



This presentation is part of an educational modular program designed to provide new and beginning farmers and ranchers with relevant information to initiate, improve and run their agricultural operations

**This program is funded by the
Beginning Farmer and Rancher
Development Program (BFRDP)**

USDA-NIFA-BFRDP 2010-03143



United States Department of Agriculture
National Institute of Food and Agriculture



CONTRACTING ISSUES IN AGRICULTURE



Disclaimer

- This presentation is intended to provide general information about contract and commercial laws and should not be construed as providing legal advice.
- It should not be cited or relied upon as legal authority.
- State laws vary and any attempt made to discuss laws of states other than Arkansas is for general information to help the viewer better understand Arkansas law.
- For advice about how these issues might apply to your individual situation, consult an attorney

Objectives:



- To understand what makes a valid contract.
- To understand basic principles of contract law.
- To understand when the Uniform Commercial Code (UCC) applies to agricultural contracts.
- To review common clauses found in a producer contract

Overview

- Producers rely on contracts for:
 - Purchasing of inputs
 - Sell commodities
 - Lease property
- Contracts can be a risk management tool
 - Producer can secure future prices of inputs
 - Producer can secure sale price of commodity

In order to be valid, contracts should conform to Arkansas legal requirements



Contract elements

In order to be valid, a contract must contain:

- An offer
- Acceptance of the offer
- Consideration
- Performance



Offer

- An “**offer**” is a statement of terms that the person making the offer is willing to enter into a contract
 - For example, farmer A offers a buyer that he will sell 3 dozen eggs for \$4.00/dozen



Acceptance

- An “**acceptance**” is an expression either verbally or by implication that the offeree is agreeing to the terms of the offer and forming a binding contract.
 - For example, Buyer says yes he is willing to buy the farmer A’s eggs at \$4.00/ dozen

•But, in the case that the offer stated:
“Buyer must accept by email before 9am” and
the Buyer responds by calling A at 8:30am

- In this case it is up to farmer A to decide
to accept the Buyer’s acceptance
because it did not conform with the offer



Counter-offer

- A “**counter-offer**” is when the offeree (person that receives the offer) makes changes to the original offer and presents them to the offeror (the farmer in this case)
 - For example, the buyer offers farmer A to buy the 3 dozens of eggs for \$3.75 each (instead of the original \$4.00 dollars)
- Now the farmer has to decide whether to accept this counter-offer or not



Consideration

- **“Consideration”** is anything of value given up by the offeror to the offeree in exchange for something of value
 - The exchange can be money or not performing an act which the offeror/offeree has the right
 - For example, farmer A's consideration would be not selling the eggs to somebody else or rising the price, once they have agreed on a deal (even if farmer A could get the original \$4.00/ dozen)



Performance

- Once an offer, acceptance, and consideration are made, then both parties must perform their obligations under the contract
 - For example, the egg contract has been accepted by the buyer. When farmer A hands the 3 dozen eggs and the Buyer pays \$3.75/dozen, performance of the contract has occurred



Other valid contract requirements

- In a limited number of situations, even a contract meeting the 4 requirements may be found invalid
- **For example, a contract is invalid when:**
 - One of the parties does not have the capacity to enter into a contract
 - The subject matter of the contract can not be legally contracted



Capacity to contract

Both parties involved must have capacity to contract, meaning each has the legal ability to enter into agreements

- Generally, adults have the capacity to legally enter into a contract
- There are some cases when an adult may not have the capacity to contract

Groups generally without capacity to enter into a contract are:

- Minors/children
- Mentally disabled
- Those under the influence of alcohol or drugs at time of contract
- Those under duress at time of contract (duress is the use of a threat that causes you to enter into the contract)
 - For example, farmer A holds a gun to Buyer's head and "offers" to sell the eggs at \$4.00. Buyer accepts because Buyer fears for his life.

Legally Contracted For

- The subject matter of the contract must be something that can legally be contracted for under state law.
 - For example, a contract to sell 3 dozen eggs can legally be contracted

Examples of subject matter that could not be legally contracted for, are:

- Contracts that violate a criminal law, such as a contract to sell stolen property
- Contracts that violate public policy, such as gambling contracts



PROPER FORM: A WRITTEN CONTRACT OR AN ORAL CONTRACT?



Proper form

- Oral contracts are permitted, but certain times written contracts will be required by state law
- A contract must be in the proper form that state law requires



When is a written contract required?

