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Chapter 12 ruling by Second Circuit

The Court of Appeals for the Second Circuit recently affirmed the confirmation of a Chapter 12 plan in which the debtor transferred property to the creditor in full satisfaction of the debt. *In re Kerwin*, 996 F.2d 552 (2nd Cir. 1993). Although it is clear that Chapter 12 allows debtors to transfer all of a creditor's collateral in payment of the debt, this case concerned the more controversial issue of a transfer of only part of the creditor's collateral. The debtor's plan provided that the oversecured creditor was to receive certain parcels of land that the bankruptcy court found to be equal to or greater in value than the debt owed to that creditor. The creditor objected to the valuation of the property and argued that even if the valuation was correct, the creditor was still entitled to retain a lien on its remaining collateral. The creditor argued that the confirmation standards set forth in section 1225(a)(5) of the Bankruptcy Code require a plan that either provides for the surrender of all of the collateral or protects the creditor by retaining its lien on any remaining collateral. The court rejected the creditor's arguments and held that the lien was required only until the property was distributed to the creditor, in this case, the time of confirmation. In this regard, the court saw the lien requirement as ensuring the debtor's completion of the plan provisions. Once the creditor had received the full value of its claim by distribution of the property, the protection anticipated by the lien was no longer necessary. The court distinguished between section 1225(a)(5)(B) and section 1225(a)(5)(C), with (B) providing for a distribution to creditors and (C) providing for a surrender of the entire property. *Id.* at 556-57. Under (B), the court found that a debtor could distribute a portion of the property to the creditor, receiving credit against the debt for its value.

The court noted that this case raised an issue of first impression. As such, this ruling by a circuit court could prove to be influential in subsequent Chapter 12 cases. For debtors, this case could offer an additional tool for dealing with oversecured creditors.

—Susan A. Schneider, Hastings, MN

Hazardous materials transportation synergies in rulemaking

The Hazardous Materials Transportation Uniform Safety Act of 1990 mandated that the Secretary of Transportation take an active part in global issues. Hazardous Materials Transportation Uniform Safety Act (HMTUSA), Pub. L. No. 101-615, 104 Stat. 3244 (1990), (to be codified at 49 U.S.C. § 1801). The United States Department of Transportation's Research and Special Programs Administration (RSPA) recently adopted HM181, the flagship rulemaking effort to harmonize U.S. hazardous materials regulations with international regulations for the carriage of dangerous goods. 49 C.F.R. §§ 100-180 (1993). Docket HM-181 was the most comprehensive revision to the Hazardous Materials Regulations in twenty years. Implementation of HM-181 began in October 1993, but the revisions to 49 C.F.R. will be phased in over a six-year period.

While shippers and carriers of hazardous materials are still adjusting to the thousands of changes mandated by the new rules, RSPA is participating in international fora that suggest even more sweeping changes are just below the horizon. Two proposals that are of particular concern to the agricultural transportation community are: adoption of higher upper limits of toxicity for poisons and elimination of the "Keep Away From Foodstuffs," Class III poison label in favor of the "Skull and Crossbones" label for all materials falling under the definition of toxic.

The DOT recently requested comments from the hazardous materials transportation community on the feasibility of such global harmonization efforts in Notice for Comment No. 92-23. 58 Fed. Reg. 69448 (1993). The international harmonization system purports to ensure that the levels of risk posed by hazardous materials are conveyed accurately and equally to those who may be exposed to these materials by

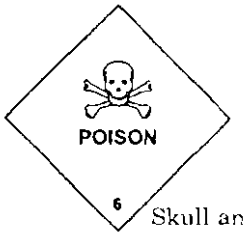
Continued on page 2

using the same definitional standards for workplace, transportation, consumer protection and environment.

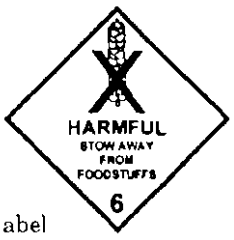
Of particular concern in Notice 92-23 is the current debate over the oral lethal dose endpoint for acutely toxic, Division 6.1, Packing Group III materials. The Organization for Economic Cooperation and Development (OECD) has offered two lethal dose (LD_{50}) endpoints for consideration, 200 mg/L and 500 mg/L for both liquids and solids. [LD_{50} is regulatory shorthand for the volume of material, measured in milligrams per kilogram of body weight, at which one-half (50%) of the tested rat population dies. An LD_{50} of 500 mg/Kg means that one-half of the tested population would find that dosage lethal. In terms of human exposure such a dose would require a 25 Kg child consume approximately 12.5 grams of material, a 70 Kg adult approximately 35 grams.] There is an indication that 500 mg/L is favored by some OECD members because this LD_{50} upper limit would harmonize international transport regulations with workplace and consumer regulations that define toxicity.

