

Dealing with Legal Liability Issues in Direct Marketing: A How-to-Guide for Protecting Yourself and Your Farm

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Direct Marketing and Associated Legal Issues

- The basics...
 - Direct marketing is marketing food products directly to the consumer to add value
 - Limiting your legal liability when marketing your products is important when you want to keep that added value
 - There are several issues you will want to think about?
 - Who am I doing business with?
 - Contracting
 - Will they pay? Etc....



How do I direct market my product?

- Farmer's markets- know your state and local laws
- On-farm sales and agri-tourism
- Niche products
- Marketing to restaurants/businesses
- Internet marketing
 - Whatever option you choose, make sure to inform yourself of your legal rights and roadblocks
 - Liability issues
 - Contracting issues



Direct Marketing- legal issue #1

- Am I hiring someone to help me with marketing my products directly?
 - Are they an "independent contractor" or an "employee"
 - Consulting with an "independent contractor" will save a business time, money, and perhaps legal liability
 - What is the difference?



What is an independent contractor?

- People who contract to perform services for others, but aren't legally employees.
- Many employment laws and tax rules that cover employees don't apply to ICs
- ICs may call themselves by a variety of names -- freelancers, consultants, the self-employed, entrepreneurs, or business owners.
- Are you an independent contractor? What duties are owed to you?



Advantages of Independent Contracting

- Employees require payroll taxes, job benefits, etc.
- Independent Contracting is for a defined period of time. Use of someone's expertise for a specified project
- May be best to reduce the terms to writing



Disadvantages of hiring Independent Contractors

- Don't blur the line between employee and independent contractor
 - Each government agency has a different way of analyzing whether you are working with an employee or IC
 - State unemployment benefits- a reason not to blur the line. If an employee files for them, you could owe a lot of money
- What if they are injured on the job?
 - Employees most often covered by worker's compensation
 - Independent contractors can sue for negligence



Getting paid

- If I am the independent contractor, how do I ensure payment?
 - Through legally enforceable contracts that set out all terms
 - If you have to take someone to court, what is the difference between small claims and district court?
 - Amount in controversy \$5000 or less
 - Structured payments through contract
 - If the bill is large, hire an attorney



Legal Issue #2- Contracting

- Protecting yourself via contracts with those you are marketing your products to:
 - Consider a Uniform Marketing Agreement if you are entering into a venture with other producers (i.e. a cooperative)
 - This is a must- sets out each member's commitment
 - If you have a marketing agreement, you are more likely to be awarded damages in a court of law
 - Express terms
 - Payment set
 - No "he said/she said"



Case Study in Contracting...

- True story
- Contract with packer, packer makes a mistake in overpayment
- Who is liable?
- Look to the language of the contract
- Is contracting always fair?



Moral of the story

- Never listen to a first year law student (even if they are your kid)
- In reality, contracts are not always fair or equal



Basic concepts of contracting

- Mutually beneficial arrangement
- Legally binding
- If K is terminated, respond immediately. If you accept termination then you are required to mitigate- meaning you have to go out and find your own supply, if possible



Ag Production Contracts

- Economic effects:
 - Very few farmers have the bargaining power a livestock supplier does
 - Less revenue for producers and growers
 - Increasing market power for suppliers



Foreign Contracts

- Currency used to be an advantage for Canadians
- What if part of contract is owned by Canadian government? Dealing with several layers of regulation
- Always look to the outside parties you are going to be dealing with



Assignment

- If contract can be assigned by supplier, do you have the ability to investigate that firm's financial well-being and ability?
- Assigning your obligations under a contract to someone else
 - Include a good-faith negotiation clause
 - What are your rights under the contract?



Contract Termination

- Look to the language of the contract
- If you receive notice of termination from a supplier, what is the basis for termination?
- Your notification may say:
 - “Act of God”? H1N1, Mandatory COOL
 - Economic impossibility
 - Renegotiate on a turn by turn basis



Force Majeure

- Example Force Majeure Clause in an Iowa Contract:
 - “Excused Performance- the performance of either party to this Agreement shall be excused during any period of time when performance becomes commercially *impossible* due to reasons which are *entirely* beyond the control of such party, such as fire, explosion, accident, final governmental law or regulation or intervention and acts of God. Changes in the hog market which impact the economic effect of this Agreement are specifically excluded... upon the expiration of the time that performance is commercially impossible, the responsibilities and obligations of the parties shall resume again.”



Another example...

