed, but these would be resolved under California contract law.

The per-acre payment contract is fairly rare in vegetable contracts. Most call for a per-pound price for the commodity. For example, the payment term from another 1993 green-cabbage contract in California was:

GREEN CABBAGE: _____ agrees to guarantee to sell to _____ according to the following schedule:

<i>Week Beginning</i>	<i>Amount per Week (pounds)</i>
<i>04/25/93 through 11/27/93</i>	<i>80,000</i>

Price will be as follows: \$.065 per pound delivered to Pasadena.

Under this contract the grower is responsible for the costs of harvest and shipment of the cabbage to the buyer.

Passed-Acres Clauses and Harvesting

A unique aspect of vegetable contracting is the idea of "passed acres," in which the buyer has the right not to harvest or accept the entire crop raised under contract—in other words, it has the right to pass on some of the acres. The idea would seem to contradict the very reason a grower would contract (to secure a sale), but many vegetable agreements include such provisions. For example, contracts used by Del Monte for peas and sweet corn include this provision:

Nothing in this agreement, however, shall be construed to mean the Company guarantees to harvest said crop, and the Company shall not, in any manner, be liable for damages in the event it fails to do so.

One of the most common reasons why a company will use such a provision is that the crop raised is larger than the quantity the processor can handle. Or weather conditions may delay harvesting so the crop becomes too mature.

When a contract includes a passed-acres clause, the most important question for the grower is how it will affect the total payment under the contract. Typically, passed-acres clauses require the grower to make a contribution of a fixed amount per ton to a pool, which is used to compensate growers whose acreage isn't harvested. The buyer makes a matching contribution to the pool. Thus, the grower's actual payment will have a deduction from it for pool contributions, and if that grower's acreage has been passed, the actual payment may only be a portion of what he expected to earn under the contract. The following is the passed-acres clause in a Stokely sweet-corn contract:

UNHARVESTED SUITABLE ACREAGE AND ACREAGE ABANDONED DUE TO A COVERED PERIL: If Company declines to harvest or accept delivery of suitable sweet com acreage grown under this contract; Producer will be paid for that suitable acreage from an unharvested acreage's pool as hereafter described. "Suitable acreage" is all acreage grown under this contract other than acreage which the Company declares to be abandoned.

Company and Producer shall share the expense for suitable acreage which is not harvested and for acreage which is abandoned as unsuitable for processing due to ear worm, com borer, frost, or adverse field conditions (the "covered perils") by contribution to an unharvested acreage pool (the "pool"). Compensation for such acreage shall be calculated according to the Schedule of Compensation and Deductions as if the acreage had been harvested, and payment shall be made from the pool. Company will determine

field yield for unharvested acreage by actual field harvest of a portion of each field, by agreement with Producer, or by using the average yield obtained in Producer's growing area for sweet corn of the variety planted by Producer that was planted within five (5) days of Producer's planting.

Producer's potential contribution to the pool shall be up to 10% of the gross compensation due Producer under this contract and shall be in the form of a deduction from gross compensation. Company will match Producer's contribution to the pool on a dollar-for-dollar basis up to the maximum Producer contribution. Pool participants will include all sweet corn producers in Illinois, Iowa, Minnesota, and Wisconsin who entered into sweet corn procurement contract with Company for the 1993 season. The pool will not be over funded. If the pool, when fully funded, is insufficient to pay the full contract amount for unharvested acreage eligible for payment from the pool, the insufficiency as it affects Iowa producers will be prorated amongst all Iowa producers who grew sweet corn for Company in 1993 so that Iowa producers whose acreage was eligible for payment from the pool are paid on the same basis as Iowa producers whose acreage was harvested.

The use of passed-acres clauses—or crop adjustment funds, as they are more innocently called in some contracts—can be very controversial. A recent Wisconsin case involving contract production of sweet corn illustrates why.

GROWERS WHO CASH CHECKS FOR PARTIAL PAYMENT MAY LOSE RIGHT TO SUE

In *Myron Soik & Sons v. Stokely USA, Inc.* [498 N.W. 2d 897 (Wis. App. 1993)], growers of sweet corn brought a class-action suit against Stokely over interpretation of their production contracts. The dispute arose over the amount the farmers received for passed acres. The contract specified that growers would be paid for passed acres from a fund created with contributions from growers and the company, based on the total tons of harvested crop. The contract provided that if the fund wasn't sufficient to provide full compensation of unharvested acres, the payments would be prorated. Following harvest, the company notified growers that the fund was insufficient for full compensation and the payments would be prorated on a calculation not yet determined. Shortly thereafter, a second letter and check for prorating payments at 53.49% were sent to growers. At this point, the growers initiated action against Stokely on the basis that the payments were inadequate; however, some of the plaintiffs cashed the checks.

Stokely raised the legal defense that the checks had been calculated under terms of the contract and when growers accepted them, this operated as an accord and satisfaction of the contract. Stokely moved for summary judgment to dismiss the plaintiffs who had accepted the checks from action over the contract. The trial court denied summary judgment after concluding that Stokely could not use accord and satisfactions as a defense; however, the Court of Appeals reversed and remanded. The court concluded there was a dispute at the time the checks were cashed and the letters and correspondence gave growers notice the checks were meant as full payment for passed acres. The court ruled that Stokely could use accord and satisfaction as a defense, even though the letter accompanying the check made no specific reference to the provision or to the effect that cashing the check would have on a grower's right to bring a subsequent claim.

The state of Wisconsin subsequently enacted administrative rules that limit a company's ability to use passed-acres clauses in vegetable production agreements. The rules restrict the use of such clauses, regulate the method of funding payment pools and require companies to pay the full contract price for passed acres that were suitable for harvest. [See Wis. Dept. of Agriculture, Trade, and Consumer Protection, chaps. Ag. 99 and 101. Also see, "Ag 101: new vegetable contract rule benefits the industry," *The Badger Common'tater*, Jan. 1993.]

Unique Production Restrictions in Vegetable Contracts

Because vegetable production is for human consumption, the contracts' quality provisions can be very detailed. Many contracts include provisions requiring the grower to use only pesticides that have been specifically approved by the company. The following provision is from Stokely's sweet-corn contract:

Producer agrees to use in the production of the sweet corn only those chemicals that are labeled for the crop and are registered under the Federal Insecticide, Fungicide and Rodenticide Act in strict accordance with the label and all applicable federal and state laws and regulations. To verify Producer's compliance with these requirements, Producer shall supply to Company, not less than twenty (20) days prior to delivery of the sweet corn, a written report which will disclose the following information regarding the sweet corn delivered: (a) identification of all chemicals used in its production of the sweet corn, (h) dates of the use of the chemicals identified, and (c) methods and rates of application of chemicals identified.

This restriction is important because some of the herbicides registered for use on field corn are not labeled for sweet corn. If a producer uses these products on sweet corn, he will be in violation of state and federal law and the sweet corn will be unmarketable for human consumption. In the late 1980s, several sweet-corn growers in Iowa improperly used the wrong pesticides on their crops. The sweet corn was not marketed as food, and the producers faced state regulatory actions for misusing pesticides,

The grower in a vegetable production contract also generally promises that all the produce delivered will comply with state and federal health standards. The following provision is from an onion production contract used in California in 1994:

GROWER AND COMPANY AGREE:

The following quality standards are criteria for acceptance of onions delivered by Grower to Company:

a. All onions on each load delivered hereunder shall have been field topped (machine topping acceptable); shall be free from all life cycle stages of insects and worms; shall comply with the pesticide residue and other requirements of the Federal Food, Drug and Cosmetic Act of 1938, as amended, and State Pure Food Laws and Regulations; and shall otherwise be of the quality and condition needed by the Company for producing frozen onions meeting its quality standards.