The possibility of raising the lethal dose ceiling for toxic materials in transportation becomes an even greater concern when it is realized that the U.S.D.O.T. is simultaneously considering Docket HM217. 58 Fed. Reg. 59224 (1993). This Advanced Notice of Proposed rulemaking suggests that the U.S. may remove the Keep Away From Foodstuffs diamond hazard label for these same materials, Division 6.1, Packing Group III.

At this time, the U.S. and international regulatory schemes for transportation of hazardous materials allow the lesser-regulated, St. Andrews Cross (Keep Away From Foodstuffs) label to be applied to packages containing materials that fall into the Packing Group III range. The current, and only, alternative to using the St. Andrews Cross is the Skull and Crossbones label. The differences are symbolically dramatic.



Skull and Crossbones label



St. Andrews Cross label

Although the drama of symbolism is significant, especially when considered in the context of agricultural chemicals, there is significant economic impact as well. The Skull and Crossbones label is used on toxic materials in Packing Groups I and II. The regulations allow no exceptions for toxic materials falling into these classifications. Transportation of Packing Group I and II materials requires special, and very expensive, exemption packaging for small shipments using common less-than-truckload or small parcel and express air type services.

The St. Andrews Cross, however, is applied to materials in Packing Group III. There are exceptions available to U.S. shippers, and the packaging requirements are far less onerous. Additionally, Packing Group III embraces a wide range of products, many of which are pesticides, herbicides, rodenticides, and other commonly used household and farm products.

The potential impact of such sweeping changes, an increase in the oral lethal dose ceiling for Packing Group III coupled with the required use of the Skull and Crossbones label, can be illustrated with such common agricultural chemicals a Diazinon and Lindane. Both have a reported oral LD_{50} of 76 mg/Kg. Under current transportation regulations, both substances, in their pure form, would be required to bear the St. Andrews Cross label. Under HM-217, if adopted, both would be required to bear the Skull and Crossbones label.

A considerable number of pesticides and pesticide mixtures are now transported as Pesticides, Solid, Toxic, N.O.S., Packing Group III. Under the combined proposal, this class, which now includes pesticides with legal does of between 50 and 200 mg/Kg would expand to include pesticides with lethal doses of between 50 and 500 mg/Kg. To date, no accurate data has been set out showing just how many new toxic materials will be added to the regulatory compliance system but estimates are the number will at least double. Add to that the fact that, if only one label is available, all that cargo will bear the Skull and Crossbones, and the resulting synergy of these two proposals will result in a major rulemaking in terms of public perception of the safety of agricultural chemicals and packaging and transportation costs to the farm community.

—Jo Anne Hagen, Ames, Iowa

ASCS denials of disaster assistance upheld

In two closely related cases, a federal district court has upheld the ASCS's reduction of disaster assistance benefits based on determinations that the respective farmer's substandard farming techniques contributed to the crop failure. *Tassin v. U.S. Dep't of Agric.*, 840 F. Supp. 52 (W.D. La. 1993); *Brouillette v. U.S. Dep't of Agric.*, 840 F. Supp. 55 (W.D. La. 1993). In each case, the crops planted by the plaintiffs were entirely destroyed by heavy rainfall. The ASCS, however, reduced each plaintiffs compensable yield by one-third based on determinations that the loss was partially attributable to each plaintiff's decision to plant in time to meet crop insurance deadlines and not for the purposes of producing a crop with the expectation of a normal harvest. According the ASCS's determinations "great deference" and noting that a witness for the plaintiffs in the administrative appeal process was able to produce a crop by using different cropping practices, the court held that the ASCS's determinations were neither arbitrary nor capricious.

