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The Farmer's Legal Guide to Producer Marketing Associations

by

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By Doug O'Brien, Neil D. Hamilton, and Robert Luedeman

September 2005

Dedication

This book is dedicated to all farmers
working together to sustain their communities.

The authors and Drake Agricultural Law Center do not endeavor to provide legal advice. Any information provided in this publication is not intended to be legal advice, nor is it intended to be a substitute for legal services from a competent professional. This work is supported in part by the U.S. Department of Agriculture under Agreement No. 59-8201-9-115, and any opinions, findings, conclusions, or recommendations expressed in the material in this publication do not necessarily reflect the view of the U.S. Department of Agriculture.

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Drake University Agricultural Law Center

Drake's Agricultural Law Center, founded in 1983, is an internationally recognized Center that provides opportunities to study how the law shapes our food system and influences the ability of the agricultural sector to produce, market and utilize agricultural products. The Center supports an array of courses, publications, conferences, research initiatives and a certification program in food and agricultural law at the Drake University School of Law. Students learn about legal issues involving the full scope of food and agriculture, including marketing and finance; biotechnology; international trade; tax planning; soil and water conservation; land use and environmental issues; food safety; and federal farm programs. The Center also hosts international law scholars to study U.S. food and agricultural law and policy through the Lorvellec International Food Law Scholar program.

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Chapter 1

Introduction

"We must all hang together, or assuredly we shall hang separately."
Benjamin Franklin at the signing of the Declaration of Independence, July 4, 1776.

American farmers are known for their deep streak of independence. This streak comes from a desire to make their own decisions and control their own destinies. One conjures images of individual families striking out to the prairies of North America to forge a better life: clearing the forests, plowing the land, and raising their own food.

Yet farmers also have a long history of working together. When the challenge required it, those in agriculture often realized the only way to get the job done was to join forces. From early barn raisings, to coming together to establish rural communities, to the rural cooperative movement, farmers recognized the advantages of pooling resources and everyone pulling in the same direction. This spirit of community and cooperation are the very roots of many rural institutions.

Farmers today face challenges that again call for a movement toward cooperation. With commodity agriculture becoming ever more concentrated, many farmers who raise crops or animals for these markets are reconsideing a theme that has resonated in agriculture through the decades: the need to join together to increase farmers' bargaining power relative to the sellers and buyers with which they deal.

Other participants in the food and agriculture sector, those who deal with food products or specialty crops, also see the need to join together. These farmers are not so much attempting to balance market power as they are concerned with accessing the capital and expertise needed to be part of these emerging markets. At the end of the day, whether it is raising soybeans in Illinois or gathering maple syrup in Vermont, farmers are looking for more options. Producer marketing associations can provide these options.

This book looks at some of the issues raised when farmers decide to work together. The book is focused on legal issues, yet it also looks at some of the business fundamentals and marketing issues farmers need to consider as they approach a producer marketing association.

Let's start with some of the basics:

What is a producer marketing association?

A producer marketing association is created when farmers enter into an association for selling, marketing, processing, promoting, or certifiying for the group. The group can be legally formed as a cooperative, limited liability company, or limited partnership, or it may be an informal network of neighbors working together toward a common goal.

Who should read this book?

Any farmer who is interested in working with other producers to further business goals. The book is designed with both big and small farmers in mind. As discussed earlier, there is a need to consider the greater use of joint producer associations in almost any type of agriculture. Farm advisors and others who are interested in rural economic development will also find the book useful because it contains information that will be valuable to their clients or communities. The book uses straight-forward language to explain some complicated legal and business ideas.

What are the goals of this book?

The intent of this book is to give farmers the tools needed to understand any producer association they might be interested in creating or joining. These tools include increased knowledge that will provide the farmer the ability to make sound decisions and avoid needless risk. Hopefully the book will answer many of the basic questions involved with producer associations. It is also intended to raise a number of questions that only the farmer, other members of the group, or its advisors will be able to answer.

Contents

The next chapter focuses on business fundamentals, a subject that has always been important to any farm or marketing group wanting to thrive. The close study of business fundamentals is even more important for groups trying to create new markets or use new business models. As a rule, the more novel the idea, the more important it is a farmer have a plan. The chapter considers some of the basic exercises people go through when considering any type of business venture – the feasibility study and the business plan. The chapter concludes by focusing on a particularly important part of the business plan – the marketing approach.

When considering a marketing approach, farmers should look at already existing models. A marketing model is simply a plan for how the farmers interact with each other and within the group in their effort to sell their goods. Chapter Three surveys different types of marketing systems farmers use to work together - from marketing associations where farmers market collectively but do not coordinate their production, to more integrated systems where producers coordinate the entire line of production. The decision on what type of marketing model to use will drive the next big decision –

Starting a producer group

As will be highlighted a number of times in the book, exactly what a group should do to get started will depend on the particular circumstances. In any event, it will require a lot of hard work. The USDA Rural Business Cooperative Development Service recommends these steps to start a cooperative. Most of the steps would also apply to organizing joint producer ventures other than cooperatives, such as limited liability companies or limited partnerships:

1. Determine an economic need and the potential for the business to fulfill that need.
2. Hold an initial exploratory meeting to gauge the support of other possible members to begin to form the general approach of the venture.
3. Select a steering committee of producers to direct a feasibility study and to create a business plan from that study; the steering committee may need to rely on outside experts for much of this work.
4. Conduct a producer survey and market analysis to determine producers' needs, anticipated business volume, how the venture will deliver its goods or services, and what business form the producers would like the business to adopt.
5. Hold a second exploratory meeting that allows possible participants to review the producer survey and feasibility study and decide whether they want to continue the project.
6. If the producers decide to proceed, prepare a business plan that explains the operations and other structural issues of the business.
7. Draft legal papers such as the articles of incorporation and bylaws.
8. Hold a third member meeting to allow members to review the articles of incorporation before filing with the State.
9. Hold first annual meeting of the partners, shareholders or members to allow the producers to approve bylaws and elect a board of directors.

Adapted from *How to Start a Cooperative*, USDA-RBCDS, Cooperative Information Report 45, sec. 14 (Sep. 1995). www.rurdev.usda.gov/rbs/pub/cir4514.pdf.

how farmers should organize legally. Chapter Four looks at this issue. Will the group be a cooperative, a limited liability partnership, or limited liability company? What are the legal implications in working together and choosing not to worry about the legalities of creating a formal business structure? The choice of the type of legal entity determines such important details as who controls the group, who receives profits and suffers losses, how the group will be taxed, and whether the group needs to register with the Securities and Exchange Commission.

The need for capital is another important factor in determining what type of business organization to form. For example, if the group's business plan requires the group to build a major processing facility, this will determine how much capital will be needed and in turn will be an important consideration for the type of business organization the group chooses. The capital question is considered in Chapter Five, which surveys the different forms of capital available within both debt and equity financing. The availability of capital will be influenced by how much risk is involved with the business.

Risk is the focus of Chapter Six, which looks at different types of risk farmers and producer associations face and ways to address these risks. In one way, merely by joining a producer association a farmer is managing risk because the association will help deal with risks associated with production, costs, or market access. The chapter concludes with a discussion of different types of crop insurance.

One way state and federal policy makers deal with certain types of risk is through regulatory schemes that address issues such as risk of nonpayment. Chapter Seven looks at some of these regulatory regimes, in particular, the Packers and Stockyards Act and the Perishable Agricultural Commodities Act. Chapter Eight then addresses basic contract law groups may need to consider in their relationships.

By joining together, farmers can create opportunities that otherwise are not available. Whether by necessity or by choice, many farmers feel now is the time to create these opportunities. As people consider creating or joining producer associations, they need to think about a range of legal and business issues to ensure they make sound choices. The chapters that follow are designed to help you consider these issues and raise questions particular to your own joint producer association.

Additional Internet Resources
For Introduction

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Chapter 2

Business Fundamentals and Marketing

When you consider creating or joining a producer marketing association, you need to have a firm handle on what the business is about and in particular how you will market the product. In any type of organization, the only way to influence the direction of the business or evaluate the viability of the business is to understand some business fundamentals. This chapter introduces you to some basic business fundamentals by examining two essential business planning documents: the feasibility study and the business plan. The chapter then focuses on a particularly important part of the business plan, the marketing strategy.

Business Fundamentals

No matter what approach your group takes in marketing products, it will need to consider some business fundamentals. Just because a business targets a nontraditional market does not mean it is exempt from some basic rules of economics. In fact, thinking through business fundamentals is even more important for novel business approaches than conventional ones. This is because new approaches to raising and selling food may include a greater amount of risk because more unknowns exist. If someone wants to grow standard winter wheat to sell into the commodity market, those concerned with the business (usually the farmer and the creditor) will have a relatively easy time determining how the business will operate because the market already has an infrastructure to supply the business and a market in which to sell commodity wheat. If a group wants to grow organic wheat to supply a particular brewers' market, it will need to prove to the creditor the ability to obtain the needed inputs and that a market exists for the product. In general, the more unfamiliar an outside party is with a type of business, the more you will have to prove to them it is workable. This is where the feasibility study and business plan come in.

Some of the most fundamental decisions you will make in bringing your products to market are determining the shape your business takes, understanding how it is financed, and knowing how you plan to market and move your products. Generally, other players in the market, most importantly financers, will not enter into significant business relationships with you unless they have confidence your business has a

Look for people who understand your business

Farmers have long understood it is easier to conduct business with people who understand farming. For example, bankers who do not really understand the financial risks and rewards involved with farming may be very hesitant to get involved in what seems a very risky business. This same idea applies to niche marketing. If your business model is truly original, it may be difficult to find a lender or other business partners who understand what you are doing, but it will still be worth attempting to seek out those who have some parallel experience.

reasonable chance of success. This is usually done with feasibility studies and business plans.

What your group's feasibility study and business plan look like will depend on the nature of your business. Some of the simplest endeavors may not even require formal versions of these documents. But no matter the business, the group will need to think through whether the idea will work. The feasibility study and business plan can help you do this.

What is the difference between a business plan and a feasibility study?

People who are forming a new business venture generally need to create a feasibility study as one of their first steps. If people find the idea feasible, much of the information will then be used to create a business plan. The best way to understand these two types of documents is by comparison.

	Feasibility study	Business plan
When is it created?	Conducted during deliberation phase of project.	Created once it is decided to start the business. Revised throughout life of business.
What are the contents?	Looks at a range of business approaches to determine which would work best.	Focuses on one business plan; usually the one that was most attractive in the feasibility study.
Who writes the document?	Usually an independent third party.	Usually the participants in the business.

Source: *Cooperative Feasibility Study Guide*, USDA-RBCS RBS Service Report 58, Appendix A. www.rurdev.usda.gov/rbs/pub/sr58.pdf.

If you intend to seek outside funding in the form of loans, grants, or investments, you need to prepare a formalized feasibility study to serve as a basis for a business plan. The business plan will function as a selling tool, part of your application package for funding, and as an indication of your business's ability to make money.

Who needs to do a feasibility study?

Anybody who is considering starting a business should consider creating a feasibility study. The degree of novelty and complexity of the business and the need to persuade others of its viability will determine how detailed the study needs to be. For example, if you plan to plant some pumpkins in your back yard this year with hopes of selling them before Halloween to raise a little income for your family, you may not need to create a formal feasibility study because you will not have to go to possible lenders, stockholders, members, or partners for financial or managerial assistance. Nevertheless, even in this simple situation you may want to consider how much time and money the pumpkin patch will take and whether there is competition in the area. You will also want to consider which types of pumpkins to plant and when to plant them. Essentially, you will want to determine whether the pumpkin patch idea is workable and which approach makes the most sense.

On the other end of the spectrum, if you are starting a cranberry processing plant requiring large amounts of capital with dozens of other producers, you will need a detailed study you can show to possible lenders and outside investors. To increase outsiders' confidence in the study, you may need to employ independent third party consultants. In any event, the feasibility study will also be the basis of your original business plan.

What is usually included in a feasibility study?

A feasibility study can include many different things. The University of Wisconsin Center for Cooperatives created a manual in 1998 entitled *Cooperatives: A Tool for Community Economic Development*, www.wisc.edu/uwcc/manual/cover.html., which states a feasibility study usually includes three areas:

1. Market issues. This area deals with the projected demand for your product, where your market is located, and what competition exists or will exist.

2. Organizational and technical issues. This organizational question considers what type of structure the business will take, who will serve on the board of directors, and what types of qualifications are required to run the business. The technical issues include the type of technology and equipment required to run the business, where the equipment will be acquired, and when it is possible to obtain the equipment.

3. Financial issues. Although it may be too early to obtain precise estimates of many of the financials related to the business, the feasibility study will require your business to begin the process of looking at where the money will come from and where it will go. Questions include estimating the start-up costs, operating costs, revenue projections, sources of financing, and possible profits.

If we have a feasibility study, do we need a business plan?

Yes. The feasibility study is designed to determine which idea will work. The business plan is designed to determine how that idea will work best. The business plan usually delves much deeper in analyzing of the market and the operations of the business. Especially with a start up business, the business plan is critical for showing people the business has a reasonable chance of success.

The complexity of a business plan should mirror the complexity of the business. The list below includes elements of a plan for a value-added business so it may be more complicated than necessary for some other, less complex types of businesses

The business plan as your group's resume

The Small Business Administration describes the importance of a business plan in the following way:

"A business plan precisely defines your business, identifies your goals, and serves as your firm's resume. … It helps you allocate resources properly, handle unforeseen complications, and make good business decisions. Because it provides specific and organized information about your company and how you will repay borrowed money, a good business plan is a crucial part of any loan application. Additionally, it informs sales personnel, suppliers, and others about your operations and goals."

United States Small Business Administration, *Business Plan Basics*. www.sba.gov/starting_business/planning/basic.html.

1. Introduction – Provides a summary of the business and how it will work.
2. Project/business – Includes more detail about the how the project will work, the mission, and the business and legal structure.
3. Management – Describes who will lead and manage the business.
4. External environment – Analyzes both the broader economic and social environment that the business will be part of as well as the industry competition.
5. Markets – Discusses who will buy your products, how you plan to reach these buyers and forecasts your sales.
6. Operations – Details how your business will use technology and labor to bring the product to market and how you will obtain these inputs.
7. Finances – Focuses on money matters, such as a budget, where the capital will come from, projected financial performance, economic variability, risk management, and contingency plans.
8. Implementation – Outlines how you will carry out the plan with milestones and timelines.

Source: Agricultural Marketing Resource Center, *Creating Your Own Value-added Business Plan*, www.agmrc.org/agmrc/business/startingbusiness/businessplan.htm

Even with a sound business plan, not all businesses succeed. The sober fact is most businesses do not survive the first years. In an article on newfarm.org called *Romance vs. Reality*, www.newfarm.org/features/0802/tall_grasses/index.shtml, a key figure in one promising venture described what she thought were the keys to success and outlined some lessons. Tallgrass Prairie Producers Coop was a group of ten ranchers in Kansas who raised grass-fed beef. They did business from 1995 until 2000 when they decided they could not find a way to make the business viable. Annie Wilson, an active member of the coop, stated the three keys to success were professional management, adequate volume to efficiently do business, and cost-effective operations. To obtain these three keys, a business must have an adequate supply and markets, and access to adequate capital should the business need to expand. The following list is adapted from Annie Wilson's observations:

1. The emperor may have no clothes. Many of the claims about market opportunities for sustainably raised foods may not be backed by fact. Sometimes overly enthusiastic farmers or advocates may whitewash some of the harsh realities of what can be a very tough business.
2. Utilize professional help when it is needed. Farmers cannot be expected to be experts in the world of food marketing and processing. You should invest in people who are.
3. Honest accounting. Be honest with yourself about how much time the business will demand. If you have to sacrifice other priorities for the business, is it worth it?
4. Do not rely on grants too much. Grants are wonderful, but they tend to be one-time infusions of money that can take a lot of energy to obtain.
5. Follow the rules every time. Be vigilant in maintaining the value of your brand to maintain credibility.
6. Price and convenience do matter. Although many consumers who support sustainably raised food may say otherwise, the real world suggests that price and convenience do matter to almost all consumers. If the product you produce is overly expensive or too difficult to obtain or prepare, consumers may shy away.
7. Seasonality can be a significant handicap. Most foods, whether plant-based or livestock, have some type of seasonality. Some customers, such as big food institutions, may not easily accommodate this seasonality.
8. Only be as different as you can afford to be. Some differentiation in the market might help you capture niches, but going to extremes to make your product different when no one is willing to pay for the difference is self-defeating.

This veteran advice includes a number of points on how important it is to have a good grasp of your market. The rest of this chapter deals with marketing issues because for all businesses, and especially for those farmers considering going into nontraditional markets, marketing is the most important part of the business plan. Without a viable marketing plan, it is pointless to think about issues such as capital formation or personnel.

Marketing your product

Why bother with marketing?

All farmers need to determine how they plan to sell their products. In the traditional commodity agricultural model, farmers have a good idea of their market because of standardized rules and institutions. For instance, a farmer who grows number two corn is practically assured to will have a market available at any time to sell the commodity. The farmer may not know the price, but knows that the grain-handling system and the world commodity market will accept the product. In terms of market information, the farmer can easily learn the estimated supply (or stocks) of corn as well as the anticipated demand from both public and private market news services. These market services even provide information on the price of the product in different parts of the country. All of this information greatly reduces the farmer's need to spend time on marketing the product. In the production contracting example, the farmer does not even own the crop or animal and does not have to worry about selling it.

A farmer looking for a different way of doing business other than the commodity model, might not find well-developed market institutions in new markets. Participating directly in this new type of food system means the seller can no longer rely on standardized marketing procedures and easily available market information. If farmers adopt entrepreneurial models intending to take over some or all of the marketing functions, they should be prepared to study the market for the products they want to produce.

The job of marketing is time-consuming, complex, and requires a completely different set of skills than those used to raise crops and livestock. This is especially true if you want to access higher volume markets such as grocery stores or institutions. Before you know it, marketing can become a full-time job. This is one of the main reasons farmers may decide to join with others to market their products. The numbers not only provide the volume needed, but joining with others makes it possible to seek outside help or spread the work involved with marketing.

> "Marketing is not just about selling. It requires a clear and astute understanding of what consumers want and the ability to deliver it to them through the most appropriate channels for a profit."
>
> Katherine Adam et al., Direct Marketing, ATTRA Business Management Series (1995), attra.ncat.org/attra-pub/directmkt.html

Evaluating your market

Market research for farmers does not necessarily have to be a formal discipline or require the services of expensive consultants, particularly when a market already exists. In those cases market research may consist only of evaluating the relevant market and surveying the price structure. This research allows you to get a better focus on the profit potential of a business. On the other hand, developing market research for a product or service that does not yet exist is significantly more difficult and speculative. Many times it requires the services of consultants, which can be a major expense, or the ability to educate yourself to a new set of disciplines.

An article published in the Alberta Agricultural, Food and Rural Development Division (2003), www1.agric.gov.ab.ca/$department/deptdocs.nsf/all/agdex1132?opendocument, explains that market research can involve either primary or secondary information. Primary information consists of data you have collected yourself from surveys or your own observations. Secondary information can come from existing data you can get from government or private resources. This not only includes how much of certain types of products are sold in your market, but can also include what type of people (age, wealth, ethnicity, etc.) live in your target market. You may also need to study your possible competition because their ability to produce products that can substitute for yours can have an impact on whether your business will be viable. Finally, you will need to be familiar with consumer trends. Some things will likely continue to be true for your market, but consumers may also change some of their buying habits. You need to consider how consumers' values related to health, taste, local communities, and the environment will change in the future to affect your business.

A relatively inexpensive way to test ideas for products, concepts, or advertising is by using a focus group. A focus group is a research tool that brings together a group of people who are representative of your market. An entry in Wikipedia, the free internet encyclopedia, en.wikipedia.org/wiki/Focus_group, describes traditional focus groups:

> "A pre-screened (pre-qualified) group of respondents gathers in the same room. They are pre-screened to ensure that group members are part of the relevant target market and that the goup is a representative subgroup of this market segment. There are usually eight to 12 members in the group, and the session usually lasts for one to two hours. A moderator guides the group through a discussion that probes attitudes about a client's proposed products or services. The disussion is unstructured (or loosely structured), and the moderator encourages the free flow of ideas. Although the moderator is seldom given specific questions to ask, he/she is often given a list of objectives or an anticipated outline."

Market differentiation

One important way to market your product is by informing consumers of its unique qualities. This can be done through certification, appellation of origin, relationship marketing, or utilizing some attribute for which buyers will pay a premium. Often efforts at product differentiation are framed for consumers by presenting a human face behind the product; this is a way for consumers to have some identity with the food that graces their tables. The consumer is no longer buying a generic product with no idea where it came from, now they are buying pork loins that came from the Biensen family farm or sweet corn from a friendly face sitting in a lawn chair next to a pickup truck .

If you cannot say anything about how your product is better because of what it is or what it stands for, then economic theory indicates that buyers will ordinarily select purchases based on price. On the other hand, if your product possesses a desirable quality, then it may be possible for an alternative marketing organization to find customers.

Identifying positive differences in your products creates opportunities to tell consumers why the products are better and can influence consumer buying decisions.

What are some ways to differentiate a product?

There are a variety of ways to differentiate your product. Some of the most common are by differentiating:

- The way you produce the product;
- The way you package the product or make it available to the public;
- The way you brand and advertise the product.

If you are going to the trouble and expense of actually producing a differentiated product, you should follow through on the packaging, branding, and advertising of the product to highlight its unique nature. To do so, you will need to continue with your differentiation effort all the way to the consumer to capture the value associated with the special product.

Fair trade coffee and the ethical consumer

More than a few consumers have been asking themselves how their choices affect the greater world beyond their doors and whether their consuming choices can effect social change. One answer to this question is the fair trade movement.

Fair trade coffee, for example, starts with the idea farmers should earn enough from their work to build sustainable communities while preserving ecological values and practicing sustainable farming methods, something that ordinary distribution systems may not pay for. This is done by developing a price structure guaranteeing farmers a floor price set far enough above world coffee prices that the true cost of production is met. In a typical fair trade program, producers' cooperatives and buyers negotiate a floor price, what Michael Rozyne of Red Tomato calls a "dignity price". The products are eligible for fair trade certification through a number of independent third party certification groups. The products are marketed as premium products that are responsibly produced.

Fair trade programs first arose in coffee production, where market prices have marginalized small farmers in the developing world, but the concept has been extended to other crops such as cotton and cocoa.

How is a product differentiated or set apart from similar items?

Some of the approaches that have worked for farmers include:

- Using a particular production technique, such as organic production or meeting animal welfare standards that may be certified by a third party;
- Growing a unique variety or breed that has special characteristics;
- Differentiating the product in terms of freshness, flavor, and purity; and
- Producing the product according to certain social values - for instance, fair trade products.

Identity preservation

A popular technique used in differentiation is called identity preservation. Identity preservation occurs when the food or processing system preserves the identity of certain attributes of the product, such as what type of seed was used, where an animal was raised, or what production technique was employed. Such identity preservation may require segregated handling facilities and more recordkeeping. Many times this is the only way to command a better price from the market because consumers need to have some confidence the product is what you say it is. Examples of product markets that have used identity preservation include organically produced grain, high oil content corn, or a variety that has utility apart from the commodity system such as canola grown for industrial uses.

Sustainable agriculture and joint producer efforts

Joint producer initiatives can serve as a link between two different dynamics occurring in rural communities. The first dynamic involves rural citizens' searching for economic opportunities to sustain rural communities. Many rural people find the best way to cultivate a number of local entrepreneurs is to tap into a second trend occurring in the food industry: the desire for food with special qualities or raised in a particular way, such as organic food, food raised locally, or animals raised with particular husbandry practices.

Rural entrepreneurs may find they have the ability and desire to participate in some of the different ways of raising food but have trouble securing markets or managing the processing, marketing, and supply management required to be successful. By joining with other producers, farmers might be able to clear these hurdles.

Relationship marketing

Relationship marketing emphasizes the retention of customers, as opposed to attracting new customers. It is typically used with higher value goods where the seller has more than one product in which the buyer might be interested. Many times these two qualities are inherent in marketing niche products to consumers. The goal of relationship marketing is to retain repeat customers by getting closer to them. The process is done by creating channels for communication, interaction, information, service, and delivery. Many times smaller, direct market enterprises have an advantage in this area. This can be as simple as striking up a conversation with your customer at the farmers' market. Community Supported Agriculture operations where farmers have seasonal relationships with their customers may be the epitome of relationship based marketing. As with all brands and businesses, it is very important that you maintain the integrity of the business for relationship marketing to work. If your business has a story that includes certain standards and you do not meet those standards, your customer support will soon vanish.

Think about the future

Although it may seem premature to be concerned about growing your business too fast, the feasibility study and business planning stage is a good time to think about some of the long-range possibilities for the business. Tom Lacina, the Executive Vice-President of PMO Wildwood in Grinnell, Iowa, started a small tofu plant on his farm that soon mushroomed into being part of the largest organic soyfood company in the world. Tom offers this advice to people considering starting their own food business:

- Know your limitations. Be familiar with your capabilities and what you are willing to do and pay attention to these factors as you plan the business.

- Keep the business on a scale you can manage and understand. You and the business need to grow together. If the business turns into something you cannot handle, chances are it will go in directions you will not want it to.

- Look at the strings attached to the money. Occasionally certain loans or grants might be available to you, but because of the timing or because of how you will need to change your business plan to meet certain requirements, you might be better off not taking the money.

- You need to be your own best expert, but you don't need to be the only expert. Seek out people with solid business experience to help with the business and do not be afraid to pay for them. That said, you cannot hand over the major decisions to others - you need to be willing to know enough about the business to question expert advice and make sound decisions. If you are not willing to dig in to these details, then maybe the business is not right for you.

- Do not rely on others to do the heavy lifting for you. State agencies, university extension, and other government advisors can help review your business plan or organize your effort, but you cannot rely on these groups to do the heavy lifting of actually working through the issues and creating the business.

- Maintain your own personal safety net. Much of the financial assistance available to you might come with important conditions – that guaranteed loan might guarantee the lender will get paid, but it does not guarantee the government will not come back to you to eventually recover the money. Consider whether you want to risk your personal financial security for the new marketing opportunity. www.wildwoodnaturalfoods.com

Conclusion

The critical first step in starting a producer marketing association is to consider business fundamentals. Your group can do this by creating a feasibility study and a business plan. These disciplined exercises force producers to look at the crucial factors that will determine the success of the group. The most important aspect of the business plan, the marketing approach, may very well dictate what type of marketing organization your group decides to adopt. The next chapter surveys these different types of marketing organizations.

Additional Internet Resources for
Business Fundamentals and Marketing

Feasibility Studies

Business Feasibility (Iowa Business Network)
Cooperative Feasibility Study Guide (USDA – RBS)
Evaluating Your Chance for Success (CCH Business Owner's Toolkit)
Feasibility Analysis (Ag Marketing Resource Center)
Feasibility Assessments for New Ag-Ventures – A Framework (Agriculture, Food and Rural Development, Alberta, Canada)

Business Plans

Business Plans (Ag Marketing Resource Center)
Guide to Business Plans (Findlaw.com)
How to Build a Business Plan (Entrepreneur Magazine)
Planning Your Business (CCH Business Owner's Toolkit)
Writing a Business Plan (www.business.gov)
Writing a Value-Added Business Plan (Ag Decision Maker)

Marketing Your Product

Overview
Advertising and Marketing (Findlaw.com)
Ag Decision Maker Marketing Guide (Ag Decision Maker)
Agricultural Marketing (Penn State University)
Marketing (Ag Marketing Resource Center)
Marketing Your Product (CCH Business Owner's Toolkit)

Marketing Research
Analyzing the Market Environment (CCH Business Owner's Toolkit)
Market Research (Ag Marketing Resource Center)
Marketing: Will it Sell? (Agriculture, Food and Rur. Dev., Alberta, Canada)
What is Marketing Research? (www.business.gov)

Marketing Plans
Building a Successful Marketing Plan (CCH Business Owner's Toolkit)
How To Create a Marketing Plan (Entrepreneur Magazine)
Marketing Plans (Ag Marketing Resource Center)
Sample Marketing Plan (www.mplans.com)

Compiled by Kurt Olson, National Agricultural Law Center Graduate Assistant

Chapter 3

Joint Producer Marketing Enterprises

Whether you sell corn or cucumbers, working with others may provide you better marketing options. For some commodity products, this may mean better prices. For some specialty crops and niche products, this may mean the difference between accessing a market and not having a market at all. This chapter looks at some of the common marketing models used by farmers who work together to sell their products. It examines how these businesses function as marketing entities. The chapter is not focussed on legal questions such as the legal organization of the group, tax liability, or who maintains legal control. All of those issues are addressed in Chapter Four.