- “Any party to this agreement shall be relieved of its responsibilities and obligations hereunder when the performance of those obligations becomes impossible because of, but not limited to, acts of God, war, disaster, destruction of the party’s facilities not attributable to the action or inaction of the party, or change in governmental regulations or laws making this agreement illegal.”



What does Force Majeure mean?

- Contracting party is not liable for damages due to delay or failure to perform under the contract because of an event beyond the party's control
- Excuses performance
- Means "greater force"
- Most often involves an "Act of God"- i.e. flooding, earthquake, war, riot, crime or the failure of a supplier or subcontractor to perform their obligations



Language of the clause is critical...

- If entering into a contract, negotiate this clause so it applies equally to both parties
- Has H1N1 "devastated both cash live hog prices and hog future prices" creating consumer fear for eating pork
 - One could argue that previous outbreaks of the same strain of flu in 1918 and 1976 put the hog industry on notice
 - Probably does not raise to the level of "Act of God"



What do I do if my contract is terminated?

- Contact your attorney
- Pool resources?
- Duty to mitigate
- If a suit is filed, you have a duty to abide by the mandatory mediation provision of Iowa Code Ch. 654B (Can obtain a release) (Farm mediation statute drafted in the 80's)



Iowa Case Law

- The Iowa Courts have not *directly* addressed the situation of force majeure in hog contracts under Iowa law. They have addressed it using MN law.
- *Nora Springs Coop. v. Brandau*:
 - K between elevator and farmer to deliver corn. Elevator refused to deliver several times, because transport was not available, Coop made no attempt to find a sub.
 - Farmer began hauling elsewhere
 - Court says: No excuse for not accepting grain. Insufficient evidence to show that the circumstances were impossible
 - In Iowa, you must show commercial impracticability (Iowa UCC) (*must be substantial evidence*)



Renegotiation

- An option: renegotiate for less now, but demand payment later to make up for loss
- When commercially practicable
- What is the desired length of contract?



Damages

- What is the measure of your damages in the event that your contract is terminated and you are successful in a lawsuit?
 - What is your loss under the contract?
 - Putting the parties back into their original position
 - Duty to Mitigate
 - Punitive damages normally not allowed in contract disputes, unless allowable under state law



Some final thoughts on contracting and direct marketing

- Seek the advice of an attorney
- Use of “buy/sell” agreements when entering into a business venture- these apply when working with family or outside parties
- In a way, it is a “business prenup” of sorts. Setting out how a partner or member can buy in or sell out their interest



Why hire legal counsel?

- Because you don't have the time to learn all of the legal nuances
- Hire a good ag attorney, familiar with direct marketing ventures and contracting
- Saves time and money in the long-run, especially if you are exposed to a lawsuit



Other legal issues to consider in direct marketing...

- Zoning ordinances
- Health ordinances
- Vendor/Small business licenses
- Business and Sales taxes



Protecting your interests...

- Ag Liens- Iowa Contract Finisher's Lien (Commodity Contract Lien) (includes Beef Cattle, Dairy Cattle, Hogs, Sheep)
 - Ch. 579B Iowa Code
 - Revisions to Art. 9- UCC- tried to bring clarity and certainty to perfection, priority and enforcement of security interests- ag liens are included and Iowa has adopted its own version of the UCC
 - Must have established a production contract (oral or written)
 - This lien beats all others in priority (except for veterinarian lien)
 - Lien is on the livestock sold or slaughtered by contractor, lien is on the cash proceeds if contractor sells prior to the time
 - Amount of lien is the amount owed to contract producer under terms of contract



Perfecting a Lien

- Be proactive- Iowa Code 554.9302- You want to perfect a lien in the jurisdiction where the collateral is- What if it moves to another state?
 - Perfect in that state
- File a Ch. 579B lien with the Iowa Secretary of State
- The financing statement can now be filed online
- www.sos.state.ia.us
- Look for Business Services



Timeline for filing

- Contract finisher's lien becomes effective when...
- Livestock arrives on property, but you must perfect
 - Unless the contract provides for continuous arrival (meaning arrival on monthly basis or more frequently), the producer files a financing statement for the livestock within 45 days after livestock's arrival
 - If continuous arrival, file financing statement 180 days after livestock's arrival
 - Lien terminates one year after livestock no longer under authority of contract producer (when livestock leaves the facility)



Priority Issues

- An agricultural lien has priority over other types of liens if the state statute says so
- In Iowa, we put a preference on ag liens
- Contract producer is the secured party and the contractor is the debtor