—Christopher R. Kelley, Lindquist & Vennum, Minneapolis, MN

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Bank liable for misrepresenting farm's productivity

e Fifth Circuit has affirmed a verdict against a commercial bank for fraudulently and negligently misrepresenting a farm's productivity when it leased the farm to producers of coriander and other spices. *Roberts v. United New Mexico Bank at Roswell*, No. 93-8024, 1994 WL 38648 (5th Cir. Feb. 28, 1994). The bank argued for reversal on various grounds, including that its representations were truthful opinions and the plaintiffs' reliance on them was not justified. While characterizing the justifiability of the plaintiffs' reliance as a "close" issue, the Fifth Circuit rejected all of the bank's contentions.

The plaintiffs were Oregon-based producers of coriander and other spices. After successfully experimenting with coriander production in west Texas, the plaintiffs approached the bank about leasing a west Texas farm the bank owned. During the discussions leading to the leasing of part of the farm, a bank employee told one of the plaintiffs that the farm consisted of "'very good land [with] very good water.'" The bank also gave the plaintiffs an appraisal of the farm prepared for the bank describing the farm as being "'highly productive'" with "'good'" quality well water. *Id.* at 1994 WL 38648 at *1.

The plaintiffs' attempts to grow coriander on the farm were unsuccessful because of soil and water salinity. At the trial, the plaintiffs established that "'good'" wells in the area averaged 1,700 parts per million (ppm) of salt, "'average'" wells contained between 2,500 and 2,700 ppm, and the three wells on the farm leased from the bank contained between 3,000 and 4,000 ppm. Based on that evidence, the jury found that the bank had fraudulently and negligently misrepresented the farm's productivity and water quality and awarded the plaintiffs their out-of-pocket costs totaling $69,154.40. *Id.*

On appeal, the bank first argued that the statements were merely unactionable opinions. The Fifth Circuit rejected that argument, noting that Texas law recognizes that "representations as to matters not equally open to parties are legally statements of facts and not opinions.'" *Id.* at *2 (citations omitted). The court concluded that the evidence showed that the facts concerning water quality were not equally available to the bank and the plaintiffs. The bank employee who represented the farm's "very good water" had previously been told by another bank employee who managed the farm "that the water on the leased land was 'really d' and that the Bank should sell that land at any price because of the water problem." *Id.* Also, the plaintiffs could not have discovered the problem without paying over $7,000. Thus, the court found "that the statements made about the water quality constitute actionable statements of fact about the present condition of land." *Id.* (citations omitted).

The bank also claimed that the statements were true as to the entire farm's average water and soil quality, and the statements were intended to apply to the farm's eleven wells, not just to the three wells on the portion leased by the plaintiffs. Noting that Texas law provides that a "'representation literally true is actionable if designed to create an impression substantially false,'" the Fifth Circuit observed that "[n]either the appraisal nor [the bank employee] indicated to [the plaintiffs] that these representations were true only as to the average productivity and water quality of the farm.'" *Id.* at *3 (citations omitted). Accordingly, the court found that the jury could reasonably conclude that the bank's statements were designed to mislead. *Id.*

Finally, the bank contended that the plaintiffs' reliance on the statements was not justified because the appraisal, the plaintiffs' inspection of the farm, and the statements of another bank employee put the plaintiffs on notice of possible water quality problems. The Fifth Circuit, however, noted that the warnings about the farm and its location in the appraisal "failed to retreat in any way from its conclusion that the farm was highly productive and the water quality was of good quality." *Id.* at *4. Also, the plaintiffs' inspection of the farm did not produce any basis for further inquiry into salinity problems.

More problematic was a statement to one of the plaintiffs by another bank employee who managed the farm for the bank describing two of the wells as "relatively salty,'" a statement intended to be a warning not to lease the land. Nonetheless, the court found that "the jury was entitled to infer, based on the Bank's prior misrepresentations, that [the employee's] statement would not lead a reasonably prudent person to conduct further inquiry... [and] the evidence adequately demonstrates that the [plaintiffs] could not have reasonably discovered the high salt content of the water." *Id.* at *4. While characterizing the "issue of justifiable reliance" as "close," court concluded that the jury's verdict was not unreasonable. *Id.*

—Christopher R. Kelley, Lindquist & Vennum, Minneapolis, MN

Conference Calendar

Twentieth Annual Seminar on Bankruptcy Law and Rules
April 14-16, 1994, Marriott *Marquis* Hotel, Atlanta, GA
Topics include: Environmental issues; dischargeability; avoiding fraudulent transfers.
Sponsored by: Southeastern Bankruptcy Law Insitute.
For more information, call 404-457-5951.

