

# 3

## Parties & Contract Relationship

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### CHAPTER QUICK TIPS

#### **Confirm Contract Changes in Writing**

Valid contract changes should be in writing. Send the buyer a letter confirming the details of the change you have agreed to, and asking the buyer to respond promptly if the buyer does not agree with the details as written.

#### **Get Lender Input Before Signing**

If you bring a contract offer to your lender prior to signing, you can negotiate with the buyer to incorporate any lender requirements – helping avoid issues with obtaining credit to cover input costs.



## **THE PARTIES**

### **Who are the parties to the contract?**

In most organic contracts, there will be only two parties:

- (1) you, the farmer and “seller”; and
- (2) the buyer, which could be an individual, marketing cooperative, processor, broker, distributor, restaurant, or other entity.

Even if there are only two parties involved, it is usually a good idea to double-check that the parties are listed accurately in the contract. It is not uncommon for buyers to use the same contract template to contract with multiple farmers, so make sure your name or your farm business name appear correctly throughout the contract. Also, if you have a farm business name, it is generally best to use that name on the contract—either instead of or in addition to your name.

### **Dealing with Buyer Subsidiaries**

If you are considering a contract with a corporate buyer, it’s a good idea to check whether the buyer named in the contract is the company you expected to do business with, or whether the named buyer is actually a subsidiary of that company. In some states, if the named buyer is a subsidiary, the larger parent company may not be responsible for the debts or other liabilities of the subsidiary.

If you are unexpectedly confronted with a subsidiary as the named buyer in your contract, you may wish to do one or more of the following:

- Ask that the larger parent company be substituted or added as a party to your contract.
- Include contract language stating the parent company is liable to you for any of the subsidiary's debts.
- Consult with an attorney about the corporate liability laws in your state. Some states have laws that prevent companies from using subsidiaries to protect themselves from liability.



### **Who owns the organic farm product being sold – the buyer or the farmer?**

As discussed in Chapter 1, if the relationship described in your contract makes it clear that the farmer owns the organic product throughout the production cycle, your contract is a marketing contract. Marketing contracts describe sales of goods (for example, organic crops, dairy or livestock). A certain set of laws, including laws based on Article 2 of the Uniform Commercial Code (U.C.C.), apply to contracts for the sale of goods. Many of these laws are discussed in Chapter 1 and Chapter 12.

If, on the other hand, a contract makes it clear that the buyer—not the farmer—owns the organic product throughout the production cycle, the contract is a production contract. Generally, production contracts describe the sale of services (for example, caring for organic crops or livestock), not the sale of goods. A different set of laws applies to contracts for the sale of services. Additionally, some state and federal laws apply specifically to production contracts for the sale of agricultural services. As stated in Chapter 1, this guide is focused on marketing contracts for the sale of goods—not production contracts for the sale of services. If you are considering an organic production contract, consult an attorney licensed to practice law in your state to understand your risks and what legal protections are available.<sup>1</sup>

**Flock-to-Flock Production Contracts:  
A Longstanding Problem**

Production contracts have wreaked havoc on the farm finances of conventional poultry and livestock farmers for many years. One of the worst examples of production contract arrangements are the “flock-to-flock” broiler contracts routinely offered to poultry farmers. This type of contract typically involves a corporate poultry processor (for example, Tyson or Perdue) offering a contract that requires a farmer to build poultry houses to the processor’s specifications. These commonly cost \$200,000 or more per house. In return, the farmer is paid for the services required to produce the processor-owned broilers. However, these contracts are only offered on a “flock-to-flock” basis, meaning that the contracts only last for the duration of one broiler flock—typically six to eight weeks. Although the contracts provide for—and farmers are counting on—open-ended renewals, there is never a guarantee. The problem comes when the processor decides to terminate a flock-to-flock contract relationship before the farmer can recover the substantial investment on the poultry houses. The end result is often financial ruin.

