



# **Abstract**

## **Cooperative Marketing Agreements: Legal Considerations**

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This report focuses on the legal characteristics of cooperative marketing agreements. The basic legal principles governing marketing contracts are first reviewed. The integral parts that make up a marketing agreement are then examined in detail. Examples of common provisions used in marketing agreements appear throughout the report for purposes of illustration.

Keywords: Cooperatives, marketing agreements, contracts, transactions

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## Preface

This report is intended to assist managers, directors, and their professional advisers in drafting new cooperative marketing agreements as well as evaluating and updating existing agreements already in place.

Samples from actual marketing agreements are used throughout this report and have been edited to preserve the anonymity of the cooperative associated with the particular sample.

The author would like to thank those cooperatives that voluntarily furnished marketing agreements for use in this project. I also want to acknowledge the assistance of Donald Frederick and George Martin of the Agricultural Cooperative Service in completing this report.

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## Highlights

A cooperative marketing agreement is a legal document recording the rights and duties of members and their cooperative with regard to marketing members' production through the cooperative.

As an enforceable instrument, marketing contracts can provide significant economic benefits to the cooperative and its farmer-members. They promote a degree of coordination and help achieve operating efficiencies.

Laws governing cooperative marketing agreements are based on traditional contract legal theories and common law principles. In addition to common law principles, one must also be aware of relevant sections found in State cooperative statutes covering marketing agreements. Another legal source, the Uniform Commercial Code (UCC), should always be considered.

The format of marketing agreements will vary somewhat from cooperative to cooperative. These differences are attributable to regional customs, or practices common to a particular commodity sector. Contract format can be influenced also by how a cooperative wants to present and accentuate its marketing agreement to the membership.

In addition to format, the style of language used in a marketing agreement should be noted. Some cooperatives intentionally keep their agreements simple to overcome potential member antipathy toward restrictive agreements. Others find it necessary to draft more detailed provisions due to a greater need for market information or performance assurance from members.

In looking over a marketing agreement, it is important to recognize the legal relationship between the cooperative and the member. An agreement either calls for the cooperative to serve as agent for the member (agency contract), or requires the cooperative to purchase the goods outright from the member (purchase-and-sell contract).

A cooperative marketing agreement consists of several essential parts. These include sections covering transaction terms, contract modification and termination, assignment, enforcement, and rights of third party creditors. Other sections are added based on the special needs of the cooperative.

The transaction terms should adequately alert the member to the conditions that govern the cooperative's handling of the crop. This includes requirements on proper delivery and acceptance as well as how and when a member is to be paid for the product. The agreement's duration is another important term.

In addition, a marketing agreement should outline suitable procedures to cover contract modification. Cancellation and termination policies should be addressed, as well as assignment of contract privileges or duties.

Important in any marketing agreement is that section discussing enforcement alternatives should there be a breach of contract. The principal enforcement tools provided in marketing agreements are liquidated damages, specific performance, and injunction.

Recent developments have prompted cooperatives to consider agreement provisions that reflect the changing forces in agribusiness. This includes matters involving food quality and the environment, as well as labor concerns.

Each cooperative faces unique external and internal forces that affect its response to the marketplace. Within this setting, a cooperative must first identify its economic objectives, then craft a marketing agreement that achieves those objectives as efficiently as possible.

The members' role in an effective marketing agreement program should not be minimized. Successful marketing cooperatives usually include a membership that is willing to give up more of its individual control for the betterment of the association. Members exemplify this by allowing themselves to be subjected to a more demanding agreement to realize greater efficiencies as a collective unit.

# Cooperative Marketing Agreements: Legal Considerations

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## INTRODUCTION

### What Is a Marketing Agreement?

A cooperative marketing agreement is a legal document recording the rights and duties of members and their cooperative with regard to marketing members' production through the cooperative. It requires the member to market output with the cooperative. And it obligates the cooperative to obtain the best possible price for that output.

A cooperative marketing agreement is unique in that it is both a contract between the member and the cooperative as well as a pact between the member and the rest of the membership. A well-written marketing agreement should eliminate confusion as to the mutual obligations of the producer and the cooperative. As a binding contract, the cooperative or the member can enforce the agreement should the other party fail to carry out agreed-upon duties.

A marketing agreement or contract should be distinguished from a membership agreement. A membership agreement encompasses participation agreements involving all types of cooperatives. A marketing agreement is one type of membership contract, and refers specifically to those agreements between a marketing cooperative and its members. Despite this distinction, marketing cooperatives will sometimes use the broader term, membership agreement.

A cooperative marketing agreement also differs from a crop or forward contract. A crop contract is a written agreement between a producer and buyer in which price is determined in advance of the time of delivery. Essentially, price is locked in and is normally hedged against the futures market.