The Pesticide Regulation Conference
May 23-24, 1994, The Grand Hotel, Washington, D.C.
Topics include: Pesticide registration and tolerance procedures; food safety; environmental exposure and ecological risk assessment.
Sponsored by: Executive Enterprises.
For more information, call 1-800-831-8333.

Federal Register in brief

The following is a selection of matters that were published in the *Federal Register* in February, 1994 (minus February 4 and 7).

1. Administrative Conference of the United States, Recommendations; pesticide regulation and right to consult counsel in investigations; 59 Fed. Reg. 4669; correction 59 Fed. Reg. 8507.

2. Employment and Training Administration; Farmworker Housing Assistance Program; availability of funds for technical assistance; 59 Fed. Reg. 4723.

3. FCIC; Announcement of the Federal Crop Insurance Corporation's pending evaluation of county cotton insurance programs; comments due 4/19/93; 59 Fed. Reg. 8168.

4. FCIC; General crop insurance regulations; small grains crop insurance provisions; final rule; effective date 3/30/94; 59 Fed. Reg. 9382.

5. FDA; Interim guidance on the voluntary labeling of milk and milk products from cows that have not been treated with recombinant bovine somatotropin; 59 Fed. Reg. 6279.

6. Packers and Stockyards Administration; Amendment to certification of central filing system; Oklahoma; 59 Fed. Reg. 5754.

7. FGIS; Fees for official pesticide residue testing; 59 Fed. Reg. 9424.

—Linda Grim McCormick, Toney, AL

Legal issues in contract production of commodities: issues for farmers and their lawyers — Part I

By Neil D. Hamilton

This series of articles surveys the legal issues associated with the increased use of contract production for grain in order to make lawyers and farmers aware of legal questions that might arise in connection with changes in how and why grain crops are produced. Part I of this series discusses the impact of these contracts on the rights and responsibilities of participating farmers and describes and analyzes actual contract provisions.

Part II of this series of articles will present a preliminary discussion of the legal analysis of several of the issues identified by reviewing the contract terms. In addition, a number of UCC contract questions as considered by courts in the context of grain contracts are reviewed.

Trends in grain production

While contracts have traditionally been used in the production of seeds and in vegetable crops, the use of contracting is spreading rapidly into traditional grains as companies involved in processing or marketing grain products attempt to vertically integrate into the production of the crops. Use of contracts to control grain production is part of a larger trend toward use of contracts throughout agriculture, a trend that has been labeled as part of the industrialization of agriculture.

Several different economic and agronomic forces are at work as relates to increases in contract production of grains. There are a variety of labels and concepts relating to the trend, which are important to understanding the increase in grain contracting, including:

1. *Identity preserved grains*, meaning crops for which the identity and thus unique characteristics of the grain are preserved from the time of production through marketing to processing and consumption. A prime example is the Pioneer Hi-Bred International Inc. "Better Life Grain" Program under which grains are raised under contracts in which producers agree to use no pesticides. The grains are used by food companies, such as cereal makers, in preparing pesticide-free consumer products.

2. *Specialty crop production*, which may relate to either production of non-traditional varieties or forms of grain such as waxy corn, white corn, or food grade soy beans; or may refer to raising identity preserved crops. Specialty crop production can also refer to producing or marketing commodities for non-traditional industrial uses. Specialty grain production can differ from "identity preservation" in that it may not be based on use of unique genetics or production methods to result in the unique trait, but rather may just depend on the producer's ability to price or market the commodity for an alternative use.

3. *End use tailored varieties*, another way of describing the process of identity preservation, but with the focus on the work of plant breeders or genetic engineers in specifically designing a grain crop to express a trait that can result in added value, for example the development of high-oil corn, which has a higher value as an animal feed component.

4. *Value-added production*, a more general and comprehensive term describing the process of producing commodities, such as specialty grains that sell for a price premium, or for marketing traditional commodities in a way that increases their value or the producer's returns, e.g., food grade soy beans or processing corn for ethanol.

5. *Composition-based grain marketing*, a process for marketing commodities based on the value of the various feed components, such as starch or oil, as opposed to using traditional market grades or standards, which do not value the traits.