What do various marketing models have in common?

The two characteristics that all of the different models in this chapter share are (1) multiple producers are involved in the venture and (2) the venture's goal is to market products. The approaches vary from purely grassroots efforts to more coordinated, top-down approaches. It is difficult to separate the efforts because the different types tend to overlap, yet it is instructive to look at some different models so you can consider how aspects of each approach might work within your group.

What should I focus on when comparing the different models?

When thinking about the functions of these different types of groups, focus on the different roles you play in the organization. First, consider your role in the decision making and control of the organization itself. Do you need to participate in decisions and do you have the ability to guide the direction of the organization? Do you make most of the major production decisions – such as what to plant, when to plant, and when to sell the crop – or does the organization require certain production standards and make the marketing decisions?

Second, ask how the organization deals with you as a separate entity – does the organization actually buy your goods or does it just serve as an agent in the sale of your goods? Perhaps the organization simply functions as a market facilitator that does not have any direct interaction with you in relation to the products.

These different marketing models are described in this chapter:

1. **Farmer collective bargaining organizations.** The farmer collective bargaining organization negotiates prices and conditions between groups of producers and large buyers. This classic model is easily recognized in many traditional cooperatives. These groups are usually owned and controlled by producers. Bargaining associations are widely used in both commodity and specialty markets.

   Some farmers' collective bargaining associations take title to products and the sale is actually made between the bargaining unit and the buyer. Others operate as agents for the farmers where the farmer retains ownership in the product until the sale, and still others are the exclusive bargaining agent for the farmers. Whether the association takes title to the goods will influence many of the legal issues considered in later chapters, such as who can use the goods as collateral to obtain financing, when the risk of loss of the product transfers, and how the Packers and Stockyards Act and Perishable Agricultural Commodities Act affect the relationship.

   Collective agricultural bargaining at work: The National Farmers' Organization

   The National Farmers' Organization was established in 1955 in Corning, Iowa as a farm organization designed to communicate to policy makers. NFO is now a producer-owned bargaining agent for farmers that negotiates prices and contracts for its members and markets their milk, cattle, grain, and hogs to processors across the nation. The organization generally deals with the traditional Midwestern commodities, but has branched out into some of the niche markets for products raised under special conditions, such as organic products and antibiotic free animals.

   Source: National Farmers' Organization. www.nfo.org

   Antitrust law generally prohibits sellers of products from agreeing among themselves on a particular price. This is exactly what many bargaining associations do when the organization bargains on behalf of many farmers for one price. The Capper-Volsted Act (7 U.S.C. 291) exempts cooperatives from this antitrust law prohibition. This means if the association works to set prices among sellers, the association will need to organize as a traditional cooperative. For a discussion on the implications of forming a cooperative and for more information on the Capper-Volsted Act, please see Chapter Four.

2. **Growers' networks**. As compared to collective bargaining associations, growers' networks can be a more organized form of group marketing arrangement where the growers may have formal requirements for membership and production standards protocols. The relationship of the grower to the organization can vary as can the level of the grower's responsibility to meet the requirements of the organization. In general, the supply and marketing is managed within the group. A number of farmers who recently started agritourism ventures in Southwest

Georgia formed a coop in 2003 to help them market their individual businesses. www.hosting.caes.uga.edu/swgaescapes. The coop's website describes its goals:

> Our cooperative, Southwest Georgia Escapes, Inc., was formed May 29, 2003 in order to more efficiently market agritourism venues located in Southwest Georgia. Our primary goal is to attract visitors to our unique area. The co-op's members are located across five counties – Calhoun, Clay, Early Randolph, and Quitman – and all are agricultural producers that are diversifying their current operations in order to increase their productivity. Included in the cooperative are hunting plantations and preserves, fishing ponds, scenic areas, campgrounds, horse and nature trails, and a vineyard and winery. These agritourism operations showcase some of South Georgia's best resources - beautiful scenery, fertile land, and plentiful wildlife.

Niman Ranch Pork: A network finding its niche

Niman Ranch Pork Company, L.L.C. ("NRPC") is the pork origination arm of Niman Ranch, Inc. Niman Ranch, Inc. and its network of family farmers raise livestock traditionally, humanely, and sustainably to deliver the beef, pork and lamb under the Niman Ranch™ brand.

Niman Ranch, Inc. was founded in the San Francisco Bay area and continues to be headquartered in Oakland, California. The company offers beef, pork, and lamb to restaurants, retailers and directly to consumers through its on-line market. The company differentiates its product by enforcing strict animal husbandry guidelines that include treating animals humanely, feeding them all-natural feeds, and allowing them to mature naturally. Since family farms are where these standards can best be met, the Niman Ranch enterprise helps to sustain traditional livestock operations on the family farm.

NRPC is an Iowa limited liability company formed in 1998, with financial assistance from the Iowa Department of Economic Development, to originate Niman Ranch™ pork. Although NRPC is not organized as a formal cooperative entity, it operates solely on a cooperative basis. NRPC is partially owned by Niman Ranch, Inc., and partially owned by pork producer members. Pork producers enter into pork origination agreements with NRPC and are required to meet husbandry standards. NRPC buys qualifying pigs from producers and pays a price that typically includes a premium above the market. A portion of the proceeds to the producer, which is matched by Niman Ranch, Inc., is retained by NRPC to build the capital required to finance the origination and distribution process. NRPC sells exclusively to Niman Ranch, Inc., which in turn distributes Niman Ranch™ meat products. www.nimanranch.com

The coop members realized that by joining together, they were able to create a better marketing program and ultimately bring more people to the area. The coop coordinates a website and produces brochures placed in rest stops, tourist offices, and chambers of commerce. Members formed the cooperative with the assistance of USDA Rural Development and the University of Georgia Center for Agribusiness and Economic Development.

One type of growers' network might involve five hog farmers coming together to build a relatively large sow unit owned by all of the growers. When they are weaned, the little pigs from the sow unit are divided between the farmers. The farmers may take title to the feeder pigs at that time or title may remain with the organization. The organization may agree to specific production protocols so all of the hogs can be marketed to a specific market. At this point, the producers may decide to bargain collectively with buyers so they can better access markets and obtain more favorable terms.

The difference between a simple farmers' collective bargaining association and a growers' network is that the farmers in the bargaining organization come together only to sell their products, while the growers' network has farmers working together in both the production and sale of the product.

Grower's networks are used throughout agriculture, but are especially useful for more specialized products because the network can set production and marketing standards usually required in the niche market.

The Rolling Prairie Farmers' Alliance

Rolling Prairie Farmers' Alliance is a CSA in northern Kansas that began operation in 1993 and later became legally constituted as a producers' cooperative for purposes of governance and responsibility sharing. Their website www.rollingprairie.net explains the special nature of their CSA:

"We call it a produce subscription service because our customers subscribe to our service for a season's worth of produce. The farmers in the alliance operate as a cooperative, which serves as a kind of insurance policy for the subscribers. The eight farms span four counties in the rolling prairie of Northeast Kansas. If one farm gets frosted, hailed out, dried up, or attacked by grasshoppers, chances are others can take up the slack. We become more efficient in our marketing efforts, which leaves us more time to concentrate on growing food without the use of chemical fertilizers or pesticides."

3. Community supported agricultural enterprises

Entities known as CSA's, which stands for Community Supported Agriculture, typically sell production shares during the growing season for a set membership. CSA's deal directly with consumers, who are also called members because they subscribe to the CSA. Members receive a portion of the farm's fresh produce each week. Members may be required to undertake some work in the field or the packing house, an involvement which fosters commitment and identification. The concept is very flexible and lends itself to a large spectrum of grassroots coalitions of growers and consumers concerned with community improvement and good eating as well as developing new outlets for small farmers.

The CSA model has gained in popularity both as a way for consumers to access sources of fresh produce and meats and for farmers as a way to plan their production and gain additional income for their families. An added benefit to the farmers is that they are able to share the risk of low yields caused by bad weather or other unforeseen problems. While many CSA's are operated by individual farm families, in recent years there have been many examples of several farmers working together in a CSA.

4. Vertical coordination and vertical integration

Vertical coordination refers to business models where different members up and down the production chain coordinate with each other. Looser forms of vertical coordination may involve more than one entity owning different parts of the process but working together, usually in the form of a long-term contract. For example, carrot growers may contract with a processor to grow a certain type of carrot on twenty acres for five years. Growers' networks can take on some of the attributes of vertical coordination. Tighter forms of vertical coordination, also known as vertical integration, may involve one firm owning the product and the processing facilities. Most of the poultry sector is vertically integrated where the same firm owns the chickens, makes most of the major production decisions, and owns the processing. Growers who raise products under a vertically integrated model usually have a production contract with the owner of the product. This means they agree to raise or produce the product, although they do not own it.

West Liberty Foods: Producers become processors

The Iowa Turkey Growers Cooperative in eastern Iowa formed in response to the impending closure of an Oscar Mayer turkey processing plant that had been in operation since 1948. In 1996, 47 turkey producers were given notice the plant would close in six months. In that time they formed a cooperative, located financing, and took over operation of the plant. The Iowa Turkey Growers Cooperative owns the processing part of the business, West Liberty Foods, LLC, as a subsidiary. Since its inception, West Liberty Foods, LLC, has become one of the largest turkey processors in the United States. It is a major supplier to the state of Iowa, the deli meat supplier of choice for two large sandwich shop chains, and also processes beef, pork, and chicken deli meats. Source: West Liberty Foods, LLC, website www.wlfoods.com

Many producers and financers like production contracts because they reduce the price risk for the farmer. But production contracting can involve other risks, such as when the contract terminates the grower may be forced to accept a less favorable contract or have no access to a contract at all. Many production contracts are for relatively short periods of time, either for the particular group of animals or crop, or for a year. Growers are commonly required to invest tens or hundreds of thousands of dollars in facilities that may take ten or fifteen years to repay. The mismatch between the long-term debt and the short-term production contract means that growers bear the risk of not being able to obtain favorable contracts in the future.

Many vertically integrated systems are usually associated with more of a top-down decision making process where the processor makes most of the major production decisions and the growers have limited input. If the growers also own the processing end of the business, this dynamic changes because the growers set the production protocols. An advantage to vertically integrated systems is that the systems can facilitate more uniform production standards. The major downside is sometimes the farmer's loss of independence is coupled with the loss of an opportunity for entrepreneurial profit.

5. Marketing organizations

A marketing organization's business primarily involves locating existing suppliers, organizing them into some type of network, and arranging collection, processing, or distribution. A marketing organization may be a nonprofit group funded by grants or other sponsorship arrangements, or a for-profit venture that is taking advantage of an opportunity. One of the key characteristics of marketing organizations is they may not formally be a group of farmers or represent the farmers' interest. Rather the goal of the organization is to facilitate a market

Small farmers use Red Tomato as broker

One example of an innovative alternative marketing organization is Red Tomato, a nonprofit corporation from Massachusetts. Red Tomato was founded by Michael Rozyne to market and distribute organic produce grown under certain protocols. It is forging links between farmers, retail markets, and consumers by creating supply chains that can serve consumer demand for fresh produce grown in a sustainable way. Red Tomato serves as a brokerage operation between small farmers and retail food outlets in the Boston area.

The organization requires products it buys be produced using integrated pest management practices or be certified organic. Becoming a grower for Red Tomato is demanding. Unlike produce buyers who work in the spot market, Red Tomato is focused on building long-term supply chain linkages between high quality farmers, sellers and consumers. Because of variables in supply, logistics, and demand, each discrete product line is organized as a separate program, and growers of each product are ranked according to seniority and quality.

Red Tomato's pricing philosophy reflects its founder's concerns in the Fair Trade movement and its alternative approach to trading. Through research, communication and negotiation, a "dignity price" is established, below which Red Tomato will not venture. The reason given is Red Tomato recognizes farmers have to make enough money to be sustainable. Source: Red Tomato website. www.redtomato.org.

that has the intention of benefiting both the buyers and the sellers. In produce, this organization can take the place of traditional brokerage houses or packing sheds, while in livestock the traditional marketing organization are the auction markets and sale barns.

Because a marketing organization does not engage in any of the actual production or processing of the food, the capital needs can be relatively low. Nevertheless, if the organization attempts to set up a market on a grand scale or a market that involves sophisticated internet technology, the organization will need a source of capital. This can come from up-front fees to the users of the organization or from some type of royalty or percentage of sales.

Farmers markets typically take on the model of a marketing organization. Sometimes these markets are organized and run by the farmers themselves, while other times a municipality or a nonprofit organization will establish the market. Either way, the market serves as a meeting place for the buyers and sellers of the farmers' products.

Many marketing organizations now use the internet for sales and marketing. For example, the National Farmers Union recently launched a site designed to link farms, CSA's and cooperatives producing specialty crops to consumers, ecoop.netsville.com. The site encourages producers to create a profile on the website that can be used to match consumers with certain products in a specific region. Another example of this approach is Local Harvest, www.localharvest.org, where the website helps consumers locate farms, CSA's, food cooperatives, restaurants, and online stores in their region.

Farmers and consumers work together to create farmers' markets

The Adirondack Farmers' Market Cooperative has as members both farmers and consumers who want to support farmers markets in the Adirondack region of New York.

Two different types of memberships makes sense when you consider the coop's goals:

1. To provide an economical market for farmers and crafters to sell their goods;
2. To offer consumers a source of quality, locally raised foods and crafted goods; and
3. To provide a community activity center.

This marketing organization does not necessarily represent the economic interests of farmers or consumers, but it does address their combined desire to create markets where local produce and crafts are available. The group encourages different organizations in the community to have a presence at the market to help make the market a vital community event.

Membership benefits for farmers include discounted rates for vendor locations at numerous farmers markets, advertising for certain events, and general liability insurance coverage for the site. Membership benefits for non-vendors include a newsletter, invitations to annual social gatherings, the ability to provide input on the direction of the coop, and a tote bag.

Source: Adirondack Farmers' Market Cooperative website: www.adirondackfarmersmarket.com.

Conclusion

You have a number of ways to work with others to market your products. When considering these different business models, consider how you fit into the group and how effective you think the group will be in meeting its goal of selling the goods. The marketing model answers the question of how the group actually markets the product. Depending on the model, you will then need to determine what type of legal business organization to use. The type of business organization will determine legal issues such as who is taxed on income, who has liability for losses, and who has legal control of the organization. These issues are considered in the next chapter.

Additional Internet Resources for Joint Producer Marketing Enterprises

Farmer Collective Bargaining Organizations

Bargaining is Big for Small Business: Resurgence Seen in Bargaining Cooperatives (USDA-RBS)
Collective Bargaining by Farmers: Time for a Fresh Look? (Choices Magazine)
Cooperative Farm Bargaining and Price Negotiation (USDA-RBS)
Farm Bargaining Cooperatives: Group Action, Greater Gain (USDA-RBS)

Growers' Networks

Are Producer Alliances/Networks an Alternative for Producers? (Purdue University)
Collaborative Marketing: A Roadmap and Resource Guide for Farmers (University of Minnesota Extension)
Farmer Alliances - A New Breed is Emerging (Ag Decision Maker)

Community Supported Agricultural (CSA) Enterprises

CSA Resources for Farmers or Producers (National Agricultural Library)
Community Supported Agriculture (Alternative Farming Systems Information Center)
Robyn Van En Center for CSA Resources

Vertical Coordination and Vertical Integration

Economic Issues With Vertical Coordination (Kansas State University)
Farmer-Owned Cooperatives and Vertical Coordination (Royer)
Vertical Coordination and Consolidation (Ag Marketing Resource Center)

Compiled by Kurt Olson, National Agricultural Law Center Graduate Assistant

Chapter 4

Legal Business Organizations

The last chapter considered different types of marketing enterprises a group of producers can consider forming. This chapter examines the different types of legal entities these marketing organizations can adopt. Each group will need to decide whether to organize as a cooperative, a limited liability company, a partnership, or possibly with no formal legal organization at all. This decision will affect how the organization operates internally and how it relates to those outside the organization. The decision will help determine who controls the organization, who receives income and suffers losses, who will be liable for any losses experienced by the organization, who pays income taxes and how much, and whether the organization will have the ability to raise capital.

This chapter first discusses some of the things you should think about when considering different types of business organizations and then presents some of the business organization alternatives.

Important considerations

What should I think about when determining what type of legal organization to use for our joint producer venture?

At the most basic level, you should consider the ultimate goals of the organization. Is the business being formed for the sole purpose of making money or are there other goals, such as bringing jobs to the community, raising food with a particular set of values, or protecting the environment? With these goals in mind, you must then answer two basic questions before moving on.

- *Who will control the organization?* Who are the stakeholders in the organization and how can they ultimately affect the operation? Possible candidates include the people who contribute capital, the producers who provide the product, employees, and the community where the business is located.
- *How much capital does the organization need and who will contribute the capital?* Does the organization plan to process and market its own products, which may require a large amount of capital? Or is the joint producer organization a bargaining agent or an information network that does not require a lot of capital to operate?

Important abbreviations for this chapter

Coop – Cooperative
LLC – Limited liability company
LP – Limited partnership
LLP – Limited liability partnership

These two ideas, capital and control, are intricately related because those who contribute capital usually expect to exert some level of control. A number of other questions flow from these two ideas.

- *Who owns the organization?* Who has equity or ownership rights in the business being created?
    - What type of profit-sharing rights do the owners have? Equity rights typically provide owners the right to certain profits. Sometimes, for instance in many cooperatives, the return on the equity investment is limited by statute.
    - Is the ability to sell or transfer shares limited? Organizations may choose to restrict who can own an equity interest. For example, the bylaws of the entity may require that the equity may pass only to other members of the organization or to members of the community.
    - Who is liable for injuries caused by the organization? The business structure usually determines who must pay for damages caused by the business. Generally cooperatives, corporations, and limited liability companies shield their stockholders or members from losses exceeding the amount the shareholder or member has invested. Certain types of partnerships can also work this way.

- *Can a corporation be set up for the sole purpose of avoiding liability?* One of the main advantages of being part of a corporation, LLC, or coop is the organization, rather than the individuals who own it, is liable for the business' debts. This concept of "limited liability" is a major consideration in why people form these type of entities. But courts will not allow people to form corporations with the intent of committing fraud or furthering an injustice. In these situations, the court will "pierce the corporate veil." In other words, the court will look past a scheme that uses the corporation as a cover for an individual's bad acts and make the individual liable.

  For example, a number of years ago in Vermont, two brothers who ran a dairy farm formed a corporation to purchase feed for the operation. The corporation did not have any real assets because the farm, buildings, and equipment were held by another entity. When the feed bills began to pile up, the feed company sought payment from the two brothers for over $150,000. The brothers said they did not have to pay the feed bill because they did not buy the feed, rather the corporation did. But the court still found the brothers liable for the debts. In choosing to ignore the corporation, the court pointed to the following facts: the corporation was undercapitalized and the brothers owned all of the assets of the business, the brothers moved money between their personal accounts and the corporate accounts without any corporate resolutions or documentation, and the brothers had created the corporation with the intent of isolating any business debt from their personal assets. *Agway, Inc. v. Brooks*, 790 A.2d 438 (Vt. 2001).

In a Wyoming case where an oil and gas LLC caused environmental damage to a cattleman's ranch, the court determined it could "pierce the veil" of the LLC. The court used the same analysis as used in piercing a corporate veil: when "corporations fail to follow the statutorily mandated formalities, commingle funds, or ignore the restrictions in their articles of incorporation regarding separate treatment of corporate property, the courts deem it appropriate to disregard the separate identity and do not permit shareholders to be sheltered from liability to third parties from damages caused by the corporations' acts." *Kaycee Land and Livestock v. Flahive*, 46 P.3d 323 (Wy. 2002).

- *Who can participate in the organization?* The organization can be set up to prefer or restrict membership to a certain class of people, for instance only those who provide livestock to the business or those who live in a certain community.

- *Who manages the organization and makes the decisions?* Most formal organizations have at least two levels of decision makers: the board of directors and the management. Generally, the board of directors make major financial and structural decisions while management handles the day-to-day affairs and reports to the board. Such decisions can include:

  - How to implement a major business strategy once it has been decided on;
  - Who to hire and fire;
  - How to deal with employees, suppliers, and buyers; and
  - Reporting on the financial performance of the business.

What does a board do?

A board of directors is a group of people legally charged to govern a corporation. In a for-profit corporation, the board of directors is responsible to the stockholders. From a more progressive perspective, the board is also responsible to other stakeholders, that is, everyone who is interested in or can be effected by the corporation. In a nonprofit corporation, the board reports to stakeholders, such as the donors and the communities which the nonprofit serves.

Major duties of board of directors

Board members have the following duties:

1. Provide continuity for the organization by setting up a corporation or legal existence and represent the organization's point of view through interpretation of its advocacy, products, and services.
2. Select and appoint a chief executive to whom responsibility for the administration of the organization is delegated, including:
   - Reviewing and evaluating the executive's performance regularly on the basis of a specific job description, including executive relations with the board, leadership in the organization, program planning and implementation, and management of the organization and its personnel,
   - Offering administrative guidance and determining whether to retain or dismiss the executive.

(continued)

What does a board do? (continued)

3. Govern the organization by broad policies and objectives formulated and agreed upon by the chief executive and employees; assign priorities and ensure the organization's capacity to carry out programs by continually reviewing its work.
4. Acquire sufficient resources for the organization's operations.
5. Account to the public for the products and services of the organization and expenditures of its funds, including:
   - providing for fiscal accountability, approving the budget, and formulating policies related to contracts from public or private resources,
   - accepting responsibility for all conditions and policies attached to new, innovative, or experimental programs.

Source: Dr. Carter McNamara, *Overview of Roles and Responsibilities of Corporate Board of Directors*, www.managementhelp.org/boards/brdrspon.htm (Adapted from Brenda Hanlon, *In Boards We Trust*).

- *How will the organization and the owners or members be taxed?* The organizational structure will determine how the income of the organization will be taxed – at the organization level, the individual level, or both. Tax rates may be different depending on the type of organization you choose.

Securities Law

As you think about what type of business organization to form, one of the first areas of law you will need to consider is securities regulation. These are federal and state laws designed to protect people who invest money or assets in certain types of businesses. Perhaps more than any other area of law covered in this book, securities law requires the help of a lawyer who specializes in this field. The following paragraphs provide only the most general information to provide an idea of what securities issues are involved in joint producer associations.

Coverage. Securities laws generally cast a wide net and cover just about anything you can think of that might be an investment vehicle – notes, stocks, bonds, profit-sharing agreements, certificates of deposit, options, and investment contracts. Securities laws may exampt many joint producer organizations, including relatively small businesses, certain types of cooperatives, businesses that issue securities only in the state they operate, businesses that offer securities under private offerings, and businesses that offer securities as part of a compensation plan. Even if the instrument is exempt, however, antifraud protections may still apply.

Restrictions and regulations. If the instrument is deemed a security, then a number of restrictions and regulations apply to anyone who provides information about the security or who wants to transfer the security. Most significantly, the person who creates or sells this interest may need to provide extensive disclosures to the prospective buyers about the nature of the business, the financial statements, and the risks involved in the investment. For larger businesses, this disclosure requirement can cost tens or even hundreds of thousands of dollars to prepare. If you ignore these requirements, you open yourself up to criminal and civil penalties, as well as the likelihood of civil litigation against those with whom you do business.

Limited liability companies and value-added cooperatives: Investment contracts as securities

Professor Carol Goforth has written an excellent article on the subject: *An Introduction to the Federal Securities Laws as They Might Apply to Agricultural Operations* (available at www.nationalaglawcenter.org/assets/articles/goforthsecurities.pdf.). The article includes extensive discussions on how securities law might apply to two of the newer forms of business organization farmers are using – LLC's and value-added coops. In some cases, the money people contribute to these businesses might be seen as an "investment contract," an instrument included under the coverage of the securities laws. The Supreme Court has said this "means a transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or third party." *SEC v. J. Howey Co.*, 328 U.S. 293 (1946). For LLC's and value-added coops, the biggest question under this test is whether the people providing the money have management authority in the business. In some LLC's, this may be the case, while in others, such as most value-added LLC's, the LLC may aggressively seek to attract capital from people who are not active in the management of the business. In the latter case, it is likely the investment will be covered by securities law. The question then becomes whether the venture might be exempt from some of the more costly registration requirements.

Agency Law

Depending on your role in the organization, you may be given the authority to enter into contracts or otherwise act on behalf of the group. This is called a principal and agent relationship. The exact nature of the relationship and the authority an agent has to act on behalf of the principal depends on the agreement between the parties. This agreement does not have to be in writing, but a written agreement can help avoid confusion. If a business person has reason to know someone else is holding themselves out as the business' agent and does not act to change this perception, then the business will be responsible for the agent's actions in the future. However, if an agent knowingly acts beyond his authority and the principal suffers losses because of the agent's actions, the agent may be liable to the principal.

In addition to the responsibility to act within the authority granted by the principal, an agent has other duties to the principal. These include duties of good faith and honesty. The agent also has a duty not to compete with the principal. For instance, if you are responsible for selling produce to institutions for your vegetable cooperative, but you take advantage of this position to sell your own goods, the cooperative could sue you for damages caused by your breach of duty.

The principal also has duties in a principal-agent relationship. These include honoring contracts the agent entered into within the scope of the relationship, as well as duties of good faith and fair dealing. This generally means a principal may not harm the agent's reputation or risk bodily harm to the agent. (Restatement Second of Agency § 435.)

Apparent agency: Who has to pay for the corn?

In a South Carolina case involving the sale of six rail cars of corn, a lender provided a farm manager with $85,000 to buy the corn. At the time the two parties entered into the lending agreement, the lender did not know the farm manager worked for another person named Serbin. Subsequently, the lender became aware the farm manager and Serbin had a farm management agreement spelling out the farm manager's duties for Serbin. The agreement clearly stated that the farm manager was an independent contractor and not an agent of Serbin, and if the farm manager wanted to incur expenses for the farm, he had to get written approval from Serbin.

The lender sued both the farm manager and Serbin for repayment of the $85,000. Part of the suit argued Serbin was the principal of the farm manager and thus was responsible for the farm manager's debts. The court found Serbin did not have to pay because the agreement made it clear the farm manager could not act as an agent for Serbin. The lender pointed out that even if there was not a formal "principal-agent" relationship, Serbin could still be liable if there was an apparent agency relationship. But the court ruled that three things must have been in place for an apparent agency relationship to be found: 1) the farm manager would have had to consciously or impliedly represented to the lender he was an agent; 2) the lender would have had to rely upon the apparent agency relationship; and 3) the lender was harmed because of the reliance. The court then determined the lender did not know of any relationship between Serbin and the farm manager at the time the lender and manager entered into the loan agreement, so the lender could not have relied on any apparent relationship.

Graves v. Serbin Farms, Inc., 306 S.E.2d 769 (S.C. 1991).

Articles of incorporation, bylaws, and operating agreements

Some of the basic legal documents joint producer organizations businesses need to create include the articles of incorporation, bylaws and operating agreements. Articles of incorporation are created by the organizers of the group and are filed with a state office to gain recognition as a legal business entity. The appendix to this book includes the contact information for the appropriate state office to file the articles of incorporation in each state. State law generally dictates what information to include in the articles and typically requires information such as the business' name, place of business, purpose, and names of the organizers or original directors.

Bylaws (or operating agreements as they are known in LLC's) are created by the members to set the rules on how the business will actually operate. The bylaws can both grant and restrict the authority of different people involved with the organization. Typical issues addressed in bylaws include membership rights and responsibilities, the procedure for the election of directors, and duties of officers. Most state laws are fairly permissive in what a group may decide to include in the bylaws.

For more information on articles of incorporation, bylaws, and other legal documents, see Donald A. Fredrick, *Sample Legal Documents for Cooperatives*, USDA Cooperative Information Report 40. www.rurdev.usda.gov/rbs/pub/cir40/cir40rpt.htm#Articles%20of%20Incorporation.