Some vegetable production contracts address the application of sewage sludge or waste water on the crop. For example, Del Monte's vegetable production contracts in Illinois include the following provision, which is set out in a box to highlight it:

Contractor further warrants that he has not and will not use or apply any municipal sludge, sewage or waste water on or to the property described in this contract. Company will neither purchase nor accept for delivery or processing any crop grown on land where such substances have been applied.

Application of State and Federal Produce Dealer Laws

As with any other production contract, one of the central questions with a vegetable production contract is the risk of nonpayment. There are three places to look for protection: the terms of the particular contract, state law and the federal Perishable Agricultural Commodities Act.

Many states have enacted laws to regulate the activities of wholesale produce dealers and to help ensure that growers are paid for the products they deliver. Minnesota's Wholesale Produce Dealers Act requires licenses for produce dealers, who must obtain bonds or provide other assurance of financial resources to satisfy their contracts [Minn. Stat. Chapter 27]. Producers who have difficulty getting paid may file a claim against the dealer's bond. If applicable to the transaction, the law provides that the proceeds received from the sale of the grower's produce are to be held in trust by the dealer to secure payment.

Minnesota's law also imposes certain standards on produce dealers and provides they may lose their state license if they engage in prohibited conduct. The law includes a requirement that a "contract for produce between a buyer and seller must contain language providing for resolution of contract disputes by either mediation or arbitration. "The law has been used by at least one pea grower to fight a company's attempt not to harvest or pay for contracted acres.

COURT RULES COMPANY MUST PAY FOR PEAS EVEN THOUGH NOT HARVESTED

On Jan. 21, 1992, Minnesotans Tim and Karen Haroldson contracted to raise and sell 40 acres of green sweet peas for Pictsweet Frozen Foods. The peas were planted on May 14, 1992, a date selected by the company and communicated to the grower by the field man. The variety of peas planted had a maturity date of 60 to 63 days, so the peas were ready to be harvested between July 13 and 16. The company's field man tested the peas using a tenderometer on July 14 and found them suitable for harvest. But on July 16 the company informed the Haroldsons that the peas could not be harvested because of wet field conditions. That same day, however, the company had harvesters working in neighboring fields. The Haroldsons were unable to harvest the peas as a soft vegetable crop and later harvested them as hard peas to minimize their losses. They sold these peas for \$3,693 to a local grain company. Using the average pea yield in the area, the Haroldsons calculated they would have received \$14,890.41 under the contract. The Haroldsons then began legal proceedings to recover their damages.

The issue in the dispute was whether the company had to pay for the peas or could decide not to harvest them and have no payment obligation. Fortunately for the Haroldsons, the Minnesota legislature had in 1990 amended the Minnesota Wholesale Produce Dealers Act to include a provision concerning harvesting disputes. Under the law, a produce dealer may not

Commit to pay and not pay in full for all produce committed for. A processor may not pay an amount less than the full contract price if the crop produced is satisfactory for processing and is not harvested for reasons within the processor's control. If the processor sets the date for planting, bunching, unusual yields, and a processor's inability or unwillingness to harvest must be considered to be within the processor's control. Under this clause, growers must be compensated for passed acreage at the same rate for grade and yield as they would have received had the crop been harvested in a timely manner minus any contractual provisions for green manure or feed value. Both parties are excused from payment or performance for fop conditions beyond the control of the parties [Minn Stat. §27.19 subd. 1 (a) (12) (1993)].

The Haroldsons initiated mediation, as required by the law, but this proved futile after one session. They then filed an administrative complaint with the state Department of Agriculture. After holding a hearing on the matter, the administrative law judge ruled that the company had set the date of planting and that the grower had produced an acceptable crop of peas. The grower argued that under the law, this meant the risk of not harvesting was the company's and its attempt to sue a contract provision to excuse payment for wet conditions was not legal. The judge agreed and ruled that the law allocated the risk on nonharvest to the company under the contract. The case is still before the agency on further proceedings. The result is an excellent illustration of how state laws concerning contracting can be used to provide a more equitable allocation of risks between growers and contractors. [See Bruce M. Kleven, "Judge Strikes Down Production Contract," *Famers Legal Action Report*, winter 1994.]

Many states with significant vegetable and produce industries have enacted similar produce-dealer licensing laws, some of which may apply only to specific commodities. California, Florida, Georgia and Washington have enacted laws regulating the actions of dealers in some or all agricultural products. Producers should contact their attorney or their grower association to receive more information on state laws that protect produce growers. (For more information on these state regulations, see Chapter 12.)

Some states have also enacted an "agricultural producer's lien" to give growers a legal claim to commodities delivered to another party until they are paid. Minnesota enacted such a law in 1990 (Minn. Stat. §514.945 (1993)). The lien is valid for 20 days after the commodity is delivered and can then be extended if the producer files a lien statement and takes the steps set out in the law. The lien has a higher priority than many other claims to the crop and is designed to make sure producers are paid under their contracts. Other states that have enacted some form of this law include Ohio, Montana, Oregon and Idaho. You should ask your attorney if your state has enacted such a law.

On the federal level, Congress has passed a law to help ensure that growers of perishable commodities who sell their products in interstate commerce are paid. The Perishable Agricultural Commodities Act (PACA), administered by USDA, provides important protections for the nation's fruit

and vegetable industry. PACA regulates a number of parties involved in the interstate produce trade, including the following:

- Commission merchants, defined as any persons engaged in the business of receiving in interstate or foreign commerce any perishable agricultural commodity for sale, on commission, or for or on behalf of another
- Dealers, defined as any persons engaged in the business of buying or selling in wholesale or jobbing quantities
- Brokers, defined as any persons engaged in the business of negotiating sales of perishable agricultural commodities (7 USC §499a (1988))

There are certain exceptions to these definitions-for instance, growers who are selling their own crops and brokers who do a total business of less than \$230,000 a year. Otherwise, these persons must be licensed with the Secretary of Agriculture and must keep accounts of all transactions (7 USC §§ 499c, 499i).

PACA covers fresh fruits and vegetables (whether frozen or packed in ice) and includes cherries in brine [7 USC §499a). Fresh fruits and vegetables include the following:

All produce in fresh form generally considered as perishable fruits and vegetables, whether or not packed in ice or held in common or cold storage, but it does not include those perishable fruits and vegetables which have been manufactured into articles of food of a different kind or character. The effects of the following operations shall not be considered as changing a commodity into a food of a different kind or character: water or steam blanching, chopping, color adding, curing, cutting, dicing, drying for the removal of surface moisture; fumigating, gassing, heating for insect control, ripening and coloring; removal of seed, pits, stems, calyx, husk, pods, rind, skin, peel, etc.; polishing, precooling, refrigerating, shredding, slicing, trimming, washing with or without chemicals; waxing, adding of sugar or other sweetening agents; adding ascorbic acid or other agents used to retard oxidation; mixing of several kinds of sliced, chopped, or diced fruits or vegetables for packaging in any type of containers: or comparable methods of preparation(7 CFR§46.2(u) (1989)).

For produce that is covered, the law provides important statutory protections to ensure that the grower is paid. It also provides an administrative reparations procedure for handling complaints. Of most importance is the requirement that buyers hold all inventories, receivables or proceeds received from the sale of the perishable commodities in trust for the benefit of unpaid sellers until full payment is made [7USC §499e (1988)]. This provision does not apply to cooperative associations, however. Should a buyer declare bankruptcy, the assets in the statutory trust are not considered part of the bankruptcy estate, and a producer has a priority interest in obtaining payment. [See *In re Fresh Approach, Inc.*, 48 B.R. 926 (N.D. Texas 1985).]