Legal significance of the changes

Presently most of the public discussion of contracting focuses on the positive economic benefits associated with it. The development is important to society for several other reasons besides the possible economic impacts. From the lawyer's viewpoint, other important questions concerning the development are:

1. How will it change methods of producing and marketing of grain?
2. What new legal issues may arise or be created? and
3. How does it reflect the industrialization of agriculture?

Impact of contracts on farmers: risk sharing or risk shifting?

Any farmer considering signing a production contract must reflect on the advantages and disadvantages offered by the contract. This will require both an appraisal of the legal terms and financial incentives in the contract and also a consideration of what entering a contract means to the farmer's control and decision-making authority.

Under a typical production contract, to obtain the promised price improvement, the farmer may give up a considerable amount of control or flexibility in the conduct of the farm operation, including: what crop to raise, when and where to plant, what production methods to employ, when to harvest, and to whom and when the crop is marketed. In exchange for this loss of freedom, the farmer generally obtains an advance assurance of a guaranteed market, perhaps at a fixed price, and usually some type of price premium for raising the crop. The contract may reduce the risk of low financial returns; however, as the following review of contract terms reveals, under the language of most contracts, the majority of risk factors remains with the farmer. Entering a production contract may even create new forms of risk not normally associated with crop production, including: the risk of not being paid by the company, which may not be subject state grain dealer laws, and the risk of having the commodity produced determined to be unacceptable under the contract for failing to meet quality or other specifications. Another significant risk of farming under contract is the risk of losing access to the special market in future years if the contract is not renewed.

A related risk if contracts are terminated concerns the investments in buildings or equipment that might have been made in order to obtain the contract. A significant issue becomes whether the court will find conduct or oral promises by the company operate to extend the contractual obligation beyond the one year period specified in the written agreement.

A final and perhaps most significant risk of entering a contract, if it fixes a sale price, is the producer has lost the opportunity to take advantage of higher prices that might result from reduced supplies or other favorable market forces.

How contracts may affect farmers' conduct

If contract production is used, producers must recognize the types of changes that can be associated with producing crops under contract. The following discussion identifies several possible changes using examples of provisions from production contracts currently in use.

1. *Evaluation of production under the*

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contract performance terms. Farmers will ve to satisfy the contract by complying with the requirements to obtain the promised price premiums. Contract production may limit the flexibility to farm as desired and introduces the risk the crop produced will not be accepted under the contract. The following is the production clause of the "1992 Seed Production Contract, Fairview Farms, Inc., Corwith, Iowa:"

3. *Production:* 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. option, be released from this contract or purchased on the local grain elevator price schedule.

2. *Contract access, or who will have the opportunity to participate*. The answer to this question will depend on the crop and e company involved in producing it, but different factors could include: will it take a certain size of operation, will there be investments in equipment or other added costs associated with the contract. [*See*, Greg D. Horstmeier, *Farming By Invitation Only*, Top Producer, Feb. 1993, p. 36.] With grain production the requirement of additional capital investments is not as obvious as with contract production of swine, for example, but there can be new requirements as to machinery.

3. *Use of contracting may change the marketing and payment system*. For example, the contract may call for the direct delivery of the crop to the end user or the contracting company, bypassing local marketing outlets. Similarly the pricing mechanisms may bypass traditional public pricing discovery processes depending on the crop involved and the contract. The price may be based simply on the contract terms rather than the traditional methods of price discovery in the marketing of commodities, e.g. local prices or futures prices. For example a 1991 Pea Bean Contract, used by Joseph Campbell Co. in Ohio, set the price term of the contract as follows:

PRICE: The price, delivered, per net cwt. of pea eans 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.

Many production contracts provide a combined pricing mechanism that uses the traditional pricing system to establish a base price to which premium is added. Contracts may give the producer flexibility to choose the date on which the base price is set. The contract will also identify any price premium the producer will receive and any bonuses that can be earned depending on the quality of crop delivered. For example the Pioneer Better Life soybean contract quoted earlier provides:

II. 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 quotes by the Company for the location stated above Call the Pioneer SPP Grain Desk at 1-800-356-0393 for pricing information.