The creation of bylaws or the operating agreement. One goal of most producers who form a joint producer association is to create a fair and flexible way of structuring the business which preserves the reasons it was created. Most groups start out as informal associations of people with similar ideas who share their energy and expertise – the "soft capital" of the business. One challenge for any successful business is how to preserve the original purpose of its creation while dealing with issues such as control and ownership.

How this objective is approached can mean the difference between the success or failure of the original vision of the founders.

Some factors an organization should consider include:

- Treating people equitably and respectfully;
- Acknowledging important contributions regardless of size;
- Respecting each member's unique knowledge;
- Preserving the communication and mutual support that was the basis for the project in the first place;
- Providing a fair and equitable means of adding new people to the group;
- Providing a reasonable method of achieving a valuation of the enterprise members can live with; and
- Providing a flexible means of management to adapt to changing market conditions.

Some of the major features of governance for a small enterprise might include:

- Limiting non-producer voting members on the board of directors. For example, producers shall always hold a certain majority (for example 51%, 67%, or 75%) of voting seats;
- Limiting members' ability to withdraw support from the enterprise in its formative period;
- Allowing any producer regardless of size to sit on the board of directors;
- Having a semi-independent marketing and operations arm; and
- Creating an informal dispute resolution mechanism.

All of these features can be included in the bylaws or operating agreement. Although it is not easy, the process of creating an operating agreement provides an opportunity for sharing knowledge, building mutual respect, and discussing different points of view. At the end of the process, the finished product will represent a real consensus, and each member who was part of the process will have an ownership stake in it and will understand exactly what it means.

Types of Business Organizations

The rest of this chapter examines different types of business organizations, ranging from sole proprietorships to corporations and cooperatives.

1. **Sole proprietorship**. This is the model most people have experience with because it is the simplest. Although by definition this type of business does not include a group of people, it is the proper place to start when comparing different forms of business organizations. It involves one person doing business alone with no legal organization to represent the business. The example is when a farmer wants to market pork and decides to raise hogs outdoors with no antibiotics. He pays someone to process the meat and then sells the pork to people in a neighboring community.

   - Ownership and control. In a sole proprietorship, ownership and control are held by one person. In our example, the farmer provides all of the capital and assets needed to run the farm, including the land, feed, equipment and costs related to marketing, and he receives all of the income and losses. He also makes all of the decisions related to the business, such as what breed to use, whether to hire help, and where to market the product.
   - Liability. In a sole proprietorship, the owner is personally liable for all of the debts of the business. This means if he owes the hardware store $100 for equipment, or owes someone who was injured on the farm $100,000, he will have to pay it either out of the cash and assets of the business or out of his own personal assets. In a sole proprietorship, there is no formal distinction between the individual and the business.
   - Financing. The farmer will need to finance the operation with loans from a financial institution and by using his own income or assets. The sole proprietorship does not have the ability to sell an interest in the business to raise funds.
   - Taxes. Because the law looks on the business and the person as the same entity, the farmer will include the income and losses from the farm in his personal income taxes.
   - Securities law. Because the sole proprietorship does not sell or transfer an interest in the business there are no securities involved. Sole proprietors do not have to be concerned with securities law.

Who's who in the organization?

The different types of business organizations have different terms for the people who have an ownership interest in the business.

Partnerships = general partners or limited partners.
Limited liability companies = members.
Corporations = shareholders.
Cooperatives = patrons, members, or shareholders.

2. **General partnership**. When two or more people enter into business together they may be entering into a partnership. By doing so, the law prescribes a number of things about the legal relationship between them and how the business relates to others. The partners may be able to modify these legal assumptions in law with their own partnership agreement. Unlike most other joint producer ventures, such as limited liability partnerships and corporations, a general partnership does not have to file any papers with the Secretary of State in order to be legally recognized. The example we will use here is where two farmers, Brian and Rita, decide to raise pasture-raised hogs, have them processed, and sell the meat at the local farmers' market. Rita owns most of the facilities while Brian wants to manage the business and has a lot of the know-how it will take to be successful. They decide to buy the hogs together.

- Ownership and control. In a partnership, unless the partnership agreement provides otherwise, all of the partners have equal rights to the profits and each owner has an equal say in the management decisions. In the example, Rita and Brian could agree that Rita will get 2/3 of the profits from the business but will not get any salary. Brian will a receive a small salary and 1/3 of the profits. If the partnership agreement does not address control issues, it is assumed both parties have equal rights to control the business. Each partner has the ability to enter into agreements with other parties that will bind both partners.

- Liability. In a general partnership, as opposed to a limited liability partnership, each partner is personally liable for the debts of the business. In the example, if Rita borrows $10,000 to purchase feed for the business and neither the partnership nor Rita is able to pay the debt, Brian will be personally liable.

- Financing. The partnership provides more options for financing than the sole proprietorship, but not as many options as LLC's or corporations. The sole proprietorship generally has to rely on debt financing or personal assets. The partnership also has these options, but it can also seek to join other people as partners who will provide financing. In the example, Brian originally had the experience and desire to raise hogs, but he did not have the facilities. To gain access to facilities, Brian approached Rita to become a partner in the new business. Rita contributed facilities and gained a right to a part of the profits.

- Taxes. Tax laws treat partnerships as a mere conduit for income and losses, and thus the partnership itself is not taxed. The default rule is the partners will share in the income and losses to the extent of the partner's interest in the partnership, generally

> A partnership is a voluntary association of two or more persons who jointly own and carry on a business for profit. Black's Law Dictionary (8th ed. 2004).

assumed to be equal, although partnership agreements often change this assumption. In our example, Rita and Brian agree their tax responsibilities should match their share in the profits, so Rita takes 2/3 of the profits and losses and Brian is allocated 1/3. This means if the partnership has an income of $30,000 this year, then Rita will need to claim $20,000 income for her personal income.

- Securities law. As a general rule, partners in a general partnership do not have to worry about securities law because the investment a partner contributes to the business is coupled with management responsibilities. This means the general partner's interest is not a security.

3. **Limited partnership**. A variation on general partnerships is the limited partnership (LP). A limited partner is someone who agrees not to be involved in the management of the business in return for limiting potential liability to the value the limited partner invests. The trade-off is giving up control in return for limited exposure to liability. An LP must have at least one general partner and one limited partner. For an LP to be recognized, the business must register with the appropriate state official, usually with the Secretary of State. In our example, Brian and Rita have the ongoing partnership with their hog farm, while they are seeking more investment for expansion. Loran has agreed to join as a limited partner and has provided $25,000 to the business. The business has filed LP papers with the state. Beyond registration, the LP usually has an LP agrement setting out many of operational details of the business.

- Ownership and control. The owners of an LP are split into two classes: general partners and limited partners. General partners have the right to manage and control the business, while limited partners have a very limited role in the controlling the business and may only participate in some major decisions, such as dissolution. If a limited partner becomes active in managing the business, the person could lose the status as a limited partner. In the example, Brian and Rita are general partners so they each have the right to make decisions about how many hogs to raise, what to feed them, where to have the farm, and how to market the meat. As a limited partner, Loran cannot participate in these decisions. But because he contributed money to the LP, he has the right to claim a percentage of the income.

- Liability. The LP treats the two classes of partners differently in terms of liability. General partners are still personally liable for the debts of the partnership, while limited partners are only liable for the amount they have put into the partnership. In the example, assume the LP owes the local implement dealer $80,000 for a new tractor and feed mixer. When the debt is due, the LP only has $30,000 available to pay the debt. In this case, Brian and Rita will have to dip into their own personal finances to pay the remaining $50,000, but Loran will not have to pay any losses beyond the $25,000 he originally put into the LP.

- Financing. LP's open another avenue of financing beyond general partnerships. Some people who want to provide money to a partnership may not be willing to expose themselves to losses beyond the contribution. A general partnership cannot provide this type of protection, while the LP does have this feature, as long as the limited partner is willing to give up most control of the LP.

- Taxes. LP's are generally taxed in the same way as the general partnership so all of the partners, both general and limited, will include a portion of the income or losses of the LP in their own personal income. One variation is limited partners usually do not have to include their LP income for purposes of self-employment taxes, whereas general partners usually do. In the example, assume the LP has an income of $60,000. The LP agreement states Brian, Rita, and Loran each have the right to 1/3 of the income. Brian and Rita will include the income as personal income, including for purposes of self employment taxes. Loran will include $20,000 in his personal income, but will not have to include that amount for purposes of self-employment taxes.

- Securities law. Securities law treats general and limited partners differently. The interests held by general partners are generally not deemed to be securities because the financial interest is coupled with the general partner's personal efforts. On the other hand, limited partners gain their profits as a result of other people's efforts, thus they are generally deemed a security. The question then becomes whether the law provides an exemption from the securities law requirements. In the example the LP will need to examine securities laws regulation to determine how the law will treat Loran's interest in the LP. Even though the general partners' interest is probably not regulated by securities law, the LP interest may be defined as a security. If it is, the question then becomes whether the security is exempt from certain regulations.

4. **Limited liability partnerships**. Another variation on general partnerships is the limited liability partnership (LLP). This type of entity blends elements of the general partnership and the LP. It is difficult to generalize about LLP's because their details vary considerably from state to state, but some helpful distinctions from other business organizations can be made. For an LLP to attain legal recognition, it must register with the state.

   - Ownership and control. Like a general partnership, an LLP only has one class of partners. All of these partners contribute to the LLP and have a right of control. In the example, Brian, Rita, and Terry decide to form an LLP as the business organization for a hog farm. Brian contributes much of the labor and know-how, Rita contributes the facilities, and Terry contributes cash. According to the LLP agreement they have executed, each of the limited liability partners have a right to 1/3 of the income and have an equal say in the management of the business.

- Liability. As the name implies, the major difference between a general partnership and a limited liability partnership is the amount of liability to which the partners are exposed. Professor Carol Goforth provides a very helpful discussion of LLP's in *An Overview of Organizational and Ownership Options for Agricultural Enterprises, Part I* (available at www.nationalaglawcenter.org/research/#ownership). Professor Goforth explains that the primary benefit of an LLP is it shields partners from certain debts of the LLP. In general terms, partners of an LLP will not be personally liable for damages caused by the misconduct of others, but will be liable for their own misconduct. In some states, limited liability partners may not be personally liable for debts incurred in the regular course of business. In the example, if Brian causes a car accident while hauling hogs on the highway, Brian could be personally liable for the injury, but Rita and Terry will not be.

- Financing. LLP's share many of the same financing considerations with LP's, that is they may be able to attract people who are willing to contribute to the partnership but who are not willing to be personally liable for some of the debts of the LLP.

- Taxes. LLP's are taxed much like general partnerships. So the income and losses will be attributed to the limited liability partners.

- Securities law. Because the limited liability partners participate in the business, it is unlikely their interest in the business would be deemed a security.

5. **Limited liability company**. Recently people have shown considerable interest in a new type of business organization, the limited liability company (LLC). LLC's share some of the characteristics of general partnerships, LP's and corporations. One of the most striking features of the LLC is its flexibility. LLC's must register with the state and most state statutes require the LLC to register for a limited number of years. In the example, we will again look to Brian, Rita, and Terry who create an LLC for their hog and pork operation.

- Ownership and control. LLC's provide members flexibility to be involved in management, much like how partners have control of a general partnership. Members, however, can choose to appoint managers, more like a corporation or coop. Even when managers are appointed, most statutes provide that all members have the right to participate in certain major decisions, such as whether to admit new members or whether to terminate the LLC. Most state statutes also assume the profits and losses will be shared equally, but the statutes allow the LLC agreement to provide for the profit sharing to be modified. In the example, our three LLC members decide to appoint Brian as manager of the business. The LLC articles provide the LLC will attribute 50% of profits and losses to Brian, with Rita and Terry each receiving 25%.

- Liability. Members of the LLC are generally shielded from personal liability beyond the amount contributed to the LLC. If as manager of the LLC, Brian purchases a new refrigeration truck that costs $60,000 and the LLC is unable to pay for the truck, the seller of the truck will only be able to look to the assets of the LLC for payment of the debt. None of the members, not even Brian who is the manager and actually entered into the deal, will be personally liable.

- Financing. The financing options for an LLC are much like those for an LP or an LLP. The LLC can attract people who are willing to contribute to the LLC but unwilling to be personally liable for the debts of the business.

- Taxes. In general, LLC's will be taxed as partnerships where the profits and losses will be allocated to the members. LLC's that become very large (500 or more members) may be taxed as a corporation. The inherent flexibility of LLC's raises the possibility of more complicated tax issues. Professor Goforth points out in her article, depending on how the LLC is organized, it may need to address issues of timing, allocation and valuation of the contributions. One thorny issue that has yet to be clearly determined is when the income of the LLC needs to be included in the calculation of self-employment taxes.

LLC provides flexbility for organic dairy

When several farmers in Southwest Iowa decided they wanted to fill a niche for organic and sustainably-produced dairy products, one of the first questions they needed to answer was what business organization the dairy would adopt. On its way to becoming Naturally Iowa, LLC, the organization required flexibility so it could bring together the capital needed for the processing facility, but also to ensure a portion of the profits would go back to the farmers to help sustain rural communities. The organizers chose the LLC model because it provided the opportunity to attract capital, but also maintained control in a small group of the original organizers who wanted to maintain the goal of sharing profits with producers. Although Naturally Iowa does not have a traditional cooperative governance structure, the LLC model provides the ability to achive what otherwise looks like cooperative patronage refunds. The supply agreement between the LLC and the producers states that ten percent of after-tax profits will go back to the producers. Producers also appreciate the stable price built into the supply agreement which is generally significantly higher than the price for the non-organic milk. www.naturallyiowa.com

- Securities law. Whether a member's interest in an LLC is deemed a security will probably depend on whether the income obtained from the LLC relies on the efforts of others. Given the inherent flexibility of LLC's, the answer to this question will vary with how the management structure is set up and how much the member participates in the LLC.

6. **Corporations**. The corporate form of business is the one people usually think of for large-scale operations. In some ways the corporate form is the most formal and clear cut, but in other ways it varies as much or more than the other types of organizations discussed. Corporations can be very large, but they can also be much smaller and "closely-held" with stockholders running the business. In the example, Brian and Rita's hog and pork business has grown and they have decided to expand to a much larger scale. For this to occur, they need large amounts of capital and a business form that provides for the efficient management of a very large business. They choose to "go public" by registering as a corporation with the state and offering to sell shares of their business to the public.

   - Ownership and control. Traditionally, ownership and control are separated in the corporate form. The owners, or shareholders, have voting rights in electing the board of directions and in some other major structural decisions, but most of the decisions are made by the board while the executives are responsible for the day-to-day decisions. Shareholders can be divided into different classes with distinctions based on voting rights, transferability, and the rate of return. In a variation from the classic corporate form, smaller, closely-held, or S-corps (discussed below) can sometimes merge the role of owners and managers, much like what occurs in partnerships or some LLC's. The example uses the classic corporation and may involve hundreds or thousands of people owning shares in a vertically integrated meat business that raises hogs and processes pork. The shareholders elect a board that in turn hires executives to run the business. Brian and Rita may still be involved in the business as board members or shareholders, but the formal control of the business now rests with the entire board and the profits will be shared among all of the shareholders based on their investments.

   - Liability. In almost all corporations, large or small, the shareholders' liability is limited to the amount invested in the firm.

   - Financing. One of the greatest advantages of the corporate form is the number of options available for financing. Because the ownership interests of large corporations are highly standardized and the trade of shares is highly regulated, it is relatively easy for people to invest small or large sums of money in the business. Unlike most partnerships and LLC's, where people need to spend time and money considering their legal and financial rights in the business before investing, corporate investors, even small ones, are familiar with the corporate form and generally do not feel the need to spend resources determining their rights should they invest. When people think about investing in corporations, they are primarily concerned with whether the investment will yield a return or whether the corporation operates in a socially responsible way. Most corporate investors do not spend resources worrying about their rights and responsibilities as shareholders.

- Taxes. The primary disadvantage of the traditional corporation is that both the income at the entity (corporate) level as well as the income to the shareholders is subject to income taxes. This differs from partnerships, LLC's, and cooperatives because those entities are generally only taxed at one of the levels. A major exception to this rule is the S-Corporation (named after subchapter S of the Internal Revenue Code). S-Corps are not taxed at the business level. To be an S-Corp, however, the number of shareholders must be limited to 75 and only individuals can be shareholders. This differs from the C-corporation that has an unlimited number of shareholders and allows other corporations, LLC's, or partnerships to be shareholders.

- Securities law. Another disadvantage of the corporation is the need to abide by securities regulations. Shares in a publicly-traded corporation are the classic definition of a security. As discussed above, securities compliance can be very expensive, whichis a reason why only relatively large businesses find it financially reasonable to organize as a publicly-traded corporation.

Corporate character

In their book *Business Organization and Finance: Legal and Economic Principles*, William A. Klein and John C. Coffee, Jr. explain four characteristics that tend to set large corporations apart from pure partnerships:

- Investors limit their liability to the amount of money they have invested in the business.
- The equity investment, known as shares, can be traded easily on a secondary market (such as the New York Stock Exchange).
- Corporate law has a highly developed set of contracts and legal forms that make it easy for people to know the rights and duties of the different people involved with the corporation. This decreases costs associated with negotiating about who does what and who gets what from the business; and
- Normally the management is centralized in a board of directors, not the shareholders.

Obviously some of these characteristics are not exclusive to the corporate form; for instance LP's, LLP's, and LLC's all feature limited liability to some extent. This illustrates the fact that these business organizations are really more on a spectrum than in distinct categories.

7. **Traditional cooperatives**. Cooperatives have a long tradition in the agricultural and food sectors. Most people are familiar with farmers using the coop model to purchase inputs or sell commodities. Coops have also been used by food retailers and consumers as a way to join together to purchase food. The main distinction between coops and other types of business organizations is coops are designed to provide benefits to the users of the coop, as opposed to the investors. Because of the focus on coop

users, some traditional coops that need a significant amount of capital have trouble attracting investors. This situation is addressed in the next section on value-added or investment friendly coops. An example of a traditional coop is where Brian, Rita, and ten other farmers form a coop as a marketing agent to sell their hogs. In this example, the farmers own and raise the hogs; the coop's function is to pool together the hogs so the group has the number of hogs to be able to be a consistent supplier to larger buyers. The coop has a staff person to deal with the day-to-day dealings with the buyers and to keep up with the trends that affect the market price of the hogs.

Cooperative principles

The following explanation of basic cooperative principles is adapted from USDA Cooperative Information Report (#55) (1997) by Donald Frederickson. www.rurdev.usda.gov/rbs/pub/cir55/cir55rpt.htm.

The User-Benefits Principle. Members unite in a cooperative to get services otherwise not available, to get quality supplies at the right time, to have access to markets or for other mutually beneficial reasons. Acting together provides members the advantage of economies of size and bargaining power. They benefit from having these services available, in proportion to the use they make of them.

Members also benefit by sharing the earnings on business conducted on a cooperative basis. When cooperatives generate margins from efficient operations and add value to products, these earnings are returned to members in proportion to their use of the cooperative. Without the cooperative, these funds would go to other middlemen or processors.

The User-Owner Principle. The people who use a cooperative own it. As they own the assets, the members have the obligation to provide financing in accordance with use to keep the cooperative in business and permit it to grow.

The User-Control Principle. As owners, a cooperative's members control its activities. This control is exercised through voting at annual and other membership meetings, and indirectly through those members elected to the board of directors. Members, in most instances, have one vote regardless of the amount of equity they own or how much they patronize the organization.

In some instances, high-volume users may receive one or more additional votes based on their patronage. Equitable voting is assured, often by limiting the number of additional votes any one member can cast. This protects the democratic control of the membership as a whole.

Only members can vote to elect directors and to approve proposed major legal and structural changes to the organization. The member-users select leaders and have the authority to make sure the cooperative provides the services they want. This keeps the cooperative focused on serving the members, rather than earning profits for outside investors or other objectives.

- Ownership and control. In the traditional coop, producers own and control the coop. Known as members, these farmers usually own at least one voting share of the coop and may own more. Traditionally, coops are democratically controlled, meaning each member has one vote on major issues, no matter how much they use the coop or how many shares in the coop they own. Depending on the size of the coop, the management structure can look much like a corporation with most of the decisions made by a board that delegates operating responsibility to managers. Because coops have more of a member focus, however, more of the decision making authority tends to be held by the members. Members receive income from the coop in proportion to the amount they use the coop (either providing products to sell or purchasing products) or in proportion to how much they have invested in the coop. Interest on coop investment is generally limited to a modest return. This reflects the fact policy makers have historically viewed coops not as an investment vehicle but as a way to help users of the coop. In our example, Brian, Rita and the other ten farmers each form the coop. Because this is a small coop, the board decides to delegate much of the day-to-day responsibilities to a manager who will do most of the marketing for the group.

- Liability. Like LP's, LLC's or corporations, coops provide members with limited liability.

- Financing. Depending on the capital needs of the coop, it may require a more substantial up front investment or sell shares in the coop. Because the return on investment is sometimes limited, and because the amount of control in the coop does not necessarily match with the amount of investment, attracting capital can be a challenge. Another way coops accumulate capital is to retain some of the earnings in the coop's coffers as opposed to distributing it to the members. Coops are also the only type of businesses that can borrow from CoBank, a Farm Credit institution that may be able to provide better loan terms than other banks.

- Taxes. A major advantage a coop has over a corporation is it may be taxed only on the entity level or the member level. Federal tax law has fairly rigorous qualifications for a coop to qualify for this treatment, but in general the law requires the firm to be operated for the benefit of the users of the coop and not investors. This approach puts coops more on par with partnerships or LLC's in terms of tax consequences. Coops can experience a myriad of special tax issues because of their ability to choose at what entity level the income is taxed as well as whether to retain the earnings of the coop.

- Securities law. Certain coops, known as section 521 coops after a section in the Internal Revenue Code, are expressly exempt from securities regulation. To qualify as a 521 coop, substantially all of the stock of the coop must be held by producers who use the coop. Otherwise, whether financial interests in

CROPP Cooperative

Most consumers are more familiar with their adopted brand name, Organic Valley Family of Farms, while farmers around its headquarters in LaFarge, Wisconsin, know the cooperative by its initials, which stand for Cooperative Regions of Organic Producer Pools. Since 1988, CROPP has grown from just seven farmers in Southwestern Wisconsin to the largest organic cooperative in North America. CROPP operates as a marketing association for its producers of milk, eggs, juice, meat, soy, and produce. All of its products are certified organic.

As a cooperative CROPP is owned and run by its producers. The producers set the price of their products, which results in fairly stable prices that do not fluctuate with the varied commodity markets. The cooperative purchases the products and then markets the products to grocery stores, institutions, and other venues. In terms of governance, farmers who produce particular products participate in separate "pools" have a say in how the coop will market the product. Producers also elect representatives from their region who have the ability, through monthly phone conferences, to voice concerns to the board and the management team.

CROPP limits the amount of "brick and mortar" investment required to process its products by entering into "co-pack" arrangements with processors around the country. This strategy allows the coop to grow without having to build processing facilities in each new region or with each new product.

CROPP has a history of paying premiums gained on the organic product soon after it receives them. This is unlike many cooperatives that retain premiums until the end of the year. The coop also generally pays interest on the equity the producers contribute to the coop.

Even though CROPP limits its capital demands, developing sophisticated marketing campaigns and distribution plans for a large business does take a significant amount of money. The coop raises capital by requiring each member to contribute equity equal to a percentage of the member's annual sales. The coop also has the option of retaining some of the profits is otherwise pledged to a member, known as "retained patronage refunds." The board has the option of distributing these patronage refunds at a later time. The coop also offers preferred stock to members and non-members with limited voting rights and a maximum of 8% annual dividend.

One of the great challenges CROPP faces, along with any growing business, is how to balance supply with demand. One tool CROPP has employed to do this is to accept new producers only as the demand can absorb the new supply. This characteristic distinguishes CROPP from many of the older traditional coops that simply marketed as much commodities product as the members delivered.

Sources: Organic Valley Website. www.organicvalley.coop/our_story/our_cooperative/index.html; University of Wisconsin Center for Cooperatives, *CROPP Cooperative: The Cooperative Regions of Organic Producer Pools: A Case Study Prepared for the North Central Initiative for Small Farm Profitability*. www.farmprofitability.org/research/cropp/cropp.htm.

a coop are securities can quickly become a complicated question. In the arena of traditional coops Professor Goforth states that "[g]enerally speaking, equity interests in traditional cooperatives will be outside the scope of the securities laws so long as the motivation behind the purchase is to enable the purchaser to use or participate in the use of the purchased item." *An Introduction to Federal Securities Laws as They Might Apply to Agricultural Operations* (2002) available at www.nationalaglawcenter.org/research/#securities. If the equity interest was invested with the intention of earning a profit, securities law may apply, an issue discussed in the next section.

Because policy makers have generally encouraged farmers to join cooperatives as a way of providing farmers a better way to market their products, there are two other legal factors for coops to consider that other types of business organizations do not need to address.

- The right to bargain collectively. Antitrust laws generally prohibit individuals who compete against each other from agreeing on or fixing prices. The Capper-Volsted Act (7 USC 291), however, provides that producers of agricultural products have the right to collectively bargain, and in essence, agree to prices among themselves, so long as the agreement does not "unduly enhance" prices. The law provides limited immunity from the antitrust laws. The trade-off is (1) the coop must operate in a democratic manner, which means one member-one vote, regardless of the amount of investment *or* (2) the return on investment is limited to 8% per year; and in any case, the majority of the coop's business must come from members. In the example, the coop wants the Capper-Volsted exemption so it can bargain for all of the members. To qualify for the exemption, the bylaws state each member only has one vote in the election of the directors and on other matters. This is the case even though Brian owns three times more stock in the coop than Rita. To qualify for the exemption, the coop also must market at least as many hogs owned by members of the coop as by non-members.

- Right to join a cooperative. The Agricultural Fair Practices Act (7 U.S.C. 2301) generally prohibits processors from discriminating against or intimidating producers who want to join or are members of a cooperative. This protection applies only to members of cooperatives that meet the definition of an association under the Capper Volsted Act. A major limiting factor in the AFPA is the "disclaimer clause." This clause states a processor can refuse to deal with a producer for any reason other than the producer's relationship to an association. This provision has greatly limited the law because processors can usually point to some other reason not to deal with a producer rather than the producer's association with the coop.

8. **Value-added coops**. In recent years, a number of producer groups have considered joining together not just to market their commodities but to actually process the product. Depending on the nature of the processing involved, these types of ventures can require substantial equity to build or buy the plant, purchase

the equipment, pay employees and purchase other inputs. Because traditional cooperatives were not designed to attract large sums of capital, some have looked at new ways of operating and financing. These cooperatives have become known as value-added coops.

- Ownership and control. Ownership is still generally vested in people who use the coop, but value-added coops generally require a greater amount of investment. To attract investment, the coop allows members to use the value-added process offered by the coop only to the degree they have invested in the venture. Shares in the coop may be transferred, but only to other producers who will also use the coop.
- Liability. Like LP's, LLC's or corporations, value-added coops provide members with limited liability.
- Financing. In general, only those who invest a significant amount in the coop may use the coop. The idea is to create a coop that includes further processing will allow farmers to capture more of the consumer food dollar. But for farmers to participate in this more attractive marketing system, they will need to contribute a significant amount of capital to finance the processing side of the business.
- Taxes. Members of a value-added cooperative risk losing the advantages of being treated as a cooperative for tax purposes. This means the income may be taxed at both the entity and individual level. Although competing approaches exist, one of the main questions a court will probably ask is whether the benefits that accrue from the entity come from the use of the coop or from the investment in the coop. If the benefits are really based on the investment, then the court would probably not consider the arrangement as a cooperative for tax purposes.
- Securities law. Whether a value-added or closed coop is exempt from securities regulation is an exceedingly complicated question that will depend on the circumstances. Groups creating these types of coops will need to tread lightly and seek the advice of lawyers familiar with this area of law. The more the membership interests or delivery rights look like simple investment vehicles, the more likely they will be regulated by federal securities law. Factors include: what type of voting rights the stock confers (democratic or based on amount of investment), whether the stock confers the right to use the coop, whether transferability is limited to other producers, and how much the value of the stock increases over time. For an excellent discussion on the possible regulatory pitfalls of value-added coops, see Christopher Kelley, *New Generation Farmer Cooperatives: The Problem of the "Just Investing" Farmer*, 77 North Dakota Law Review 185 (2001).