- Written contracts will be required in certain situations by **Arkansas' "Statute of Frauds"**
(ARK. CODE §§ 4-59-101 to 4-59-103)
- Statute of frauds - in order for certain contracts to be valid they must be in writing



Statute of frauds

Contracts required to be in writing per the Statute of frauds:

1. Sureties (promising to pay the debt for a third party, if the third party fails to pay)
2. Contracts for executor of estate to pay debt of the estate (similar to a surety)
3. Contracts for the consideration of marriage
4. Contracts for the sell of an interest in land
5. Leases for a term longer than one year
6. Contracts that can not be performed within one year of making the contract (SEE NEXT SLIDE)

ARK. CODE § 4-59-101(a)(1)-(6).

Contracts that cannot be performed in One-Year

Contracts which cannot be performed within one year of making the contract:

- Contract that require deliveries or payments in intervals for more than 1 year
 - For example, farmer A agrees to deliver eggs to the buyer for the next 3 years. This cannot be performed in one year and would fall under the statute of frauds, and thus a written contract is required
- Lifetime contract would generally not be a contract that cannot be performed within one year
 - Reason is a life could end at any time and could within the one year of making the contract.

Statute of frauds requirements

If entering into 1 of these 6 types of contracts, you will need to meet 2 requirements:

1. Contract will need to be in writing
 - A form which captures the essential terms of the contract
2. Contract will need to be signed by both parties





Exceptions to the statute of frauds

1. Full performance exception

- If one party has fully performed, then the contract is now outside of the statute of frauds and does not need to be in writing

2. Part performance with the sale of land

- Change in possession of property and improvements made by the buyer or renter

3. One party's reliance on the other party's statement that the statute of fraud requirements have been met

Written vs. oral contracts

- Oral contract is legally binding except when the statute of frauds applies
 - Parties are more likely to forget what was agreed
 - No written record of terms
- **Best business practice - demand a written contract over an oral contract**
 - Provides both parties with a written record of the terms
 - Easy to prove existence of contract when written
 - Ensures compliance with the statute of frauds



BASIC CONTRACT LAW PRINCIPLES



Basic principles

Always read and understand the entire contract before signing

- Contracts establish the parties rights and duties
- As an investment to avoid future litigation costs, consult an attorney if you do not understand any language in the contract



Basic principles

Make sure the contract reflects all negotiations

- In Arkansas, the general rule is absent of fraud, accident, or mistake, the written contract extinguishes all prior and contemporaneous negotiations and verbal agreements
- Before signing, make sure all negotiations are included, or include in a separate writing that amends the current contract



Basic principles

Negotiate terms that protect your interests

- Farmer will typically be presented with contract written by supplier/buyer and this contract will protect only the supplier/buyer's interests
- Farmer should negotiate to include terms that also protect their interests



Basic principles

Payment disputes or “accord and satisfaction”

- **“Accord and satisfaction”** – is when one or both parties are having a dispute over how much is owed under the contract and create a new contract for the discharge of the amount owed
- The dispute must be in good faith and one party has to agree to receive payment of an amount less than owed under the contract
- A new contract can be created by one party cashing a check for a lower amount clearly marked “Full Payment”



Basic principles

Accord and satisfaction (cont.)

- For example, farmer B and Buyer are having a dispute over how much is owed for livestock sold under contract to Buyer.
 - Buyer sends Farmer a check for an amount lower than what the Farmer believes he is owed
 - The check is clearly marked “Full and Final Payment.”
 - If the farmer B cashes the check, the farmer is agreeing to this arrangement and this would be an accord and satisfaction.
- If such a dispute arises, the parties should consult an attorney to discuss their legal options to receive or pay the amount the party believe is owed



BREACH OF CONTRACT REMEDIES



Contract remedies

- Typically a court will reward monetary damages when one party breaches a contract
- Courts prefer to award monetary damages, but in limited circumstance will award “**specific performance**” or ordering the breaching party to perform
 - Specific performance is typically only awarded when monetary damages will not make the non-breaching party whole
 - For example, Seller agrees to sell Blackwood Farm, but Seller breaches contract. A court could order Seller to convey title, because land is viewed as unique and monetary damages will not make the non-breaching party whole

Contract remedies

Types of monetary damages:

1. **Expectation damages** – the foreseeable damages an injured party could expect had the contract not been breached
2. **Reliance damages** – damages awarded based on the non-breaching party's reliance on the contract
3. **Restitution damages** – damages awarded to prevent the non-breaching from unjustly enriching the breaching party
4. **Liquidated damages** – when drafting the contract, the parties can agree on a specific amount or a formula to determine the amount of damages to be paid if one party breaches the contract

Contract remedies

Monetary damages will be limited to the amount that makes the non-breaching party whole

- For example, farmer A experiences \$500 worth of damages because the feed company did not deliver the feed as indicated in the contract (breach of contract). Farmer A could seek \$500 in damages from Farmer A, but not \$501
- Courts will rarely rule monetary damages for the breach of contract to punish the breaching party

It is important to consider that the non-breaching party might not be able to recover losses that could have been mitigated or avoided if some actions had been taken

- For example, if farmer A had obtained feed from other source or replaced them with another product, maybe the losses wouldn't have been as substantial.