III. A premium of $2.00 per bushel will be paid for the net bushels of clean food grade soybeans."

One question of pricing that can arise under contract sales is the issue of the applicable level of price and quality discounts. It is common for a contract to provide the final price is subject to "discounts applying at the time of delivery." Producers may not realize the level of discounts applied within the grain trade can change significantly during a marketing period. For example, the discounts applied in the Midwest for low test weight corn were much smaller in the spring of 1993 than the discounts now being applied. The poor growing conditions during 1993 have resulted in a great deal of low test weight corn. As a result elevators are trying to limit the amount of it they acquire by lowering the price paid for low weight corn and by refusing to accept corn below a certain level.

4. *Timing and method of payment may be altered*. Instead of being paid on the day of delivery as may be required under grain dealer laws for normal market sales, the contract may not require payment on delivery or sale, but instead provide for installments payments or bonuses paid at later times. The Pioneer contract quoted above 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. **DEFFERRED 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).

5. *Contracting creates the potential for non-production reasons to serve as the basis for termination*. If a farmer violates any clause of a contract, it may be a basis for breach, even though the real reason could be an adverse price movement or other market concerns. Similarly, quality compliance provisions that leave the determination solely in the hands of the company, without an outside independent inspection process, create an opportunity for market factors to serve as the basis for rejecting the crop and finding the contract has not been performed.

Inventory of typical provisions in grain production contracts

To understand the potential range of legal questions that can arise under grain production contracts, it is valuable to review some of the other typical provisions found in such contracts.

1. *Title to the crop*. The contract provision relating to the title to the crop is important for purposes of determining who has the right to the crop at which times, a factor that can influence who bears the risk of loss or can claim a financial interest in the crop. Consider the following clause from the 1989 Stokely USA Sweet Corn Contract:

TITLE TO SEED AND CROP: The title to the seed and the crops grown herefrom 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 therefrom; and his possession of the seed and crop shall be that of a bailee only.

Some contract provisions concerning title to the crop are interesting because they attempt to establish the company's ownership of the crop while at the same time attempt to place any risk of loss on

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the producer until the crop is delivered. Consider the following provision for the "Beatrice/Hunt-Wesson Gourmet Popcorn Agreement":

7. **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.

2. *Risk of loss*. As can be seen in the "title" provisions quoted above, the location of the title will help determine who bears the risk of loss of any crop failure. Some contracts, which do not call for passage of title until delivery, do include provisions on risk of loss. The example, the "1992 Seed Production Contract, Fairview Farms, Inc., Corwith, Iowa" for the production of food grade soybeans provides:

9. *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.

3. *Growing obligations*. Because grain production contracts are generally employed with high value or specialty marketed crops, such as those for human food consumption, the contracts commonly include specific provisions concerning how the crop must be raised.

This is especially true in production arrangements such as Pioneer Hi-Bred's Better Life Grain program where the additional price premium is in exchange for meeting a series of production standards requiring avoiding the use of pesticides. Growing obligations can also be reflected in the quality standards incorporated in the pricing or acceptance provisions, such as the standards for delivery of food grade soybeans quoted above. The following is an example of a provision on growing obligations found in a Pioneer Hi-Bred Inc., Agri-Con Division Contract for the production of alfalfa seed:

IV. **GROWING** The grower agrees to plant on land with proper crop history, to grow, care for in a good and farmlike 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 therefrom; 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.

4. *Owner approval of contract — no other liens*. Another common provision in crop production contracts concerns the right of the third parties to the crop. The issue can involve either the claims of the landlord for rent, if the crop is produced on rented ground, or the claims of third party lienholders, such as banks that might have financed production of the crop. The Pioneer Hi-Bred contract for the production of alfalfa seed addresses the issues in the following clause:

IX. OWNER'S APPROVAL OF CONTRACT

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 which 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 the Du Pont Optimum Quality Grains Agreement to Grow Topcross Corn, quoted previously, includes a clause dealing with the rights of third parties. It provides:

d. GROWER agrees not to grant or cause to be placed any lien or claim against TOPCROSS material

5. *Entire agreement*. One provision almost universally found in grain production contracts, is a clause providing that the written contract is the entire agreement between the parties. The purpose of such a clause is to prevent subsequent attempts to use oral modifications or other evidence to argue the terms of the agreement had been modified by the parties. The following is the "integration" clause found in the Waxy Corn Contract 1992-93, used by the Farmers Cooperative Company of Aurelia, Iowa:

13. This agreement constitutes the entire understanding between the parties hereto. Except as set forth elsewhere herein, Neither (sic) Buyer nor Seller has any authority to alter, modify or assign this agreement or any part hereof 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. The agreement shall bind each of the parties hereto, their heirs, administrators, executors, successors, and assigns.