Income from a cooperative

When trying to determine how to treat cooperative income under the tax code, courts and experts usually cite the 1965 U.S. Tax Court case, *Puget Sound Plywood, Inc. v. C.I.R.*, 44 T.C. 305. The court said there were three guiding principles for an entity to be deemed a coop for tax purposes:

"(1) Subordination of capital, both as regards control over the cooperative undertaking, and as regards the ownership of the pecuniary benefits arising therefrom; (2) democratic control by the worker-members themselves; and (3) the vesting in and the allocation among the worker-members of all fruits and increases arising from their cooperative endeavor (i.e., the excess of the operating revenues over the costs incurred in generating those revenues), in proportion to the worker-members' active participation in the cooperative endeavor."

9. **Investor-friendly cooperatives.** Some states have considered legislation to make it more attractive for non-patrons to invest in and control cooperatives. The state laws do this by providing more rights to non-patron members of the coop. For instance, Minnesota and Iowa have passed laws that allow a cooperative to pass bylaws to provide members as little as 15% of the voting rights and 15% of the financial rights in the coop. (Minnesota Code Ch. 308B; Iowa Code Chapter 501A). If the coop is set up to include nonpatrons, the laws do provide the patrons voting rights will be voted in a block. This is an effort to unite the patron's voting rights in case the nonpatrons want to move the coop in a direction against the patron's interest. This protection, however, may not be that effective if the coop only provides the patrons 15% of the vote.

   Because these types of entities can sometimes look more like LLC's than traditional coops, investor-friendly coops may share many of the same considerations listed above for LLC's. This applies to questions of capital formation, control, taxes,

Farmers' markets join together into nonprofit corporation

As discussed in Chapter Three, farmers markets are an example of how farmers can come together to market their products. This idea can be taken a step farther by the markets themselves joining together to promote the creation and success of farmers' markets. For example, a group of farmers markets in Arkansas originally formed an informal coalition to promote farmers markets in the state. The original ad hoc group worked with University Extension and the State Plant Board to formalize the group that eventually decided to organize formally as a non-profit corporation known as the Arkansas Farmers Market Association. This status, known as a 501(c)(6) from the IRS code section that provides the tax exemption, gives the group the ability to promote their agenda in the market as well as the political arena. The IRS code allows groups such as business leagues, boards of trade, and chambers of commerce to organize to promote the common business interest of the members if it does not engage in a regular for-profit business.

and securities regulation. For an analysis of the genesis of these new forms of businesses and how they will be treated under federal law, see Doug O'Brien, *Legal and Policy Considerations of Investor-Friendly Cooperatives* on the National Agricultural Law Center website. www.nationalaglawcenter.org/assets/articles/obrien_cooperatives.pdf.

Conclusion

State laws provide groups of producers a number of ways to legally organize their producer marketing association. Determining which type of organization to use will depend on issues related to control, liability, taxes, and securities regulation. Another key consideration for groups requiring significant amounts of investment is which type of legal entity will provide access to capital. The next chapter considers some of the financing options and legal issues related to financing any joint producer initiative.

Additional Internet Resources for
Legal Business Organizations

Business Structure Basics

National Agricultural Law Center (website)

An Overview of the Organizational and Ownership Structures of Agricultural Enterprises (Goforth)

Other Resources

Alternative Financial/Organizational Structures (Purdue Extension)
Choosing Your Business Structure (Entrepreneur Magazine)
Forms of Ownership (www.business.gov)
Incorporation, Legal Structures, and Business Formation (Findlaw.com)
Legal Organizational Structure (Ag Marketing Resource Group)
Starting a Value-Added Agribusiness: The Legal Perspective (Illinois Institute for Rural Affairs)

Cooperatives

National Agricultural Law Center (website)

Cooperatives Reading Room
Legal and Policy Considerations of Investor-Friendly Cooperatives (O'Brien)

USDA Rural Development Business and Cooperative Programs (website)

Co-ops 101: An Introduction to Cooperatives (PDF)
Designing Membership Structures for Large Agricultural Cooperatives (6.3 MB)
How to Start a Cooperative (PDF)
USDA-RBS Library of Publications

Other Resources

Cooperative Development Manual (University of Wisconsin Center for Cooperatives)
New-Generation Cooperatives: An Internet Guide (PDF) (Purdue Extension)
What is a New Generation Cooperative? (Missouri Department of Agriculture)

Securities Law

National Agricultural Law Center (website)

An Introduction to Federal Securities Laws as They Might Apply to Agricultural Operations (Goforth)

Other Resources

Q & A: Small Business and the SEC (SEC)
Securities Law Issues (CCH Business Owner's Toolkit)

Compiled by Kurt Olson, National Agricultural Law Center Graduate Assistant

Chapter 5

Financing

Many producer marketing associations need substantial amounts of capital to operate the business. The necessity of locating financing can be the first big challenge for the group and can occupy a significant amount of time during the start-up process. This chapter considers some of the possible avenues to obtain capital and raises some of the special legal issues involved with these different approaches.

Importance of having enough capital

Almost any type of business needs some infusion of capital to get started. Even if your group merely wants to market products locally, there may be some marketing costs and wages for part-time help to coordinate deliveries. On the other end of the spectrum, you may decide to enter a value-added processing venture requiring sophisticated machinery, experienced management, research and development, an elaborate distribution system, and vast amounts of inputs. Either way, the organization needs to consider where it will come up with the necessary capital.

Before searching for capital, you might want to step back and ask how much your group really needs. Starting a business is a risky process, especially when dealing in emerging markets. The sober fact is that many new businesses fail, and when they fail the people who contributed money usually lose most or all of their investment. This fact leads many veteran entrepreneurs to advise newcomers to start off on a scale they know they can handle and that limits the amount of money people might lose. This is an especially important consideration for organizations expecting producers and other people from the local area to provide the start-up capital. In this case, if the business is not successful, the whole community will suffer.

Once you have decided how much you need, you will look at two basic sources for capital:

1. **Equity financing**. In equity financing, people invest capital in the business in return for ownership rights, usually including some right to profits and a level of control.

2. **Debt financing**. In debt financing, an outside entity lends money you will need to pay back with interest. Generally, you will not be required to give up

any of your legal rights to control the business in debt financing, but lenders may still influence your operation because they may not lend money unless you conduct the business a certain way.

Capital questions

As your group considers how to obtain needed capital, it will want to ask some basic questions:

- How do you define your capital needs? Is it for start-up, expansion, or to manage risk? Lenders will want to know the specific need for which the capital will be used.
- How great are your risks? The level of risk will determine the cost and availability of financing options.
- Can you obtain capital by doing a better job of managing your cash flow? Before going outside the organization, be sure to consider ways to obtain the capital from within the business.
- What is the status of your product's market? Depressed, stable, or growth conditions require different approaches to financial needs and sources.
- Is your business seasonal or cyclical? This consideration can be especially important in agriculture. Seasonal needs for financing are generally short term, while loans designed for cyclical businesses are often designed to support a business through depressed periods. Agriculture can fit both of these categories.
- How strong is your management team? Potential financers will focus closely on the people you have running your business.
- Finally, how does your need for financing fit into your business plan? As discussed in Chapter Two, the need for capital should be a step in a well-developed plan to becoming a viable business.

Source: Adapted from U.S. Small Business Administration, *Financing Basics.* www.business.gov/phases/launching/finance_startup/financing_basics.html.

The capital paradox

Those in most need of capital are usually the ones who have the hardest time obtaining it. Investors and lenders look for a combination of low risk of loss and high rate of return when deciding to whom to provide money. So the ideal business has a lot of assets and relatively strong profits, in other words a business that can probably rely on its own resources to finance expansion. The paradox is that start-up businesses often have the most need of money but usually have few assetts and only projections of profitability. The challenge is matching your business plan with the available capital.

What are the pros and cons of equity financing versus debt financing?

	Pros	Cons
Debt Financing	• The lender has limited participation in management of your business. • The lender's share of the profits is limited to the interest payments. • Loans from those close to the business (producers or local citizens) often have flexible repayment terms.	• The loan repayments may be due when your need for the cash is greatest. • The business or those involved with the business may need to assign a security interest in the business or personal property to obtain the loan. This can place your own personal property at risk.
Equity Financing	• Repayment requirements are generally more flexible. • Investors may be experienced in the field and can provide valuable advice. • If the business loses money or goes broke, you do not have to pay the investors.	• Equity investors may take a large share of the profit. • Equity investors may exert control of the business and take it in directions you do not want it to go.

Source: Findlaw.com, *Loans and Equity Investments Compared.* www.smallbusiness.findlaw.com/starting-business/starting-business-financing/starting-business-financing-loans-equity-compared.html.

What do you need to attract capital?

Both investors and lenders will usually look at two key factors when considering whether to invest or lend to a business: A strong business plan and an experienced and proven management team.

Control – who has the right to make which decisions

Probably the largest practical concern with obtaining capital (beyond whether you will be able to find it) relates to control of the business. When someone contributes capital to your business, whether with debt or equity financing, you usually need to give up at least some decision-making control of the business. Exactly what this means will depend on the agreement you reach with the investors or lenders. In the most clear-cut example, an investor might require a certain percentage of the shareholder or board of director voting rights. An investor might also be interested in becoming directly involved in the day-to-day operations of the business.

Grants as an alternative source of capital

A grant is usually the transfer of monetary aid that does not require repayment or give the grantor any ownership interest in the business. Because foundations and governments often use grants to encourage development of certain kinds of businesses, to obtain a grant you will need to meet their criteria. Sometimes significant strings are attached, such as requirements on what you produce, how you produce it, and where it is produced. As a rule, nonprofit groups are most commonly the recipients of grants, but for-profit businesses might be eligible for grants for such things as market research and feasibility studies.

Grant seeking is not for the faint of heart. Grant writing can be a very time-consuming activity that involves cultivating relationships with the grant community and dealing with long and cumbersome grant applications. Some people like to think of grants as "free money," but the time and energy expended in obtaining a grant can sometimes be costly, especially if you do not receive the grant.

On the other hand, you might have a lender who does not request any formal control of the operation, but for most major decisions the lender may require its approval as a condition of maintaining a line of credit in the future. A lender might also put certain contingencies on a loan that essentially cause you to change your business plan. Many times these influences from investors and lenders can be positive; you can benefit from this business experience. You should be aware, however, that sometimes outside actors may not have the same priorities as you or may not agree with where you want to take the business. The best way to deal with possible disagreements is to consider them up front and make clear who has the right to make certain decisions. If the investor or lender is demanding significant changes, the group will have to determine whether the access to the capital is worth the demands.

These control issues cut across all types of financing. The rest of this chapter is more specialized in nature and looks at debt financing, equity financing, and then two federal agencies that offer both types of financing and have missions to help small businesses in rural America – USDA Rural Development and U.S. Small Business Administration.

Debt Financing

Debt financing can be difficult to obtain for start-ups because lenders like to have a good idea of cash flow and the value of the business' assets before lending money. Nevertheless, if members of the business are willing to use some of their own assets as security or if some type of program guarantees at least a portion of the loan, lenders will consider lending to start-ups. The first thing to think about with debt financing is who will be responsible for paying back the loans.

The five C's of credit

Lenders look at certain characteristics of your business when determining what terms to offer in the loan package. To make sure your organization receives the best terms possible, you will want to highlight those characteristics where you excel. This can be done with a solid business plan. The traditional list of characteristics is known as the Five C's of Credit:

Capacity to repay is the most critical of the five factors. The prospective lender will want to know exactly how your group intends to repay the loan. The lender will consider the cash flow from the business, the timing of the repayment, and the probability of successful repayment. Payment history on existing credit relationships – commercial and personal - is considered an indicator of future payment performance. Prospective lenders will also want to know about your alternative sources of repayment.

Capital is the money producers already have invested in the business and is an indication of how much the producers will lose should the business fail. Prospective lenders and investors will expect producers to contribute their own assets and undertake personal financial risk to establish the business before asking the lender to commit any funding. If the business has a significant personal investment from the participants, the lender will assume producers are more likely to do everything possible to make the business successful.

Collateral or guarantees are additional forms of security you can provide the lender. If the business cannot repay its loan, the bank wants to know if there is a second source of repayment. Assets such as equipment, buildings, accounts receivable, and in some cases, inventory, are considered possible sources of repayment. Business and personal assets of the producers can be sources of collateral for a loan. A guaranty, on the other hand, is just that - someone else signs a document guaranteeing to repay the loan if the organization is unable. Some lenders may require such personal guarantees in addition to collateral for security.

Conditions focus on the intended purpose of the loan. Will the money be used for working capital, additional equipment, or inventory? The lender will consider the local economic climate and conditions - both within your industry and in other industries - that could affect your business.

Character is the personal impression the people involved in the business make on the potential lender or investor. The lender subjectively decides whether or not a borrower is sufficiently trustworthy to repay the loan. People's history with the lender, educational background, and experience in the particular business and industry will be reviewed. The quality of your references as well as the experience of your employees will also be considered.

Adapted from Small Business Administration, *Applying for a Loan.* www.business.gov/phases/launching/finance_startup/applying_for_loan.html.

Will I be personally liable for the loans incurred by the organization?

It depends. If you have joined with other people in a business endeavor but you have not legally organized the business as a cooperative, LLC, or some other type of formal business organization with limited liability, then the law treats you as a general partner in the business. If the business incurs debt, general partners are responsible for paying back the debt whether or not they are the ones who signed the loan documents. For further discussion on who may be liable within different types of business organizations, please see Chapter Four.

Even if the business is not a general partnership, an individual may still be responsible for its debt. The most clear cut example is when an individual signs a guaranty for the loan. In this case, a banker might ask the farmer to guarantee payment of a loan taken out by an LLC. This guaranty circumvents the limited liability status that the farmer currently has with the company. For example, an LLC involved in making cheese with milk from twelve different farms plans to buy some new equipment for the business. If a farmer guarantees the loan for the LLC, he will be responsible to pay back the loan if the LLC does not. So if the business fails, both will be responsible for payment. The lesson here is you always need to be aware of what you are signing, especially when a lender is involved.

Will I be personally liable for debts guaranteed by someone else?

As described later in the chapter, a number of government organizations such as the U.S. Small Business Administration and USDA Rural Development provide guarantees to lenders who agree to lend to certain types of businesses. For instance, USDA Rural Development may agree to guarantee up to 80% of the amount of a loan your business receives from a local bank. This does not mean you do not have to worry about 80% of the loan. The guaranty is to the bank, not to the business. If the business fails, your business will be responsible for the first 20% of the loan while USDA will pay off the rest if your business cannot. Even then, USDA may still require you eventually pay back the money they provided to the lender.

What happens if a business exaggerates its net worth or does not disclose all current liabilities to a lender?

Borrowers have a legal responsibility to be truthful when communicating with the bank. For example, when dealing with a federally insured bank (those insured by the Federal Deposit Insurance Company or FDIC), it is a federal crime to obtain money or credit as a result of false pretenses. (18 U.S.C. sec. 1344). A similar provision makes it a federal crime to knowingly make any false statement in an attempt to influence an action of USDA Rural Development, the Farm Service Agency, or any Farm Credit institution. (18 U.S.C. sec. 1014). The punishments are harsh, with fines of up to one million dollars and imprisonment of up to 30 years. To convict someone of a crime the prosecution will need to prove intent.

Read the guaranty

In a case involving the Small Business Administration, the Mallett's guaranteed a loan taken out by Linderhoff Resorts. Linderhoff was unable to make the payments and its property was eventually foreclosed. The proceeds of the foreclosure sale were used to pay off some of the loan, yet there was not enough to pay the entire loan amount. SBA looked to the Mallett's to meet their commitments under the guaranty and pay off the rest of the loan. But the Mallett's argued they should not have to pay on the guaranty because SBA mismanaged the loan. In essence, they argued if SBA had not mismanaged the loan, the Linderhoff's would have been able to pay the entire amount and the Mallett's would not have been forced to pay under the guaranty. In particular, the Mallett's claimed "that the agency unreasonably delayed in pursuing its remedies against Linderhoff, failed to notify them of the serious nature of the default in time for them to take appropriate corrective action, failed to pursue other available remedies, altered materially the terms of repayment of the debt, failed to participate in the foreclosure proceedings, and made other decisions of a similar nature which constitute mismanagement."

The court, however, pointed to language of the guaranty that essentially waived Mallet's right to make this "mismanagement" argument. The language of the agreement, which is common in guaranty agreements, provided SBA with full discretion on how to handle the loan and said that in any case if the borrower does not pay, the guarantor (in this case, the Mallett's) must pay the unpaid amount.

The lesson here is that once you guarantee a loan, it may be completely out of your control on how the loan is handled. And how the loan is handled will determine how much you may need to pay under the guaranty.

United States v. Mallett, 782 F.2d 302 (1st Cir. 1982).

As opposed to criminal fraud, which involves the government prosecuting a crime, parties to a loan can also sue each other for non-criminal fraud or misrepresentation. If someone innocently misrepresents a material matter on a loan document, the lender may later decide to treat the contract as void. Black's Law Dictionary defines something as "material" if it has "such a nature that knowledge of the item would affect a person's decision making." For instance, suppose your group told the bank your equipment, which will be used for collateral for a loan, is worth $500,000 because you relied on an estimate from a reputable source. The bank agrees to provide you a loan, largely based on the fact it has a security interest in the equipment. Later you and the bank learn the estimator was wrong and the equipment is only worth $200,000. The bank would probably be able to void the loan agreement because the loan application included mistaken information material to the bank's decision to loan you the money.

Intentionally misrepresenting something to induce the bank to act is called fraud. In a fraud case, the bank not only has the ability to void or set aside the contract, it may also sue for any damages caused by the fraudulent act if it can prove you intended to misrepresent the information.

Say what you will do and do what you said

A cattleman in Oklahoma was having a difficult time paying back a loan to one bank, so he went to a different bank to obtain another loan. He knew he would not be able to get the money if he told the second bank why he needed the money (to pay back the first bank), so he lied to the second bank and told them he was borrowing the money to purchase cattle. He gave the second bank a security interest in the imaginary cattle. He continued to use this scheme until it was uncovered. A federal court convicted the cattleman of bank fraud.

United States v. Taliaferro, 979 F.2d 1399 (10th Cir. 1992).

The bottom line is you should always do your best to tell the truth in communicating with lenders. Failure to do so will open you to possible criminal prosecution and private lawsuits. Dealing with these kinds of problems can take a lot of time and resources you need to run the business.

Sources of debt financing

Different sources of debt financing may be more flexible, have more money available to lend, or even have a mission to lend in rural areas or to agricultural businesses. Because of all of these variables, you should shop around when considering debt financing. Different institutions may be willing to provide you packages that better fit your business plan. Variables to consider include interest rates, payment schedules, how much security the lender requires, whether the lender requires a guarantee, down payment requirements, and fees involved with the loan. Here are some different types of sources of debt financing:

1. **Producers involved with the organization**. This is the most logical place to start because it may provide you with the most flexibility. Because the producers involved with the project have a stake in the success of the venture, they may be willing to lend money to the new business. As with all loans, it is very important to get the loan in writing to avoid any misunderstanding in the future as well as to be able to prove to the IRS and others it is a loan and not an investment. One consideration is if the farmer already has capital invested in the project, lending more money may be putting too many eggs in one basket. Another consideration is if the organization provides favorable loan terms to one particular producer, others involved in the business may feel they have been cheated. Because of this, it is best to treat these deals at "arms length", in other words, deal with each producer the same way the business would deal with an outsider.

   Producers need to consider whether to secure the claim to repayment by entering into a security agreement with the business. If the parties decide to enter into a security agreement, it will need to be perfected by filing a financing statement with the appropriate government office, usually the Secretary of State. By filing a financing statement, the producer gains a priority interest in the secured property relative to anyone who files a financial statement later.

Some common terms have special meaning in the context of debt financing

Promissory note. A promissory note is a contract. When you sign a promissory note, you promise to repay the lender a certain amount of money, at a certain time, and according to certain terms and conditions.

A promissory note may be *unsecured* or *secured*. If a promissory note is *unsecured*, the lender looks only to your cash flow and profits for repayment of the loan. If a loan is *secured*, the lender still looks to your cash flow and profit for repayment of the loan, but if you do not pay, the lender looks to the security or "collateral" as a secondary source of repayment.

Security agreement. A security agreement gives the lender a "security interest" in specific *personal property* owned by the signor. This means you pledge property as collateral for the loan. If you do not repay the loan as required, the lender can seize the collateral, sell it, and apply the proceeds to your loan. The lender may take all assets of your business (everything your company owns) as collateral up to the value of the debt. Sometimes the lender requires only certain assets as collateral, such as inventory and accounts receivable or specific vehicles or equipment.

Personal property. All property other than real estate.

Mortgage. A mortgage gives the lender a security interest in *real property* owned by you. This means if you pledge the real property as collateral for the loan and you do not repay the loan, the lender can foreclose on the real property, sell it, and apply the proceeds to your loan.

Real property. Real estate.

Loan or credit agreement. If your company's loan is fairly large, the lender may require a loan or credit agreement. A loan agreement contains terms and conditions for your loan in addition to those contained in the promissory note, security agreement, or mortgage. Common provisions in a loan agreement regard the lender's commitment to lend, repayment and note terms, conditions that must happen before the lender is obligated to advance funds, representations and warranties, agreements by the borrower to take or not take certain actions, and events of default.

Source: Findlaw.com. www.smallbusiness.findlaw.com/starting-business/starting-business-financing/starting-business-financing-loans-glossary.html

2. **People and firms from the area**. People or businesses in the area might also have an interest in supporting the producer association as a form of economic development. This means there may be people or firms in the area willing to provide loans to your new business. These types of firms may be able to provide more flexible terms than a mainstream lender. This means you might be able to include payment terms that will better fit into the business plan.

3. **Private banks**. Federal or state-regulated banks are the lenders with which most people are familiar. They offer both short and long-term loans and have a presence in just about every community. Banks are for-profit institutions that have a primary interest in making sure they are paid back the money they lend. Certain banks are more familiar with the challenges related to agriculture then others. These private institutions are generally not restricted on what type of business or the location of the business they lend to.

4. **The Farm Credit System**. The Farm Credit System (Farm Credit) can be a viable source of credit for producer-owned ventures. Farm Credit is a nationwide network of borrower-owned financial institutions and specialized service organizations. Farm Credit consists of four Farm Credit Banks and one Agricultural Credit Bank that provide funding and affiliated services to nearly 100 locally-owned Farm Credit associations and numerous cooperatives nationwide. The fundamental purpose of this network of government-sponsored enterprises created by Congess in 1916 is to provide American agriculture with a source of sound, dependable credit at competitive rates of interest. Farm Credit provides credit and related services to farmers, ranchers, producers and harvesters of aquatic products, rural homeowners, certain farm-related businesses, agricultural and aquatic cooperatives, rural utilities, and certain foreign or domestic entities in connection with international agricultural credit transactions.

   Farm Credit can lend money to businesses which process or market agricultural products, provided more than 50% of the business is owned by farmers and those owners provide some of the "throughput". Farm Credit can also lend money to businesses that provide services to farmers (such as crop spraying, seed cleaning, and cotton ginning.). The extent to which financing can be provided is based on the amount of the business's total income from farm-related services. (12 USC sec. 2017, 2019; 12 CFR 613.3010).

   Farm Credit also has a bank called CoBank with jurisdiction nationwide designed especially to serve the credit needs of cooperatives that does business with all types of cooperatives with a full line of credit services. Agricultural cooperatives, as well as aquatic cooperatives, may borrow from the bank if:

   - They do at least 50% of their business with or for their members;
   - Generally at least 80% of their voting stock is in the hands of farmers, ranchers, or commercial fishermen; and
   - They operate on a cooperative basis with respect to member control and distribution of earnings.
     (12 USC sec. 2129).

Joint ventures and partnerships of ag cooperative customers with noncooperatives in the U.S. and international markets are also eligible for financing by CoBank.

5. **State and local economic development programs**. Most states have loan programs that may share some of the features of the Small Business Administration programs discussed below. Some counties or cities may even offer some special loan programs. These loans may feature reduced interest rates, low down payment requirements, or delayed payment schedules. Many of the programs may guarantee portions of the loan. You should contact officials from your city, county, and state to see what they may have available.

Royalty financing

This unique way of financing gives a lender a stake in the sales of a company rather than ownership. It could be seen as a hybrid of lending and investing because the lender provides the capitalwith the intention of being paid back and not with the intention of owning a piece of the business it could sell, but it also looks like investing because it is understood if the business fails, the lender will simply lose its stake in the business. For example, an outside investor provides the business $100,000 for the right to earn 3% of all sales in the next five years, up to a maximum of $200,000. The upside to this deal is your group does not have to give up its stake in the equity of the company while receiving an influx of capital. These arrangements are also less likely to require the business to transfer much control to the investor. The downside is most investors will not consider this type of financing unless the business is established and in need of capital for intensive sales and marketing activities that will have a direct effect on what the investors will receive.

Source: Entrepreneur.com, *Royalty Financing*. www.entrepreneur.com/article/0,4621,300801,00.html.

Equity Financing

Those who provide equity financing usually attain some of the attributes of owners of the business. The rights and responsibilities of the equity financers will depend on the particular agreement you have with them and how your business is organized. Because the business organization is so crucial to equity financing, the major legal issues tend to be the same in both the equity financing and business organization areas. These issues include who has the right to control the business, who takes responsibility for liabilities, and how securities laws affect the business. These issues are considered in Chapter Four. This section focuses on the different types of equity financing available.

1. **Producers.** The most common source of equity comes from the producers involved with the business. This could occur in a traditional investment situation where the producer is treated like any other investor and contributes a certain amount of capital for a right to some of the profits and the ability to sell the equity interest.

Another way the group could raise capital from its producers is by retaining some of the money it would otherwise have paid to the producer. This could come from the proceeds of the sale of the producer's goods or from the dividends or surplus income of the group. The tax consequences of these retains may vary depending on whether the group is a corporation, LLC, partnership, or cooperative. The main advantage to retains are the producers do not have to raise capital from outside sources to contribute to the organization. The downside is this may not be a viable option for start-up capital because before retains flow into the organization, there must be income. Another downside is that depending on how the retains are structured, the producer may not have a choice of when to liquidate the capital.

How can cooperatives raise equity capital from members?

Subchapter T of the Internal Revenue Code allows cooperatives to retain patronage dividends and allocate them to the patrons' equity accounts with the cooperative through "written notices of allocation." Patronage dividends are surplus earnings returned to the members. If the equity is qualified, as defined in the code, the cooperative can deduct the amount of allocations from its taxable income the same year. Patrons include the amount allocated in their taxable income in the year they receive the qualified written notices of allocation. Subchapter T requires at least 20 percent of the patrons' patronage dividends be paid out in cash in order for the allocation to be qualified. The result is the cooperative can retain up to 80 percent as equity investments without owing tax on those investments.

Cooperatives can choose to delay the pass-through by retaining patronage dividends as nonqualified investments. The cooperative can retain any amount of the patronage dividends and add the amount to its taxable income for the year. When the patronage dividends are later redeemed in cash by the patrons, the cooperative can deduct the amount from its taxable income for the year of redemption.

Source: National Cooperative Business Association, *Legal Considerations When Forming a Cooperative*. www.ncba.coop/abcoop_ab_legal.cfm.

2. **Venture capital and angel investors.** The internet craze of the 1990's raised the profile of one particular kind of investor, the venture capitalist. Venture capitalists (VC) provide relatively large amounts of capital to small but proven businesses that are on the verge of rapidly expanding. As with all equity investments, the capital provider is not looking to be repaid; rather, the VC wants a piece of the business in order to receive high returns and look for the right opportunity to sell the shares for a profit. VC's are willing to take risks many others avoid. In return for shifting some of the financial risk to the VC, the business must be willing to be flexible and possibly change its business plan to suit the wishes of the VC. As with obtaining grants, searching for venture capital can be a very timely process and may require the assistance of specialists.

   Although traditional VC's are not usually interested in small, unproven start-ups, a first-cousin of the VC, the angel investor, might be. Angel investors are often successful entrepreneurs who understand the possible risks and rewards of start-up businesses. Some angel investors have a particular agenda they pursue with their investments, such as sustainably raised food, and might be willing to forgo some of the high returns for the satisfaction of helping build a business or industry in which they believe. Many times they will want to become a close consultant to the business. Angel investors come in many shapes and sizes so their legal involvement with the business will depend on the particular investor.

