

# 6

# Price, Quantity & Quality

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## CHAPTER QUICK TIPS

### **Always Take Samples For Yourself**

Even if the contract does not require you to submit samples, it is always smart to take and keep samples of your organic products for yourself.

Maintaining reliable samples can help you prevent or settle a quality dispute.

### **Buyers Should Pay for Produce Within 30 Days**

To avoid losing important rights to payment under federal law, farmers who sell produce should require buyers to pay within 30 days from the date the buyer accepts produce.



# PRICE

## How is the base price determined?

Base pricing methods in organic contracts vary widely. Further complicating matters, the base price is usually just the starting point for calculating the price the farmer will actually receive. Farmers must generally factor in discounts, premiums, and potential deductions for cleaning, transport, and other services. Still, the base price will have a big impact on the farmer's overall profit, so it is wise to carefully scrutinize base pricing methods.

For any pricing method, it is helpful to ask the following questions:

- Are the provisions describing pricing and the method of calculating payment clear? If not, consider negotiating clearer language.
- Are any of the payment criteria (such as quantity and quality) out of your control? If so, consider negotiating limitations on the buyer's power to control payment criteria.
- Is the price calculation fixed, or is it dependent on future conditions?
- How do the best- and worst-case scenarios under the contract's pricing method affect the final price at delivery?
- Is the method of calculating payment appropriate for your operation?

## Common Base Price Methods

- *Is the price a flat rate negotiated at the time the contract is signed?*

A flat rate set at the time the contract is signed reduces uncertainty and creates a more certain financial outlook for the farmer by protecting against falling market prices. However, the farmer has

also given up the chance to profit from any increase in market price at the time of sale.

- *Is the price tied to the cost of inputs?*

A base price tied to the cost of inputs can protect the farmer from spikes in input costs, and can therefore be highly beneficial. For example, is the contract price for organic dairy products linked to the market price for organic grain? Does the price the farmer receives increase or decrease as organic feed prices rise or fall?

Prices tied to inputs might be calculated as a set base price plus (or minus) a certain amount based on the cost of inputs. If the base price is linked to the market price of grain or some other input, make sure you understand the linked price calculation and whether it is advantageous for the product you are selling.

- *Is the price determined by the organic market or linked to the organic market price for the product (for example, a certain percentage of the organic market price or the organic market price plus a certain amount)?*

A base price term determined by the market price for the product is not as helpful in reducing uncertainty and protecting farmers from falling market prices. However, it can allow farmers to take advantage of increases in market prices over the course of the contract. Still, organic farmers who agree to contracts with a base price linked to the market for their product should be aware that this kind of price provision requires more detail to avoid uncertainty.

If the contract's price provision is linked to your product's organic market, it is a good idea to include in the contract language about the following:



- Who determines the organic market price for contract purposes (the farmer or the buyer), and how?
- Is the market price tied to an institutional report (such as the USDA Agricultural Marketing Service reports for organic grain, feed, seed, poultry, eggs, and dairy) or tied to another standard?
- When is the market price determined? Timing can significantly affect the price paid.
- What is the geographical boundary of the market? For example, in determining the market price for organic grain,

is the market price the national price, the Eastern Cornbelt price, or the Upper Midwest price?



Example: Vague Market-Linked Price Term

Price Term: Current organic market price feed grade oats plus \$0.55 per bushel.



Example: More Detailed Market-Linked Price Term

Price to be determined based on organic market price for feed grade oats as reported in the bi-weekly USDA Eastern Cornbelt Organic Grain & Feedstuffs Report for the final week of September, 2012.

- *Can the buyer change the base price during the contract?*

If the buyer can change the base price during the contract, the buyer has the power to change the farmer's entire cost-benefit calculation of the contract. Although this is an increasingly common feature of organic dairy contracts with the large dairy buyers, signing a contract that allows the buyer to change the base price during the contract is a risky proposition for any farmer.

**Example: Buyer Can Change Base Price During Contract Term**

Buyer shall pay Producer for organic milk at the Base Price referenced herein per cwt. Buyer may, at its sole option, increase or decrease the Base Price upon 30 days' written notice to Producer. Notwithstanding the foregoing, a decrease in the Base Price of greater than 20 percent shall require Producer's written approval.



If you cannot avoid this kind of provision in your contracts, try to negotiate:

- a reasonable notice period (perhaps longer than 30 days);
- a price floor below which the base price cannot go;
- a requirement that any further downward adjustment to the new base price must have the farmer's written agreement;
- language stating the farmer can cancel the contract without penalty if the farmer does not agree to the lower base price.

**Does the contract include a clearly defined process for earning premiums and taking discounts?**

The final price a farmer receives for organic farm products will almost certainly be linked to the quality and quantity of the products delivered. It is quite common for organic contracts to include premiums for products that exceed set quality levels and discounts for products that fall below quality standards.