Although organic poultry production contracts are still relatively rare, farmers considering organic poultry production would be wise to steer clear of production contracts.

**Is anyone else’s approval required before the contract can begin?**

It is not uncommon for a contract to require the approval of someone else—like a lender, a landlord, or a spouse—before the contract can become effective. These so-called “third parties” are not directly involved in the contract but have a close connection to one or both of the contracting parties and generally have something at stake in their operations, often either as a partner or creditor. If such approval is required, make sure to obtain it before taking any significant steps that rely on the contract working out, like purchasing seed, feed, or other

inputs. If approval by a third party does not seem appropriate in your situation, consider asking the buyer to delete that requirement.

**Include Lenders Early in Organic Contract Negotiations**

It is not uncommon for a lender to require a farmer to provide a marketing contract as evidence that the farmer will be able to make payments on a line of credit, mortgage, input lien, or other type of credit arrangement.

Some lenders may not understand organic production, or may be biased against organic farming due in part to the mistaken belief that organic farming is more risky than conventional farming. Lenders that are wary of lending to organic farmers may be concerned about specific contract provisions, like whether the organic pay price for milk will increase if feed prices increase.

Rather than bringing your lender a finalized contract that cannot easily be changed, consider bringing your lender a contract offer prior to signing. That way, you can negotiate with the buyer to incorporate any changes the lender requires. Also, you will be less likely to breach your contract because you cannot fund the input costs required to fulfill your organic contract. Additionally, you may be able to use the lender's requirements as leverage to negotiate a better deal with the buyer.





A requirement for third-party approval of an organic contract could come up if the farmer is required to provide proof of organic certification prior to the contract taking effect. The certification itself, of course, requires a qualified organic certifier (a third party) to issue the certification. If your organic contract requires organic certification prior to the contract taking effect (not just prior to beginning production), be sure to settle the certification issue promptly because neither party is bound to the contract until you obtain certification.

If you have a provision requiring certification prior to the contract taking effect, be sure to keep a record of the date you obtained the certification so that you have proof the contract has begun. It would also be prudent in such cases to notify the buyer in writing of the date you obtained the certification.

### **Does any part of the contract describe you as a merchant?**

If any part of the contract describes you as a “merchant,” the contract is making clear that you are a person who can legally be considered to have a good understanding of the business aspects related to the organic farm product you are selling. A merchant is defined as “a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction.”<sup>2</sup> In other words, merchants are businesspeople who are knowledgeable about their particular business. As a result of this level of knowledge, contract law generally holds merchants to stricter standards than non-merchants and removes some of the formal requirements for sales agreements to make it easier for merchants to quickly make deals, assuming that they are knowledgeable enough about the risks to protect their own interests.

#### **You and the Buyer Are Probably Merchants**

Farmers who regularly sell organic farm products should know that they probably qualify as merchants in organic farm products regardless of what the contract says.

Courts often consider farmers to be merchants if they regularly sell crops and/or livestock.<sup>3</sup> Therefore, it is usually safest to assume that you would qualify as a merchant and to operate according to the more rigorous contract laws that apply to merchants (like the implied warranty of merchantability, discussed on the next page, and the contract formation rules discussed in Chapter 1, pages 1–2 and 1–3). Any buyer who regularly

deals in organic farm products is probably going to be considered a merchant as well.

Even if your contract says you are a merchant, or is silent about whether you are one, there is a small chance a court might later decide that you are not a merchant. Courts have looked closely at the particular facts of each case to decide whether or not a farmer is a merchant.<sup>4</sup> If you are considered to be a non-merchant, some parts of contract law treat you more leniently because they assume you are not a businessperson. Also, some contract formation rules may not apply if you are not a merchant; this could make it more difficult for you to form an enforceable contract with an informal writing (like a purchase order).

Again, though, most farmers and almost all buyers will qualify as merchants under contract law.