With both VC's and angel investors, the main thing to consider is the degree of control the outside investor will have in the company. As you consider their involvement you should determine whether the outside investor will have the power to take the business in a direction unacceptable to the producers, such as changing the product line or the place of production.

Finding VC's and angel investors is not as easy as walking into your community bank or talking to your local investment advisor. The best advice is to talk to attorneys, accountants, and others in your industry to seek referrals to venture capital firms that might be a good fit for your company.

What is a venture capitalist looking for?

An article on Findlaw.com lists the following characteristics sought by venture capitalists:

"The strength of a company's management team can be more important to a venture capitalist than the company's product. A venture capitalist wants to see a capable, committed set of managers who are adaptable and comfortable with growth and change. A venture capitalist is always looking for a high rate of return. The earlier your company is in its business cycle, the higher that rate will have to be to compensate the venture capitalist for his or her risk. This means that the company must be positioned for rapid growth, in terms of both management and product.

"A venture capitalist also wants to see a realistic set of financial projections and requirements. He or she will take a conservative view of your company's chances for profit and success. It is helpful to emphasize financial requirements for this stage in your company's growth. Showing a realistic reflection of the company's financial state shows discipline and the ability to plan for the future.

"The owners' commitments to the business through personal financial stakes are also key. A venture capitalist will be leery of investing money in any enterprise in which the principals are unwilling to invest their own.

"Finally, the venture capitalist will want a clear exit strategy -- how to get his or her investment and return back out of the company. Some preferable exits are through an IPO [initial public offering of stock] or the sale of the company. However, other methods include management buyout, corporate redemption, forced receivership, sale of shares to principals, or sales of shares to other equity partners."

Source: FindLaw.com. *FAQ: Venture Capital*, www.smallbusiness.findlaw.com/starting-business/starting-business-financing/starting-business-financing/starting-business-financing-venture-capital-faq.html.

3. **Acquisition or merger**. Another way to get a fledgling business off the ground is to join your group with another existing, business. This strategy may give you access to some of the infrastructure needed to get your product on the market such as distribution and marketing channels. The catch with this strategy is determining who will control the business once the merger is complete. If your group purchases the ongoing business, it would retain control of the firm. On the other side of the coin, if the ongoing business contributes most of the capital, it is likely they will gain control of the business. Nevertheless, if you have a new product, production method, or brand you can bring to the new business, you may have some negotiating leverage.

4. **Federal, state and local programs**. Just as in debt financing, government bodies may have programs to increase the amount of equity capital available in certain areas or firms. Typically your group will actually deal with a private intermediary who has tapped into government resources to enlarge the amount of capital it has to invest. In the federal government, the primary examples include USDA Rural Development Rural Business Investment Companies as well as the Small Business Administration Small Business Investment Companies, both of which are discussed later in this chapter. State and local governments may also have funds set aside and may deal directly with your group.

Federal programs

A number of programs exist at different levels of government to help joint producer associations obtain capital with loans or equity. The next section focuses on two federal agencies charged with helping certain kinds of businesses. USDA Rural Development focuses on businesses in rural areas, while the Small Business Administration works with small businesses in both rural or urban areas.

1. **USDA Rural Development.** An agency in USDA called Rural Development, www.rurdev.usda.gov/, offers a number of programs to assist a producer associations locate capital. This financial assistance may come in the form of guaranteed loans, low interest loans, or grants. In general, the programs have a goal of spurring economic activity, job growth, and sustainable development in rural areas, which usually means in any city or town with a population of less than 25,000 or 50,000 people, depending on the program.

   USDA often administers these programs indirectly, there may be some type of intermediary between USDA and the rural business. This intermediary might be a bank, a cooperative, a local non-profit, or a regional government. Some programs may not be available in your area because no local intermediary is participating. Another limiting factor to many of these programs is USDA usually does not have enough funds to meet the demand in the countryside.
   The best advice when thinking about accessing USDA Rural Development programs is to talk to your state Rural Development office. The appendix to this book includes contact information for the state Rural Development office in each state.

The following are summaries of Rural Development's programs:

- **Business and Industry Guaranteed Loan Program**. By far the most accessible and flexible of the Rural Development programs, B and I loans are where USDA guarantees up to 80% of a loan made with most any financial institution, such as a bank, Farm Credit Service institution, or credit union. Individuals, as well as nearly any legally organized entity, are eligible for this program, including for-profit businesses, non-profits, and political subdivisions. Loan proceeds can be used for working capital, machinery and equipment, buildings and real estate, and certain types of debt refinancing. Types of businesses eligible include manufacturing, wholesaling, retailing, and renewable energy projects. The applicant must be located in a rural area (an area that does not include a city of more than 50,000 people), although some exceptions are made for value-added ventures and cooperatives. The maximum any one borrower can borrow is $10 million; the administrator may waive that limit under certain circumstances. To determine who receives the guarantees, USDA prefers businesses that provide numerous and decent jobs, and are in areas with high levels of poverty and declining populations.

- **Intermediary Relending Program**. In this program USDA utilizes intermediaries – a nonprofit, cooperative, or state or local government – to create revolving loan funds. A typical intermediary is a local economic development corporation or an electric coop. The ultimate recipients of the loan funds must establish new businesses, expand current businesses, create employment opportunities, or assist community development projects. While the ultimate recipients must live in a rural area (for purposes of this program, outside of a metropolitan area of greater than 25,000 people), there is no "rural area" restriction for

Rural Cooperative Development Grants and Rural Business Opportunities Grants support entities that provide technical assistance

Two different types of grants provide certain entities the funds to provide technical assistance to help establish rural businesses. Nonprofit institutions, colleges and universities are eligible for Rural Cooperative Development Grants to help groups form successful cooperatives. If your group is considering establishing a fairly complex business with other producers, it should consider checking to see if anyone in your area has received this type of grant. A good place to start might be the local extension office or land grant institution.

Rural Business Opportunities Grants provide public bodies and nonprofit institutions with the ability to offer a broader array of business development assistance, such as assisting with feasibility studies, training, and economic development planning.

the intermediary. The loans may not be used for agricultural production. The largest loan a recipient can receive from an intermediary is $250,000.

- **Value-Added Producer Grants**. Rural firms that plan on creating a business that adds value to agricultural products can apply for this grant to use for planning purposes or working capital. Producer organizations, including cooperatives or other types of entities, must have at least a majority control by producers. Any producer group that applies for a grant must propose to enter an emerging market. Independent producers who apply for a grant may propose to enter an existing market. The applicant must provide at least fifty percent matching funds. A planning grant can be used for such things as hiring independent consultants to perform feasibility studies and business plans. A working capital grant can provide start-up funds for legal assistance, purchasing inventory, and making payroll. These grants are limited to $500,000. Evaluators prefer grants with a likelihood of success,which improve the local economy, and have well qualified people involved.

RBIP: Encouraging venture capital in rural America

The 2002 Farm Bill directed USDA to develop a Rural Business Investment Program to promote investment in rural areas. USDA and the Small Business Administration are implementing the program together. The program is designed to use federal money to leverage private investment in rural areas. The program also certifies certain venture capital firms, known as Rural Business Investment Companies (RBIC's), and provides funds for technical assistance to rural businesses. RBIC's can invest in any commercial or non-commercial activity (for profit or nonprofit).

At least 50% of a RBIC's investments (measured by number of entities and dollars invested) must be in "smaller enterprises," those with a maximum net worth of $6 million and net income of $2 million in the prior two years. At least 50% of these investments (measured by number of entities and dollars invested) must be in smaller enterprises that also qualify as small business concerns.

RBIC's share many of the same qualities possessed by Small Business Investment Companies (SBIC's), which are discussed later in the chapter.

2. **Small Business Administration**. The Small Business Administration is a federal agency charged with helping develop small businesses. A small business can be any type of legal entity - an individual proprietorship, joint venture, partnership, LLC, corporation, or cooperative. Whether a particular business is small depends on the industry in which it operates and generally depends on whether the business could dominate the industry.

   Although its focus is not exclusively in rural areas like USDA's Rural Development Agency, SBA offers loan programs many rural entrepreneurs find useful. Most

SBA programs focus on guaranteeing loans commercial lenders otherwise would not have made if not for the guaranty. The following is a summary of the loan programs described on SBA's website. www.sba.gov/financing/index.html.

- **Basic 7(a) Loan Guaranty.** The 7(a) program serves as the SBA's primary business loan program to help qualified small businesses obtain financing not available through normal lending channels. The program works as a guaranty for a loan at a commercial institution. It is also the agency's most flexible business loan program since financing under this program can be guaranteed for a variety of general business purposes. Loan proceeds can be used for most sound business purposes including working capital, machinery and equipment, furniture and fixtures, land and building (including purchase, renovation and new construction), leasehold improvements, and debt refinancing (under special conditions). Loan maturity is up to 10 years for working capital and generally up to 25 years for fixed assets. Typical customers include start-up and existing small businesses.

- **Certified Development Company (CDC) or 504 Loan Program.** The 504 Loan Program provides long-term, fixed-rate financing to small businesses to acquire real estate, machinery, or equipment for expansion or modernization. A business accesses the program through a Certified Development Company, which is a private, nonprofit corporation set up to contribute to the economic development of a community or region. Typically a 504 project includes a loan secured from a private-sector lender with a senior lien, a loan secured from a CDC (funded by a 100 percent SBA-guaranteed debenture) with a junior lien covering up to 40 percent of the total cost, and a contribution of at least 10 percent equity from the borrower. The maximum SBA debenture generally is $1 million (and up to $1.3 million in some cases). Typical customers include businesses requiring "brick and mortar" financing

- **Microloan or 7(m) Loan Program.** The 7(m) Loan Program provides short-term loans of up to $35,000 to small businesses for working capital or the purchase of inventory, supplies, furniture, fixtures, machinery or equipment. Proceeds cannot be used to pay existing debts or to purchase real estate. SBA makes or guarantees a loan to an intermediary, who in turn, makes the microloan to the applicant. The intermediary is a nonprofit organization with experience in lending. These organizations also provide management and technical assistance. The loans are not guaranteed by SBA. The microloan program is available in selected locations in most states. Typical customers include businesses needing small-scale financing and technical assistance for start-up or expansion.

Small Business Investment Companies: SBA licenses venture capital firms and banks to serve as Small Business Investment Companies (SBIC's). SBIC's are private companies allowed to leverage the financial resources of the federal government if they meet regulatory requirements, the most significant being that they finance small businesses in a particular area. The following Q and A is adapted from the SBA website, www.sba.gov/INV/overview.html.

Who benefits from the SBIC program?

Small businesses which qualify for assistance from the SBIC program are able to receive equity capital, long-term loans, and expert management assistance. Venture capitalists participating in the SBIC program can supplement their own private investment capital with funds borrowed at favorable rates through the federal government.

Who usually becomes an SBIC?

People with solid venture capital expertise and capital. Most SBICs are owned by relatively small groups of local investors, although many are owned by commercial banks. Some SBICs are corporations with publicly traded stock.

What are SBIC's supposed to do?

SBIC act as a financier for small business concerns. SBIC's have great flexibility in terms of financing options, which result in financing specifically tailored to the needs of each small business concern.

Can SBIC's make loans?

SBIC's can make long-term loans to small businesses to provide them with funds needed for their sound financing, growth, modernization, and expansion. An SBIC may provide loans independently or in cooperation with other public or private lenders. Such a loan may have a maturity of no more than 20 years, although under certain conditions the SBIC may renew or extend a loan's maturity for up to 10 years.

What type of equity position can an SBIC take in a small company?

By law, the SBIC must provide equity capital to small businesses and may do so by purchasing the small business's equity securities. The SBIC may not, however, become a general partner in any unincorporated small business or otherwise become liable for the general obligations of an unincorporated business.

Leasing

As a substitute for raising equity or debt capital, your group could consider leasing land or equipment. Under a lease, you pay rent to the owner of land or equipment for the privilege to use it. Once the agreement is over the owner of the equipment takes it back. The main advantage to leasing is the initial lease payments require much less capital than needed to buy the equipment. Another advantage of leasing is you will have newer equipment less likely to break down. The downside of leasing is you are making payments to use the equipment but you are not building equity.

Producers involved in a joint producer venture may decide to lease some of their equipment to the business. As with other legal agreements between joint producers and their organizations, the best piece of advice is to get the agreement in writing so both parties have a clear understanding of the arrangement. This might be necessary for tax purposes so both the producer and the business have evidence of the precise type of arrangement.

Sometimes sales and leases are treated differently for tax purposes. The main tax advantage of a lease is you can usually deduct the cost of a lease as a business expense, as opposed to deducting only part of the expense of buying the equipment through depreciation. As with most tax situations, this area is highly technical and requires the advice of an accountant or an attorney familiar with the area.

One of the main legal issues with leases is whether the arrangements are true leases or sales. The typical instance where this issue arises is in a rent-to-own contract where the contract provides that if you make lease payments for a set number of years, you can own the equipment in return for an added fee. To determine whether the arrangement is a true lease or a sale, courts will usually look at whether the leasing company intended to retain ownership in the property. The main factors are whether the renter has the right to purchase the equipment at the end of the lease and how much it costs to exercise the right.

This distinction can make a big difference to the owner of the equipment if the person leasing the equipment has financial trouble. The business' other creditors may argue the business owns the equipment so it can then be sold to pay off other debts of the business. To protect the leasing company's interest in the property, most states allow leasing companies to file a financing statement with the state to warn others of its financial right in the property. If the lease is a true lease, this filing is not necessary. But if there is any question, the leasing company should file the financing statement.

Conclusion

Obtaining capital can be the first real test of your project's viability because you are asking others to risk their money. Control should be one of the major considerations when thinking about capital needs – how much and what type of control will you need to give up to get the capital. Although control is always an issue when dealing with capital, your group also needs to be concerned with special legal issues related to debt and equity financing. A variety of financing options exists, your task is to determine which ones fit the goals of the business.

Additional Internet Resources for Financing

Finance 101 – The following links serve as launching points for further exploration of financing sources and techniques.

Financing for Small Business (Findlaw.com)
Financing Start-up (www.business.gov)
Getting Financing for Your Business (CCH Business Owner's Toolkit)
How to Raise Money for Your Business (Entrepreneur Magazine)
Raising Money (Ag Marketing Resource Center)
Raising Start-up Capital (Inc. Magazine)

Leasing 101

Leasing 101 (Farm Credit Leasing)
Leasing Your Equipment (CCH Business Owner's Toolkit)

The Farm Credit System

Overview of the Farm Credit System
Which Bank serves my area?

- CoBank (also serves cooperatives nationwide)
- AgFirst Farm Credit Bank
- AgriBank Farm Credit Bank
- Farm Credit Bank of Texas
- U.S. AgBank, FCB

Federal Government Financing Programs and Funding Sources*

USDA Rural Development Business and Cooperative Programs

- Business and Industry Guaranteed Loan Program
- Intermediary Relending Program
- Rural Cooperative Development Grants
- Rural Business Opportunity Grants
- Value-Added Producer Grants
- Rural Business Investment Program

U.S. Small Business Administration Financing Resources

- 7(a) Loan Guaranty Program
- Certified Development Company (CDC) or 504 Loan Program
- Microloan or 7(m) Loan Program
- Small Business Investment Companies (SBIC's)

*Be sure to check out your state and local government for any online information regarding similar programs offered in your area.

Compiled by Kurt Olson, National Agricultural Law Center Graduate Assistant

Chapter 6

Risk Management

The last chapter noted one key factor determining the types of financing available to a producer association is the level of risk associated with investing in or lending to it. This chapter considers the idea of risk and how it affects your operation. The chapter discusses risk management strategies and the legal issues raised by these different strategies. The chapter concludes with a special form of risk management for farmers-crop insurance policies.

What is risk?

Risk occurs when there is the possibility of loss or injury. When thinking about risk, two factors to consider are how severe the loss may be and how frequently the loss may occur. All of us experience risk everyday – risk of bodily injury, risk we will lose our job, or risk of major property damage to our house. Because of the nature of raising crops and livestock, farming has its own special types of risk. Nature is the riskiest factor on the farm, but many others exist, such as injury to employees or visitors, product liability if someone becomes ill from something you sell, contamination of your crop by chemicals or certain types of pollen, loss of a market, or price declines. The ways to manage risk vary according to different regions of the country, different crops grown, and different production practices used. With so much depending on how you deal with risk, it is a good idea to have a risk management strategy.

The USDA Risk Management Agency in *Introduction to Risk Management* (www.rma.usda.gov/pubs/1997/riskmgmt.pdf) points out one of the most important elements in managing your risk is determining your goals for the business. What do you want the business to look like? How much income do you hope to earn? Are you risk averse, meaning you are more prone to avoid risk, or are you willing to take a risk if there is a good chance of a substantial reward? Until you and the other people involved in your project answer these basic questions, you will not be able to determine your best risk management strategy.

What do joint producer organizations have to do with risk management?

Joining a producer association can itself be a risk management strategy. By deciding to become part of a producer group, you are managing the risk of not being able to access a market by yourself. Producer associations can also help you deal with price risks or the risk of not having needed inputs. Entering into a relationship with a producer association may also increase some risks. If you sign a contract to deliver something to the joint producer association, you may increase your risk of loss in case you are not able to produce the crop or animals and you have to pay to replace the product.

Who should be concerned about managing risk, the farmer or the producer association?

The key to determining who bears risk is finding out who will suffer a loss if something bad happens. In almost all marketing contracts, where the farmer owns the crop or livestock until it is sold, the farmer bears the risk of loss. This means if the crop is wiped out, the farmer will not get paid. Conversely, if a cooperative purchases the products and holds title to them, the coop will suffer the loss if the products are damaged. Issues sometimes arise as to exactly when title passes from the farmer to the buyer. Does title pass when the farmer loads the goods on the truck, or when the goods are delivered to the final destination? To avoid confusion, the best thing to do is to make it clear in the contract.

It is not surprising the owner of crops or livestock bears the risk of loss in cash market sales or in marketing agreements. What is surprising is that even in production contracts, where the grower is raising crops or livestock owned by someone else, the grower may still bear at least part of the risk of loss for the crop or livestock. For instance, some poultry production contracts discount the amount the grower is paid if a certain number of the chickens die in the grower's barn. The grower may also have responsibility for disposing of the dead chickens, a cost the grower must absorb if the birds die.

Joint producer associations also bear risk. If an association agrees to deliver a product to someone on a specific day, the association needs to determine what happens if it is unable to keep the promise. Sometimes the association will have to go into the market to find replacement products. For some specialty and niche products this may not be possible. In this case, the association may bear the risk of liquidated damages provided for in the contract. Liquidated damages are a specific sum a party must pay for failing to perform under the contract. The other risk born by the association in this situation is the loss of customers. The grocery store or restaurant may not want to deal with a supplier who is not reliable. Of course the joint producer association bears other typical business risks, such as product liability and employee injury.

Because both the farmer and the joint producer association sometimes have risk, the rest of this chapter examines the risks that these parties might have and some of the strategies to manage them. A special emphasis on the federal crop insurance program is provided at the end of the chapter.

UCC and risk of loss

The Uniform Commercial Code (discussed more fully in chapter seven) provides the general rules for when the risk of loss transfers from the buyer to the seller. It provides:

§ 2-509. Risk of loss in the absence of breach

(1) If the contract requires or authorizes the seller to ship the goods by carrier:
(a) if it does not require the seller to deliver them at a particular destination, the risk of loss passes to the buyer when the goods are delivered to the carrier even if the shipment is under reservation (Section 2-505); but
(b) if it does require the seller to deliver them at a particular destination and the goods are there tendered while in the possession of the carrier, the risk of loss passes to the buyer when the goods are there so tendered as to enable the buyer to take delivery.
...
(3) In any case not within subsection (1) or (2), the risk of loss passes to the buyer on the buyer's receipt of the goods.
(4) The provisions of this section are subject to contrary agreement of the parties and to Sections 2-327 and 2-510.

This section provides a default rule when a contract authorizes the seller to ship the goods. If the contract specifies the place of delivery, the risk of loss does not pass until the goods arrive at the place. If the contract does not specify a particular place of delivery, then the risk of loss transfers to the buyer when the goods are placed in the carrier's possession. Importantly, the contract can modify this default rule to whatever the parties desire.

Four types of risk to manage.

The following list covers some of the typical risks associated with farming and selling food, as well as strategies to manage these risks. Much of the information provided here can be found in USDA-RMA publication, *Introduction to Risk Management* www.2.rma.usda.gov.pubs/1997/irm_intr.html

1. **Production risk**. This is probably the first thing people think of for risks on the farm. What happens if the yield is low or the animals contract a disease? Who will bear the loss? Insurance is the most typical risk management approach to deal with production risk, but insurance may not exist for the particular crop or animal you are growing. Crop insurance is discussed separately later in this chapter. Farms may also consider diversifying the operation so if one crop does poorly, the farm still has other sources of income.

2. **Marketing risk.** Risks related to marketing can occur in two ways. First, there is a risk a market may not exist for your crop or livestock. This is a real risk for a some growers of specialty or niche products. For growers of commodity products, the market likely exists, but all farmers bear the risk the price will be low. To deal with market access risk, farmers need to have a marketing plan and have an idea where they will sell the crop. To deal with the

possibility of a steep price decline, farmers may be able to set the price by using forward contracts. Many commodity products also provide farmers the option of using futures contracts to manage price risk. Some of the crop insurance products discussed later also help farmers deal with the risk of low prices.

3. **Financial risks.** Financial risks can be separated into the risk of interest rate changes and liquidity risk, or the risk you will need cash in a short period of time. Interest rate risks occur when you have a loan with a variable interest rate or you know you will need to borrow money in the future and are not sure what the interest rate will be. In either case, if the interest rate goes up, you will bear greater costs. Beyond taking steps such as locking in an interest rate, this risk is largely out of your control. In a broader sense, you may be able to lower the interest rate if you take other steps to lower the lender's own risk that you will not be able to pay back your loan, such as by obtaining insurance or providing assets to secure the loan. The other type of financial risk is liquidity risk. This risk occurs when something happens on the farm or in your business that requires you to have cash on hand, as opposed to having all of your assets tied up in land or equipment. For example, if a tractor engine gives out and needs to be rebuilt, you may need to come up with the $3500 for the repair bill. If all of your assets are tied up in land and other equipment, you may need to sell something at a discount or obtain a loan with relatively unfavorable terms to pay the bill. Obviously the easiest way to deal with this risk is to keep enough money in accounts that can be easily liquidated.

Basic risk management strategies

In his book *The Lawyer's Guide to Insurance*, Ben G. Baldwin lays out the basic strategies for dealing with risk:

1. For risk that has high frequency and high severity, the best route might be to avoid the risk altogether. For example, if you have looked into growing artichokes on your farm, but determine you risk low yields because of your farm's soil type and a high risk there will be no market for the crop, you may decide to avoid the risk and not plant the crop.
2. If you decide to accept the risk, then you should reduce it as much as possible. In other examples, you could make sure an otherwise dangerous power-take-off shaft is covered with the appropriate guards or keep visitors away from your young pony that likes to kick. These strategies lower the likely frequency of the loss.
3. A third strategy in dealing with risk is sharing the risk with someone else, such as shifting the risk of loss to an insurance company. In essence you pay the insurance company a premium every month to bear the possibility of loss.
4. Finally there are some risks you may need to absorb, such as the risk you will need to repair a new deep freeze. When the dealer sold you the deep freeze, she offered you an extended warranty for an extra fee but you decided to forego the extended warranty because you thought the likelihood you would need the warranty (frequency of loss) is low and the cost of fixing the freezer (the severity) is also low.

4. **Regulatory risks.** Laws and

regulations from different levels of government can have a big impact on the success of your farm or business. If you rely on a private certifier to be able to label a product a certain way, private rules can also have an impact on your business. There is risk these rules might change in the future. This could occur with a change in how the federal government implements the commodity programs, the way the state supreme court interprets whether your operation is creating a nuisance, or the way the city writes its public health ordinances. This could also occur if a private certifier changes the definition of what it means for pork to be raised under animal welfare standards. These are just a few examples of the most difficult risks to manage because these changes are unpredictable. The best advice is to stay informed on where policy makers may be heading and prepare for the changes to the extent you think you need to.

Comprehensive farm liability policies

What is a comprehensive farm liability policy?

A comprehensive farm liability policy is a specially designed insurance policy that deals with many of the risks inherent in farming. For a thorough discussion on these types of policies, see John Copeland, *Understanding the Farmers Comprehensive Personal Liability Policy*, National Center for Agricultural Law, Research, and Information (1992). The typical comprehensive farm liability policy shifts the risks of personal injury and property damage from the farmer to the insurance company. For example, an insurance policy recently entered into by a farmer in central Iowa was divided into the following parts: 1) Liability to the public; 2) Medical payments to the public; and 3) Liability to farm employees. The policies vary, but most will only insure injuries that occur on the farmer's property or caused by activities directly related to the farming operation. One policy defines farming as "the ownership, maintenance, or use of the insured premises for the production of crops or the raising or care of livestock. Farming also includes operations of roadside stands maintained solely for the sale of any insured person's products. Farming does not include altering the characteristics of farm products through processing operations."

Are direct farm marketing businesses covered under a comprehensive farm policy?

It depends on the language of the policy. In the policy quoted above, a farmer who is selling non-processed food from a roadside stand would be covered. But a farmer who is selling processed food, or is selling food anywhere other than his own roadside stand would not be covered. As Professor Neil Hamilton discusses in his book *The Legal Guide for Direct Farm Marketing*, the main determinants for when direct farm marketing businesses will be covered is whether the activity is included in the definition of farming (for instance, a policy may expressly cover roadside stands but exclude processing food) or whether the activity is excluded because it is a separate business from farming.

For example, policies commonly exclude any injury that arises from a "business," and define "business" as "1) any full or part time trade, profession or occupation;

2) incidental activities conducted by any insured person if gross receipts are more than $2000 in the prior calendar year from the incidental activities; or 3) the rental or holding for rental of any premises by any insured person." If the farmer has this policy and the direct marketing business earns more than $2000 per year, the venture will not be covered by the policy.

Will the comprehensive farm policy cover damages caused by activities undertaken for the producer association?

Another provision in most comprehensive farm policies applies directly to some joint producer initiatives and excludes coverage for any injury caused by the farmer if he is acting on behalf of a corporation or other type of organization. This would generally include most producer associations.

The insurance policy used as an example above excludes from coverage any injuries that arise out of "custom farming." "Custom farming" is defined as "any activity arising out of or connected with: a) the use, lease, rental, maintenance, or transportation of any farm tractor, farm machine, farm implement, or animal for agricultural purposes; or b) care or raising of livestock or poultry by any insured person for any other person or organization in accordance with a written or oral agreement." To be safe, the best advice is to make sure you and the organization are both named as a covered person in a liability policy.

Depending on the size of the business, your group may want to consider visiting with an insurance agent or attorney to help you assess the types of risks involved with the business and the types of insurance you should obtain. This consultation may be especially helpful in determining how both you and the producer association are open to liability claims.

Members of association not covered, unnless it is a nonprofit

Although farmers are generally not covered in a comprehensive farm liability policy for injuries caused when the farmer is acting on behalf of another organization, some policies will cover the activity if the farmer is working for a nonprofit organization. For example, one policy states:

> We do not cover bodily injury or property damage arising out of any act or omission of any insured person as an officer, director, trustee, member or agent of any corporation or other organization, not listed as an insured person on the declarations, unless:
>
> a. the corporation or organization is a not-for-profit entity which is not subject to either state or federal taxation;
> b. the insured person serves without compensation from the corporation or organization;
> c. the act or omission of the insured person was within the scope of the insured person's responsibilities as an officer, director, trustee, member or agent of the corporation or organization; and
> d. the act or omission of the insured person does not constitute intentional, willful, wanton, or reckless conduct.

What is directors' and officers' insurance?

Producers who are directors or officers of an organization should also be concerned with possible liability for acts they commit in relation to the organization. In general, if the organization has limited liability status, officers of the organization will not be held liable for injuries caused when acting in the scope of their organizational responsibilities. But this is not always the case. For example, if an officer is deemed to make decisions breaching the officer's duty of care to the organization, the officer could be personally liable for injuries caused by that decision. This type of claim could arise in everything from a wrongful termination claim to a violation of a federal environmental law. In practice, this means that the officer will be sued separately from the organization for damages allegedly caused by the officer's wrongful conduct. To protect officers from personal liability, many insurance companies offer "directors' and officers'" or "D and O" insurance. Often the organizations will purchase this insurance for its directors and officers.