Some questions to consider related to premiums and discounts include:

- What are the premium/discount criteria, and who determines when the criteria are met?
- How are premiums and discounts calculated?

- Can you examine the calculations used to determine the amount of premium or discount in order to verify whether the calculation was done correctly?

Be cautious of contract language that allows discounts determined entirely at the buyer's discretion. All premium and discount calculations and criteria should be clearly spelled out in the contract, so each party knows exactly what to expect.



Example: Discounts to Price Term

Discounts will be taken at Buyer's sole option and will depend on the amount of deviation from quality standards at the time of delivery.

If the contract language leaves it to the discretion of the buyer when to take a discount and/or the amount of the discount taken, you may want to consider negotiating a specific discount scale. If you do not want to set a discount scale in advance, you and the buyer could agree to negotiate a discount rate at the time of delivery. However, because farmers are typically in a weaker bargaining position and are less likely to just walk away from a deal when the product is sitting at the buyer's door, waiting could cause you to later agree to a higher discount rate than you might have agreed to at the time you signed the contract.



Example: Price Discounts Negotiated at Time of Delivery

If all or part of the commodity is nonconforming, Buyer may reject all or part of the commodity, or the price may be discounted by mutual agreement of the Buyer and Seller.

## **Can the buyer take price deductions unrelated to quantity or quality?**

Watch out for contract provisions that allow the buyer to take deductions for costs unrelated to the quantity of product delivered, the quality of your product, or even whether you keep your other contract promises.

### **Consider Deleting Language Allowing Deductions for Factors Out of Your Control**

Some organic contracts might include deductions for costs incurred by the buyer “related to the Seller’s contract duties or responsibilities.”

This kind of broad language leaves farmers extremely vulnerable to deductions for a wide range of potential costs that could be deemed “related” to contract obligations, including the buyer’s labor costs for unloading deliveries or the cost of overnighting paperwork.

Seriously consider negotiating the deletion of any contract language that allows the buyer wide latitude to make deductions from the contract price.



## **When will you get paid?**

It is helpful for the contract to include language stating exactly when payment will be made. This reduces uncertainty and ensures the payment schedule satisfies the farmer’s cash flow needs. It can be beneficial to negotiate a payment deadline that is close to the delivery date. Organic contracts vary widely on payment timelines—payment might be prior to delivery, upon delivery, or a certain number of days after delivery.

Contracts may also create conditions that have to be met in addition to delivery before payment will be made. For instance, before getting paid the farmer may be required to request payment, provide an invoice, provide certain certifications, or wait until after inspection, cleaning, or other quality verification (including potential laboratory testing).





**Protections Against Late Payment for Farmers Who Sell Organic Produce:**

If you sell fruit, vegetables, or other produce, and the buyer accepts the produce but fails to pay you (1) fully and (2) promptly, you may be able to recover the unpaid amounts (plus any losses caused by the buyer's failure to pay fully and promptly) by filing a complaint under the federal Perishable Agricultural Commodities Act (PACA). You can file a PACA complaint even if the buyer paid you part of the contract price.

Under PACA, buyers are required to pay the full contract price within the time frames PACA establishes (typically 5-20 days), unless the contract states a different payment deadline.

**\*\*\*IMPORTANT NOTE:**

Farmers who sell produce should avoid entering into agreements extending the time for payment beyond 30 days from the date the buyer accepts the produce.

If a farmer agrees to extend the time for payment beyond 30 days from the date of the buyer's acceptance, the farmer will lose the right to claim payment through PACA's statutory trust should the buyer file bankruptcy or go out of business.

Before agreeing to any payment extension, farmers should consult with an attorney familiar with PACA to determine whether using particular contract language could cause you to lose any rights under PACA. Please see Chapter 12 for more information about PACA rights and complaints.

Try to assess what might be reasonable conditions of payment and what might be too burdensome. Also try to determine how long processes like inspection, cleaning, or testing could delay payment. The bottom line is that you should be able to make an informed decision based on contract language about how long it could take for you to get paid and whether your cash flow needs can be met given the timing of payment.

**Buyer Penalties for Late Payment**

Does the contract provide for any penalties against the buyer for late payment? You may wish to include language that requires the buyer to

pay a cash penalty or take some other action if payments are late. This kind of provision can give a buyer who might otherwise be careless about paying you an incentive to be more prompt with payment.

Example: Penalty for Late Payment

Payment shall be received by Seller within 10 business days of delivery. Buyer shall be assessed a penalty of 1 percent of the contract price for each day payment is delayed.