BASIC PRINCIPLES OF COMMERCIAL LAW

Uniform commercial code

- Commercial law governs commercial and business transactions
- Commercial transactions in Arkansas are governed by the **Uniform Commercial Code (UCC)**
- Article 2 of the UCC applies to the sale of **goods** for more than \$500

Goods

- Broadly defined to include all things movable and identifiable to a contract for sale
- It includes growing crops and unborn livestock
- Do not include information or money



Missing contract terms

The **Uniform Commercial Code (UCC)** provides solutions when the parties may have forgotten to include a specific term that speaks to their current situation

The **UCC** allows courts to look at the “course of dealing,” the way the parties have acted in the past in handling this issue



Missing contract terms

- The UCC provides gap filler terms, or terms in the UCC that are used when the contract does not speak directly to an issue
 - For example, if the contract has left off a delivery term, the UCC requires that goods be delivered in a single delivery and payment due when the goods are delivered

ARK. CODE § 4-2-307



Anticipatory breach

Situations where 1 party gives notice of their intent not to perform the contract

- For example, a farmer enters into a contract for 17 loads of animal feed from a feed supplier. After 3 deliveries, the dairy finds a better deal on animal feed and cancels the contract with the feed supplier
- To receive damages for breach of contract, show the breach “substantially impaired” the value of the whole contract
 - Example, Arkansas court found contract was substantially impaired
 - Up to court to decide when contract is substantially impaired

Damages for anticipatory breach

Type of damages depends on who breached

- If buyer breaches:
 - Seller can choose to stop and withhold all deliveries to the buyer; or
 - Seller can resell to third party and sue buyer for damages, such as the difference between the contract price and the sold price and any costs incurred to sell the goods to the third party

For example, farmer A makes a contract to sell eggs to store 1 at \$4.00 dozen. Store 1 breaches contract and does not buy the eggs. Farmer A manages to sell the eggs to store 2 for \$3.50. Farmer A can sue store 1 for the \$0.50 a dozen that he lost in this deal and any costs incurred in selling to store 2.



Damages for anticipatory breach

Type of damages depends on who breached

- **If seller breaches:**

- Buyer can cancel the contract and seek to recover any part of price already paid to the seller; or
- **Seek either:**
 - The difference between the cost of replacement goods and the contract price; or
 - The difference between the current market price and the contract price

- With both types of monetary damages, the buyer can receive reasonable expenses incurred from the breach and any reasonable loss incurred by the breach.

Who is a “Merchant”?

Certain UCC protections only apply if the seller is a “merchant”


- **If farmer is the seller then farmer would have to qualify as a “merchant” under the UCC for the protections to apply**
- UCC defines a merchant to be:
 - “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 or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill”



ARK. CODE § 4-2-104(1).

Who is a “Merchant”?

- Shortly after UCC’s adoption in Arkansas, Arkansas Supreme Court found farmers are not merchants under the UCC
- Since that decision, majority of other states’ courts have found farmers to be merchants
 - Arkansas court could reverse earlier decision
 - Farmer should be prepared if that happens



Farmers are not
considered
“merchants” in
Arkansas

UCC's modified Statute of frauds

- The UCC modifies the written signed contract requirement for goods sold for over \$500
- The UCC takes a broad view of what qualifies as a written contract:
 - A written contract is one that is “sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought[.]”

ARK. CODE § 4-2-201(1).



UCC's modified Statute of frauds

- Courts have found the following to be written contracts under the UCC:
 - Series of letters
 - Receipt
 - Invoice
 - Statement of account
 - Draft or bank note
 - Check

[illegible]

UCC's modified Statute of frauds

- The one exception to the UCC's statute of frauds:
 - When the buyer has received and accepted the goods and a sufficient signed writing is no longer required

- For example, farmer A makes an oral contract to sell 10 goats to Buyer for \$600, with Buyer paying 10 days after delivery
- Farmer delivers the goats to Buyer and Buyer does not pay within 10 days
- Farmer A would not need to show a written contract existed because Buyer has received and accepted the goats



UCC's Implied warranties

Article 2 of the UCC contains 2 warranties that are implied in all sale of goods contracts unless they are expressly waived in the contract:

- **Warranty of fitness**
- **Warranty of merchantability**

- **Warranty of fitness:**

- “[T]he seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods[.]”

ARK. CODE § 4-2-315

- With this warranty if the farmer knows of any quality the buyer is looking for in the farmer's commodity, the farmer would want to make sure the commodity meets that quality, unless the warranty is waived

UCC's Implied warranties

- **Warranty of merchantability:**

- The goods sold “are fit for the ordinary purposes for which such goods are used[.]”