Products liability, negligence, and strict liability

Much of the information in this section is taken from an article on the National Agricultural Law Center website by Michael Roberts and Doug O'Brien, *Animal Identification: Liability Exposure and Risk Management*, lmic.info/memberspublic/animalID/fs06.pdf.

What is products liability?

Tort law generally covers the liability exposure of farmers and processors whose products injure someone else. Generally, tort law deals with cases where a plaintiff has suffered a loss and is trying to shift the responsibility for the loss to one or more defendants. The plaintiff must first prove a defendant's conduct was of a type entitling the plaintiff to compensation. The two most common forms of conduct that may justify such shifting of loss are negligence and strict liability.

In the food and agriculture business, the plaintiff could be anyone harmed by someone else's conduct. The plaintiff could be a consumer harmed by food poisoning or a producer association harmed by something the farmer did. To prove the case, a plaintiff will need to know who caused the injury. In other words, the product causing the harm will need to be traceable back to the person responsible. Depending on what type of marketing and processing system the food went through, the food might not be traceable.

What is the negligence standard under strict liability?

Negligence is the failure to exercise reasonable care. Reasonable care is what a reasonably prudent person would do in the same circumstances. Therefore, in a negligence action, a defendant must show that he or she exercised the kind of care in the management of a farm or business a reasonable person would have exercised under similar circumstances. This is a fact-specific question usually determined by juries on a case-by-case basis. If the defendant fails to exercise reasonable care, the plaintiff must show the defendant's action was a proximate cause of the plaintiff's injury and the plaintiff suffered legally compensable damages.

For example, in a case where a consumer becomes ill from E. coli poisoning, the consumer may initially sue the retailer and packer for negligent handling of the meat. If the packer has a traceability system in its plant, the packer may bring in as another defendant the feeder who fed the steer. For the producer to be liable, the packer will have to show the feeder failed to exercise reasonable care in raising and feeding the steer and this failure caused the meat to carry E. coli. Although it is impossible to predict what a court might find as "reasonable care," it might mean the usual level of cleanliness of other feeders.

Is strict liability any different than negligence?

Strict liability is imposed when one has introduced a defective product that is unreasonably dangerous into the stream of commerce. Unlike negligence, strict liability pays no attention to whether someone employed a duty of care. If strict liability applies, the farmer or organization could be liable even if they used the best management practices in good faith.

The critical issue for strict liability is whether the plaintiff can prove the defendant caused the harm. Under strict liability, a farmer can be liable only if the plaintiff can trace a defect to the producer's operation. If a third party altered the product in the time between when the producer had control of the animal and the plaintiff consumed the product, then the producer may not be liable. For example, if an E. coli

Can an animal be an unreasonably dangerous product?

Although the law is not well developed on whether animals can be defined as "unreasonably dangerous products" for purposes of strict liability, it is probable at least in some cases where an injury is caused by a characteristic of an animal. For example, if a plaintiff alleges harm from beef from consuming an animal with BSE (also commonly referred to as Mad-Cow Disease), it is possible the cattle feeder could be held liable under strict liability. This could happen if the court determined the cow was unreasonably dangerous when it entered the stream of commerce. Under a negligence analysis, however, the feeder would not be liable if the feeder used best management practices and raised the cattle as any reasonable person would have. In this case the feeder had no reason to suspect the feed had a chance of causing BSE.

Animals used as pets have sometimes been found to be "products" for strict liability purposes. The court in *Beyer v. Aquarium Supply Co.*, 404 NYS2d 778 (1977) defined diseased hamsters as products. Some courts have refused to define farm animals as products. For example, in *Anderson v. Farmers Hybrid Cos.*, 408 N.E.2d 1194 (Ill. App. Ct. 1980), the court refused to define hogs as products, even though the hogs spread the contagious and infectious disease "bloody dysentery" to other hogs. See Christopher H. Hall, Annotation, *Live Animal as "Product" for Purposes of Strict Products Liability*, 63 A.L.R.4th 127 (1988-2004).

contamination occurs during or after slaughter, the producer should not be held liable. In contrast, if drug residues in meat are caused by improper withdrawal periods and harm results, a producer may be found liable. Just as with negligence, it is sometimes difficult to predict exactly when an action "causes" injury. Ultimately, these are questions of fact left to the jury.

A court will likely focus on the condition of the product at the time of the purchase rather than concentrating on the ability of the product to become defective after the transaction. For example, for liability to attach to a livestock producer, the diseased animal must have been infected at the time it was sold. If meat is contaminated with E. coli during the grinding process, even if the meat can be traced back to the ranch, the producer will not be liable if the animal was sold without E. coli in the meat.

What does all of this mean for my relationship with a producer association?

In most products liability cases, the injured party will include everyone who could possibly be responsible for the product causing the harm. What typically occurs is the various defendants point fingers at other defendants in an effort to avoid liability. This can lead to the situation where the producer association selling or processing your products will try to blame you for problems caused by the food that you produced. Because the organization's executives have a duty to protect the interests of the entire organization (and not just one member), they may have no choice but to single you out for liability if you are the possible cause.

Crop insurance

Crop insurance can help producers deal with production risks, and some types of policies may help producers deal with the marketing risk of low prices. In 2000, Congress passed the Agricultural Risk Protection Act to encourage the Federal Crop Insurance Corporation (FCIC) to contract with private companies to develop more insurance products so more farmers utilize federal crop insurance. Since then a number of new products have come on to the market. Typically, a new product is tested as a pilot program in a limited geographic area, such as a number of counties or states. The pilot program also limits which crop or animal species are covered.

USDA Risk Management Agency (RMA) administers many different kinds of crop insurance programs and operates the FCIC. The premiums for crop insurance are subsidized by the federal government so the premiums producers pay are less expensive than if private companies offered them. In some situations, such as catastrophic insurance discussed later, the government will pick up the entire premium and require the farmer to pay only an administration fee. While RMA approves various crop insurance programs, policies are actually administered by private insurance companies.

When should I consider obtaining crop insurance?

If you rely on yield or income from a crop and you bear the risk of loss, you should consider acquiring crop insurance. Crop insurance will shift some of the risk to the insurance company and help you project stable levels of income.

What does crop insurance actually insure?

You are insuring either the crop yield or revenue you expect to receive from the crop. Obviously the amount of revenue you receive for a crop is closely related to the yield, but these different insurance approaches can lead to different results. Crop insurance policies based only on yield will pay out if the yield falls below a certain level, no matter what happens to the price of the commodity; while revenue-based policies consider both yield and price.

Will all crop insurance policies cost the same no matter the agent?

Not necessarily. Until a few years ago, FCIC set the price of the policies and private agents were not allowed to offer different prices. In recent years, some insurance companies have begun to offer discounted policies that may save you money. As a result, it may pay to shop around.

What is the connection between crop insurance and federal disaster assistance?

Both programs are designed to help farmers deal with natural disasters. Generally, if a crop is eligible for crop insurance, a farmer must purchase a minimum level of that insurance before being eligible for disaster assistance. In recent years, Congress has become more active in requiring farmers to utilize crop insurance as a condition of receiving disaster assistance.

What happens if I am not sure what a term in my policy means?

If people disagree on the meaning of language in a crop insurance policy, they can seek clarification from RMA. This process is known as "Subpart X Final Agency Determination" and it provides a relatively quick way to answer questions about the meaning of federal crop insurance statutes and regulations. The determination controls the policies because the meaning of words in the statute and regulations determines the meaning of the same words in the policy. Any participant in the crop insurance program may seek a determination. Participants include anyone who has applied for or has obtained an insurance policy, insurance companies, loss adjustors, or contractors. In this review process, RMA only considers questions of general applicability, meaning it will only look at questions that affect everybody, not just a particular farmer.
A participant must first submit a request for determination by citing the language in question and providing their own interpretation. Then RMA has 90 days to either agree or disagree with the interpretation. If RMA does not provide a final agency determination within 90 days, the requestor may assume the suggested interpretation is correct for the applicable crop year.

For legal purposes, this is the final agency determination, meaning only a federal court can overturn it. This varies from most other agency determinations that may be overturned by appealing within the USDA to the National Appeals Division.

Basic obligations

The USDA-RMA website (www.rma.usda.gov/policies/) provides the following information about important expectations and deadlines related to crop insurance.

Producers must:

- Report acreage accurately,
- Meet policy deadlines,
- Pay premiums when due, and
- Report losses immediately.

Failure to do any of these things means the producer will probably not be covered under the insurance policy. One of the most common problems producers experience is when the number of acres reported to the insurance company does not match the number of acres reported to the Farm Service Agency for commodity program purposes. If these two numbers vary by more than five percent, the farmer may lose crop insurance coverage.

Important Deadlines

- Sales closing date--last day to apply for coverage.
- Final planting date--last day to plant unless insured for late planting.
- Acreage reporting date--last day to report the acreage planted. If not reported, insurance will not be in effect.
- Date to file notice of crop damage--after damage, the date the producer decides to discontinue caring for the crop; prior to the beginning of harvest, immediately, if farmer determines the crop is damaged after harvest begins, or the end of the insurance period, whichever is earlier.
- End of insurance period--latest date of insurance coverage.
- Payment due date--last day to pay the premium without being charged interest.
- Cancellation date--last day to request cancellation of policy for the next year.
- Production reporting date--last day to report production for APH.
- Debt termination date--date company will terminate policy for nonpayment.

Example: Assume a participant requested RMA to determine whether the term “measurement” in the context of revising acreage reports includes only on-farm measuring of acres or if it also includes digitized measurement. The requestor interpreted the term “measurement” as not including digitized measurements. In its final agency determination, RMA disagreed and ruled that digitized measurements could be used.

For more information on Subpart X, as well as the actual Final Agency Determinations, go to www.rma.usda.gov/regs/533/section533.html.

Can my producer association obtain insurance?

A producer association may obtain insurance in a crop, but only if the association has an interest in the crop. (See box). If the organization does have an interest in the crop, it can not also be covered by the producer's insurance policy. The Common Crop Policy provides that for a crop insurance policy to extend to any other person, such as a partner or a landlord, the other person shuld be specifically included on the accepted insurance application. 7 CFR section 457.8.

The next section looks at some of the developments related to crop insurance designed for specialty crops and considers how the basic crop insurance policies may or may not apply to them.

Insuring specialty crops.

In the Agricultural Risk Protection Act of 2002, Congress directed RMA and private crop insurers to place a special emphasis on developing products for specialty crops. The crop insurance policy providing the best opportunity for specialty crop producers who live in eligible states is a program called Adjusted Gross Revenue-Lite. As a result producers now have a broader range of insurance products to consider.

Who has the right to obtain crop insurance?

The Common Crop Insurance regulations (7 CFR section 457.8) provide:

Application for insurance on a form prescribed by the Corporation, or approved by the Corporation, must be made by any person who wishes to participate in the program, to cover such person's share in the insured crop as landlord, owner-operator, crop ownership interest, or tenant. No other person's interest in the crop may be insured under an application unless that person's interest is clearly shown on the application and unless that other person's interest is insured in accordance with the procedures of the Corporation.

Adjusted Gross Revenue-Lite (AGR-Lite). The idea for AGR-Lite is to insure the revenue of the entire farm rather than the individual crops. It is designed with small to mid-sized diversified operations in mind and is available in states where traditional types of crop insurance did not work well with the types of crops that were raised. Eligible areas in 2005 include most counties in Alaska, Connecticut, Delaware, Idaho, Massachusetts, Maine, Maryland, North Carolina, New Hampshire, New Jersey, New York, Oregon, Pennsylvania, Rhode Island, Vermont, Washington, and West Virgina.

AGR-Lite can be used alone or with other crop insurance policies. Recordkeeping beyond that already done for tax purposes is minimal because the program is based on the five-year average of revenue reported to the IRS on Schedule F. Eligible revenues include income from almost all crops, livestock, and animal products such as milk. The policy excludes income from processing, post packaging, and sorting. Typical of almost all insurance policies, the policy covers only unavoidable losses and not those due to negligence, mismanagement, or wrongdoing. The policy modifies a standard definition of negligence for use in this context, providing: "The failure to use such care as a reasonable prudent and careful person experienced in the production of agricultural commodities would use under similar circumstances."

The following types of agricultural products are eligible for coverage under AGR-Lite: Grain and non-grain crops, vegetables, fruits, nuts, nursery plants, floriculture, Christmas trees, maple tree sap, animals, products from animals such as milk and eggs, and any other agricultural production, excluding timber, forest, and forest products.

To be eligible for AGR-Lite:

- You must have filed a Schedule F in the five years prior to applying for a policy using essentially the same tax entity;
- Your average annual adjusted gross revenue must be less than $512,821; and
- Not more than 50% of your allowable income comes from agricultural commodities purchased for resale.

If you suffer a loss of revenue, the amount of payment depends upon two variables that you choose – the coverage level, which is the amount of your AGR you want to cover, and the payment level, which is the percentage of the covered loss.

AGR-Lite is based on its big brother AGR. The main differences between the two programs is that AGR-Lite will provide coverage only to farms with less than about $513,000 gross income, while AGR has no income limitation but the liability limit is $6.5 million. Another difference is that AGR will not insure farms that derive more than 35 percent of their income from livestock; AGR-Lite has no such limitation.

Around 60 specialty crops are specifically covered by federal crop insurance in at least some parts of the country. But the geographic areas vary widely. For example in 2003, almonds were covered in 16 counties in one state, cabbage in 27 counties in 15 states, mint in 9 counties in 4 states, and potatoes in 325 counties in 39 states. One of the primary factors determining whether a particular region is eligible for coverage will be whether data exists for insurers to determine the amount of risk involved in growing a crop in that particular region. The following discussion covers some of the other basic approaches to crop insurance under the federal system.

USDA-RMA report on specialty crop insurance

RMA has prepared a number of specialty crop insurance reports in the past years. The latest 71-page report is available at www.rma.usda.gov/pubs/2004/specialtycrop.pdf. It features research and development on the latest risk management products. RMA generally refers to specialty crops as any agricultural crop, except wheat, feed grains, oilseeds, cotton, rice, peanuts, and tobacco. The report includes a number of tables providing information on underserved states (states Congress identifies as having unmet insurance needs), crops insurable under crop insurance programs, and other USDA initiatives.

Good farming practices

The AGR-Lite policy will not cover losses due to the "failure to follow good farming and management practices." The policy also provides that "[f]or conventional or sustainable farming practices, these practices are those generally recognized by agricultural experts for the area; or for organic farming practices, these practices are those generally recognized by the organic agricultural industry for the area." The policy states that insurers or producers can contact the Federal Crop Insurance Corporation to determine whether or not a practice would be considered a "good farming practice."

For an example of what this might mean, consider a case about a tobacco farmer in Kentucky. The farmer bought a crop insurance policy that did not cover losses due to a "failure to follow recognized good farming and harvesting practices." The farmer had committed to raising twice as much tobacco as he had ever raised before and had trouble getting the crop planted in a timely manner. After making a claim just three weeks after planting, insurance adjusters found that over 90 percent of the crop was already dead. The farmer blamed an untimely rain and then a drought, for the crop's failure. The insurer, however, argued the farmer failed to plow the ground at the right time and he planted the tobacco so shallow it was unable to withstand the lack of water. The court agreed with the insurance company and found the farmer failed to follow good farming practices so the farmer was unable to collect from the insurance company. *Royalty v. Federal Crop Insurance Co.*, 618 F. Supp. 650 (W.D. Ky. 1985).

When trying to prove you exercised good farming practices, one of the most important things you can do is to document what you did to the crop and when. Good records could make the difference between being paid for a loss or not if the insurance company believes the crop failed because of your bad practice.

Yield-based insurance coverage

Common crop policy or actual production history (APH). The basic crop insurance policy is known as the "common crop policy." It is also known as APH because this policy utilizes a producer's actual production history. This policy insures the producer against yield losses due to natural causes such as drought, too much rain, wind, frost, insects, and disease. It does not provide any type of insurance against low prices. In determining the insurance level, the producer needs to make two choices – the amount of average yield to insure (from 50 to 75 percent) and the percent of an RMA-predicted price to insure (between 55 and 100 percent). For example, assume the average yield for a particular farm is 150 bushels of corn per acre and the RMA predicted price is $2.00. A farmer could choose to insure 65 percent of the yield (130 bushels) at 75 percent of the predicted price ($1.50). There would be no pay out unless the actual yield was 130 bushels or below. If the crop only yielded 100 bushels, the policy would pay the farmer for 30 bushels times the insured price of $1.50, or $45 per acre.

Group risk plan. A variation on the common crop policy is known as the common group risk plan or GRP. GRP utilizes county yield information, as opposed to the actual individual yields, to determine losses. These policies involve less recordkeeping and paperwork, but they do not address situations where your farm might be the only one in the country that experiences losses.

CAT coverage – the basic yield policy

Catastrophic or CAT insurance is the most basic APH-type policy and provides a minimum level of protection from low yields at 50 percent of the APH yield and 55 percent of the expected price. This means CAT does not pay out until you have lost at least 50 percent of your crop. Although producers need to pay an administration fee on a CAT policy, the actual premium is subsidized by the federal government. The Administrator may waive the fee for limited resource farmers (farmers who had less than $20,000 income from all sources in the previous two years).

Revenue-based insurance coverage

The other basic approach to crop insurance addresses the risk of low revenues from the crop. Adjusted Gross Revenue plans dealing with revenue from the entire farm have already been discussed. The following types of policies are revenue-based, but focus on only one type of crop or livestock. One of the main components of all of the policies in this section is the price of a futures contract traded on a commodity exchange such as the Chicago Mercantile Exchange. Because of this, specialty crops are not generally eligible for these types of insurance.

Crop Revenue Coverage (CRC). CRC insures against both low yields and low prices and is specific to a particular crop. This type of policy pays out when the gross revenue from the crop falls below an insured level. The main variables in CRC are the actual production history and the base price, which is determined by looking at a future's contract price for the end of the season. For example, for corn the base price is determined by looking at December's future's contract prices during February. To determine the actual revenue guarantee, the policy looks to the higher of the base price or the actual price at harvest time, meaning CRC also provides some upside potential if the price moves upward during the growing season.

Income protection (IP) and Revenue Assurance (RA). IP also insures against both low yields and low prices. The main difference between CRC and IP is that IP looks only to the early season base price; if the crop price goes up during the season, the policy does not insure the crop at the higher price. You can choose to insure between 50 and 75 percent of the expected revenue. Another product called Revenue Assurance (RA) is similar to IP except with RA you may be able to insure up to 85 percent of the revenue if you include your entire farm under the policy.

Livestock Risk Protection (LRP). The Agricultural Risk Protection Act of 2000 provided for the development of livestock insurance. The main type of policy, known as Livestock Risk Protection (LRP), protects producers from low prices. Only swine, fed cattle, and feeder cattle are eligible for coverage. The policy uses the Chicago Mercantile Exchange (CME) to determine prices so the actual price you receive for your livestock does not determine your coverage. For example, assume you have a group of hogs you plan to sell in 20 weeks but you are concerned the live market for hogs might plummet before you are able to sell. You decide to purchase an LRP policy, which will use the price on the CME for the time you estimate you will sell the hogs, say 50 dollars per hundred weight. You can choose to buy 80 percent coverage, which translates to 40 dollars per hundredweight. When the 20 weeks has passed, if the CME price is 37 dollars the policy will pay you three dollars per hundredweight that you have insured. Notice the price at which you actually sold the hogs is not part of the equation. To be eligible for LRP, you must have ownership in livestock.

Livestock Gross Margin LGM insurance policy

A pilot program created in 2003, LGM takes the Livestock Risk Protection policy a step farther by insuring the gross margin a producer receives. The gross margin is the difference between livestock prices and feed prices. In 2005, the policy is available only for swine and only for most counties in Iowa. LGM builds on LRP's use of the futures markets for the price of swine by using the Chicago Mercantile Exchange prices for corn and soybeans to determine possible coverage levels and payments. The policy does not consider the actual price paid for feed or the actual price received for the sale of hogs.

Non insured Crop Disaster Assistance Program (NAP). If you raise a crop not eligible for a policy from the federal crop insurance program, you may be able to utilize the Noninsured Crop Disaster Assistance Program (NAP). NAP is administered by the USDA Farm Service Agency as opposed to RMA. NAP works much like CAT coverage in that you need to sign up by providing actual production history before the planting season. You will need to pay an administrative fee of $100 per crop per county. You receive a payment under NAP if you lose over 50 percent of your expected production. The actual payment rate is 55 percent of the expected market price determined by the FSA county committee.

Conclusion

Risk is inherent in everything that you or your producer association does. The keys to dealing with risk are recognizing where it exists, determining who bears the risk, and creating a strategy to manage the risk. Risk management strategies may include everything from changing the way you do business to purchasing crop insurance. You may choose to manage risk by entering into contractual arrangements with others, such as a producer association, to limit the risk of accessing a market or price variability. The next chapter considers the basic rules that regulate these contracts.

Additional Internet Resources for Risk Management

Agricultural Risk Management

Farm Risk Management Briefing Room (USDA – ERS)
Introduction to Risk Management (USDA – RMA)
National Ag Risk Education Library (University of Minnestoa)
Risk Management Education Centers (USDA - CREES)
Risk Management Links (Ag Marketing Resource Center)

Business Liability and Insurance

Overview

Insurance and Liability (Findlaw.com)
Insurance Center (Entrepreneur Magazine)
Insurance Links (Ag Marketing Resource Center)
Small Business Insurance and Risk Management Guide (Iowa Business Network)

National Agricultural Law Center (website)

Animal Identification: Liability Exposure and Risk Management
Landowner Liability Reading Room

Crop Insurance

USDA Risk Management Agency (website)

Crop Insurance Policies
Crop Insurance Providers for 2006
Specialty Crop Insurance Report

USDA Farm Service Agency Disaster Assistance (website)

Noninsured Crop Disaster Assistance Program (NAP)

National Agricultural Law Center (website)

Crop Insurance Reading Room

Other Resources

FarmDoc Crop Insurance Guide (University of Illinois)

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Chapter 7

Contract Law

This chapter considers some of the basic elements of contract law and highlights legal issues addressed in the Uniform Commercial Code. The chapter concludes by looking at a sample contract and identifying general questions that apply in most sales situations.

In the context of producer marketing associations, buyers are often an organization in which producers are members, such as a cooperative, LLC, or some other type of grower network. While you might assume because you are already a stakeholder in the group you do not need to worry about protecting your own personal interests, this is not true. This sense of security means producers often enter into marketing agreements with their organizations without much concern over the terms of the contract. Unfortunately, this may be the wrong thing to do because the contracts establish enforceable rights and obligations for both parties.

Your sales relationship with the group results in you having two different roles with the organization. In one sense, you are concerned with the success of the group and are willing to contribute toward this goal. It is reasonable to expect you may even need to make some occasional sacrifices for the organization. In another sense, however, if the organization is having difficulty, your interests may no longer align with the group's. You may be left with unpaid bills or a crop you cannot market. Desperate times call for desperate measures, and although the association may not want to take advantage of a provision in a contract that is against your interests, it may have no choice. On the other side of the coin, you may assume because you are a member you do not need to be concerned about meeting all of the requirements of a contract. You should not make this assumption. The organization is counting on you to supply a certain type of product to meet its own obligations with buyers. If the organization suffers losses because you breached the agreement, it may have little choice but to try to shift those losses to you.

Depending on how your group is organized, the people who run the business have a duty to do what is best for the organization, even if that means it might injure some of its members. This is not to suggest you should shy away from working with a joint producer association. Rather, you should enter into any agreements with your eyes wide open and recognize what real risks and responsibilities you have in relation to the organization.

To understand the risks and responsibilities involved in the buyer-seller relationship, you need to know the rules of the game. This chapter looks at some of the law that affects the business sales relationship between farmers and buyers. It examines basic contract law and the Uniform Commercial Code. Other types of contracts, such as loan documents and insurance policies have already been addressed in other chapters.

Contract law

Black's Law Dictionary defines a contract as "[a]n agreement between two or more parties creating obligations that are enforceable or otherwise recognizable at law." For purposes of this chapter, we are concerned with agreements to buy and sell some type of agricultural product.

Contracts 101

You should be concerned about contract law because it determines how parties to the contract will need to keep the promises they make. Although very few contracts ever end up in court, if the parties to a contract disagree on something and are unable to resolve the disagreement, they may have to resort to the judicial process. This means that as the parties negotiate a contract, they need to consider how a judge might ultimately interpret it.

For a contract to be enforceable, it must involve:

1. **Competent parties**. A court will not uphold a contract entered into by parties the law does not believe have the capacity to take on such a legal responsibility, such as minors or people who are mentally incapacitated.
2. **A legal subject matter**. A court will not uphold a contract requiring anyone to do something illegal.
3. **An offer**. An offer occurs when a party communicates the intention of doing something if the other party does another specific thing. Either the buyer or seller can initiate an offer so it could occur when you approach a cranberry cooperative with an offer to sell your cranberries for a certain price, or if they approach you with a form contract to sign.
4. **Acceptance**. Acceptance occurs when a party communicates a willingness to be bound by the proposed agreement. When dealing with a written contract, this usually means when the offeree signs the contract.
5. **Consideration**. Each party to the contract must provide consideration for the contract to be binding. Consideration is something of value or a promise to do, or not to do, a certain act in the future. In a contract between a producer and an LLC that processes and sells honey, the producer's consideration could be the promise to deliver a certain amount of honey while the LLC's consideration could be the promise to pay a certain amount per pound.

The Drake Agricultural Law Center has published an entire book on this subject by Professor Neil Hamilton titled *A Farmer's Guide to Production Contracts*. The book broadly discusses all of the issues involved with agricultural sales and service contracts--everything from entering into the contract, performing under the contract, getting paid, and resolving disputes. The book analyzes a number of different types of contracts involving vegetables, livestock, and grain.

In a section on the basics of contracting, Professor Hamilton provides twelve rules to consider when entering into a contract. The following list is taken from those rules and is slightly modified with some of the special issues involved with joint producer relationships.

1. **Remember the first rule of contracts – whoever wrote the contract took care of himself**. Although you might be a member of the group with whom you are contracting, you still need to make sure the terms are fair and your interests are protected. The people representing the organization will take care of the interests of the group; it is your job to take care of your own interests.

2. **Read and understand any contract before signing it.** Because the words in the contract will be enforceable in the future, you need to understand what you are promising to do and what you can and cannot hold the other party responsible for. If the contract is relatively large or involves a long duration, you should consider having your attorney go through the contract with you to make sure you understand all of the provisions.

3. **Know that complying with contract terms is required before you have performed under the contract.** To receive a premium for raising organic vegetables, you will need to certify they are organic. If you are unable to deliver the amount or type of product you promised, you may need to go out into the market to find replacement products, otherwise, you might open yourself up to a lawsuit for breach of contract. Because of this, you will want to make sure you are able to live up to the promises you make in the contract or be willing to pay the consequences.

4. **Never assume your failure to perform a contract will be excused.** If the buyer is damaged by your failure to perform under the contract, assume you will have to make amends. If you think you will not be able to fully meet your obligations under the contract, it is usually best to let the buyer know so both of you can deal with the situation. For instance, before planting, you promised to deliver 1000 pounds of blue potatoes to your cooperative but your crop was wiped out because of a late freeze. You should inform the coop that you will not be able to deliver the potatoes. The buyer might know about a good substitute source for the potatoes and be able to acquire the product for much less cost than you would be able to. You may still have to pay for any cost difference for the substitute potatoes, but you will not have to pay as much.

5. **Know the other party's financial situation and performance history.** This is especially important when you are not paid immediately for your product because in this case you become a creditor for the buyer. If the buyer experiences serious

financial problems after you deliver the product, you may never get paid. This situation is partially dealt with for livestock with the statutory trust in the Packers and Stockyards Act and for fruits and vegetables with the PACA trust in the Perishable Agricultural Commodities Act, both of which are discussed in Chapter Eight.

6. **Weigh the advantages of the contract in terms of higher prices against any increased costs or risks**. This suggestion is especially important in niche and specialty markets. Although you usually receive a higher price for the products, you will usually face greater costs or risks as well.