By contrast, a producer entering into a marketing agreement generally will not know the price to be received until delivery or some point thereafter.

Finally, it is important to differentiate a marketing agreement linking the farmer-member with the cooperative and a producer contract with an investor-owned firm. Unlike an investor-owned firm, a cooperative usually cannot dictate the production decisions of its farmer-members.

### **Marketing Agreements: Traditional Economic Rationales for Their Use**

This report's primary focus is on marketing agreements as a legal instrument. As an enforceable document, however, marketing contracts are capable of providing a number of significant economic benefits to the cooperative and its **farmer-members**.

In our free market economy, contracts serve as the primary means of achieving balance at different sectors in the agricultural market. Contract coordination can promote production of a more uniform product, as well as facilitate production aligned with the market needs of sellers and buyers.

Marketing contracts offer a number of other specific advantages. They serve as a catalyst for market information, helping cooperatives organize more efficient resource combinations. An orderly program of marketing agreements promotes greater integration and less uncertainty, which reduces transaction costs of cooperatives doing business with farmers.

Through marketing agreements, cooperatives can also lower procurement, assembly, and delivery expenditures because there are no soliciting costs. Processing and other activities also cost less since volume will often be less of a variable. With agreements in place, cooperatives can offer forward contracts with quantity, quality, and schedule guarantees to outside customers. Finally, marketing agreements,

especially those that require an extended commitment from members, free a cooperative to concentrate more on long-term objectives.

Member-patrons also gain from contract commitment. It ensures a market for their production. Additionally, by using marketing agreements members are, in effect, selling product to themselves (as opposed to an outside middleman) to be resold. The decision to contract with the cooperative transfers the job of marketing to one with greater expertise and bargaining power. A cooperative knows about how much product it will receive and market at a given time and should on average attain a better market price,

Cooperative marketing agreements can also give producers an advantage in securing credit, since banks recognize that an agreement reduces risk and helps provide a market.

Marketing agreements play a constructive role in the dealings between local cooperatives and affiliated regional or federated cooperatives. The regional or federated cooperatives do the actual marketing on the theory that they have greater expertise and are more knowledgeable of market conditions. This prevents locals from engaging in “unchecked marketing” with the possible effect of setting prices at a lower level.’

## **PUTTING TOGETHER A MARKETING AGREEMENT**

### **Basic Legal Considerations**

***General Contract Legal Principles Apply*** The laws governing marketing agreements essentially follow traditional ‘contract legal theories and common law principles (i.e., legal

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‘See Black, W. and Knutson, R., “Let’s ***Talk About Marketing Agreements,***” U.S. Department of Agriculture, Farmer Cooperative Service (Reprint 393 from September 1974 News for Farmer Cooperatives). Washington, D.C. (1974).

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principles based on decisions handed down in prior cases based on similar fact or issue patterns).

In addition to common law principles, one must also be aware of the provisions found in State cooperative statutes covering marketing agreements. Another legal source, the Uniform Commercial Code (UCC), should always be considered.

The basic concepts of marketing agreements have become fairly well settled since the 1920's and 1930's. Before then, marketing contracts were a relatively new convention, and farmers tended to be wary in submitting to the various restrictions found in such **agreements**.<sup>2</sup> At that time, a number of lawsuits by farmer-members contested the basic validity of cooperative marketing agreements. These challenges were generally unsuccessful, which effectively validated marketing agreements as a legitimate instrument for **cooperatives**.<sup>3</sup> Today, cooperatives are established organizations, and their members are better informed about markets and prices, as well as the objectives of their cooperatives.

**State Statutes** State cooperative statutes typically include some discussion on marketing agreement matters. Some of the material is merely advisory in intent, while other particulars require compliance. Topics appearing in a number of State statutes include filing, contract duration, exclusive dealing, title to product, payment, liquidated damages, injunction, specific performance, and interference with contract.

To avoid disputes on applicable State law, a marketing agreement should stipulate which State jurisdiction is controlling. This is particularly important if the association is **incor-**

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<sup>2</sup>For further information, see Harl, N., 14 AGRICULTURAL LAW, § 133.01 [2]. New York: Matthew Bender (1984) (hereinafter **Harl**).

<sup>3</sup>See *Washington Cranberry Growers' Association v. Moore*, 117 Wash. 430,201 P. 773 (1922); *Tobacco Growers' Co-op Association v. Jones*, 185 N.C. 265, 117 S.E. 174 (1923); Harl, § 133.03 [2].

porated under a State statute that differs from the State where its headquarters is located or where it conducts business. Even if a cooperative intends to limit its activity to a single State, disputes involving the marketing agreement can arise from transactions that cross State lines in any number of ways. To avoid confusion, a marketing agreement should include a provision such as the following:

This Agreement and all facets of the cooperative relationship between the parties shall be governed and interpreted under the **laws** of the State of \_\_\_\_\_ **(name of State)** applicable to agreements to be performed therein.