Laws Providing Protection Against Buyer Non-Payment

Federal Protections: Two major federal laws, the Perishable Agricultural Commodities Act (PACA) and the Packers and Stockyards Act (PSA), provide trust protections for farmers to ensure that there will be money available to pay farmers for agricultural commodities even if the buyer is insolvent, in bankruptcy, or has already used the money for something else. See Chapter 12, pages 12–10 through 12–12, for more information about trusts and other federal protections for some farmers who do not receive full and prompt payment.

State Protections: Some states have agricultural production lien laws to protect farmers' payment rights. Under some circumstances, these laws can provide farmers with a lien on farm products delivered to buyers. These liens are designed to help farmers secure payment from buyers.



**Do Not Let Your Contract Interfere With State Lien Protections**

If you live in a state with farm lien protections, it is a good idea to ensure that your contract does not interfere with your state agricultural production lien rights. For example, you should be very wary of contract language stating that the buyer purchases your organic farm products free of all security interests or liens. You may wish to pay special attention to this kind of language if you are concerned about the buyer's solvency or have had trouble getting paid in the past.

One state lien protection law is the Minnesota Agricultural Producer's Lien Statute, Minn. Stat. § 514.945, which applies to all agricultural commodities except grain and raw milk. California also provides producer lien protection under Cal. Civ. Code §§ 55631-55633 for all agricultural commodities sold to a processor. Check with an attorney licensed in your state to see whether your state has any agricultural lien protection laws.

## QUANTITY

The quantity of organic product under contract can be determined in a variety of ways. It is important to understand exactly how the quantity will be determined for a particular contract and the potential consequences of that type of quantity determination.

### **Is the quantity set at a specific amount of product?**

Does the contract require that you deliver a specific quantity of organic product? For example, is the quantity set at 1,000 bushels of corn, 20 pallets of eggs, or 575 cwt of raw milk per month? This type of quantity term has the benefit of allowing the farmer to know exactly how much product the buyer will purchase at the time of delivery. However, if the contract requires delivery of a specific quantity and your expected output falls short, you could be forced to purchase product on the spot market (or dip into any reserves you might have) to make up the difference. On the other hand, if you have a bumper crop and your buyer is not interested in purchasing your excess output, you may have to look for a buyer on the spot market for the extra production.

### **Is the quantity based on production level?**

Rather than being a specific volume or weight of product, the contracted quantity might be identified as the entire amount of product from a certain number of acres or a certain number of livestock. For example, you could promise to provide the buyer with the entire crop harvested from a specific number of acres. Thus, even if you have a poor crop or a bumper crop, you do not have to worry about either making up for a shortfall or finding a buyer for the excess harvest because you have merely promised to deliver whatever those acres produce.



Example: Quantity Based on Production Level

Buyer will purchase 100 percent of the crop produced from the 50 acres on Seller's property listed as the "Northwest Plot" on the plat attached and incorporated as part of this agreement.

Detailed Descriptions Are Best

If you decide to sign a contract with the quantity based on your production level, make sure the contract includes a detailed description of the crop acreage or the livestock covered (and the fact that the contract is for an organic product). A precise description for crops would include the type of crop, the number of acres, and the legal description or identification of the land on which the crop is grown. For livestock, a description might include the type and number of animals, the location where they are being raised, the identification of a specific flock or herd, or (if the specific animals are tagged, branded, or otherwise individually identified) a list of the tags or identifying marks. You do not want to end up in a dispute with a buyer over which fields your wheat was supposed to be harvested from or which animals were supposed to be sold for slaughter—especially if some fields' production or some animals result in losses or are of poor quality.

Be Cautious About Written Production Estimates

It might seem reasonable to estimate the expected production from the acreage or livestock covered by the contract, and to record the estimate in the contract. However, this can be risky. If your output far exceeds expectations, or if the market price drops far below the contract price, the buyer might refuse to take delivery of anything more than the estimated amount stated in the contract. To protect yourself, you could include language clearly stating that the buyer agrees to purchase your entire production, even if it is significantly different from any estimate. As a further protection, you could give your estimate as a range. For example, instead of stating that you estimate 30 bushels to the acre, you could state that you estimate 25 to 35 bushels to the acre. Alternatively, you could consider keeping your estimates out of the contract itself.

### Can the Quantity Be Changed During the Contract?

Watch out for contract language giving the buyer the right to change the quantity during the contract. This kind of provision can be very risky if you cannot find another buyer for any surplus resulting from the change or do not have enough of your own production to cover an increase and have to make purchases on the spot market to meet your new contract obligations.

Provisions allowing changes in quantity are rarely seen outside contracts requiring frequent deliveries throughout the life of the contract, such as those for eggs, dairy, and livestock. At the very least, quantity change provisions should be accompanied by a significant notice period that may allow the farmer to adapt to the new required quantity.