7. **Remember proposed contracts are always subject to negotiations**. Many contracts dealing with the purchase of agricultural goods appear to use fixed "boilerplate" language. But all contracts are negotiable before signing; nothing forces you to sign the contract until you are satisfied with the deal. An important thing to keep in mind is you have much greater power to negotiate changes in the agreement before the contract is signed than after, so make sure you are satisfied with the agreement before signing.

8. **Make sure any changes to the contract are made in writing**. Although it can be difficult to change a contract after it is signed, shifting conditions can persuade both parties it is in their best interest. To ensure the changes are enforceable, the new terms need to be in writing and signed or initialed by both parties.

9. **Do not rely on oral communications made by the buyer, either before the contract is signed or during the contract performance**. If your agreement ever has to be interpreted in court, the court will most likely rely only on the written language in the contract itself. Courts usually refuse to accept evidence of oral agreements that goes against the contract language, and most contracts include a similar restriction. Because of this, you will want to get in writing any agreements important to you. If you are unable to do this, then make sure to keep copies of any documents, such as letters, payments sheets, and checks you can use to show what was agreed to.

10. **Keep good records of your performance**. You never know when you will need to prove you have lived up to your end of the bargain. Keeping good records is the only way to do this. This is especially true when a crucial part of the contract requires you to raise your product in a certain way. Whether this means not using antibiotics, raising organic tomatoes, or treating your animals in a certain way, if you have records indicating you have done what you promised, you can avoid headaches in the future.

11. **Do not hesitate to ask questions when you do not understand what is happening**. The best time to ask questions about what you are promising to do is before you promise to do it. For example, if your contract with a wholesaler requires you to certify your operation with a third party certifier, make sure you understand what this will entail. To make sure you understand the terms of the

contract, you can ask questions of the buyer or your advisors. To make sure you understand the concepts in the contract, ask other people such as extension officers or others who are growing products under similar contracts.

12. **Stay in touch with the other party to the contract**. Regular communication with the buyer will help prevent misunderstandings about the contract or about what is required to satisfy the contract requirements. Open lines of communication will help both parties make sure that each is doing what the other party understood they would do.

The Uniform Commercial Code

The rules governing contracts traditionally came from common law, meaning the law that is produced on an ad hoc basis by courts. When the courts came up against a novel problem, they look at what they have done with somewhat similar issues in the past and craft a new rule for the new problem. From then on, when the same set of circumstance arise, the court will follow its precedent. Because different courts and jurisdictions evolved in various directions, different states handle the exact same issue in various ways. This can lead to confusion for people who do business with firms in other states. To avoid this confusion, policy makers in the U.S. decided to create a set of common rules for commercial law. The result was the Uniform Commercial Code (UCC).

All of the states have adopted a version of the UCC. The laws can differ from state to state, but states generally do not vary from the major themes in the UCC. The UCC deals with a number of subjects related to commerce, such as leases (Article 2A), warehouse receipts (Article 7), and secured transactions where a lender obtains a security interest in goods (Article 9). This section will focus on the UCC article that covers sales: Article 2.

Applicability. Article Two deals only with sales and does not deal with contracts for services, such as production contract that pays a farmer for raising livestock or vegetables owned by someone else.

Statute of Frauds. To prevent people from lying about non-existent contracts (that is, committing fraud), the UCC has adopted the statute of frauds to encourage people to write down their agreement. Under the UCC, a contract for the sale of goods for a value of $500 or more needs to be in writing to be enforceable. The writing, however, does not need to be a formal contract and it only needs to be signed by the person against whom enforcement is sought.

A contract can also be reached if the agreement is between merchants (see text box for a discussion on whether a farmer is a merchant) and one of the merchants sends a writing confirming the agreement and the other merchant does not object in writing within ten days. For example, assume a sugar beet LLC contacted you in the spring about purchasing your entire crop of beets in the fall. You agreed to the price and other terms over the phone. Within a few days, you receive a letter from the LLC

When is a farmer a merchant?

In general, a farmer is a merchant for purposes of Article 2 when the farmer is familiar with the marketing practices in the industry. To determine whether a farmer is "merchant" for these purposes, a court might look to the length of time the farmer has been engaged in the sale of the particular goods, the degree of business acumen shown by the farmer, and the farmer's awareness of farm markets. At any rate, whether a farmer is a merchant depends on the particular facts, and states are split on the question. *Colorado-Kansas Grain Co. v. Reifschneider*, 817 P.2d 637, 640 (Colo. Ct. App. 1991).

that outlines the details of your agreement. If you are a merchant, this can be enforced against you as a contract, although you never actually signed the document. If you do not agree with the terms as written, then you have ten days to send a written response to the LLC. If you are not a merchant, then the letter could not be enforced against you as a contract.

Warranty of merchantability and warranty of fitness for a particular purpose. The UCC assumes or "implies" two types of warranties in sales contracts. The first deals with a warranty of merchantability which means the goods should be "fit for the ordinary purposes" for which the goods were intended. This implied warranty applies only if the seller is a merchant. Importantly for those who prepare food, the implied warranty of merchantability applies to food sold for consumption on or off the premises. (UCC § 314). If someone is injured by consuming the food, the question is whether the food "was not reasonably fit for eating" and whether the injured person can prove the defect caused the injury. The second type of implied warranty is the warranty that the product is fit for a particular purpose. (UCC § 315). This warranty arises where the "seller at the time of contracting has reason to know the particular purpose for which the goods are required" and that the buyer is relying on the special skill or knowledge of the seller to supply these goods. For example, if you are selling apples to a group you know produces organic apple cider and the group is relying on your knowledge as an organic apple grower, you will probably breach your warranty if you deliver apples that are not organic or have significant traces of insecticide.

Consumers have a responsibility to prepare food appropriately

A woman in New Jersey bought raw pork chops in a supermarket. After preparing the pork and serving it to her family, the woman and her children became ill from what was revealed to be trichinosis, a parasitic infection that was more common in pork in the 1970's. The woman sued the supermarket for, among other things, a breach in the warranty of merchantability. In essence, the woman was arguing the supermarket breached its promise to sell pork that was fit for its ordinary purpose. The supermarket, however, argued the pork was fit for its ordinary purpose, which was for someone to take home and cook thoroughly before serving in a meal. Such thorough cooking would have eliminated the trichinosis. The court agreed with the supermarket and found the supermarket was not liable to the woman. *Hollinger v. Shoppers Paridise of New Jersey, Inc.*, 340 A.2d 687 (N.J. Super 1975).

Remedies related to a breach. The UCC provides a number of possibilities for a party to a contract who incurs costs because of a breach. If a seller breaches a contract, the buyer can cancel the contract and keep what has already been paid. The buyer can also seek substitute products and sue the seller for the extra costs incurred. If the product involved is hard to replace, then the contract may provide liquidated damages, which are fixed damages of a reasonable amount in relation to the actual harm caused by the breach.

When a buyer refuses to purchase the products as promised under the contract, the typical remedy is for the seller to find another buyer for the product and charge the original buyer the difference between the contract price and the price actually received. With some specialty or niche products, finding a suitable buyer in a timely manner might be almost impossible. Nevertheless, in general the seller has a responsibility to make a good faith effort to limit the amount of damages.

Example contract

When someone sells something on the spot or cash market, the seller attempts to seek bids from a number of buyers to receive the highest market price possible. When someone is using a more formal contract to market goods, they should also determine whether they can receive a better deal. This means comparing the contract with other similar contracts. This simple idea can be a challenge for farmers raising specialty crops or commodities because similar contracts may not exist. For those who raise commodities, some contracts include confidentiality clauses that prohibit people from sharing the contents. Some states, such as Iowa, prohibit these types of clauses in livestock contracts, but most states allow the provisions.

Can a warranty be waived?

Either type of warranty can be waived if the waiver is in writing and is reasonably conspicuous. In a case involving a farmer who purchased chickens for the purposes of laying eggs and in which the farmer relied on the expertise of the seller to furnish healthy chickens, most of the chickens became ill soon after delivery and many of them died. The farmer sued the seller for, among other things, breach of both the implied warranty of merchantability and the implied warranty of fitness for a particular purpose. The seller pointed to language on the receipts the farmer signed that stated that "no warranties, express or implied, have been made by the Seller or Grower as to the quality or condition of the pullets" and that the farmer accept them in "as is" condition. While persuading the farmer to purchase the chickens, the seller repeated that they would be good chickens. A lower court dismissed the suit because it found the language in the receipt waived any warranties. A higher court, however, ruled the case should have gone to the jury because there was a question whether the representation of the seller was an express warranty. Furthermore, the higher court questioned whether the language in the receipt was conspicuous enough to draw the farmer's attention given that it was in normal type in the middle of the document.

Woodruff v. Clarke Co. Farm Bureau Cooperative Assoc., 286 N.E.2d 188 (Ind. App. 1972).

Swine contract library

In 1998, Congress required USDA to implement a swine contract library. The Grain Inspection Packers and Stockyards Administration implements this web-based library designed to provide a catalogue of the different types of marketing agreements that have been offered or entered into and provides regional and monthly reports on swine marketing contracts. The website is: scl.gipsa.usda.gov/.

Even in states where confidentiality clauses are prohibited, there usually is not a formal clearinghouse to provide farmers an idea of what contracts have been offered and accepted. This means that the market for contracts may not be very transparent.

This lack of transparency can be an even bigger problem in specialty and niche contracts because no similar contracts may exist. When considering entering into a contract in this type of market, you may need to be creative in determining what types of provisions the contract should include. Contracts can be simple one-page documents setting out the most basic provisions of the agreement, or they may go on for pages attempting to consider every possible issue that might arise in the sales arrangement.

State law prohibits confidentiality clauses

Iowa Code chapters 202 and 202A prohibit the use of confidentiality clauses in livestock production and marketing contracts. Iowa Code section 202.4 states:

> A packer shall not include a provision in a contract executed on or after the effective date of this section for the purchase of livestock providing that information contained in the contract is confidential.

Set out below is an example of a shorter contract that considers most of the essentials of a contract for the sale of a specialty or niche product. It is presented not as a form contract to be used, but simply as a way of raising issues you should consider when drafting or entering into your own contract.

SUPPLY AGREEMENT

This agreement is between Bernard's Best, a dairy processing plant and marketing operation located in Bernard, Iowa, hereinafter know as BB,

AND ________________________________ an individual dairy milk producer supplying raw milk to BB hereinafter known as the producer.

BB and the producer agree to the following terms:

Article I.	Regarding purchase of the raw milk supplied to BB by the producer:
Section 1.01	BB will purchase from the producer and producer will sell to BB any and all milk that meets the certification requirements discussed in Article II.
Section 1.02	BB agrees to provide in writing the testing specifications from Section 1.01.
Section 1.03	The base price of the raw milk will be $__ per hundredweight.
Section 1.04	BB will provide transportation of the raw milk to the BB plant at no cost to the producer.
Section 1.05	BB will pay a combined rate of ten percent of after tax profits at the end of each fiscal year to all producers that have signed this agreement on an individual basis. The ten percent will be apportioned to individual producers based on the percentage of the total milk supplied to and used by BB.
Section 1.06	BB will maintain accurate records of producer's volume and pricing with records to be made available to the producer upon written request.
Article II.	Certification Requirements.
Section 2.01	Producer must obtain and maintain certification from Food Alliance Midwest. This certification includes both the Whole Farm certification and the product specific certification for dairy.
Section 2.02	Producer must obtain and maintain certification as an organic dairy operation as specified under the USDA National Organic Program. BB recommends the State of Iowa as the Organic Certifier. However, the producer may choose another certifier, provided the certifier is part of USDA's National Organic Program (NOP).
Section 2.03	Producer will be responsible for the costs associated with any certifications related to this agreement.
Section 2.04	Producer will maintain records required for the certification programs and will provide them to BB upon request.
Section 2.05	BB will provide the producer a comprehensive listing of the certification standards required by this agreement upon request.
Article III.	Additional agreements by BB and/or the producer
Section 3.01	Each party has a right to terminate this agreement with 180 days notice.
Section 3.02	BB may immediately terminate the agreement if the producer fails to maintain a certification required under this agreement.

Agreed to this _______ day of _______________ , 2005.

The following section uses this sample contract to raise specific questions you should consider when entering into a contract:

1. **Quantity**. Section 1.01. Is the contract an exclusive contract? Will you be able to sell some of your products to other sellers? Many farmers like to have this option to make sure the buyer is grading their products fairly and to maintain options should the buyer no longer be in the market in the future. Buyers, on the other hand, want to lock in as much supply as they can and do not want to work with the seller to improve the seller's operation just so the seller can market to other operations.

2. **Price**. Section 1.03. Is the price set in the contract or does it rely on another market as the base price? For instance, most marketing agreements for hogs look to USDA reported prices for the spot market as a base price.

3. **Duration**. Section 3.01. What is the duration of the contract? If it is open ended, what type of notice must the parties give to terminate the contract? If there is a set duration, is there an opportunity to renew the contract?

4. **Delivery.** Section 1.04. Who has responsibility and pays for shipping the goods? Will the buyer pick them up at your place or do you need to deliver the goods to a particular place? Is there a specific time when the goods need to be delivered?

5. **Profit sharing**. Section 1.05. Is there any sharing of profits? The idea of profit sharing is inherent in the cooperative model, but a number of LLC's also look for ways to share profits with producers.

6. **Recordkeeping.** Sections 1.05 and 2.04. What are the recordkeeping requirements and who has a right to see the records? Records can be especially important when trying to prove you adhered to certain standards for raising a crop or livestock.

7. **Certification requirements**. Article II. Are there certification requirements? Who is the certifier? Is there a chance these requirements will change over time? Who pays the costs of certification? What happens if the seller is not able to maintain the required certification?

8. **Dispute resolution**. What happens if disagreements occur? Is there a particular process, such as mediation or arbitration, the parties must follow if disagreements occur?

Conclusion

This chapter introduces the general legal framework of contract law. If you enter into contracts with a producer marketing association, these rules will apply just as if you were dealing with an outside party. By becoming familiar with how contracts are interpreted and enforced, you can help ensure a smoother relationship between members and the association.

Additional Internet Resources for Contract Law

Contracts 101 –The following links provide a general overview of the basic legal concepts surrounding contractual arrangements.

- Business Contracts and Arrangements (Ag Marketing and Resource Center)
- Contract Law: The Basics (FindLaw.com)
- Five Questions to Ask Before Signing a Contract (Entrepreneur Magazine)
- Plain English Guide to Contracts (www.business.gov)

The Uniform Commercial Code (UCC)

- Overview of Sales Under the UCC (Cornell's Legal Information Institute)
- UCC as Adopted by Specific States (Cornell's Legal Information Institute)

Contracts in Agriculture

Overview

- Agricultural Production Contracts (University of Minnesota Extension Services)
- An Introduction to Agricultural Production and Marketing Contracts (University of Nebraska Cooperative Extension)
- Contracting in Agriculture: Making the Right Decision (USDA-AMS)

Contract Libraries

- Production Contract Library (Iowa Attorney General's Farm Division)
- Swine Contract Library (USDA – GIPSA)

Contract Evaluation Checklists

- Grain Production Contracts (Iowa Attorney General's Farm Division)
- Livestock Production Contracts (Iowa Attorney General's Farm Division)
- Vegetable Production Contracts (Illinois' Value Project)

National Agricultural Law Center (website)

- Commercial Transactions Reading Room
- Production Contracts Reading Room

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Chapter 8

Federal Laws Regulating Agricultural Sales

This chapter considers federal laws that regulate the sales of certain agricultural products or commodities, specifically the Packers and Stockyards Act (PSA) and the Perishable Agricultural Commodities Act (PACA).

These laws are important in the producer association context because they are generally designed to regulate entities that deal in certain agricultural commodities. Depending on the type of relationship a producer has with the organization, these laws could directly affect the producer-association relationship because farmers may be selling to the organization or the organization may be acting as a sales agent for the farmer.

PSA and PACA apply to producers and joint producer associations who deal in livestock, poultry, and perishable agricultural commodities. Congress passed these laws because of the inherent disadvantage sellers of perishable goods have relative to buyers. Because of the perishable nature of the products, sellers need to market their products quickly to retain any value. This fact can lead to abusive tactics by the buyers, such as wrongfully claiming the products are of inferior quality. Another concern Congress attempted to address with these laws, especially PSA, is the relatively weak bargaining position sellers possess because of the concentrated nature of the buyers' market.

Packers and Stockyards Act

Any group purchasing livestock or poultry needs to determine if it is regulated under the Packers and Stockyards Act (PSA) (7 U.S.C. sections 181 to 229b). Sellers of livestock or poultry should also know what protections PSA provides them. Congress originally passed PSA to protect sellers of livestock and subsequently amended the Act to protect contract poultry growers and swine production contract growers.

What does the Act prohibit?

PSA prohibits unfair, unjustly discriminatory or deceptive trade practices by packers, live poultry dealers, market agencies, and dealers. Specifically, the Act prohibits any undue or unreasonable preferences given to any seller, apportioning the supply of

USDA GIPSA

Administration of the Act is performed by the Grain Inspection, Packers and Stockyards Administration (GIPSA) of USDA, and all matters of licensing, bonding and complaints under the Act are addressed by that agency. GIPSA maintains a national headquarters and three field offices with responsibility for administering Packers and Stockyards programs in various states.

USDA GIPSA Headquarters
1400 Independence Avenue SW
Washington, DC 20250
GIPSA violation hotline: (800) 998-3447

USDA GIPSA Atlanta Regional Office
Primary responsibility for poultry industry and oversees trade practice regulation in the following states: AL, AR, CT, DC, DE, FL, GA, LA, MA, MD, ME, NC, NH, NJ, NY, PA, RI, SC, TN, VA, VT, WV.
75 Spring Street Suite 230
Atlanta, GA 30303
(404) 562-5840

USDA GIPSA Denver Regional Office
Primary responsibility for the cattle industry and maintains trade practice regulation in the following states: AK, AZ, CA, HI, ID, KS, MT, NE, NV, NM, OK, TX, UT, WA, WY.
1 Gateway Center
3950 Lewiston, Suite 200
Aurora, CO 80011
(303) 375-4240

USDA GIPSA Des Moines Regional Office
Primary responsibility for the swine industry and maintains field staff in the following states: IA, IL, IN, KY, OH, MI, MO, MN, ND, SD, WI.
210 Walnut Street, Room 317
Des Moines, IA 50309
(515) 323-2579

animals if it creates a monopoly, and the manipulation of prices. Specific examples of unfair practices under PSA include paying with a bad check or not paying cash sellers promptly. In addition, short weighing is an unfair trade practice.

The Act provides a number of financial protections for sellers by requiring prompt payment, creating a trust in favor of unpaid cash sellers, and requiring certain entities to be bonded.

Who is regulated?

Exactly how an entity is regulated will depend on how it is classified under PSA. The potentially regulated entities are:

"Packer" means any person engaged in buying livestock for slaughter, who manufactures meat food products, or who markets meats in an unmanufactured form acting as a wholesale broker, dealer or distributor. A small scale farmer organization that gathers animals, contracts for slaughter, and markets the meat is classified as a packer.

"Dealer" means a person engaged in buying or selling livestock on his own account or as the employee or agent of the seller or purchaser. If an organization takes title to livestock before reselling it, the organization could be a dealer.

"Market agency" means anyone who buys and sells livestock on commission. If a marketing organization is simply an agent for the sale, they will be regulated as a market agent.

Short weights are unfair practices

In a "sting" operation, USDA sold three test lots of hogs to the defendants, who owned a stockyard, and concluded the defendants were engaged in a practice of weighing livestock at less than their true and correct weights and were not issuing scale tickets as required. USDA filed an administrative complaint against the defendants arguing the short weighing was an unfair practice and a violation of PSA. After an administrative hearing, the administrative law judge decided the defendants violated the Act. The defendant appealed to the Fifth Circuit Court of Appeals. The court found there was substantial evidence the defendants engaged in unfair trade practices in violation of PSA by "short weighing" animals delivered by sellers and by not furnishing scale receipts as required.

Livestock Marketers Inc. v. U.S., 558 F.2d 748 (5th Cir. 1977).

"Swine contractor" means a person who pays another to raise and care for hogs under a production contract.

"Live poultry dealer" generally means a poultry integrator that pays someone else to raise their poultry for slaughter.

Buyers of what kinds of animals are regulated by PSA?

People who deal in livestock and poultry are regulated by PSA. The statute defines livestock to mean only cattle, sheep, swine, horses, mules or goats. The definition does not include bison, elk, llama, deer or other quadrupeds, exotic, or farm-raised game animals. Poultry means only chickens, turkeys, ducks, geese, and other domestic fowl. It does not include exotic fowl. It is not clear whether the definition of poultry includes ratites such as ostrich, emu, or farm-raised game birds. Only those who deal in "poultry for slaughter" are regulated. This phrase has been interpreted to mean those who process birds that were not raised primarily for slaughter, such as breeder hens, are not regulated by PSA.

What is unfair under the Packers and Stockyards Act?

A case involving a turkey farmer's claim that a processor violated the PSA through its use of turkey contracts raised the issue of what "unfair" means under PSA. The processor offered individual contracts that were both an agreement to sell poults (baby turkeys) to the farmer and buy the mature turkeys. The processor offered two types of contracts: (1) a floor contract guaranteed a minimum price but limited the upside potential, or (2) a performance contract that involved more risk to the producer but gave an opportunity to make more money. The contracts lasted only one year. During trial, the grower testified the processor's representative stated the grower would have a choice of either contract each year. After a number of years of signing floor contracts, the grower decided he wanted a performance contract, but the processor refused.

The case involved a number of alleged violations of the PSA, most prominently the turkey processor's refusal to offer the performance contract to the grower. The grower argued this was unfair and unjustly discriminatory because, among other things, other growers in the area were offered both kinds of contracts.

The court ruled that because the processor and grower entered into one-year contracts, nothing obliged the processor to offer any kind of contract to the grower. The court also determined PSA was not designed to minimize the processor's right to freedom to contract. For these reasons, the court found the processor did not violate the law refusing to offer the grower the performance contract.

Jackson v. Swift Eckrich, Inc., 53 F.3d 1452 (8^{th} Cir. 1995).

Are small operations regulated?

Smaller operations are covered under some of PSA regulations and exempted from others. The Act's regulatory prohibition against unfair, deceptive, and unjustly discriminatory trade practices applies in all cases regardless of the size of the entity. In addition the Act requires careful record keeping by packers, live poultry dealers, market agencies and dealers regardless of their size. If a packer or buyer of live animals for slaughter has average annual purchases less than $500,000 per year, the packer is exempt from the provisions of the statutory trust. In the case of poultry, if a dealer's annual average purchases are less than $100,000 per year, the poultry dealer is exempt from the provisions of the statutory trust. In addition, packers do not have to be bonded if their annual purchases do not exceed $500,000.

What is an undue preference and how does it affect a producer marketing association?

PSA prohibits giving undue or unreasonable preferences to any particular person. The meaning of "undue preference" is not defined in either the statute or in the regulations. Because of this, whether a particular practice is an undue preference will be determined according to the facts of each case and within the public purposes of PSA. Generally, courts will look at whether the person had a valid business justification for providing the preference and whether the preference had an anticompetitive effect on the market.

This means a producer association will usually be able to provide preferences to members without worrying about violating PSA.

What is the PSA bond?

PSA requires certain regulated entities to obtain a bond before USDA will allow them to do business. The PSA bond is a financial instrument a packer obtains from a private bond company stating the bond company will meet the packer's financial obligations to pay sellers of livestock if the packer is unable to do so. Bond companies usually have to pay on the bonds only when the packer enters into bankruptcy.

Who must obtain a bond?

Packers must be bonded if their annual average purchases exceed $500,000. If the packer is required to post a bond, the amount of coverage is based on the average value of livestock the packer purchases. The minimum bond amount is $10,000.

Market agencies and dealers must also be bonded. Bonding requirements do not apply to live poultry dealers or swine contractors.

What is the statutory trust?

PSA establishes a "statutory trust in favor of unpaid cash sellers" that provides a remedy for cash sellers to receive payments from packers and live poultry dealers who become insolvent. The statute requires all livestock, proceeds from the sale of livestock, inventories, and receivables be held in trust for the benefit of unpaid cash sellers. Only packers with average annual sales of over $500,000 and live poultry dealers with average annual sales of over $100,000 are subject the statutory trust provisions.

What is an unpaid cash seller?

Unless the statutory trust provisions are expressly waived in writing, all sellers are defined as "cash sellers." This means a cash seller who fails to receive a payment or receives a payment that is dishonored is an "unpaid cash seller."

How does an unpaid cash seller claim against the trust?

If a cash seller is not paid promptly, the unpaid cash seller must give written notice to the packer or live poultry dealer and the Secretary of Agriculture. To preserve an interest in the trust, the unpaid seller must provide notice within 30 days from the final date payment was due or 15 days after the seller receives notice a bank draft has been dishonored. If the cash seller does not act to preserve an interest in the trust, it is lost.

What does "prompt payment" mean in relation to PSA?

"Prompt payment" in the case of livestock means payment in full before the close of the day following purchase, transfer and possession of the live animals, or, if the carcasses are subject to a grade and yield pricing, not past the close of business on the day the price is determined on the carcass.

In the case of poultry, "prompt payment" means payment in full before the close of the day following purchase. If the poultry is produced under a growing arrangement, payment must be made before the fifteenth day following the week in which the poultry is slaughtered.

May a packer buy livestock on credit?

A packer may buy livestock on credit, but it must make sure the seller waives the right to prompt payment and the waiver must be in writing.

The following acknowledgement is required if a packer purchases livestock on credit.

> On this date I am entering into a written agreement for the sale of livestock on credit to __________________, a packer, and I understand that in doing so I will have no rights under the trust provisions of sections 206 or 207 of the Packers and Stockyards Act, 1921, as amended (7 U.S.C. 196-197, Pub. L. 94-410), with respect to any such credit sale. The written agreement for such selling on credit
>
> __ Covers a single sale
> __ Provides that it will remain in effect until ____________
> __ Provides that it will remain in effect until canceled in writing by either party
>
> Date______________
>
> Signature_________

Are there record keeping requirements under PSA?

The Act requires all entities, regardless of size, to keep records that fully and correctly disclose all transactions in the business.

How is the Act enforced?

Depending on the type of regulated entity involved and the alleged violation, injured parties and USDA may bring actions against regulated entities. Fines for violations are a maximum of $11,000 for each violation. Regulated entities may also be liable to injured parties for the damages caused by violations of the Act. USDA can bring an administrative action against packers, dealers, market agencies, and swine production contractors. The Department of Justice can file a complaint against live poultry dealers in federal district court.

Injured parties can file a claim in federal district court against packers, live poultry dealers, and swine production contractors. Those injured by dealers or market agencies can seek reparations in a USDA administrative action.

Perishable Agricultural Commodities Act

The Perishable Agricultural Commodities Act (PACA) (7 U.S.C. sections 499a to 499t) is intended to promote fair trading practices in the fruit and vegetable industries. The law does this by licensing certain actors in these industries and requiring the licensees to abide by certain trade practices. The law also provides financial protection to sellers of fruits and vegetables from the PACA trust. USDA administers PACA. Much of the information below comes from a publication on the USDA PACA website called "PACA Factfinder." www.ams.usda.gov/fvpaca/FactFinder.htm.

USDA PACA branch offices

For questions related to PACA licenses, disputes, or anything else related to the Act, contact the nearest USDA PACA office.

USDA, AMS, F&V Programs
PACA Branch
P.O. Box 96456
Washington, DC 20090-6456
Telephone: (877) 622-4716 (toll-free)
Fax: (202) 690-4413

USDA, AMS, F&V Programs
PACA Branch
300 W. Congress Street, Box FB30
Tucson, AZ 85701-1319
Telephone: (888) 639-0575 (toll-free)
Fax: (520) 670-4798

USDA, AMS, F&V Programs
PACA Branch
Building A, Suite 360
Glen Ellyn, IL 60137-5832
Telephone: (888) 693-0423 (toll-free)
Fax: (630) 858-9304

USDA, AMS, F&V Programs
PACA Branch
622 Georges Road, Suite 303
North Brunswick, NJ 08920-3303
Telephone: (877) 471-7720 (toll-free)
Fax: (732) 846-0427

USDA, AMS, F&V Programs
PACA Branch
1200 East Copeland Road, Suite 404
Arlington, TX 76011-4938
Telephone: (888) 901-6137 (toll-free)
Fax: (817) 276-1968

USDA, AMS, F&V Programs
PACA Branch
8700 Centreville Road, Suite 206
Manassas, VA 20110-8411
Telephone: (888) 639-9236 (toll-free)

Who must obtain a PACA license?