The trust assets can even be commingled with other assets as part of a "floating trust," and there is no need to specify which assets relate to the buyer's debt owed to the producer. The producer must only establish the amount owed for the perishable commodity. The buyer/debtor then bears the burden of proving that the "disputed assets were not acquired with proceeds from the sale of produce

or produce-related assets" and therefore are not part of the producer's statutory trust. [See *Sanzone-Palmisano Co. v. M. Seaman Enterprises*, 986F.2d 1010 (6th Cir. 1993).]

In some cases, a producer can attempt to recover trust assets even though they have been distributed to third parties [*C.H. Robinson Co. v. B.H. Produce Co., Inc.*, 952 F.2d 1311 (11th Cir. 1992)]. But a third party has a possible defense that could prevent recovery by the producer. If the third party is a bona fide purchaser of trust assets (one who acquires the trust property for value and without knowledge of the breach of trust), the PACA trust assets may not be recoverable from that third party. [See *In re H. R. Hindle and Co., Inc.*, 149B.R. 775(E.D.Pa.1993).]

To reap the benefits of the PACA statutory trust, producers must take affirmative action. The act provides that the seller must give written notice of intent to preserve the benefits of the trust to the buyer and file the notice with the Secretary of Agriculture within 30 days after the payment due date [7 USC §49ge(3) (1988)]. Generally, the courts require strict compliance with the notice provision and the sufficiency of same. [See *J.W. Looney, Protection for Sellers of Perishable Agricultural Commodities: Reparation Proceedings and the Statutory Trust under the PACA*, 23 U.C. Davis L. Rev. 675 (1990).] But a notice that does not explicitly set out the payment due date or state that it was in fact a notice to preserve the benefits of the trust may still be acceptable as long as the seller sends it directly to the buyer. [See *Hull Co. v. Hauser's Foods, Inc.*, 924 F.2d 777 (8th Cir. 1991).]

Under the regulations, the prompt-payment due date is 10 days after acceptance of the commodity. Oral agreements that extend this time are not binding because the act specifically requires that different payment due dates be agreed to in writing. In no case can they be later than 30 days after acceptance of the commodity. Producers should be aware of this in order to file a timely notice and obtain the PACA trust benefits. Any payment arrangement other than the 10-day period must be disclosed on invoices. Failure to do so may void a producer's rights in the PACA trust. [See *In re San Joaquin Food Service, Inc.*, 958 F.2d 938 (9th Cir.1992).]

Ten Questions to Ask About Your Vegetable Production Contract

Any farmer who decides to raise vegetables under contract should ask himself a number of questions, including these:

1. Who is responsible for harvesting my crop?
2. What happens if bad weather delays or prevents the harvest? Who bears the risk of loss?
3. Does a passed-acres clause allow the buyer to decide not to harvest some of the crop, or must it take all I deliver?
4. If the contract is a sale, am I protected under a state produce dealers law or under PACA?
5. Does my state regulate vegetable production contracts or protect producer bargaining associations?
6. Who determines the quality of the crop I deliver, and can I appeal any determinations that reduce its value under the contract?
7. Will I have to alter any of my normal production practices to produce a crop for human consumption?
8. Who determines which chemicals I can use on the crop and when I can use them?
9. Who is liable if the vegetable seed I buy or receive turns out to be defective?

10. If the company refuses to take my crop or releases it, what can I do with it? Are there alternative local markets?

CHAPTER TWELVE: STATE AND FEDERAL LEGISLATION ON PRODUCTION CONTRACTS

Increasingly, people concerned about the fairness of production contracts are calling for state regulation of the agreements. In recent years several states-most notably Minnesota, Wisconsin and Kansas-have passed laws to regulate some uses of the contracts. Legislatures in many Southern states are being asked to pass laws designed to protect the rights of poultry growers. Legislation such as this may prove to be one of the most controversial issues in determining the future of agriculture. The types of laws enacted may strongly influence how production contracts develop, and even where.

General Legal Options for States to Regulate Contract Production

The most direct way for states to address production-contract issues is to regulate them specifically. No state has out-and-out banned production contracts, but Iowa does restrict packer feeding of livestock and contracting for pork. Other states, such as Minnesota, have begun to regulate contracting relationships, either by establishing requirements for them or by requiring that legal disputes go through mediation before a party can take the issue to court. States can also require annual reports by contractors in an attempt to gather more information about contracting, and they can require registration or certification of certain entities that engage in contracting. Licensing enables the state to control the use of certain practices more directly and to require the use of standardized contracts.

IOWA LEGISLATURE CONSIDERED REQUIRING MODEL CONTRACTS FOR SWINE FEEDING

In 1990 the chairman of the Agriculture Committee of the Iowa House of Representatives introduced a bill, H.R. 2529, that would have required the state to develop model livestock production contracts. Under the law, which was not enacted, the producer would receive the model contract and be given at least 24 hours before signing the actual contract offered by contractor. (The law did not require companies to adopt any provisions of the model contract, however.) If the producer was not given the model, the other contract was voidable.

Lawyers in the farm division of the Iowa Department of Justice were to develop the model contracts and include various provisions reflecting the concerns that many people associate with the production contracts. The list is still valuable as a checklist for parties interested in developing a model agreement.

The bill provided that:

Each model contract shall provide terms expressing alternative methods of structuring an agreement, including but not limited to methods of compensation. A model contract shall not state a price to be paid under the contract. It shall provide for the division of expenses and losses. A contract shall include provisions relating to the following...

The required provisions included these:

1. The exchange of financial information including any perfected security interest in the livestock. The contractor could grant the grower a security interest to secure the contractor's performance.
2. The party responsible for insurance.
3. The delivery of livestock to the feeder, including terms of notice, delays and compensation for delays.

4. The grower's right to refuse livestock when delivered if the livestock was in less than normal condition.
5. Information on the payment of expenses related to feeding and sheltering the livestock.
6. A term on the use of veterinary care.
7. Any requirements related to construction and capital improvements.
8. A term on death or loss of the livestock and who bears the risk. The law provided a shifting presumption related to timing of death from the date of arrival. The cost of disposal was to be shared.
9. Procedures for contract termination, including the conditions or actions that could result in termination. The contractor couldn't remove livestock merely because of a grower's refusal to agree to changes in the contract, and termination couldn't be based on a subjective evaluation of feeder's husbandry practices unless done by a person other than the owner. The provision was to require a method for notice of termination and a minimum period of notice. Terms for automatic renewals were also provided.
10. Compensation paid to the feeder, including the manner of compensation and when it was due. If the contract included profit-sharing, the information on the sale of the animals was required to be given to the feeder.
11. A mediation or arbitration requirement.
12. A term on death or loss of the livestock and who bears the risk. The law provided a shifting presumption related to timing of death from the date of arrival. The cost of disposal was to be shared.
13. Procedures for contract termination, including the conditions or actions that could result in termination. The contractor couldn't remove livestock merely because of a grower's refusal to agree to changes in the contract, and termination couldn't be based on a subjective evaluation of feeder's husbandry practices unless done by a person other than the owner. The provision was to require a method for notice of termination and a minimum period of notice. Terms for automatic renewals were also provided.
14. Compensation paid to the feeder, including the manner of compensation and when it was due. If the contract included profit-sharing, the information on the sale of the animals was required to be given to the feeder.
15. A mediation or arbitration requirement.

Although Iowa did not enact the proposal, its introduction did lead the Iowa Pork Producers Association to initiate an educational program for members about contracting. This campaign resulted in a detailed legal review of various hog contracting provisions. A copy of the study, IPPA Swine Contract Approaches, may still be available; call the Iowa Pork Producers Association at 800-372-7675, or write to it at P.O. Box 71009, 1636 NW 114th St., Clive, Iowa 50325-0009.

can also use indirect ways to regulate contracting or protect producers' interests. Because of concerns about contract producers' ability to organize and bargain for more favorable contract terms, several states, including Maine and Washington, have enacted Agricultural Marketing and Fair Practices acts to protect producers who form associations. [See Washington: Wash. Rev. Code Ann. §§ 15.83.005 -,905; and Maine: Me. Rev. Stat. Ann. tit. 13 §1953, et seq.]