#### Example: Seller Able to Decrease or Increase Quantity

Buyer retains the right to decrease or increase the agreed quantity. Buyer will purchase by up to 10 percent upon 60 days' written notice.



If you are presented with a contract provision allowing the buyer to decrease the contracted quantity, you should consider whether the contract would still be worth signing if a quantity change occurred—and whether you could find another market for your excess production.

Similarly, if the contract allows the buyer to increase the quantity, you should consider whether the contract would require you to deliver that additional amount even if your production level or yield is not high enough to cover it. Put another way, think about whether the contract could require you to purchase additional product to fulfill an increased contract quantity.

### Can the buyer manipulate the quantity after delivery?

Often, buyers will pay farmers based on the amount and quality of the organic commodity delivered. In some situations, such as when a buyer has received more of a particular commodity than it has demand for, the buyer may not want to pay for the full quantity delivered even though

it was called for by the farmer's contract. In this situation, some buyers may attempt to manipulate the quantity measurement.

To limit this kind of activity, the farmer could try to negotiate contract language allowing the farmer to be present when the delivered commodity is weighed (either in person or electronically through videoconference technology) or requiring the weight to be certified by a neutral third party. The parties could also agree that the commodity will be weighed before delivery to the buyer and that an official weight certificate (such as an Official Grain Weight Certificate authorized by the U.S. Grain Standards Act) will be provided to both parties.<sup>1</sup>

The quantity of organic commodity delivered could also be manipulated through quality determinations. For example, the contract might require a premium price for any bushels in excess of 75 bushels. Let's say the farmer delivers 100 bushels. Based on the contract, the farmer would expect a premium price for the 25 extra bushels. However, a buyer who is not interested in paying for that many bushels might argue that quality problems with the delivery bring the useable quantity below 75 bushels, and therefore no premium price is applicable. For an in-depth discussion of quality standards and organic contracts, please see pages 6–20 through 6–29 of this chapter and Chapter 12, pages 12–26 and 12–27.

Finally, handling practices for commodities such as grains, beans, and seed might allow the buyer to manipulate quantity by increasing the stringency of cleaning procedures, as discussed below.

### **Does the contract require cleaning or “cleanout”?**

If the contract requires cleaning of the product, be sure that the contract clearly answers the following questions:

#### **Who Pays for Cleaning?**

If cleaning is required, the contract should clearly state who is responsible for the cleaning costs. If you are required to pay for cleaning, make sure to factor that cost into your overall profit calculation.

**Example: Producer Must Pay for Cleaning of Commodity**

Any cleaning and/or processing required to remove foreign material from delivered commodity shall be conducted by Buyer at Producer's expense.



Cleaning provisions often require the farmer to pay for cleaning but place no cap on the total cost the farmer could be charged. Be wary of contract language that gives the buyer too much discretion over how much the buyer could charge you for cleaning.

For example, if you agree to pay for “all costs buyer incurs related to the cleaning required for commodity to meet quality standards,” you could end up responsible for a large sum. This is so because: (1) you cannot control the costs of the cleaning process; (2) you cannot control the wage paid to workers for the cleaning; and (3) costs “related” to the cleaning is a very broad category, allowing costs that might not be directly part of the cleaning process.

**Better Examples: Cleaning (Buyer Pays, Price Cap)**

The cost of cleaning shall be borne by the Buyer and shall not be deducted from the price paid to Producer.

**Or:**

The cost of cleaning shall be borne by the Farmer, but no more than the actual cost of cleaning incurred by Buyer, or \$.50 per bushel, whichever is less.



**Who Takes the Loss if the Organic Product Is Damaged During Cleaning?**

Ownership during cleaning will likely determine who takes the loss if the organic product is damaged during cleaning. If the farmer owns the product during cleaning, and the product is damaged, the farmer could



suffer significant losses. Thus, you may wish to negotiate a contract provision stating that the buyer bears the risk of loss for damage to organic product during cleaning, meaning that the buyer cannot charge you for any damages caused by cleaning processes.



Example: Buyer Bears Risk of Loss During Cleaning and Other Handling

Buyer shall bear the risk of loss for any damage to the organic product that occurs during cleaning, processing, storage, or other handling activities conducted by Buyer.

How Clean Is Clean?

It is important to know how thoroughly the buyer will clean your commodity. This is important because if two buyers offer the same price for a bushel of grain, but one buyer has a higher standard for what “clean” means, you could end up with a smaller payment from that buyer because the amount of cleaned product will be smaller.

Think about whether you could use the contract to help control the level to which your product is cleaned. For example, the buyer could agree to allow you to be present to observe the cleaning process. Alternatively, if the cleaning process is mechanical, perhaps you and the buyer could agree on settings for the machines. Or, the contract could set out that you will test the product before delivery and that cleanout dockage will be no more than test results indicate.