6. *Choice of law*. Grain production contracts generally include a clause designed to select the forum for the resolution of any disputes that might arise. Not surprisingly, the provisions commonly designate the home state and county of the company as the applicable forum. For example, the Gourmet Popcorn Agreement used by Beatrice/Hunt-Wesson in Indiana includes the following provision:

14. **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.

7. *Incorporation of other laws*. Many production contracts include provisions concerning the application of other laws to the agreement. The other laws incorporated may range from an agreement the grower will comply with all environmental laws, and worker protection requirements, to the statement the contract will be interpreted under the terms of the Uniform Commercial Code. For example, the Du Pont Optimum Quality Grains Agreement to Grow Topcross Corn, includes the following sentence in paragraph 8:

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

The clauses are important because they may obligate the grower to comply with laws that might not be applicable in a normal farming venture. An example of a considerably more detailed "incorporation of other laws" clause is found in the Beatrice/Hunt-Wesson Gourmet Popcorn Agreement, which provides:

10. **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 1948, 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(1) to (7) inclusive, of Executive Order No. 11246, as amended by Executive order No. 11375, and regulations thereunder, 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 Viet Nam era, 41 CFR § 60-250.4, 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 hereunderder, or at any other time during the term hereof when requested by the Company.

It is fair to ask, without questioning the good intention of any of the reference laws, how informed the farmers' agreement to be bound by them is, given that most farmers have no idea what the laws

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State Roundup

MONTANA. *Claim that weed poison caused death of fish.* In *Hagen v. Dow Chemical Company and Madison County Weed Management District*, 863 P.2d 413 (Mont. 1993), the Hagens filed suit to recover damages sustained to their fish farm following the nearby application of herbicide mixture.

In July of 1989, the Madison County Weed Management District sprayed a mixture of Tordon 22K and 2, 4-D adjacent to the ditch that was the water supply to the Hagen's fish farm. Soon thereafter, a rainstorm washed some of the weed poison into the ditch and eventually into the tanks at the fish farm. Almost immediately, more than 8,000 pounds of rainbow trout died.

The Hagens alleged that the Weed District acted with gross negligence in applying the herbicide in a no spray zone. The Hagens also sued Dow Chemical, the manufacturer of Tordon 22K, for negligence in representing that the weed poison was not dangerous to fish and under product liability for failure to warn. The Hagens also sought to recover punitive damages on the basis that Dow Chemical was aware of Tordon's danger to fish and acted with fraud or malice by representing that it could be safely applied. Concluding that there was not sufficient evidence to raise an issue of fact on the question of causation, the trial court granted the defendants' motions for summary judgment.

On appeal, the supreme court noted that proof of causation may be met by circumstantial evidence, especially in chemical poisoning cases. The record revealed that the Hagens offered evidence that the Weed District applied the herbicide mixture close to the fish farm. The evidence also disclosed that the fish were exposed to the weed poison. Investigation and testing by the Montana Department of Agriculture showed that the herbicide moved from the point of application to the ditch and eventually into the fish tanks. Finally, the evidence was clear that 8,000 pounds of trout died within hours after a rainstorm that washed the herbicide into the fish tanks.

Dow Chemical argued that while autopsies performed on the fish by the Department of Agriculture revealed the presence of 2,4-D, no picloram, the active ingredient in Tordon, was detected. Dow Chemical also argued that the cause of death was oxygen deprivation resulting from reduced water flow in the tanks. The court held that such contradictory evidence merely demonstrates that the cause of death constitutes a material question of fact, precluding summary judgment.

The court next turned to the issue of punitive damages. The Hagens argued that Dow Chemical was aware of research indicating that picloram was lethal at much lower levels than it represented, constituting actual malice or actual fraud. The record contained evidence of a test demonstrating that picloram was unsafe at levels of .035 parts per million (ppm). Dow Chemical's testing indicated a toxicity level of 15 ppm. The Environmental Protection Agency requires a warning label stating "This Pesticide is Toxic to Fish" if the pesticide contains an active ingredient that is toxic to fish at a concentration of 1 ppm or less. 40 C.F.R. § 156.10(h)(2)(ii)(B). The Tordon label did not carry the warning. Again, given the contradictory evidence, the court held that a fact issue exists as to whether Dow Chemical represented that Tordon could be safely applied in the manner it was applied by the Weed District when it knew otherwise. The court reversed and remanded for further proceedings.