Such indirect regulation can work both ways. When Arkansas considered proposed regulations on the disposal of waste from poultry houses in 1992, the integrators proposed including in their production contracts a requirement that growers comply with all state environmental rules. Growers criticized the provision as a way for integrators to claim compliance with state environmental rules while shifting responsibility and costs of compliance to the growers. In 1994 Kansas enacted such a provision for swine contracts, as discussed below.

Anti-corporate farming laws also affect contracting. Nine states in the Upper Midwest and Great Plains have enacted some form of corporate farming law; they are South Dakota, North Dakota, Minnesota, Wisconsin, Nebraska, Iowa, Missouri, Kansas, and Oklahoma. The laws focus on corporate involvement in farming and corporate ownership of agricultural land. While each law contains a variety of exceptions, such as for family farm corporations and authorized corporations, there are certain business entities, generally large publicly traded corporations, whose activities are restricted.

STATE CORPORATE FARMING LAWS AND PRODUCTION CONTRACTS

Both forms of corporate farming laws are important when considering legislative restrictions on contracting. First, consider laws such as Missouri's, which provides that, "no corporation not already engaged in farming shall engage in farming; not shall any corporation, directly or indirectly, acquire, or otherwise obtain interest, whether legal, beneficial or otherwise, in any title to agricultural land..." You could argue that this prohibits contract feeding of livestock by corporations because the ownership of the livestock is a way of engaging in farming. State officials have not taken this approach, however.

Second, consider laws such as Iowa's, which provide that "no corporation...shall, either directly or indirectly, acquire or otherwise obtain or lease any agricultural land in this state." This could also be interpreted as a prohibition against contracting by the restricted corporations-if contracting is viewed as an indirect form of land ownership. The argument would be that the contract feeding of livestock lets the corporation "indirectly....acquire....agricultural land." This would be a more difficult legal argument to make and would probably not succeed.

Direct Regulation of Livestock Contracting and Packer Feeding

In recent years Oklahoma, Kansas and Missouri have amended their corporate-farming laws to provide specific exemptions that allow corporate ownership of livestock facilities. These amendments have increased the tension in other states, such as Iowa, over the effect corporate-farming laws may have on the future of the swine industry. [See Libby Powers, "Second thoughts: Midwestern states begin to rethink their anti-corporate farming laws," Top Producer, March 1993.]

In addressing the use of production contracts by livestock packers and processors, state legislatures have considered a number of possible actions. In 1990 South Dakota considered but failed to

pass a bill that would prohibit packers with annual sales over \$10 million from "owning livestock for contract feeding purposes." In 1992, the Indiana legislature considered a bill to forbid packers with annual sales of more than \$4 million to own livestock or "contract for or purchase more than ten percent (10%) of the packer's annual livestock purchases from one (1) person."The bill was not enacted.

Iowa and Kansas were the only two states to enact specific prohibitions of packer feeding. But Nebraska also prohibits most packers from engaging in contract feeding if the packers are corporations that are otherwise restricted from engaging in agriculture.

The Iowa law, which was enacted in 1975, prohibits packers from direct feeding of beef and swine and prohibits packers, except cooperatives, from having swine fed on contract. The Kansas law, which was enacted in 1988, originally prohibited packers from contracting for swine feeding or owning hogs directly, but the Kansas bill was substantially amended in 1994 (see sidebar).

KANSAS AMENDS LAW TO ALLOW CORPORATE HOG FEEDING AND REGULATE SWINE CONTRACTS

In 1994, Kansas became the latest Midwestern state to change its corporate farming law significantly. Kansas had been the only state other than Iowa to prohibit pork packers and processors from feeding or contracting for animals. Seaboard Corporation's decision to construct a large swine-packing facility in Guymon, Okla., led Kansas lawmakers to amend the law in April 1994 so producers could feed pigs for packers. The governor, who vetoed a similar amendment in 1993, signed the bill.

The 1994 law authorizes corporate hog operations on a county-by-county basis, and many Kansas counties have already acted to authorize such ventures. (The county's decision must be put to a vote if 5% of the county's qualified voters sign a protest petition within 60 days of the county's decision.) The law specifically provides that use of swine production contracts is not a violation of the corporate farming law; such contracts "shall not be construed to mean the ownership, acquisition, obtainment, or lease, either directly or indirectly, of any agriculture land" in the state. The law also includes a number of provisions to regulate the use of swine production contracts (see next sidebar).

One way to obtain information on the extent of packers' involvement in contract feeding is to require annual reports of their activities. In 1991, the South Dakota legislature passed a law requiring that any packer with gross sales of more than \$100 million annually submit

a list of all livestock producers with whom the packer has entered into livestock contracts or amended existing livestock contracts during the reporting year, copies of standard contracts used by the packer in South Dakota during the reporting year, and information by plant location on the type of livestock contracted or purchased in this state, including method of purchase, price, distance transported, weight, sex, species, other characteristics, grade and yield discounts, prices paid to producers, and other discounts and premiums.

States may also require parties using contracts to file copies of them with the state. In 1990 Minnesota added a provision to the Minnesota Packers and Stockyards Act requiring a packer to file with the Commissioner of Agriculture:

a copy of each contract a packer has entered into with a livestock producer and each agreement that will become part of the contract that a packer has with a livestock producer for the purchase or contracting of livestock,

A bill that failed to pass in Indiana in 1992 included a provision on packer reporting of contracts:

Each packer shall file annually with the commissioner a copy of each contract or agreement between a packer and a livestock producer.

Recent State Laws to Regulate Production Contracts

Many states have considered legislative proposals to protect farmers who enter production contracts, but only Minnesota and Kansas have enacted new laws on the subject. Agencies in several states have enacted administrative rules regulating use of certain contracting practices. The most important contracting legislation enacted is Minnesota's.

In 1990 Minnesota became the first state to enact legislation directly regulating many provisions of agricultural production contracts [Minn. Stat. Ann §§17.90-.98 and §514.945 (1993)]. The legislation was the result of a report prepared by the Agricultural Contracts Task Force, created by the legislature in 1988 to explore the subject. The laws enacted as a result of the task force's effort established a number of requirements for all agricultural contracts. These include the following:

Dispute resolution. The law requires that a "contract for an agricultural commodity between a contractor and a producer must contain language providing for resolution of contract disputes by either mediation or arbitration."

Recovery of investments. When a producer is required by a contract "to make a capital investment in buildings or equipment that cost \$100,000 or more and have a useful life of five or more years," the contractor must not cancel or terminate the contract until:

1. "the producer has been given written notice of the intention to terminate or cancel the contract for at least 180 days notice before the effective date of the termination or cancellation" ... [except when the producer abandons the contract or is convicted of an offense related to the contract business], and
2. "the producer has been reimbursed for damages incurred by an investment in buildings or equipment that was made for the purposes of meeting minimum requirements of the contract."

Right to cure. If the producer breaches the contract, the contractor must still give the producer 90 days' notice before terminating the agreement and must give the producer 60 days to correct the breach.

Parent-company liability. Parent companies of subsidiaries licensed to purchase agricultural commodities are "liable to a seller for the amount of any unpaid claim or contract performance claim if the contractor fails to pay or perform according to the terms of the contract..."

Implied promise of good faith. All agricultural contracts must be interpreted by the Minnesota courts as including an "implied promise of good faith." If the court finds a violation of the implied promise of good faith, the court may allow the party to recover "good-faith damages, court costs, and attorney fees."