In a variation of the situation described above, be cautious if one buyer is offering a significantly higher price than all of the other buyers. That buyer might be attempting to attract farmers with the high price, but might also have a much higher cleaning standard, meaning farmers will not end up receiving the benefit of the advertised higher price. Consider asking other organic farmers who produce similar commodities about their experience with your potential buyer.

Will the Buyer Clean Instead of Rejecting?

One way cleaning could operate in the farmer’s favor is if the farmer can negotiate a provision allowing cleaning of a low-quality product in place

of rejection. Instead of an all-out rejection if a delivery fails to meet quality standards, the buyer could agree to be responsible for cleaning the product to raise the quality (assuming this is possible, such as for some grains, beans, and seeds). However, if the farmer agrees to pay for cleaning that will be arranged for or performed by the buyer, it is advisable to set a price limit for the cleaning.

To put a limit on possible cleaning costs, the farmer could agree that the buyer will clean a low-quality delivery to higher quality standards in place of outright rejection, but that the cost will be no more than a certain dollar amount per pound, bushel, ton, or another unit of measurement. In this way, the costs the farmer could incur are limited by the quantity delivered, which gives the farmer more control over how much might have to be paid for if cleaning becomes necessary.

**Example: Cleaning in Lieu of Rejection**

If the contracted crop falls below quality standard outlined herein, Buyer may reject, or, in Buyer's discretion, deduct the costs related to cleaning the crop so that it meets quality standards, and to reduce the purchased quantity of the crop by the amount of cleanout resulting.



**Example: More Limited Cleaning in Place of Rejection**

If necessary, Buyer may clean the delivered crop to meet quality standards outlined herein. If significant cleaning is necessary, Buyer will obtain Seller's permission before proceeding to clean the crop. However, Seller will receive a \$1.00 per bushel deduction for any cleaning services performed by Buyer.



**Who Owns the Cleanout?**

The contract should also clearly state who owns the “cleanout.” “Cleanout” is the portion of the delivery that is removed during the

cleaning process and can be quite valuable. If the farmer owns the cleanout, the farmer may be able to sell the cleanout directly to the buyer because it can often be further cleaned, leaving a small portion of higher-value commodity.

Farmers who could profit from cleanout should address cleanout in their contracts. It could be helpful to include language stating:

- Who owns the cleanout.
- Whether there is an option for the buyer to purchase the cleanout.
- Whether the buyer agrees to purchase the cleanout and at what price.

Additionally, it is important to confirm that the cleanout will remain an organic product, and to require that all cleaning activities be conducted in certified organic handling facilities.

Some cleaning methods might damage the cleanout to the point that it is no longer saleable. If you are worried about this, you could negotiate contract language requiring the buyer to either maintain the cleanout in saleable condition to be returned to you or to purchase the cleanout (regardless of condition) at a mutually agreeable price. Alternatively, the buyer could agree to use a different cleaning process that would not damage the cleanout.

**Better Examples: Cleanout**

Grower shall own cleanout. However, Buyer reserves the option to purchase cleanout at 30 percent of the contract price. Buyer agrees to maintain cleanout in a saleable condition, and further agrees to maintain cleanout as a certified organic product. If Buyer does not exercise option to purchase cleanout, Buyer shall return cleanout to Grower in good condition.

Or:

Buyer agrees to bear reasonable cleaning costs and to purchase cleanout at a price to be agreed. If the parties cannot agree on a price, cleanout shall be returned to Grower in saleable condition.

**Does the contract include a utilization clause or a quota option?**

Utilization clauses and quota options will likely apply only to contracts for organic milk.

Utilization clauses state that a farmer will be paid different prices based on the percent of organic milk sold in the organic or conventional markets. For example, a buyer might pick up 20 cwt of a farmer's organic milk. The farmer will not know what price will be paid for that milk until the buyer attempts to sell the milk into the downstream milk market (that is, to a processor). At the end of the day, the buyer may be able to sell 75 percent of the farmer's milk as organic, but may end up selling 25 percent of the milk as conventional milk. In this scenario, under a utilization clause the farmer will receive an organic price for only 75 percent of the 20 cwt (15 cwt) and will receive the lower conventional price for the remaining 25 percent (5 cwt).

Quota options allow buyers to put a cap on the amount of product they will accept from farmers (even if the buyer normally purchases farmer's entire production). In an oversupplied market, such as during the 2008-2009 organic milk surplus, quota options allow buyers to avoid being locked in to purchasing farmers' entire production.



**Quota options are generally less harmful to organic dairy farmers than utilization clauses, especially if:**

1. The buyer agrees to provide the farmer with enough notice before exercising the quota option so that the farmer can decrease production, and
2. There is a floor level below which the quota cannot be set and which is acceptable to the farmer, and
3. The buyer agrees that the farmer can use milk in excess of the quota in any way the farmer chooses, such as making cheese or using the milk as fertilizer.