#### Implied Warranty of Merchantability

Part of the stricter standards that contract law imposes on merchants is the “implied warranty of merchantability” that often applies when a merchant sells goods. An implied warranty of merchantability is a promise that the goods will conform to the description in the contract and will be of adequate quality. The warranty is “implied” because it exists even if the contract itself says nothing about a warranty of merchantability.

It is possible for a contract to successfully disclaim a warranty of merchantability by specifically stating in the contract that this kind of warranty does not apply. Still, it is unlikely any organic buyer would accept this kind of disclaimer in a contract for organic farm products because quality and organic integrity are highly valued in the organic marketplace.



## THE CONTRACT RELATIONSHIP

The contract provisions discussed in this section describe the nature of the business relationship between organic farmers and buyers.

### **Are the buyer’s contract obligations clear?**

Generally, the buyer’s main obligations are: (1) to accept delivery of the organic commodity under contract; and (2) to make appropriate and timely payments. However, organic contracts vary widely, and buyers may take on additional obligations. For example, buyers might provide inputs or training, agree to market the organic commodity on the farmer’s behalf (especially if the buyer is a marketing organization), or provide support for the farmer’s organic transition and/or certification. Buyers might also cover transportation costs, or agree to certain dispute resolution procedures.

What is most important is identifying and understanding what the buyer is and is not obligated to do. If necessary, consider changing the contract language so that the buyer’s obligations are clear. Be aware that the buyer’s contract obligations may be found in multiple sections scattered throughout the contract.

### **Are the farmer’s contract obligations clear?**

Identifying and understanding your contract obligations is also extremely important. Like the buyer’s obligations, your obligations may be scattered throughout the contract—even under contract headings that seem unrelated to your contract duties. Try to assess whether the contract obligations will outweigh your expected benefits under the contract.

Because contracts are often presented to farmers on a “take it or leave it” basis, and the extent to which buyers are willing to negotiate on specific contracts varies widely, it is wise for farmers considering a contract offer to first determine whether the contract is a deal worth signing as written. The information contained in this guide can help you make that decision, and identify areas for possible improvement through negotiation. Later, if your negotiation attempts are rejected, you will have already made an informed decision about whether you are willing to accept the contract as-is, and you will be able to give the buyer an informed response to the contract offer.

When thinking about potential areas of improvement through negotiation, remember that both farmers and buyers can benefit from making vague or unclear contract language clearer. When the parties expect different results from the same contract, contract disputes are common. Both sides benefit when clarity prevents expensive and unnecessary disagreements.

**Example: Vague Provision**

Seller agrees to use best management practices in performing all aspects of the instant agreement.

It is unclear here what “best management practices” really means. Vague provisions like this one give farmers an opportunity to begin discussions with buyers about what kind of practices are expected. You may discover that vague language is unnecessary and can easily be deleted. Or, when you have clarified what the buyer really means by “best management practices” (or by another vague provision), you can write the clarifying details into the contract.



**Better Example: Vague Provision Clarified**

Best Management Practices: In performing all aspects of this contract, Buyer and Seller agree that Seller will comply with the federal organic regulations (the NOP regulations).

Unlike the example in the box above, this language clearly states that “best management practices” equals compliance with NOP regulations.



The types of organic contract obligations discussed throughout this guide can appear in an organic contract in unlimited varieties and combinations. You can use the guide to help you understand your contract obligations and the potential implications of those obligations.

### **Breach: What happens if the farmer or the buyer fails to fully perform or keep contract promises?**

Failing to keep a contract promise is called “breach.” Generally speaking, if one party breaches the contract, that party will suffer some type of consequence under the contract. Common consequences for breach include: termination of the contract, rejection of goods, and reduced payment.