Return of prepayments. If a producer makes prepayments "for agricultural production inputs that include but are not limited to seed, feed, fertilizer, or fuel for future delivery, the producer may

demand a letter of credit or bank guarantee from the provider of the inputs to ensure reimbursement if delivery does not occur.”

The Minnesota law creates a position within the Department of Agriculture "to provide information, investigate complaints, and provide or facilitate dispute resolution" related to contract production. The law also authorizes the department to adopt rules to implement the various contracting provisions. In 1991 the department adopted rules that provide further guidance on the interpretation of the provisions. One requirement is that contractors using written commodity contracts must submit samples of their contracts for review by the department at least 30 days before offering the contracts to producers for signature.

The Minnesota law contains a number of important legal protections. The requirement of notice of termination and the grower's right to cure any problem provide more security in the relationships. Similarly, the prohibition against early termination of contracts that require large investments addresses an issue of fairness raised by growers in a number of cases.

There are weaknesses in the Minnesota law, as in any new legislative approach. But the Minnesota law is a valuable example of how states can address legal issues in contracting. Minnesota's law has served as a model for legislation considered in several other states. In 1994, when Kansas became the second state to enact a contracting law, many of the provisions were adapted from the Minnesota statute.

KANSAS REGULATES CORPORATE SWINE CONTRACTING PRACTICES

Besides amending the corporate farming restriction, the 1994 Kansas law discussed in the previous sidebar includes a number of provisions that regulate the way swine production contracts are used. The Kansas law, which is limited to swine production contracts, defines “contractor” as *any corporation, trust, limited liability company, or limited partnership or corporate partnership other than a family farm corporation, authorized farm corporations, limited liability agricultural company, limited agriculture partnership, family trust, authorized trust or testamentary trust, as defined in KSA 17-5903 and amendments thereto, which established a swine production facility in this state and in either case which in the ordinary course of business buys hogs in this state*

The law defines “producer” for purposes of a swine production contract as *an individual, family farm corporation, authorized farm corporation, limited liability agriculture company, limited agriculture partnership, family trust, authorized trust or testamentary trust, as defined in KSA 17-5903 and amendments thereto, which raises hogs in this state or provides the service of raising hogs in this state and which is able to transfer title in such hogs to another or who provides management, feed, labor, facilities, machinery or other production input for raising hogs in this state.*

The law provides that for the provisions on swine contracts, production input “includes, but is not limited to, management, labor, facilities, machinery or feed used in the raising of hogs in this state.” The law includes the following protections for producers who enter swine production contracts:

1. If the contractor is a subsidiary of another business, the parent company is liable to the producer for any unpaid claims arising from the contract's failure to pay according to the contract.
2. All contracts with producers are read to include "an implied promise of good faith" that would allow for the recovery of damages, court costs and attorney fees, if a court finds the promise has been breached.
3. Contractors must include in all contracts a provision requiring producers to comply with applicable state and federal environmental laws, and contractors must provide information about how to comply with the laws at the request of producers.
4. Contracts that require a capital investment of more than \$100,000 and with a useful life of five years or more are subject to a notice of cancellation and right to cure procedure. This requires the contractor to give the producer 90 days' notice prior to cancellation or termination and affords the producer an additional 60 days after receipt of the notice to "correct the reasons" given. Notice of cancellation is not required in certain situations, including abandonment of the relation by the producer, material breach, or failure to use good animal-husbandry practices.
5. The law authorizes the formation of swine marketing pools by producers and it requires swine contractors to deal with registered pools. They must "actively negotiate in good faith" with such pools, pay a "fair price" and make prompt payment. The law does not require dealing with swine marketing pools if they cannot meet quality specifications or delivery terms.
6. All swine production contracts must "contain language providing for resolution of contract disputes by either mediation or arbitration."

There are a number of other ways in which states may regulate some forms of contracting. For example, another Minnesota law enacted in 1990 creates an agricultural producer's lien for his products. The lien is perfected by delivery of the agricultural commodity and is good for 20 days after delivery. The producer may extend it by filing within the 20 days, but it is void six months after filing. The agricultural producer's lien has priority over all other liens and encumbrances in the commodity. The lien extends to proceeds from the commodity, the proportionate share of commingled commodity and products manufactured from it.

Another example of contract regulation is Wisconsin's rule concerning passed-acres clauses in vegetable production agreements. The rule restricts the use of such clauses, regulates the method of funding payment pools and requires companies to pay the full contract price for passed acres that were suitable for harvest (see Chapter 11).

Many states have also enacted laws on the marketing of agricultural commodities, such as for wholesale produce buyers and grain dealers. Growers who are considering entering a production contract should become familiar with their state's laws on agricultural marketing. Contact your attorney or farm organization for more information about what protections are available.

LEGAL CITATIONS FOR OTHER STATE LAWS RELATING TO CONTRACTING

While Minnesota and Wisconsin have the most detailed regulation of the agriculture contract itself, many states require parties who buy and sell agricultural products, such as dealers, handlers and commission merchants, to be licensed and bonded. These provisions are often similar to the regulation of livestock dealers under federal laws such as the Packers and Stockyards Act.

Some states, such as Idaho, lump together all dealers in farm products and require general licensing and bonding provisions [Idaho Code §22-1301 (1993).] Other states, such as Washington, separate the licensing requirements by commodities [Wash. Rev. Code Ann. §§20.02.038, 20.01.040 (1993)]. States that specialize in certain agricultural products-such as Florida with citrus- have licensing and bonding requirements particular to these industries [Fla. Stat. ch. 601.61 (1993)]. Many states have enacted laws concerning seed production. [See Indiana Seed Law (Ind. Code Ann. §15-4-1-14 (Burns 1993) and Iowa Seed Permits (Iowa Code §199.15 (1993).] Many of these statutes require dealers to keep certain records, including records of all contracts; in some cases dealers must submit them to state commissioners. [See Va. Code Ann. §§3.1-722.8, 3.1-722.14 (Michie 1983). See also Wash. Rev. Code Ann. §20.01.520 (1993).]

Many of the states on agricultural marketing set out specific provisions to ensure payment to producers, such as a trust fund for producers [Cal. Code §56701 (West 1986) and Minn. Stat. §27.138 (1993)]. Other states provide for a priority producer's lien that attaches at the time of delivery of the agricultural product [Ohio Rev. Code Ann. §1311.55 (Anderson 1989), Mont. Code Ann. §80-4-420 (1993), Cal. Code §55631 (West 1986), Or. Rev. Stat. §87.705 (1993), Idaho code §45-1802 (1993), Minn. Stat. §514.945 (1993)]. In most cases, a producer must file notice or a lien statement to perfect or to continue the lien.

Some states also have provisions for when payment for agricultural produce is due, assuming there is not contractual provision [Cal. Code §56302 (West 1986) (payment due in 30 days); Ga. Code Ann. §2-9-11.1 (1993) (payment due in 20 days following delivery); Wash. Rev. Code Ann. §20.01.390 (1993) (30 days); and La. Rev. Stat. Ann §3:3414.1 (West 1993) (10 days for grain)].

In several states there are specific contractual regulations. A Tennessee statute requires that contracts not exceed three years [Tenn. Code Ann. §43-15-101 (1993)]. South Carolina, California, Louisiana, and Illinois all require contracts between producers and dealers, and generally the contracts must be in writing [S.C. Code Ann. §5-72, 5-581.03 (Law. Co-op.), Cal. Code §56619 (West 1986), La. Rev. Stat. §3:34114 (West 1992), and Ill. Rev. Stat. ch. 110 para. 11.1 (1994) (for Illinois seed contracts)].