Utilization clauses are risky because the farmer cannot control the buyer's sales efforts, and because it is hard for the buyer to keep track of exactly how one farm's milk is used when there is so much commingling of milk during bottling and processing.

If you must agree to a utilization clause, try to negotiate language that limits your exposure. For example, you could agree that for any given period, the buyer must pay the organic price for at least a set percentage of the milk delivered (for example, 85 percent).

## QUALITY

### **What are the quality requirements?**

Quality issues can be some of the most contentious in any farmer-buyer relationship. This can be especially true for organic farmers and buyers because organic integrity is taken so seriously in the organic market. Organic products are “credence goods” (also known as “trust goods”). Credence goods have attributes that buyers cannot directly evaluate. Instead, buyers must trust that the farmer has followed organic production practices; it is difficult or impossible to determine the integrity of an organic farm product simply by examining the product or even by testing it.<sup>2</sup>

Disputes over product quality generally occur when the buyer and the farmer do not agree about either how quality will be tested or what the test results mean. Consequently, clearly defining the quality requirements and the quality determination process can help prevent quality-related contract disputes.

Note that some buyers might require written documentation related to quality and organic integrity in connection with deliveries of organic farm products. See Chapter 7, pages 7–9 through 7–12, for a discussion of documentation related to organic commodities.

### **Is quality measured using objective standards?**

Buyers generally assess the quality of organic farm products by evaluating certain criteria—such as color, size, weight, protein levels, brix, moisture, somatic cell count, etc. Although there are a wide variety of criteria for evaluating organic commodities, every organic farmer can assess the criteria that will be used for their product by looking for one element: objectivity.

If organic quality criteria are measured by “objective” standards, the standards exist independently of individual perception or preconceptions. Put another way, when measuring a certain criterion (for example, weight) using an objective quality standard, two individuals conducting separate measurements of the same commodity would be expected to reach the same conclusion.

An example of contract language that measures quality using an objective standard could be, “All cucumbers delivered must be at least 5 inches in length.” Here, the quality criterion is length, and the standard is a set number of globally recognized units of measurement (inches). Thus, if a farmer and a buyer separately measure the same cucumber, they are likely to reach the same decision as to whether the cucumber is at least 5 inches long.

In contrast, an example of contract language that measures quality using a standard that is not objective could be, “Buyer will only accept delivery of ‘large’ organic cucumbers.” This standard is not objective, because two people assessing the same cucumber could easily come to different conclusions about whether the cucumber is actually “large.” The meaning of “large” is not tied to any objective measurement; it is instead a highly unpredictable subjective assessment tied to individual perception.

### **Aim For Objective Quality Standards**

Objective quality standards are important for farmers because buyers often test quality outside the farmer’s presence. Objective quality standards make the quality assessment process more predictable for the farmer.

Therefore, if the organic contract does not measure quality using objective standards, consider negotiating for more objectivity. If the quality measurements for your organic farm product are inherently subjective, or if the buyer is unwilling to agree to an objective standard, consider negotiating contract language that allows you to be more involved in the quality testing process.



### **Who will conduct the quality test?**

It is important to think about who will be conducting the quality assessment (the farmer, the buyer, or a third party). The person who conducts the quality assessment often has significant control over the outcome. Consequently, a farmer might understandably be concerned if a buyer has total control over weighing, grading, testing, or cleaning the farmer’s organic farm products, because the assessment might be more likely to favor the buyer. You might be even more concerned about your buyer having total control over the quality assessment process if the

quality criteria are hard to measure or the criteria are measured using standards that are not objective. At the end of the day, quality assessments often have a big impact on how much money farmers earn under organic contracts.

If the buyer is conducting the quality test, as is often the case, it is most important to try to negotiate objective quality standards, as discussed above. In addition, try to include contract language that will act as a “check” on the buyer’s total control over the quality assessment. For example, the farmer and the buyer could agree that the assessment will be conducted in the farmer’s presence. Or, the farmer could agree that the commodity will be weighed or graded by an independent third party. The contract could also create a quality dispute resolution process if the parties cannot agree on a fair assessment (see page 6–25 of this chapter).

In sum, it is possible to design a quality assessment process that does not give the buyer total control. You can be creative in negotiating a solution that works best for your situation and particular organic commodity.

### **Are the quality testing conditions clearly defined?**

In the organic contract context, quality testing can present a number of issues for farmers. However, many difficulties can be prevented if the farmer and the buyer clearly spell out the conditions of quality testing in the contract.