#### Farmer Breach

Organic contracts often discuss what will happen if the farmer fails to keep contract promises. Some contracts will include specific consequences tied to specific breaches (for example, if you breach the contract by delivering late, the consequence could be a \$100 penalty for each day you are late). Other contracts will include a so-called “blanket breach provision” (discussed further in Chapter 5, pages 5–4 through 5–7) that spells out what would happen if you failed to comply with any provision of the contract (for example, if you commit any breach no matter how minor, the buyer can cancel the contract). Some organic contracts include both specific and blanket breach provisions.



#### Example: Blanket Breach Provision

Breach of Contract: Seller agrees to comply with all terms and conditions herein. If Seller fails to comply with this agreement in any respect, Buyer may immediately declare this contract null and void upon written notice.

Note that this provision is extremely one-sided in favor of the buyer. Only the buyer is given termination power, and only the farmer must promise perfect compliance, with threat of termination for a breach “in any respect.”

Be especially cautious about blanket breach provisions. If something changes for the buyer (the buyer loses a big contract, organic premiums shrink unexpectedly, etc.), and the buyer is looking for a way to get out of the contract, one of the easiest things for the buyer to do is wait for you to make a small misstep and then claim its termination rights under a blanket breach provision.

If You Encounter a Blanket Breach Provision:

- Replace it with a provision that allows termination only for material breach—not for minor breaches. See Chapter 5 for a discussion of material breach.
- If you cannot replace the term with a material breach term:  
Try to get the blanket breach term deleted.

Better Example: Termination Upon Material Breach Provision

Breach of Contract: The parties agree to comply with all terms and conditions herein. If either party commits a serious and material breach of the contract, the non-breaching party may declare this contract null and void upon written notice.



You should also be sure to understand the possible consequences of failing to keep a contract promise, and think about how you would cope if you had to deal with those consequences. If the potential consequences of a breach seem too damaging or risky, think about negotiating less burdensome breach provisions. Consequences of a breach can vary widely, ranging from termination of the contract to payment reduction, rejection of delivery, etc. In the end, if the buyer is requiring consequences for breach that would be too burdensome, consider negotiating new language or finding a different buyer.

Fill the Silence on Farmer Breach

If the contract does NOT state what will happen if one side breaks a contract promise, think about whether you would like to clarify what should happen. Spelling out the consequences of a breach can help avoid a dispute between you and the buyer after a breach occurs. For example, if the contract is silent as to what happens if you deliver product that falls below quality standards, the buyer could decide the appropriate consequence for low-quality delivery is rejection of your entire shipment. In contrast, if the contract states the consequence of low-quality delivery is a 15 percent price discount (not rejection), you are much less likely to lose the entire benefit of your contract and be forced to look for another buyer.

Making the consequences of a contract breach clear can help provide some certainty in case of a breach and help prevent a dispute that could end up in court. Negotiating acceptable consequences in advance can also prevent the buyer from choosing the worst possible consequence if it turns out you cannot keep your contract promises.



When reviewing an organic contract, think through the most likely ways you might be unable to carry out the contract promises. Then figure out whether the contract states what should or will happen if any of those possible breach scenarios occur. If the contract is silent (or unclear), think about negotiating language that spells out what should happen.

### Buyer Breach

Organic contracts are less likely to spell out consequences of buyer breach, perhaps because they are usually drafted by the buyer. Nevertheless, it can be somewhat risky for organic farmers to enter into a contract that is relatively consequence-free for the buyer. Stated consequences for breach can be a powerful incentive for both parties to fully perform their contract obligations. Therefore, consider negotiating consequences for the buyer's breach of its important promises in the contract. For example, if a buyer promises to send payment by a certain date, the contract could impose penalties for late payment.

#### Example: Penalty for Late Payment Provision

Seller shall receive payment within 10 business days of delivery. If Buyer fails to pay by said date, Buyer agrees to pay Seller 1 percent of the contract price for every calendar day payment is late.



### **How can contract terms be changed after the contract is signed?**

Any changes to a written contract should be made in writing. Any changes you do not put in writing will generally not be enforceable in court, even if

the contract says otherwise. See Chapter 1 for a more detailed discussion about forming enforceable contracts.