Other state laws contain detailed requirements for such issues of agricultural contracts as clear indication of duration [(S.C. Code Ann. §5-72); requirements of grain dealer contracts (S.C. Code Ann. §5-581.03); requirements for including when title passes (Mont. Code Ann. §80-4-422 and Wash. Admin. Code §16-212-170 (1992)] and issues relating to seed bailment contracts [Wash. Rev. Code Ann. §15.48.270 (1993)]. California specifically provides for grape purchase contracts [§55601.5(g)]; packout basis contracts [§§55602-55604]; and consigned basis contracts [§55605]. Further, a few states require certain clauses in agricultural contracts, such as Florida's clause that bonds do not ensure full payment of contractual claims [Fla. Admin. Code Ann. R. 20-2.007 (1993)]. Finally, several states have regulations regarding use of credit sales contracts for grain. [Colo. Rev. Stat. §12-16-208 (1993) and Iowa Code §203.15 (1993)].

Recent Efforts to Enact Contracting Laws

In the past three years the legislatures in Alabama, Florida, Louisiana, North Carolina, North Dakota and Oklahoma have all seen such proposals introduced to regulate production contracts. Many of the bills were developed by the National Contract Poultry Growers Association, which is aggressively promoting growers' rights legislation throughout the South. The bills have not passed, but they have affected contracting practices, and they may be a good indication of what states will consider in the years ahead.

Louisiana's proposed Poultry Growers Act of 1993 is a good example of these recent state efforts. Although the bill did not pass, it led ConAgra, the major broiler contractor in the state, to reach a compromise with state officials and agree to several major changes to the contract terms the company offered growers. The law's main goal was to require poultry integrators to include a number of specific terms in their contracts. Section 552.4 of the bill dealt with the terms that would be required in an agreement, including clauses on these issues:

- Duration of the contract
- Conditions for termination
- Terms related to payment, including the party liable for condemnations, the method of figuring feed conversion ratios, the formula used to convert condemnations to live weight, per-unit charges for feed and other inputs, and factors to be used in grouping or ranking growers
- Implied promise of good faith by both parties
- Availability of dispute resolution through mediation or arbitration
- Proper execution by both parties

The proposed law also included a number of protections concerning payment and records. Section 552.5 dealt with such issues as prompt payment, parent company's liability, the preparation of accurate settlement sheets, the duty to give information to the state agriculture commissioner, inspection of integrators' records by state officials and the integrators' requirement to provide growers with information about their bill of rights.

The bill also addressed the services that integrators provide to growers under the contracts, especially the issue of weighing for both live poultry and feed. The requirements dealt with such matters as mandatory printouts of weight-ticket information and other information such as weather conditions and whether the driver was in or off the truck. The information is important because it directly affects the growers' rankings and payment.

The proposal also set out a number of duties for integrators in the way they conduct their end of the contract. For example, the bill would impose a duty or standard to "exercise reasonable care and promptness" with a number of activities, including "loading, transporting, holding, yarding, feeding, watering, weighing, hatching or otherwise handling" live poultry or eggs so as to "prevent waste of feed, shrinkage, injury, death or other avoidable loss." Section 552.7 of the bill also incorporates an implied promise of good faith for both parties.

The proposed law also banned integrators from various activities, including unfair, unjustly discriminatory or deceptive practice and devices and coercing a grower not to join an organization; discriminating against growers who belong to associations; giving undue preference to some growers;

issuing false reports about the financial conditions of growers; trying to prevent growers from using outside experts or tests; and using a ranking system that includes employees of the company.

For enforcement, the law proposed an investigative process that would let the state issue cease-and-desist rulings against contractors found in violation. If these weren't followed, the Commissioner of Agriculture could refer the matter to the state Attorney General for enforcement of civil penalties. Section 552.9 provided for fines of up to \$10,000a day for each violation. Another important protection authorized growers to bring legal actions alleging violations against the act and to recover damages and attorney fees. Legally, this is known as an "express private right of action" and may be very important in allowing for future lawsuits to enforce the law.

In 1994 North Dakota also considered a contracting law. Sarah Vogel, the state Commissioner of Agriculture, developed a legislative proposal with four goals. The law would require mediation of any dispute over a production contract. It would provide for parent-company liability for agricultural contractors. It would incorporate an implied promise of good faith, as contained in the UCC, in "an agricultural contracts."And it would require that any preprinted form contract used in the state for the raising of a commodity be filed by the contractor with the Commissioner.

The bill defined a contractor as "a person who in the ordinary course of business buys agricultural commodities grown or raised in this state based upon a contract with a producer to grow or raise agricultural commodities in this state." The legislative hearing on the proposal, held in late July, resulted in several modifications, including a clarification that the definition of contractor did not include grain elevators. At this writing the proposal has an uncertain future in the state legislature.

Alabama poultry growers also pushed for a contracting law in 1994-a comprehensive bill on grower's rights and producer bargaining associations that was developed by the Alabama Poultry Growers Association. The final proposal stated the following Legislative Intent and Policy:

The Legislature finds and determines that many present contractual arrangements for the production of certain agricultural products by persons engaged in the production of farm products and livestock with large companies engaged in the processing, marketing, distributing, and retailing of such products tend to create a business environment fostering anticompetitive trade practices in the agricultural industry, which practices may result in a reduction of the ability of the family farmer and small producer generally to survive and prosper. The Legislature declares that it is in the public interest that the family farm be preserved and that contract producers, as hereinafter defined, of certain products of the farms and forests of the state who contract for production of such products with large vertically integrated companies be protected from the financial hardships likely to be caused by trade practices that the legislature has determined to be unfair, harmful or unethical. This act shall be liberally construed to achieve these ends and shall be administered and enforced with a view to carrying out the above declaration of policy.

The legislation was patterned after a 1979 federal proposal (HR3535) and included major sections on a number of topics: unfair trade practices, accreditation of producer associations, good-faith negotiation of contracts, mediation, administration and enforcement by the Commissioner of Agriculture, judicial review, civil remedies and investigative powers of the commissioner.

The legislation was controversial. A highly charged public hearing in March 1994 led to additional support for the bill, but it ultimately died in Committee, in part due to a \$90,000 lobbying campaign by poultry processors to defeat the measure. [For a discussion of the bill and the legislative action, see C. Tom Greene. "Contract poultry farmers get double whammy as Alabama lawmakers wind up special session," *The Poultry Patriot*, May 15, 1994.)

Whether state legislation such as the Alabama, North Dakota and Louisiana proposals is needed is a question that will be answered in part by the experiences of farmers with their contracts. As farmers enter such agreements more often, the role of state legislation in standardizing the contracts used or practices for their enforcement will become clearer. State law makers will find they have many tools and approaches to choose from. One possible source of legislative ideas is other countries' laws and regulations concerning production contracts.

FRANCE AND THE UNITED KINGDOM REGULATE PRODUCTION CONTRACTS AS CONSUMER PROTECTON

Like many other agriculture law issues, the matter of regulating production contracts and protecting growers also arises in other major food-producing countries. France first enacted a law regulating contracts of vertical integration in 1964, in connection with developments in that country's broiler production. Since then French courts have heard hundreds of cases on issues ranging from the definition of a contract for vertical integration to the damages that a grower suffers when a contract is terminated. The French have treated the contracts as a matter of consumer protection. Instead of regulating the relationship between the parties, perhaps by treating it as an employment relationship, French law requires full and detailed disclosure of the contract's terms. If a contract for vertical integration into production meets the tests for detailed disclosure, it is legal; if it does not, it is subject to annulment by the farmer and to the payment of damages.

The United Kingdom has taken a similar approach, treating production contracts as an issue of consumer protection best regulated by full disclosure of the risks and terms of the agreement. In addition, producers and trade organizations have spent a great deal of time developing standardized contracts for use throughout the country. Their involvement provides a way to regulate industry practices and develop predictable answers to common issues. Neither of these approaches-applying consumer protection full-disclosure standards and using producer groups to help negotiate improved contracts-has seen much use in the U.S.