#### **Will the Test Be Conducted by the Farmer, the Buyer, or a Third Party?**

Usually, farmers will not be conducting quality tests. Independent third-party lab tests are also relatively uncommon as a first test due to their expense. Thus, if the buyer is conducting the quality test, as is typically the case, consider whether you wish to negotiate protections to ensure testing fairness.

For example, you may wish to negotiate language stating that quality testing must be conducted by someone who has experience in using the necessary test and who will follow proper testing protocol. User error is a concern for all tests, but it is even more of a concern outside of a laboratory setting. For example, GMO strip tests can be compromised if they are conducted without proper procedures, such as being performed in windy conditions or too close to known GMO crops. If the person conducting the test fails to observe proper procedures, you could end up with an unwarranted rejection that could be both costly and time-consuming.



### Who Will Pay for the Test?

Quality testing can be a significant expense, especially if the test samples are numerous or multiple tests are needed. Therefore, it is recommended that the contract specifically state whether the farmer or the buyer will bear testing costs. Some organic contracts require the buyer to pay for any initial testing, but may shift all or part of the cost burden to the farmer if the farmer requests independent third-party testing for any disputed test results.

### Where Will the Test Be Performed?

Quality testing can be performed at a variety of locations, including the farm, the delivery site, the buyer's facility, or a laboratory. From the farmer's perspective, it might be most desirable to test at the farm, where the farmer can better supervise testing and the organic commodity has less exposure to contamination. However, if the buyer will not agree to test at the farm, you may wish to negotiate contract language that requires the buyer to test under certain conditions, such as in a sterile environment or away from non-organic and GMO commodities.

### When Will the Test Be Conducted?

As mentioned above, from the farmer's perspective, it may be most desirable to quality test the commodity before it leaves the farm. The second best option is to perform testing as soon as possible after the shipment leaves the farm. In general, the longer the organic product has been away from the farm, the more opportunity there is for contamination, commingling, physical damage, spoilage, etc. Timeliness is especially important for perishable goods like produce and meat. Furthermore, it is risky to allow any test for contaminants like GMOs or pesticides to occur after cleaning or processing because the machinery used in those processes could be the source of contamination.

Consider placing a specific time limit on any required quality testing, either measured in units of time (hours, days) or in relation to stages of production (immediately upon delivery, prior to processing, etc.).

### What Are the Test Criteria?

The contract should state exactly what quality criteria (for example, moisture, protein, somatic cell count) or contaminants (such as GMOs or pesticides) are being measured by the test. The contract should also clearly state the level above which (for contaminants) or below which (for desired traits) the delivery will be rejected and any other important measurement levels related to test results, such as premium or discount

levels for various qualities or contaminants. It is risky not to clearly set out rejection, premium, and discount levels in the contract.

### What Test Documentation Is Required?

You may wish to negotiate contract language requiring the buyer to send you documentation of any quality test results. You might also require documentation of the testing process itself, through real-time photography, video, or other means.

### **Does the contract require you to take product samples?**

If the organic contract requires you to take samples, make sure you understand exactly how many samples should be collected, what size they should be, how they should be packaged and labeled, where and when they should be taken, and whether the samples must be shipped to the buyer or a third party. Be sure to clarify any uncertainties in the contract language before signing.

You might be required to send a sample to the buyer and receive approval before delivering your organic commodity. Consider keeping “copies” of all samples you send (that is, additional samples taken at the same times from the same locations).

#### Example: Farmer Required to Submit Product Sample

Seller agrees to deliver a representative five-pound product sample from each storage unit within a reasonable time after harvest. Buyer will test samples immediately upon receipt. Samples must be clearly labeled with Seller's identity, lot number, and the number of storage units per lot.



**Always Take Samples for Yourself**

Even if the contract does not require you to submit samples, it is always smart to keep samples of your organic commodity for yourself. Maintaining reliable samples can help you prevent or settle a quality dispute with the buyer, as can good recordkeeping and photographs.

**Is there a quality dispute process?**

It can be extremely helpful to have a contract provision detailing what will happen if you disagree with the results of the buyer's quality assessment. For example, if the buyer receives a delivery of your organic farm products and claims that the quality is below the standard required in the contract, can you dispute this assessment? If so, how would you and the buyer resolve the dispute?

Think about whether, if a dispute occurs, you and the buyer might wish to identify a third party (such as a laboratory or an independent expert in the particular organic commodity) who could conduct a "tiebreaker" quality assessment. You and the buyer could agree to abide by the results of the third party's test. It is important, however, to choose a third party that both you and the buyer trust to be independent and neutral. Also consider agreeing in advance how a third-party quality assessment will be paid for.

**Example: Independent Laboratory Testing**

Should a quality discrepancy or dispute arise between the parties regarding a particular sample or delivery, either party can request the sample be tested by an independent, qualified laboratory. The parties shall bear the expense of the test equally.