Ag Supply Dealer's Lien

- Iowa Code Section 570A – Claimant of this lien is an ag supply dealer engaged in retail sale of ag supplies to farmers.
- Property attached is crops and livestock produced using the ag supplies
- File with Secretary of state
- Lien attaches on date lien statement is filed
- This lien is superior to subsequent liens, except liens of other ag supply dealers, landlords, etc.
- Equal to prior perfected lien or security interest of financial institution



Ag Supplies

- Includes ag chemicals, seed, feed, or a petroleum product that is used for an ag purpose



How it works

- Ag dealer sends certified request to financial institution which has loan with farmer or security interest, prior to or upon sale of supply on a credit basis to farmer. (Farmer has to sign waiver of confidentiality for this)
- Bank must respond within four business days with a memo stating whether or not the farmer has sufficient net worth or line of credit to assure payment
- If no sufficient net worth, bank transmits financial history to dealer.
- If sufficient, the memo is irrevocable and unconditional letter of credit to benefit ag supply dealer for 30 days following date of final payment



What if bank doesn't respond?

- If bank doesn't respond and request from dealer was proper or if no sufficient net worth, then ag supply dealer must make a choice
- May file lien anyway
- Lien applies to crops and livestock



Perfecting the lien

- Lien becomes effective upon purchase of ag supply
- To perfect, ag supply dealer must file financing statement with Sec of State within 31 days after purchase



Priority of Lien

- If lien is properly perfected, lien shall have priority over a lien or security interest that applies after the time that the lien was perfected
- Lien will have equal priority to a lien or security interest which was perfected prior to time of ag supply dealer's lien
- Landlord's Lien (for leasing landlords) that is perfected (must be filed now) has priority over conflicting ag supply dealer's lien
- Lien in livestock feed has priority over earlier perfected lien to extent of difference between acquisition price of livestock and FMV of livestock at time lien attaches or sale price of livestock, whichever is greater.



A cautionary tale...

- Berger v. Cas' Feed Store (Iowa 1998)
 - Facts: Farmers made prepayments to feed store for inputs to be delivered in spring. Farmers didn't know Coop was indebted to bank. Bank seizes prepayments.
 - Findings: Court says no "constructive trust" with farmers that prepayments would be used to ensure delivery. Funds were not separated into a separate account. Bank had a legal right to seize funds.
 - Court held that the farmers were knowledgeable and experienced business persons and should have known
 - Problem: Bank made loans to farmers for the inputs



Bankruptcy and direct marketing your products

- What if someone I am marketing to takes bankruptcy...
 - What are your options?
 - Talk to your lender
 - Non-bankruptcy workout
 - Ch. 12- Family farmer bankruptcy
 - Definition of "family farmer"



General Farm Liability Insurance Policies

- Insurance companies make money by paying out less in claims than they receive in premiums
 - Accomplished by careful drafting language
 - An insurance policy is a contract
 - Always read and understand all terms in your policy before signing
 - Attempt to negotiate any unfavorable terms



An example of insurance contract language...

- *Simon v. Krogmann (Iowa Ct. App., Dec. 17, 2008)*
 - Facts: Cattle owner placed cattle with another farmer to care for until marketed. Cattle counted as they came off the delivery trucks and when they were loaded.
 - Owner had insurance policy providing for "theft," but there had to be evidence
 - No coverage if the loss was discovered upon taking inventory
 - If the insured actually saw the cattle being stolen, even if there was substantial evidence



Simon v. Krogmann

- At trial, the jury found that the evidence was substantial enough that the policy exclusion didn't kick in
- Iowa Ct. of Appeals: Evidence was enough to show that the loss of the cattle was discovered before taking inventory
- Bottom Line: Always read your policy, make sure terms are defined



Pollution Exclusion

- Iowa Case- *Bituminous Casualty Corp v. Sand Livestock (Iowa 2007)*
 - Facts: A hog confinement builder constructed a facility in Ida County. During construction, he installed propane power washer in washroom. Employee overcome by carbon monoxide and died. Widow sued for wrongful death. Builder requested his insurance company defend him.
 - Insurance company refuses to defend
 - Policy said that it didn't cover bodily injury which occurred because of escape of pollutants.
 - Does this situation fit under the pollution exclusion clause?



Outcome of the case...

- Iowa Supreme Court asked whether the carbon monoxide was a "pollutant" under the policy. Builder argued that a reasonable policyholder would expect the pollution exclusions to prevent coverage for certain situations, but not for the wrongful death claim based on negligent design. But, they didn't present this issue before the court.
- Court says that pollutant was broadly defined and carbon monoxide was a pollutant
- What are your reasonable expectations as an insured?
- States differ: Illinois S.C. says that carbon monoxide isn't covered under pollution exclusion