Many joint producer operations that buy fruits and vegetables from members or negotiate sales on behalf of members will need to obtain a license. These are the three categories of licensees:

1. Anyone who buys or sells more than 2000 pounds of fresh or frozen fruits and vegetables in a given day. This includes wholesalers, processors, and food service firms.
2. Brokers or commission merchants. These firms negotiate the sale of fruits and vegetables on behalf of another person. If the negotiated sales of fruits and vegetables are less than $230,000 per year, a broker does not need to obtain a license.
3. Food retailers who purchase at least $230,000 of fruits and vegetables per year.

Growers who sell only products they have grown are exempt from the licensing requirements. Unless the organization itself raises the products, as opposed to its members, the organization would not fall under this exemption.

What is the penalty for operating without a license?

Firms that operate without a license are subject to fines of up to $1000 for each offense and $250 for each day the offense continues. A court can prohibit people from doing business who persist in operating without a license.

What responsibilities do PACA licensees have?

PACA helps enforce the marketing contract by requiring that firms comply with the contract and not take advantage of people who are in a vulnerable position because of the perishability of the product. PACA also requires sellers be paid within ten days after the buyer accepts the fruits or vegetables unless the buyer and seller, prior to the sale, agree in writing to extend the payment time. Licensees must keep records of all fruit and vegetable transactions.

What happens if there is a dispute concerning a transaction regulated by PACA?

PACA branch offices provide both informal and formal complaint services. Informal complaints can involve mediation which allows the parties to resolve the issue themselves. If the party is not satisfied with mediation, they can file a formal complaint that will be handled by USDA in much the same way a lawsuit is handled in court. USDA may award damages plus interest based on the damages proved in the case. There is a $300 filing fee for a formal complaint, but the complainant can recover the filing fee if an order is issued in its favor. USDA has the authority to suspend licenses for up to three years if a firm refuses to satisfy a PACA award.

What does it mean if a firm's license is revoked?

As long as the firm's liscense is suspended, it cannot do business in the produce industry. The suspension also applies to most owners, partners, managers, officers, and directors of the firm.

What are some typical unfair trade practices?

Typical violations include a buyer rejecting the product without reasonable cause or failing to pay promptly. Sellers could violate PACA by failing to deliver the produce in a timely manner or at the quality level agreed to in the purchase agreement. Any PACA licensee could violate PACA by basing a transaction on false records.

Does USDA have the ability to bring disciplinary actions:

If a firm repeatedly and flagrantly violates the Act, USDA may bring a disciplinary action and assess a civil penalty of up to $2000 for each violation.

These are some activities that typically lead to disciplinary actions
- Basing payment on inaccurate records;
- Flagrant misbranding; and
- Making false and misleading statements for a fraudulent purpose.

What is the PACA trust?

The PACA trust means a buyer must hold all of the produce and the proceeds of produce (the money received from the sale of produce) for the benefit of unpaid produce sellers who have preserved their rights in the trust.

To have a defendable interest in a PACA trust, a claimant must show (1) the goods in question were perishable agricultural commodities; (2) the commodities were received by a commission merchant, a dealer, or broker; and (3) the claimant preserved its rights under PACA within thirty days after payment became due.

How do sellers preserve rights in the trust?

Sellers of produce must provide the buyer with written notice of the seller's intent to preserve trust benefits under PACA within 30 days from the date payment was past due or notification was received that a check was dishonored by the bank. For sellers who are PACA licensees, USDA requires the following language to preserve the trust:

> "The perishable agricultural commodities listed on this invoice are sold subject to the statutory trust authorized by Section 5(c)

Is a french fry a vegetable?

For PACA to apply to a person's business, the person must be dealing in perishable agricultural commodities. The statute defines this term to mean fresh or frozen fruits and vegetables. In the context of the PACA trust, this means someone will not be able to claim an interest in the proceeds of the goods unless they can prove the goods are a fruit or a vegetable. PACA regulations state that a product is no longer a fresh fruit or vegetable if it has been manufactured into a food of a different kind or character. (7 C.F.R. section 46.2). The regulations describe a long list of processes that only minimally affect the fruit or vegetable and therefore do not change the product into a different kind of food. The list includes such things as steaming, curing, chopping, refrigerating, or washing.

The issue of what products are perishable agricultural commodities often arises in bankruptcy. For example, in one case the bankruptcy court needed to determine whether a seller of battered french fries to Long John Silver's had an interest in the PACA trust. The court determined that although unbattered french fries had been held to be perishable agricultural commodities, battered fries are not because the batter changes the essential character of the product. Because the court decided the battered french fries were not covered under PACA, the seller could not claim an interest in the PACA trust.

In re Long John Silver's Restaurants, Inc., 230 B.R. 29 (D. Del. 1999).

> of the Perishable Agricultural Commodities Act, 1930 (7 U.S.C. 499e(c)). The seller of these commodities retains a trust claim over these commodities, all inventories of food or other products derived from these commodities, and any receivables or proceeds from the sale of these commodities until full payment is received."

How do I receive payment from the trust?

You must file for payment under the trust in Federal District Court or in Federal Bankruptcy Court if the buyer has filed for bankruptcy. You do not file a complaint with USDA or undergo any type of mediation when enforcing your rights to the trust. Because the two complaint systems are separate, you can file both a trust claim in federal court and a PACA complaint with USDA for the same underlying facts.

Conclusion

Producer associations who deal in livestock and poultry or fruits and vegetables need to be aware how PSA and PACA might affect their business. These laws are generally designed to protect sellers of certain types of agricultural products and add legal requirements to businesses that deal in these goods. Many times regulated entities will be producer marketing associations.

Additional Internet Resources for
Federal Laws Relating to Agriculture

Packers and Stockyards Act
USDA Grain Inspection, Packers and Stockyards Administration (website)

- Overview of Packers & Stockyards Programs
- Livestock Sellers' Rights Under P&S Trust Provisions
- Live Poultry Growers' and Sellers' Rights Under P&S Trust Provisions
- Other GIPSA P&S Programs Publications and Brochures

National Agricultural Law Center (website)

- Packers and Stockyards Reading Room
- An Overview of the Packers and Stockyards Act (Kelley 2003)

Perishable Agricultural Commodities Act (PACA)
USDA Agricultural Marketing Service (website)

- PACA Branch Homepage
- PACA FactFinder
- PACA - A Valuable Tool for Growers

National Agricultural Law Center (website)

- Perishable Agricultural Commodities Act Reading Room

Compiled by Kurt Olson, National Agricultural Law Center Graduate Assistant

Appendix

State & Federal Agencies

This appendix includes contact information in each state for two federal agencies and one state agency. As discussed in the chapter on business organizations, to be legally recognized as an LLC, limited partnership, cooperative, or corporation, your group will need to file certain papers with a state office, usually the Secretary of State.

When looking for financing opportunities, your organization may want to contact two different Federal agencies, USDA Rural Development Agency and U.S. Small Business Administration. The state offices (and in some cases, regional offices) of these agencies will be able to share specific information about programs in your state. In addition you may want to contact the state agency responsible for economic development to see if it has any special programs for farmers.

Alabama
Agency to contact for filing papers of incorporation:
Alabama Secretary of State
Corporate Section
Box 5616
Montgomery, AL 36103
(334) 242-5324

USDA Rural Development
Suite 601, Sterling Centre
4121 Carmichael Road
Montgomery, AL 36106-3683
(334) 279-3616

U.S. Small Business Administration
801 Tom Martin Drive, Suite #201
Birmingham, AL 35211
(205) 290-7101

Alaska
Agency to contact for filing papers of incorporation:
Alaska Department of Commerce and Economic Development
Corporations Section
Box 110808
Juneau, AK 99811-0808
(907) 271-4022

USDA Rural Development
800 W. Evergreen, Suite 201
Palmer, Alaska 99645
(907) 761-7722

U.S. Small Business Administration
510 L Street, Suite 310
Anchorage, AK 99501-1952
(206) 553-5676

Arizona
Agency to contact for filing papers of incorporation:
Arizona Corporation Commission
Corporation Filing Section
1300 West Washington Street
Phoenix, AZ 85007
(602) 745-7200

USDA Rural Development
230 North 1st Avenue, Suite 206
Phoenix, Arizona 85003
(602) 280-8745 ex 8701

U.S. Small Business Administration
2828 North Central Ave, Suite 800
Phoenix, Arizona 85004-1093
(818) 552-3434

Arkansas
Agency to contact for filing papers of incorporation:
Arkansas Secretary of State
Corporations Division
State Capitol
Little Rock, AR 72201
(501) 682-1010

USDA Rural Development
700 West Capitol, Room 3416
Little Rock, AR 72201-3225
(501) 301-3280

U.S. Small Business Administration
2120 Riverfront Drive, Suite 250
Little Rock, AR 72202-1796
(501) 324-5871

California
Agency to contact for filing papers of incorporation:
California Secretary of State
Statement of Information Unit
P.O. Box 944230
Sacramento, CA 94244-2300
(916) 657-5448

USDA Rural Development
430 G Street, Agency 4169
Davis, CA 95616-4169
(530) 792-5800

U.S. Small Business Administration
330 North Brand Boulevard Suite 1270
Glendale, CA 91203-2304
(818) 552-3434

Colorado
Agency to contact for filing papers of incorporation:
Colorado Secretary of State
1700 Broadway, Suite 2000
Denver, CO 80202
(303) 894-2200

USDA Rural Development
655 Parfet Street, Room E-100
Lakewood, CO 80215
(720) 544-2903

U.S. Small Business Administration
721 19th Street, Suite 426
Denver, CO 80202
(303) 844-2607

Connecticut
Agency to contact for filing papers of incorporation:
Connecticut Secretary of State
30 Trinity Street
Hartford, CT 06016
(860) 509-6003

USDA Rural Development
451 West Street, Suite 2
Amherst, MA 01002-2999
(413) 253-4318

U.S. Small Business Administration
330 Main Street, Second Floor
Hartford, CT 06106
(860) 240-4700

Delaware
Agency to contact for filing papers of incorporation:
Delaware Department of State
Division of Corporations
Box 898
Dover, DE 19903
(302) 739-3073

USDA Rural Development
1221 College Park Drive, Suite 200
Dover, DE 19904
(302) 857-3580

U.S. Small Business Administration
1007 N. Orange Street, Suite 1120
Wilmington, DE 19801-1232
(302) 573-6294

Florida
Agency to contact for filing papers of incorporation:
Florida Department of State
Division of Corporations
Box 6327
Tallahassee, FL 32314
(800) 755-5111

USDA Rural Development
4440 N.W. 25th Place
Gainesville, Florida 32606
(352) 338-3482

U.S. Small Business Administration
233 Peachtree Street, NE Suite 1800
Atlanta, GA 30303
(404) 331-4999

Georgia
Agency to contact for filing papers of incorporation:
Georgia Secretary of State
Corporations Division
2 Martin Luther King Jr. Drive
Suite 315 West
Atlanta, GA 30334
(404) 656-2817

USDA Rural Development
Stephens Federal Building
335 East Hancock Avenue
Athens, GA 30601-2768
(678) 583-0866

U.S. Small Business Administration
233 Peachtree Street, NE, Suite 1900
Atlanta, GA 30303
(404) 331-0100

Hawaii
Agency to contact for filing papers of incorporation:
Hawaii Department of Commerce
and Consumer Affairs
Business Registration Division
Box 40
Honolulu, HI 96810
(808) 586-2744

USDA Rural Development
Room 311, Federal Building
154 Waianuenue Avenue
Hilo, HI 96720
(808) 933-8310

U.S. Small Business Administration
300 Ala Moana Blvd
Room 2-235
Box 50207
Honolulu, HI 96850
(808) 541-2990

Idaho
Agency to contact for filing papers of incorporation:
Idaho Secretary of State
Corporations Division
Box 83720
Boise, ID 83720
(208) 334-2301

USDA Rural Development
9173 West Barnes Drive, Suite A1
Boise, ID 83709
(208) 378-5623

Small Business Administration
380 East Parkcenter Blvd., Suite 330
Boise, ID 83706
(208) 334-1696

Illinois
Agency to contact for filing papers of incorporation:
Illinois Secretary of State
Department of Business Services
Springfield, IL 62756
(217) 782-6961

USDA Rural Development
2118 West Park Court, Suite A
Champaign, IL 61821
(217) 403-6217

U.S. Small Business Administration
500 W. Madison Street, Suite 1250
Chicago, IL 60661-2511
(312) 353-0357

Indiana
Agency to contact for filing papers of incorporation:
Indiana Secretary of State
Corporations Division
302 West Washington
Room E018
Indianapolis, IN 46204
(317) 232-6581

USDA Rural Development
5975 Lakeside blvd
Indianapolis, IN 46278
(317) 290-3100, ext. 427

U.S. Small Business Administration
429 North Pennsylvania Street, Suite 100
Indianapolis, IN 46204-1873
(317) 226-7272

Iowa
Agency to contact for filing papers of incorporation:
Iowa Secretary of State
Lucas Building, 1st floor
Des Moines, IA 50319
(515) 281-5204

For state economic development grants and loans:
Iowa Department of Economic Development
200 East Grand Avenue
Des Moines, IA 50309
(515) 242-4707

USDA Rural Development
210 Walnut Street, Room 873
Des Moines, IA 50309-2196
(515) 284-4714

U.S. Small Business Administration
210 Walnut St. Room 749
Des Moines, IA 50309-4146
(515) 284-4422

Kansas
Agency to contact for filing papers of incorporation:
Kansas Secretary of State
Corporation Division
120 SW 10th Street
Topeka, KS 66612
(785) 296-4564

USDA Rural Development
1303 SW First American Place, Suite 100
Topeka, KS 66604
(785) 271-2728

U.S. Small Business Administration
271 West 3rd Street, Suite 2500
Wichita, KS 67202
(316)269-6616

Kentucky
Agency to contact for filing papers of incorporation:
Kentucky Secretary of State
Filings Branch
Box 718
700 Capital Avenue, Suite 154
Frankfort KY 40601
(502) 564-2848

USDA Rural Development
771 Corporate Drive, Suite 200
Lexington, KY 40503-5477
(859) 224-7435

Small Business Administration
600 Dr. MLK Jr. PL
Louisville, KY 40202
(502) 582-5971

Lousiana
Agency to contact for filing papers of incorporation:
Louisiana Secretary of State
Corporations Division
P.O. Box 94125
Baton Rouge, LA 70804
(225) 925-4704

USDA Rural Development
3727 Government Street
Alexandria, LA 71302
(318) 473-7922

U.S. Small Business Administration
365 Canal Street, Suite 2820
New Orleans, LA 70130
(504) 589-6685

Maine
Agency to contact for filing papers of incorporation:
Maine Secretary of State
Bureau of Corporations, Elections and Commissions
Attn: Examining Section
101 State House Station
Augusta, ME 04333 - 0101
(207) 624-7736

USDA Rural Development
28 Gilman Plaza, Suite 3
Bangor, ME 04401-3550
(207) 990-9160

Small Business Administration
Edmund S. Muskie Federal Building, Room 512
68 Sewall Street
Augusta, ME 04330
(207) 622-8274

Maryland
Agency to contact for filing papers of incorporation:
Maryland Department of Assessments and Taxation
Carter Division
301 West Preston Street, Room 801
Baltimore, MD 21201-2395
(410) 767-1340

USDA Rural Development
1221 College Park Drive, Suite 200
Dover, DE 19904
(302) 857-3625

U.S. Small Business Administration
City Crescent Building, 6th Floor
10 South Howard Street
Baltimore, Maryland 21201
(410) 962-4392

Massachusetts
Agency to contact for filing papers of incorporation:
Commonwealth of Massachusetts
Corporation Division
One Ashburton Place, 17th floor
Boston, MA 02108
(617) 727-9640

USDA Rural Development
451 West Street, Suite 2
Amherst, MA 01002-2999
(413) 253-4318

U.S. Small Business Administration
10 Causeway Street, Room 265
Boston, MA 02222
(617) 565-5590

Michigan
Agency to contact for filing papers of incorporation:
Michigan Department of Commerce
Corporation and Securities Bureau
Corporation Division
Box 30054
Lansing, MI 48909
(517) 241-6470

USDA Rural Development
3001 Coolidge, Suite 200
East Lansing, MI 48823
(517) 324-5190

U.S. Small Business Administration
477 Michigan Avenue
Suite 515, McNamara Building
Detroit, MI 48226
(313) 226-6075

Minnesota
Agency to contact for filing papers of incorporation:
Minnesota Secretary of State
Business Services Division
180 State Office Building
St. Paul, MN 55155
(651) 296-2803

USDA Rural Development
410 Farm Credit Service Building
375 Jackson Street
St. Paul, MN 55101-1853
(651) 602-7814

U.S. Small Business Administration
100 North 6th Street
Suite 610-C Butler Square
Minneapolis, MN 55403
(612) 370-2324

Mississippi
Agency to contact for filing papers of incorporation:
Mississippi Secretary of State
Corporate Division
P.O. Box 136
Jackson, MS 39205
(601) 359-1350

USDA Rural Development
100 West Capitol St.
Federal Building, Suite 831
Jackson, MS 39269
(601) 965-4316

U.S. Small Business Administration
AmSouth Bank Plaza
210 E. Capitol Street, Suite 900
Jackson, MS 39201
(601) 965-4378

Missouri
Agency to contact for filing papers of incorporation:
Missouri Secretary of State
Corporation Division
P.O. Box 778
Jefferson City, MO 65102-0778
(573) 751-4153

USDA Rural Development
601 Business Loop 70 West
Parkade Center, Suite 235
Columbia, MO 65203
(573) 876-0976

U.S. Small Business Administration
200 North Broadway, Suite 1500
St. Louis, MO 63102
(816) 374-6380

Montana
Agency to contact for filing papers of incorporation:
Montana Secretary of State
Corporations Bureau
Box 202801
Helena, MT 59620-2801
(406) 444-2034

USDA Rural Development
P.O. Box 850
Bozeman, MT 59771
(406) 585-2540

U.S. Small Business Administration
10 West 15th Street, Suite 1100
Helena, MT 59626
(406) 441-1081

Nebraska
Agency to contact for filing papers of incorporation:
Nebraska Secretary of State
Corporate Division
P.O. Box 94608
Lincoln, NE 68509-4608
(402) 471-4079

USDA Rural Development
Federal Building, Room 152
100 Centennial Mall North
Lincoln, NE 68508
(402) 437-5554

U.S. Small Business Administration
11145 Mill Valley Road
Omaha, NE 68154
(402) 221-4691

Nevada
Agency to contact for filing papers of incorporation:
Nevada Secretary of State
202 North Carson Street
Carson City, NV 89701
(800) 583-9486

USDA Rural Development
1390 S. Curry Street
Carson City, NV 89703
(775) 887-1222 ext 19

Small Business Administration
400 South 4th Street Suite 250
Las Vegas, NV 89101
(702) 388-6611

New Hampshire
Agency to contact for filing papers of incorporation:
New Hampshire Secretary of State
Corporation Division
107 North Main Street
Concord, NH 03301
(603) 271-3246

USDA Rural Development
City Center 3rd Floor
89 Main Street
Montpelier, VT 05602
(802) 828-6080

U.S. Small Business Administration
JC Cleveland Federal Building
55 Pleasant Street, Suite 3101
Concord, NH 03301
(603) 225-1400

New Jersey
Agency to contact for filing papers of incorporation
New Jersey Department of State
Division of Revenue
Business Support Services
Commercial Recording
P.O. Box 308
Trenton, NJ 08625
(609) 292-9292

USDA Rural Development
5th Floor North, Suite 500
8000 Midlantic Drive
Mt. Laurel, NJ 08054
(856) 787-7751

Small Business Administration
Two Gateway Center, 15th Floor
Newark, NJ 07102
(973) 645-2434

New Mexico
Agency to contact for filing papers of incorporation:
Corporation Bureau
1120 Paseo De Peralta
Room 413
Santa Fe, NM 87504
(505) 827-4508

USDA Rural Development
6200 Jefferson NE
Albuquerque, NM 87109
(505) 761-4953

U.S. Small Business Administration
625 Silver SW Suite 320
Albuquerque, NM 87102
(505) 346-7909

New York
Agency to contact for filing papers of incorporation:
New York State Department of State
Division of Corporations,
41 State Street
Albany, NY 12231-0001
(518) 473-2492

USDA Rural Development
441 South Salina Street, Suite 357
Syracuse, NY 13202
(315) 477-6425

U.S. Small Business Administration
26 Federal Plaza Suite 3108
New York, NY 10278
(212) 264-1450

North Carolina
Agency to contact for filing papers of incorporation:
North Carolina Secretary of State
Corporations Division
PO Box 29622
Raleigh, NC 27626-0622
(919) 807-2225

USDA Rural Development
4405 Bland Road
Raleigh, NC 27609
(919) 873-2043

Small Business Administration
6302 Fairview Road, Suite 300
Charlotte, NC 28210
(404) 331-4999

North Dakota
Agency to contact for filing papers of incorporation:
North Dakota Secretary of State
Corporations Division
600 East Boulevard Ave. Dep. 108
Bismarck, ND 58505-0500
(701) 328-2900

USDA Rural Development
P.O. Box 1737
Bismarck, ND 58502
(701) 530-2037

U.S. Small Business Administration
657 Second Avenue North, Room 219
Fargo, ND 58102
(701) 239-5131

Ohio
Agency to contact for filing papers of incorporation:
Ohio Secretary of State
P.O. Box 670
Columbus, OH 43216
(614) 466-3910

USDA Rural Development
Federal Building, Room 507
200 North High Street
Columbus, OH 43215
(614) 255-2420

U.S. Small Business Administration
Two Nationwide Plaza, Suite 1400
Columbus, OH 43215
(614) 469-6860

Oklahoma
Agency to contact for filing papers of incorporation:
Business Filing Department
2300 N. Lincoln Blvd., Room 101
Oklahoma City, OK 73105-4897
(405) 521-3912

USDA Rural Development
100 USDA, Suite 108
Stillwater, OK 74074
(701) 530-2037

U.S. Small Business Administration
Federal Building
301 NW 6th St
Oklahoma City, OK 73102
(405) 609-8000

Oregon
Agency to contact for filing papers of incorporation:
Secretary of State
Corporation Division
255 Capitol St. NE, Suite 151
Salem, OR 97310-1327
(503) 986-2200

USDA Rural Development
1201 NE Lloyd Blvd., Suite 801
Portland, OR 97232
(503) 414-3366

Small Business Administration
601 SW Second Avenue, Suite 950
Portland, OR 97204-3192
(503) 326-2682

Pennsylvania
Agency to contact for filing papers of incorporation:
Pennsylvania Department of State
Corporation Bureau
206 North Office Building
Harrisburg, PA 17120
(717) 787-1057

USDA Rural Development
One Credit Union Place, Suite 330
Harrisburg, PA 17110-2996
(717) 237-2181

U.S. Small Business Administration
Robert N.C. Nix Federal Building
900 Market Street, 5th Floor
Philadelphia, PA 19107
(215) 580-2807

Rhode Island
Agency to contact for filing papers of incorporation:
Rhode Island Secretary of State
Corporations Division
100 North Main Street
Providence, RI 02903
(401) 222-2357

USDA Rural Development
451 West Street, Suite 2
Amherst, MA 01002-2999
(413) 253-4318

U.S. Small Business Administration
380 Westminster Street, Room 511
Providence, RI 02903
(401) 528-4561

South Carolina
Agency to contact for filing papers of incorporation:
South Carolina Secretary of State
Corporations Department
P.O. Box 11350
Columbia, SC 29211
(803) 734-2158

USDA Rural Development
Strom Thurmond Federal Building
1835 Assembly Street, Room 1007
Columbia, SC 29201
(803) 765-5881

U.S. Small Business Administration
1835 Assembly Street, Room 1425
Columbia, South Carolina 29201
(803) 765-5377

South Dakota
Agency to contact for filing papers of incorporation:
South Dakota Secretary of State
500 East Capitol
Pierre, SD 57501
(605) 773-4845

USDA Rural Development
200 4th Street SW
Federal Building, Room 210
Huron, SD 57350
(605) 352-1142

Small Business Administration
2329 N. Career Ave., Suite 105
Sioux Falls, SD 57107
(605) 330-4243

Tennessee
Agency to contact for filing papers of incorporation:
Tennessee Department of State
Business Services
312 8th Ave. North
6th Floor, Snodgrass Tower
Nashville, TN 37243
(615) 741-2286

USDA Rural Development
3322 West End Avenue, Suite 300
Nashville, TN 37203
(615) 783-1341

U.S. Small Business Administration
50 Vantage Way, Suite 201
Nashville, TN 37228
(615) 736-5881

Texas
Agency to contact for filing papers of incorporation:
Texas Secretary of State
Corporation Section
Box 13697
Austin, TX 78711
(512) 463-5583

USDA Rural Development
101 South Main Street, Suite 102
Temple, TX 76501
(254) 742-9780

Small Business Administration
4300 Amon Carter Boulevard
Suite 108
Fort Worth, X 76155
(817) 684-5581

Utah
Agency to contact for filing papers of incorporation:
Division of Corporations
P.O. Box 146705
Salt Lake City, UT 84114-6705
(801) 530-4849

USDA Rural Development: Room 4311
Wallace F. Bennett Federal Building
125 South State Street, Room 4311
Salt Lake City, UT 84138
(801) 524-4322

U.S. Small Business Administration
125 South State Street, Room 2231
Salt Lake City, UT 84138
(801) 524-3209

Vermont
Agency to contact for filing papers of incorporation:
Vermont Secretary of State
Corporations Division
81 River Street
Montpelier, VT 05609-1104
(802) 828-2386

USDA Rural Development
City Center 3rd Floor, 89 Main Street
Montpelier, VT 05602
(802) 828-6080

Small Business Administration
87 State Street, Room 205
Montpelier, VT 05601
(617) 565-8420

Virginia
Agency to contact for filing papers of incorporation:
Virginia State Corporation Commission
P.O. Box 1197
Richmond, VA 23218
(800) 552-7945

USDA Rural Development
Culpepper Building, Ste. 238
1606 Santa Rosa Road
Richmond, VA 23229
(804) 287-1567

U.S. Small Business Administration
400 North 8th Street
Federal Bldg., Suite 1150
Richmond, VA 23240
(804) 771-2400

Washington
Agency to contact for filing papers of incorporation:
Washington Secretary of State
Corporations Division
P.O. Box 40234
Olympia, WA 98504-0234
(360) 753-7115

USDA Rural Development
1835 Black Lake Blvd. SW, Suite B
Olympia, WA 98501-5715
(360) 704-7707

Small Business Administration
1200 Sixth Avenue Park Place Building
Suite 1805
Seattle, WA 98101-1128
(206) 553-5676

West Virginia
Agency to contact for filing papers of incorporation:
West Virginia Secretary of State
Building one suit 157-k
1900 Kanawha Blvd East
Charleston, WV 25305
(304) 558-8000

USDA Rural Development
75 High Street, Suite 320
Morgantown, WV 26505
(304) 284-4860

U.S. Small Business Administration
320 West Pike Street, Suite 330
Clarksburg, WV 26301
(304) 623-5631

Wisconsin
Agency to contact for filing papers of incorporation:
Wisconsin Secretary of State
Corporations Bureau, 3rd Floor
Ray Allen
PO Box 7846
Madison, WI 53707-7846
(608) 261-7577

USDA Rural Development
4949 Kirschling Ct.
Stevens Point, WI 54481
(715) 345-7615

Small Business Administration
740 Regent Street, Suite 100
Madison, WI 53715
(414) 297-3941

Wyoming
Agency to contact for filing papers of incorporation:
Corporations Division
Wyoming Secretary of State's Office
The Capitol Building, Room 110
200 West 24th Street
Cheyenne, WY 82002-0020
(307) 777-7311

USDA Rural Development
P.O. Box 11005
Casper, WY 82602-5006
(307) 233-6700

U.S. Small Business Administration
P.O. Box 44001,
Casper, WY 82602-5013
(307) 261-6500

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