Many organic contracts will expressly state that the contract cannot be changed except in writing. Some will also require the written amendment to be signed by both parties.

**Example: Modification Only in Writing Provision**

Except as otherwise specified in other provisions of this agreement, the agreement may not be modified or amended except by an instrument in writing signed by both parties.



You should carefully follow the directions set out in the contract for making changes to the contract. At the very least, put everything in writing. Do not rely on promises the buyer makes over the phone or even in person; the contract itself will be unaffected if nothing is in writing. See additional guidance on oral agreements in Chapter 1.



**Send the Buyer a Written Confirmation of Any Contract Changes**

If you and the buyer agree to make a change in the contract terms after the contract has begun, you **MUST** get the change in writing.

An easy way to do this is to send the buyer a letter, fax, or email confirming the details of the change. Include the date of the call or conversation in which you and the buyer agreed to change the terms, and explain all of the details of the new agreement. Make sure to keep copies of all papers related to contract changes.



**Include Provision Stating Contract Can Be Mutually Re-Negotiated During Contract Term**

Mutual re-negotiation is always legally allowed if both parties to a contract agree to change the contract language. However, having a contract provision expressly stating that mutual re-negotiation is allowed can increase the chances that the buyer will actually agree to re-negotiate the contract if needed. At the very least, having mutual re-negotiation language in the contract should prevent a needless dispute about whether the contract can be re-negotiated during the contract term, hopefully focusing the discussion on the pros and cons of changing the contract language.

**Does the contract require exclusivity?**

**Farmer Agrees to Sell Exclusively to the Buyer**

Does the contract require you to sell a particular organic commodity only to the buyer? If so:

- Make sure that the contract includes a reciprocal requirement for the buyer to purchase the entirety of your exclusively produced commodity.
- Make sure that the contract clearly states which organic commodity you are agreeing to sell only to the buyer.
- Make sure that an alternative arrangement exists if the buyer decides for any reason to reject your organic commodity produced for the buyer. You do not want to end up in a situation where the buyer refuses to pay the full contract price and/or rejects your delivery and you cannot sell the product to another purchaser without violating the contract.
- Consider negotiating for a provision that will allow you to sell your product elsewhere (or use your product yourself, like using excess milk to spread on fields) if the buyer rejects your product or refuses to make appropriate payment under the contract.

**Example: Exclusivity Provision**

Seller agrees to provide all organic soybeans produced by Organic Farm to Buyer. Seller further agrees Buyer shall be the exclusive purchaser of Seller's organic soybeans for duration of this agreement.

This provision requires the farmer to sell all organic soybeans produced to the buyer, but does not require the buyer to purchase all of the farmer's soybean production. This could lead to a situation where the buyer refuses to purchase some of the soybeans, but prevents the farmer from selling the rejected soybeans elsewhere.



Adding the following language to the example above would require the Buyer to purchase all of the farmer's soybean production:

Buyer agrees to accept and pay for the entirety of Seller's organic soybean production during the contract term, provided it meets quality standards set forth herein.



Adding the following language to the example on the previous page could protect against a situation in which the Buyer refuses to purchase all of the soybeans the farmer produces, or rejects some portion of the delivery for any reason:

If Buyer refuses to purchase any amount of Seller's organic soybeans for any reason, Seller shall be free to find another purchaser for any soybeans Buyer refuses to purchase.





### Buyer Agrees to Buy Exclusively From Farmer

An exclusivity arrangement can also bind the buyer. For example, the buyer could agree that you are the buyer's exclusive supplier of organic barley for a certain period of time, which would prohibit the buyer from buying organic barley from another farmer for that time period. Generally, buyers would agree to this only if they were confident that one organic farmer could supply all of their product needs.