Federal Involvement in Contract Production Relations

Like state legislatures, Congress has enacted laws to protect the rights of producers to organize and bargain when marketing commodities. Poultry producers have recently used the laws, in particular the Agricultural Fair Practices Act (AFPA) of 1967, to challenge the ways that companies terminate contracts: Congress passed AFPA to protect the right of farmers and ranchers to form associations to bargain for better prices or terms with handlers and processors. AFPA prohibits a number of practices for handlers, including persons engaged in "contracting ... with ... producers with respect to production or marketing of any agricultural product " The act focuses on prohibiting handlers from discriminating

against or intimidating producers because they belong to an organization or exercise their right to organize one.

Relying on the act, Florida poultry producers brought suit against Cargill for terminating their contracts, allegedly in response to efforts to organize other Florida growers. In *Baldree v. Cargill, Inc.*, the Florida Poultry Growers Association and the U.S. Department of Justice sought a preliminary injunction forcing Cargill to reinstate its grower's agreement with Arthur Gaskins, president and organizer of the association.

The federal district court, as affirmed by the Court of Appeals, granted the preliminary injunction. It found a substantial likelihood that the growers association would succeed in showing that Cargill had terminated the agreement to discourage Gaskins from supporting the association and to hamper the association's claim against Cargill and that Cargill had done so without economic justification in an unfair, discriminatory and deceptive practice. The court cited the Packers and Stockyards Act and the Agricultural Fair Practices Act as authority for its decision. The dispute underlying the case concerned a suit that Gaskins and other growers had filed against Cargill, alleging various forms of fraudulent practices such as misweighing.

A statute such as AFPA and cases such as *Baldree* matter because they offer protections that may become important if growers decide to organize to bargain for better contract terms. One result of contract production and agricultural industrialization may even be the need for farmers to consider collective action similar to that of organized labor's Tom Urban, president of Pioneer Hi-Bred, recognized this in his article on industrialization of agriculture:

We may even see farmers organize with like members of a system, or systems, as labor did at the turn of the century, to protect their interests in the face of contracts perceived to be unfair. They will certainly ask for, and receive, legislative protection at state and federal levels as labor has done in the past.

Other Possible Applications of Federal Law

Even though most of the attention on regulating production contracts has focused on state law, Congress could enact laws regulating production contracts because most grain, vegetables and livestock cross state lines. The Packers and Stockyards Act and Perishable Agricultural Commodities Act (discussed in chapters 10 and 11, respectively) demonstrate congressional regulatory action in the agricultural marketplace.

Proposed federal legislation regulating the terms of livestock feeding contracts was introduced in the late 1970s when then-Rep. Leon Panetta (D., Calif.) introduced H.R. 3535 relating to fair contracting practices. In light of the recent organizing activities of growers, it may only be a matter of time before Congress again considers such a law.

Meanwhile, livestock producers have important federal protection through the Packers and Stockyards Act of 1921 [7 USC § 192] when they think their contractors' actions have affected prices or the producers' ability to enter into fair contract relations. The act lists a number of unlawful practices for packers and live-poultry dealers or handlers. Among other actions, they shall not:

- a) Engage in or use any unfair, unjustly discriminatory, or deceptive practice or device; or...

- e) Engage in any course of business or do any act for the purpose or with the effect of manipulating or controlling prices, or of creating a monopoly in the acquisition of, buying, selling, or dealing in any article, or of restraining commerce; or
- f) Conspire, combine, agree, or arrange with any other person (1) to apportion territory for carrying on business or (2) to apportion purchases or sales of any article or (3) to manipulate or control prices...

For these provisions to affect contract feeding, federal officials would have to determine that the contract had somehow caused a violation of the act. Such a determination could come either in a specific complaint or because of widespread concerns about the practice, in which case USDA could undertake rule-making on the subject.

FEDERAL REGULATIONS MAY INCREASE SCRUTINY OF POULTRY CONTRACTS

USDA's Packers and Stockyards (P&S) Administration may have to opportunity to increase its scrutiny of the terms of poultry contracts now used. In summer 1994 it was reported that P&S had found that a contract used by a Mississippi poultry company, McCarty Farms Corporation, was allegedly in violation of the act. Two sections of the contract in particular worried the growers who complained to P&S. Section 11 of the contract stated that either party could terminate the agreement without cause, and Section 12 stated that any legal action concerning the contract had to be addressed in Simpson County, Miss., in the state court system.

The growers' concerns were that Section 11 violated the act by permitting noneconomic justifications for termination, an arguably unfair and discriminatory practice. Also, limiting jurisdiction to state court prevented growers from obtaining the protections of federal law. Officials of P&S were reported to have said that the parties could not make a legal contract for an illegal matter, and because the act is a federal law they would investigate possible violations. Attorney for USDA's Office of General Counsel were reported to be in negotiations with the company over the terms of the contract. Representatives of the National Contract Poultry Growers Association noted that the incident should help encourage growers to report what they believe are illegal terms in their contracts so they can be investigated. [See Michelle M. Jones, "McCarty Farms contract violates Packers and Stockyards Act," *Poultry Growers News*, July 1994.]

The Role of Producer Groups and Industry in Promoting Fair Contracts

The answers that anyone gives to questions about regulating production contracts will depend on that person's perspective and experience. The goals of fairness, full disclosure and reasonable allocation of risks and benefits are the underlying issues in the debate.

One important opportunity, which is largely untested, is for producers and their organizations to work with the companies using production contracts to develop reasonable standards for contract use.

INTERMOUNTAIN CANOLA FINDS FAIR CONTRACT ATTRACTS GROWERS

Some contracts are balanced and equitable and attract good growers. For example, InterMountain Canola contracted for the production of over 75,000 acres of canola in Western states in 1993, up from only 30,000 acres the preceding year. One reason for the increase was the company's decision to use an innovative contract that offered growers a guaranteed payment per acre, a guaranteed market for the harvested crop regardless of quality, a guaranteed contract price, and oil and yield bonuses. [See Ed Narigon, "InterMountain Canola doubles contracted acreage with contract growers can't refuse," *Seed and Crops Industry Journal*, June/July 1993.] Contracts that share the risks instead of simply shifting them to the producer are possible. But the development of such contracts may be possible only if producers and their attorneys work to ensure such terms. It is unreasonable simply to rely on the goodwill of the company writing the contract and expect it to offer terms that protect the farmer's financial interest.

Meanwhile, production contracts perceived as unfair will only lead to more litigation and to new proposals for stricter regulation of contracting practices. Producer organizations may be well suited to play a role in mediating the growing tension between grower-producers and other producers, who maybe the integrators using production contracts.

One possibility is for industry organizations, such as the National Pork Producers Council, to develop guidelines for fair contracting practices in their agricultural sectors. By bringing together large and small growers, processors, integrators, attorneys and other parties, these organizations could address legitimate concerns over contracting practices before legislation is needed.

Innovative approaches would aid such an effort. Perhaps the organizations could certify the members or processors that agree to adhere to a code of fair contracting practices. Or the organizations might draft a model contract. It is clear that the use of contract production will continue to evolve, bringing important changes to agriculture. How traditional institutions---cooperatives, farm organizations, producer groups, government agencies and agribusiness companies-and farmers respond to the development will in many ways determine the future shape of farming.

GLOSSARY OF CONTRACT TERMS

Accord and satisfaction: A method of settling a disputed claim by accepting something other than and in place of the originally agreed-on consideration. For example, accepting a check for a lesser amount than the Original price may discharge the claim.

Act of God: An event that occurs by the forces of nature without human intervention or foresight, such as a tornado or earthquake, which prevents performance of the contract.