ARK. CODE § 4-2-314(2)(c)

- If the farmer is selling dairy goats, then when the buyer asks for dairy goats he should receive goats that can actually produce milk



Waiver of Implied warranties

- To waive any of the implied warranties need to include language in the contract that draws buyer's attention to the exclusion of the warranties

ARK. CODE § 4-2-316(3)(a)

Examples of language to for waiver include:

- "As is"
- "With all faults"
- The seller could also expressly waive the implied warranties by name.
 - Ex: *"The warranties of fitness and merchantability are waived in this contract."*





COMMON CONTRACT CLAUSES



Common contract clauses

- No two contracts will be exactly the same
 - Each contract will include clauses that meet the parties' needs
 - Contracts will still include some clauses that could be common across contracts

1. Price clause
2. Quantity clause
3. Quality clause
4. Transfer of agreement clause
5. Alternative dispute resolution clause
6. Excuse in performance clause



Common contract clauses

1. Price clause

- States the sellers and buyers price
- One way both the buyer and seller can protect against the risk of changes in price

2. Quantity clause

- States the exact quantity agreed upon by buyer and seller
- For farmer, quantity clause creates financial certainty because the farmer will know the exact quantity of a commodity he/she will be selling to a certain buyer

Common contract clauses

3. Quality clause

- Would specify the quality that the buyer is willing to accept
- Could be very important if farmer is buying certain inputs under contract and he/she requires the inputs to be of a certain quality, such as livestock feed

4. Transfer of agreement clause

- Would restrict both the buyer and seller from transferring their rights under the contract to an unknown third party
- Included usually because buyer or seller does not want to be dealing with third party they did not chose to deal with
- Could include language that requires buyer or seller to approve of any transfers of the contract
- Common in long-term contracts and leases

Common contract clauses

5. **Alternative dispute resolution clause**

- Would require the parties to use either mediation or arbitration to settle any disputes involving the contract
- This can result in quicker settlement of disputes and flexible solutions to their disputes
- Mediation involves a neutral third party who tries to help the two parties come to a mutually agreeable resolution
- Arbitration has a neutral third party that conducts a hearing for evidence, reviews written submissions from the parties, similar to a court proceeding, and then issues a decision
- This decision can either be legally enforceable or not enforceable depending on the type of arbitration chosen by the parties

Common contract clauses

7. Excuse in performance clause

- Also known as an Act of God clause or a Force Majeure clause
- This clause excuses non-performance of the contract by one of the parties when the cause is a flood, drought, war, insurrection, or some other event out of the control of the parties
- For example, the Arkansas Court of Appeals found that flooding on the Mississippi River which prevented a rice merchant from picking up rice fell under this clause



Conclusion

- Contracts have wide uses in agriculture. From the advance purchase of inputs from suppliers to the selling of commodities
- Producers should always check to insure the contract meets the requirements to be a legal contract
- Producers should always request a written contract over an oral contract
- Producers should always read the contract before signing the contract



Conclusion

- If the contract is breached, the injured party will be able to collect monetary damages caused by the breach
 - Courts are less likely to require specific performance
 - Do you really want someone who you are currently involved in a lawsuit being forced to perform their contractual obligations?
- In some cases, non-breaching party will need to work to mitigate their damages
 - For example, selling any commodity at a loss and suing for difference between sale price and contract price



Conclusion

- UCC will govern some agricultural contracts and provide added protections to contracting parties
 - The UCC provides protections when one party give notice of breaching the contract
 - Modified statute of frauds for transactions involving the sell of goods over \$500
 - Implied warranties concerning the condition of the goods, if the seller falls under the UCC's merchant definition
 - Arkansas does not currently view a farmer to be a "merchant" under the UCC, but this view could change
 - Warranties can be waived with proper language in the contract



Conclusion

- No two contracts contain the same clauses, contracts will be written to meet the needs of the parties to the contract
- Contracts could contain similar clauses, each written to meet the needs of those parties
 - For example, most contracts will contain a price clause stating how much the seller will be paid upon delivery of goods.





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This project is the result of the collaboration of these institutions:



USDA-NIFA-BFRDP 2010-03143



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Additional resources

- Neil D. Hamilton, *Farmer's Legal Guide to Production Contracts* (Farm Journal 1995)
http://www.nationalaglawcenter.org/assets/articles/hamilton_productioncontracts.pdf
- Christopher R. Kelley, *Agricultural Production Contracts: Drafting Considerations*, 18 Hamline L. Rev. 397 (1995)
http://nationalaglawcenter.org/assets/bibarticles/kelley_agricultural.pdf
- Joseph A. Miller, *Contracting in Agriculture: Potential Problems*, 8 DRAKE J. AGRIC. LAW 57 (2003)
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