—Scott D. Wegner, Lakeville, MN

IDAHO. *Claim of negligent warehouse inspection.* In *Crown v. State*, No. 19874, 1994 WL 37941 (Idaho App. Feb. 8, 1994), the Idaho Court of Appeals considered a negligence action against the Idaho Department of Agriculture.

Crown and others are bean growers who stored their 1988 bean crop with the Hawkins Warehouse. Hawkins Warehouse, now defunct, was a licensed, bonded commodities warehouse located in Filer, Idaho. The Idaho Department of Agriculture had a policy of inspecting each warehouse on a yearly basis to insure sufficient inventory.

In May 1988, a field examiner for the Department inspected the Hawkins Warehouse. At the time of inspection, the warehouse manager knew the bean inventory was insufficient to meet its obligations. To conceal the shortage, the manager moved into the warehouse 100 to 200 boxes filled with dirt and bean culls and surrounded these with boxes of good beans. The manager also altered the warehouse records. The field examiner's inspection of the warehouse failed to reveal the manager's fraud. Even so, following the inspection, the books still showed a shortage of 6,475 cwt. of beans. The examiner accepted the manager's explanation for the deficiency. The warehouse continued receiving beans until November, 1988, when the warehouse's license was suspended.

Thereafter, the bean growers filed an action against the Idaho Department of Agriculture claiming the department was responsible for their losses. The bean growers alleged, *inter alia*, negligent inspection. The district court granted the Department's motion for summary judgment, holding that the Idaho Tort Claims Act provided immunity to the Department.

On appeal, the court of appeals first determined that damages may be recovered for losses caused by a negligent regulatory inspection. The court next considered whether a statutory exemption applies. The relevant statute states in part:

> A governmental entity and its employees while acting within the course and scope of their employment and without malice or criminal intent and without gross negligence or recklessness, willful and wanton conduct as defined in section 6-904C, Idaho Code, shall not be liable for any claim which arises out of the failure to make an inspection, or the making of an inadequate inspection of any property, real or personal, other than the property of the governmental entity performing the inspection.

Idaho Code § 6-904B(4).

The bean growers did not assert that there was any knowing or intentional wrongdoing by the examiner. Rather, the bean growers argue that the evidence was sufficient to create a genuine issue of fact as to whether the examiner conducted the inspection "without gross negligence." The court states that to establish gross negligence, there must be a showing of a "deliberate indifference" to the harmful consequences of others. After reviewing the record and the trial court's decision, the court of appeals concluded that the examiner did not act with deliberate indifference and thus was not grossly negligent. Accordingly, the court affirmed that grant of summary judgment on the grounds of governmental immunity.

—Scott D. Wegner, Lakeville, MN

Contract production of commodities/cont. from page 6

require or how to find out, or how effective the promise of compliance and certification really is. The inclusion of such detailed incorporation clauses may illustrate how entering grain production contracts can bring on unintended obligations of uncertain magnitude for farmers.

Conclusion

The various provisions discussed above raise a number of legal questions that might need to be resolved if a dispute develops concerning a grain production contract. These issues will be explored in Part II of this series, which will appear in the May, 1994 *Agricultural Law Update*.

Staff report

John Reilly, legal advisor at USDA's Agricultural Cooperative Service, has prepared a Staff Report (94-S1) from research he has done on cooperative law. The Report, *Selective Bibliography of Legal Articles Covering Agricultural and Other Types of Cooperatives*, compiles law review articles published from 1920 to the present. For further information, or a copy of the report, contact John Reilly at 202-690-1429.

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agriculture update

AMERICAN AGRICULTURAL LAW ASSOCIATION NEWS

1994 American Agricultural Law Association membership renewal notice

Member dues for 1994 are currently payable. For the 1994 calendar year, the dues schedule is as follows:

Regular membership: $50.00
Student membership: $20.00
Institutional membership (3 members): $125.00
Sustaining membership: $75.00
Foreign membership (outside U.S. and Canada): $65.00

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