### **Does the contract state that you are an independent contractor?**

Contracts often state that the parties do not have an employee-employer relationship, that one party is not an "agent" of the other party, or that the parties are not "joint venturers." Sometimes, the contract simply states that one party (probably the farmer in an organic contract) is an "independent contractor." The contract might also state that you and the buyer have a "vendor/vendee" (buyer/seller) relationship.

Under a typical organic marketing contract, these statements will generally accurately describe the farmer-buyer relationship. Thus, as a farmer reviewing an organic marketing contract, agreeing that you are an independent contractor (or a vendee) should not be worrisome. As a seller of goods, you are very unlikely to be an employee or agent of the buyer.

#### Example: Relationship of Parties Provision

NO AGENCY, RELATIONSHIP: The parties to this contract intend to establish a vendor/vendee relationship. Seller is not an agent of Buyer, and neither party is authorized by this contract to act on behalf of the other party. This contract does not form a partnership, licensor/licensee relationship, landlord/tenant relationship, joint venture relationship, employer/employee relationship, or profit-sharing arrangement.



Buyers put these provisions into contracts out of an abundance of caution to easily defeat any arguments about: (1) potential liability, and (2) obligations imposed on employers by federal and state labor laws.

With respect to liability, most states have laws that require an employer to be liable for the acts of his or her employees or agents. This is often termed “vicarious liability.” Therefore, by stating that the farmer is an independent contractor and not an employee or an agent, the buyer is creating evidence to counter any arguments about liability under these laws. Additionally, employment laws create various requirements for employers, such as providing workers’ compensation insurance and unemployment benefits, and collecting payroll taxes. By making it clear that the farmer is not an employee of the buyer, the buyer can protect itself against government enforcement actions or later claims for employee benefits on behalf of the farmer.

**Example: Avoiding Vicarious Liability Provision**

Buyer is not liable for the acts or omissions of Seller; Seller is in all respects an independent contractor and shall not act as Buyer’s agent.



The question of whether someone is an independent contractor or an employee is not determined by contract language alone. Instead, it is a multi-factor test that takes the actual circumstances of the relationship into account.<sup>5</sup> Nevertheless, putting this kind of language in a contract is one way that a buyer could attempt to prove to a court that a farmer is an independent contractor.

**CHAPTER 3 – ENDNOTES**

- <sup>1</sup> See generally Susan E. Stokes, *The Dilemma of Contracting: Risk Management or Risky Business?* (Farmers' Legal Action Group, 2006), available at [http://flaginc.org/topics/pubs/arts/CLE\\_SES.pdf](http://flaginc.org/topics/pubs/arts/CLE_SES.pdf). See also David Moeller, *Livestock Production Contracts: Risks for Family Farmers* (Farmers' Legal Action Group, 2003), available at <http://flaginc.org/topics/pubs/arts/artcfo05.pdf>.
- <sup>2</sup> U.C.C. § 2-104(1) (1977).
- <sup>3</sup> See, for example, *In re Montagne*, 431 B.R. 94, 113 (Bankr. D. Vt. 2010) (determining a dairy farmer is a merchant in all aspects of his mercantile capacity, that is, with respect to goods for dairy farming operations, but not for every purchase of goods).
- <sup>4</sup> See 10 Williston on Contracts § 29:25 (4th ed.), at footnote 9 (May 2012) (“[T]he issue of whether a particular farmer may also be classified as “merchant” within the meaning of U.C.C. § 2-104(1) must be determined on a case by case basis. The court in each case must determine, on the basis of the evidence presented, whether an individual who is considered a farmer also possesses expertise in the area of marketing...sufficient enough to classify him as a “merchant” within the purview of the Uniform Commercial Code.”).
- <sup>5</sup> See *S.G. Borello & Sons, Inc. v. Dept. of Industrial Relations*, 48 Cal.3d 341 (1989) (using a multi-factor test to determine “sharefarmer” cucumber harvesters are employees).