### Access to Samples

In addition to keeping your own duplicate samples, as recommended above, you may wish to negotiate contract language that allows you to have access to any samples that the buyer determines to have “failed” the quality test. You can then perform your own quality test on those samples, or send them to be tested by an independent third party. Make sure to keep good records of any tests that you conduct.

### Timing of Quality Issue Notifications

Consider setting time frames within which: (1) the buyer must notify the farmer that the buyer believes there is a quality issue, and (2) the farmer must dispute the buyer’s quality assessment. Ideally, the buyer would notify the farmer shortly after delivery, and the farmer would have a reasonable amount of time to dispute the buyer’s quality assessment.

### Keep Your Product Separate While a Quality Dispute Is Ongoing

Consider including contract language requiring the buyer to keep your product separate from the other farmers’ products while a quality dispute is ongoing. This is most applicable to crops that are often mixed with other farmers’ products during shipment, storage, processing, or other handling (such as grain or milk). It is very difficult to dispute a test result you do not agree with if your product cannot be identified.



**Example: Quality Testing and Dispute Resolution**

Buyer shall conduct quality testing inside Buyer's facility within two business days of delivery. Buyer shall notify Grower of any test results within one business day of testing; Grower shall be allowed three business days to object to test results. If Grower objects, Buyer may retest once and/or send samples to XYZ independent third-party laboratory for a final test. Grower and Buyer agree that the laboratory test results shall be final.

Grower and Buyer shall bear the cost of laboratory testing equally, and Grower shall have access to test samples at all times. Buyer shall maintain the integrity of Grower's delivery until such time as any quality dispute is resolved.

**What are the consequences of poor quality?**

It is important that the consequences of delivering low-quality product be clearly spelled out in the organic contract. In addition to helping the farmer decide whether the contract is worth signing, detailing the exact consequences of poor quality will give both parties certainty as to what will happen if quality falls below contract standards.

One of the most common consequences of a low-quality product is buyer rejection. It is helpful for the contract to state whether a delivery, if rejected, must be rejected in its entirety, or whether the buyer has the option to accept a portion of the delivery and reject the rest.

Additionally, the contract should set a specific time frame for buyer rejection. Be careful with contracts that use vague language to describe the time frame for rejection—like “reasonable” or “acceptable.” This is especially important if the organic commodity must be rejected in a short period in order to allow for potential resale (such as for perishable commodities), or if you are worried about contamination or infestation occurring at the buyer's facility.

**Example: Rejection for Failure to Meet Quality Requirements**

After a reasonable time for inspection and evaluation of the conformity of product to the minimum quality requirements stated herein, Buyer shall have the option to reject either the entire shipment or a portion of the shipment. In the event of material nonconformity, Buyer may also declare the contract null and void.



Consequences of poor quality can also include:

- dockage or discounts,
- a requirement that the farmer refund payments the buyer has already made,
- a requirement that the farmer reimburse the buyer for the costs of shipping and handling the rejected product when sending it back to the farmer, or
- a requirement that the farmer compensate the buyer for the cost of obtaining replacement organic product.

Consider how these requirements could cut into your potential profits and whether they make the contract too risky for you to sign.

Some organic contracts require the buyer to provide a written explanation of reasons for rejection or evidence of the basis for rejection (for example, photographs or test results). This kind of provision can provide farmers some protection against baseless rejection.

**Who is responsible for poor quality?**

Organic contracts often include a statement that the farmer is wholly responsible for the quality of the organic product, and that the buyer cannot be held liable for the farmer's inability to meet contract standards. This kind of statement may sound reasonable on its face, but might not be fair if the quality is not tested until the organic commodity has been in the buyer's control for some time. Consider negotiating language changing such a statement to include a limitation on the farmer's responsibility

once the commodity has passed into the buyer's control. See Chapter 7 for a discussion of ownership, liability, and control during the transportation and processing stages.



Example: Shifting Risk of Loss to Buyer Upon Delivery

Seller bears risk of loss and responsibility for quality of the organic product under contract up to the moment of delivery at Buyer's facility; at that time the risk of loss shifts to Buyer.

**CHAPTER 6 — ENDNOTES**

<sup>1</sup> See 7 U.S.C. §§ 71-87 (2012).

<sup>2</sup> See Miriam Berges and Karina Casellas, *Quality Warranties and Food Products in Argentina: What Do Consumers Believe In?*, at 4 (International Association of Agricultural Economists Conference, 2006), available at <http://ageconsearch.umn.edu/bitstream/25526/1/pp061249.pdf> (noting the existence of a market for credence or “trust” goods is either made possible by: (1) the reputation of the seller; or (2) a third-party quality guarantee, “often in the form of a regulation which provides consumers with a substitute for the information and trust they lack”).