Agency: A relationship between two parties in which one (the agent) has the authority to actor bargain on behalf of the other (the principal).

Anticipatory breach (or repudiation): A statement or act by one party to a contract that clearly indicates the party will not perform a future contractual obligation. The other party can then treat the contract as breached and is justified in not performing their part of the bargain.

Arbitration: A method of resolving legal disputes (other than going through the traditional court system) that is intended to decrease the costs and time involved in legal disputes; in arbitration, a neutral third party hears both sides, then renders a binding decision.

Article Two: Part of the UCC that pertains to and governs transactions involving the sale of "goods"; does not apply to the sale of "services."

Bailment: Situation in which one party (the owner) leaves goods or property with another party for future return to the owner (e.g., for storage purposes) or other type of agreed disposition of the goods; no ownership of the property is transferred and the party in possession is obligated to exercise reasonable care to maintain the property.

Beneficial interest: Profit, benefit, or advantage resulting from a contract that is distinct from legal ownership or control; e.g., a farmer may have a "beneficial interest" in a crop but not own it.

Breach: When one or both parties break their contractual obligations by failing to perform one or more promises made in the contract; the other party can then sue for damages.

Consequential damages: Loss or injury that occurs as a consequence of breach. Consequential damages must be reasonably foreseeable or specially communicated between the parties at the time of making the contract. For example, if a farmer is unable to pay hired hands because the processor fails to pay for the crop, any interest or additional costs that accrue are recoverable as consequential damages.

Consideration: A bargained-for exchange of value that binds the parties to contractual promises and obligations; it is usually in the form of monetary payment or services.

Course of dealing: Previous acts or conduct (outside of the current contract) between the parties that establish a common understanding of how to interpret the current contract; for example, "prompt payment" may mean two or more weeks after delivery of goods if that is what was accepted in any past dealings.

Course of performance: Acts or conduct occurring during the current contract that are not objected to and that establish a common understanding of how to interpret the contract.

Cover: The right of a buyer to purchase substitute goods if a seller has breached and not delivered the contract goods; a buyer can then sue for the difference between the cost of cover and the contract price plus consequential and incidental damages.

Damages: Money awarded to the injured party as the remedy for a breach of contract; the amount of damages depends on the extent of injury but usually attempts to restore the plaintiff to the position he would have been in had the contract been performed.

Default: Failure to perform a contractual or legal duty such as the failure to pay for goods.

Disclaimer: A contractual clause that attempts to limit or shield one from liability; companies often attempt to disclaim warranties for input products, such as seed, delivered to farmers to grow under a production contract.

Encumbrances: Any right, interest or claim someone has to property that may diminish its value, e.g., a mortgage, easement or judgment lien.

Express warranty: A promise made by a seller, either orally or in writing, in which the seller assures the quality, description or performance of the goods and which becomes part of the basis of the sale or bargain.

Force majeure: A contractual clause that protects the parties against breach of contract action in the event certain obligations cannot be performed due to events outside the control of the parties that could not be avoided by exercising reasonable care; similar to "Act of God" clause.

Goods: All tangible items of merchandise. Also includes the unborn of animals and growing crops and other items attached to realty as fixtures.

Identity preserved: Type of grain crop that preserves unique characteristics of the crop (such as uniquely altered genetics or unique production methods) from the time of production through marketing to processing and consumption.

Implied warranty: An unwritten promise by a seller that goods sold will be fit for the purpose for which they will be used (and that the seller has reason to know the purpose). An understanding that goods

conform to the seller's description of them on the container or label but that does not have to be expressly stated or written.

Independent contractor: One who contracts to do work for another but is not an employee.

Intellectual-property rights: Method of protecting intangible and valuable property created through research or experimentation (such as plant genetics) that allows the creator to retain the value and confidentiality of processing the property. Intellectual property can be protected through patents, trade secrets or contractual provisions.

Joint venture: The formation of a type of partnership between two or more persons for the purpose of sharing profits and risks in a particular business transaction.

Mediation: A form of resolving disputes in which a neutral third party helps the disputing parties reach an agreement but has no power to render a decision in the matter.

Merchant: A person who engages in the buying and selling of goods and who holds himself out as having knowledge of or skill related to those goods.

Mitigation: To make less severe; usually refers to mitigating damages, which means that after a breach of contract occurs, the injured party must make reasonable efforts to reduce his damages. For example, if a company refuses to accept a farmer's goods according to contract, the farmer must sell them elsewhere if possible and recover any loss through a lawsuit.

Oral modifications: Verbal changes made to a written agreement. They may not be binding because they are not in writing.

Parole evidence rule: A rule used in court that excludes any prior oral or written agreement from being admitted as evidence of any contradiction of the parties' formal written agreement.

Passed-acres clause: A clause in a contract that describes payment procedures for acres that are fit for harvest but are not taken by the contractor, usually in periods of surplus.

Principal and agent: An agency relationship in which one party (the principal) has primary authority and control and the other party (the agent) acts for the benefit of and at the direction of the principal.

Punitive damages: Damages assessed against a defendant that are in excess of paying a plaintiff for the loss; used to punish the defendant for wrongdoing or to make an example in order to prevent future wrongful conduct. Punitive damages are generally not available in breach of contract actions unless there is also some evidence of fraud, malice, or willful and malicious conduct.

Rejection: A refusal to accept an offer or goods delivered according to contract; a rejection of an offer terminates the offer so it cannot be later accepted; a rejection of goods must be for a legitimate reason such as that the goods do not conform to contract terms.

Release: A written or oral statement that discharges a person from a contractual duty or allows a person to give up a right, privilege or claim they were otherwise entitled to.

Sales contract: A contract involving the sale of goods (or real estate) in which the ownership of the goods is transferred from seller to buyer for a fixed price to be paid by the buyer.

Service contract: A contract involving the sale of services rather than goods, in which no transfer of ownership takes place. Such services may include paying a farmer to grow a crop while the company retains ownership of the crop.

Severability: Relating to a contract that is capable of being divided into separate transactions. For example, a crop being delivered in installments can be separated by installment. If one installment is not paid for, that does not necessarily mean the whole contract is breached.

Specific performance: A court remedy in which the party who has not performed is ordered by the court to perform their part of the bargain rather than paying damages. This remedy is given in which monetary damages would be inadequate. For example, if the goods are unique (such as a specialty crop) and the company fails to pay, the company could be ordered to accept delivery and pay for the crop, since the farmer may be unable to sell elsewhere.

Statute of frauds: A law that requires certain contracts to be in writing in order to be valid and enforceable. For example, a contract for the sale of goods of \$500 or more, a contract for the sale of land, and a contract that cannot be performed within one year must be in writing.

Termination: Ending a contract (before the anticipated time) either by mutual agreement between the parties or by one party exercising the legal right to end the contract upon default of the other.

Title: A legal term that signifies ownership of goods or land. If a contract indicates that title to goods passes at time of delivery, then a buyer's right to ownership of the goods begins upon receipt of the goods.

Uniform Commercial Code (UCC): A uniform set of rules that govern commercial transactions (such as the sale of goods); for example, the Statute of Frauds, which requires sales of goods for \$500 or more to be in writing, is part of the UCC. Generally, each state has adopted all or part of the UCC provisions, although they may make amendments.

Vertical integration: Control by one company (or its subsidiaries) of a system of production and distribution of goods from raw materials to the finished product. For example, a processing company

may control the planting, harvesting, processing and selling of a farm product in order to achieve great efficiency and avoid paying any middlemen.

Waiver: An intentional expression (either oral or written) that indicates one is giving up a right or privilege to which they otherwise would be entitled. For example, if a grower waives his right to have his own quality inspection performed, then the quality of the crop will be based on the company's inspection alone.

Warranty: An express or implied promise that certain facts or representations made are true and can be relied upon.