Uniform Commercial Code (**UCC**) The Uniform Commercial Code (UCC) has been adopted by most States as the principal legal authority with respect to sales and other commercial transactions. Briefly, the UCC requires any agreement involving the sale of goods of more than \$500 to be in writing. While not all of the contract has to be in writing, the agreement must contain enough written information to alert the parties to their obligations. For example, a written agreement for more than \$500 that does not specify the quantity to be sold is not enforceable under the UCC. The agreed-upon quantity, however, need not be exact, but it should be ascertainable from the written description provided.

Marketing agreements often require members to deliver their entire crop production, or their total crop harvested from specified acreage. Such quantity descriptions are sufficient for UCC purposes.

Similarly, the UCC does not require that a contract specify a price as long as the contract identifies a way the price can be determined.

A written agreement, as a rule, is binding only if it is signed by both parties. However, if the farmer does not sign the agreement, it still may be enforceable if the farmer is considered a “merchant.” The UCC states that a merchant is:

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.<sup>4</sup>

State jurisdictions differ on characterizing a farmer as a merchant. Over the years, States traditionally precluded farmers from the UCC definition of merchant based on a widespread policy of protecting the farmer. Recently, more jurisdictions have adopted an approach that treats whether a farmer is a merchant as a factual determination based on the farmer’s professionalism, special knowledge, and experience with the type of goods involved.<sup>5</sup>

To summarize, a marketing agreement should be in writing and signed by both parties. It needs to clearly set forth the rights, duties, and obligations of the cooperative and the member. In its final written form, it is presumed to represent the entire agreement, and usually cannot be successfully dis-

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<sup>4</sup>UCC 2-104(1).

<sup>5</sup>See generally Juergensmeyer, J & Wadley, J., *AGRICULTURAL LAW*, vol. II, §332.2, at 272-277, Boston: Little Brown and Company (1982 & 1985 Supp.); and Looney, Wilder, Brownback, & Wadley, *AGRICULTURAL LAW: A LAWYER’S GUIDE TO REPRESENTING CLIENTS*, ch. 9, at 298-300, Chicago: American Bar Association (1990).

<sup>6</sup>See UCC 2-202.

puted by oral evidence.<sup>6</sup> A sample contract provision illustrating these points:

Entire Agreement. This Agreement, along with the items and particulars referred to herein as they exist from time to time, constitute the only and entire agreement between the parties with respect to the subject matter hereof. There are no oral or other conditions, promises, agreements, representations or inducements **in addition to or at variance with any of the terms hereof.**

Agreement Format A cooperative marketing agreement consists of several essential parts. This includes sections on sales and transaction conditions, modification and termination, assignment, and enforcement. Within this general framework, the agreement format will vary somewhat from cooperative to cooperative. These differences are attributable to regional customs, or practices common to a particular commodity sector. Contract format can be influenced also by how a cooperative wants to present and accentuate its marketing agreement to the membership.

Some marketing agreements are quite detailed and appear as a complete and separate legal document. In other instances, cooperatives use a brief marketing agreement to outline key marketing provisions, then provide more extensive interpretation in the bylaws. Some cooperatives consolidate the entire marketing agreement within the bylaws. Any of these approaches is acceptable since the articles, bylaws, membership agreement, and marketing agreement are generally enforced collectively.

Even when the marketing agreement and bylaws appear as separate documents, some overlap in content is likely because of the common subjects covered in each document. This replication, however, can be useful if the subject is impor-

tant enough to deserve special emphasis, such as member retain and payment procedures.

Cooperatives that market more than one commodity or product (i.e., fruit and vegetable cooperatives) sometimes implement a general marketing agreement, then have an additional agreement for each crop. These individual commodity agreements supplement the general marketing agreement by rendering more detailed conditions and requirements relative to growing and delivering the specific crop.

Cooperatives may institute a number of rules and regulations in connection with marketing operations. This can involve such matters as the time and manner of delivery or grade and inspection standards. Some cooperatives choose to leave the bulk of such rules out of the agreement, especially if the rules are subject to frequent change.

If a cooperative does rely on a substantial body of rules outside of the marketing agreement, then the agreement should state that any rules or regulations adopted by the board shall be enforceable as if part of the marketing agreement itself. A sample provision:

**Each member is to be bound by marketing agreement, articles of incorporation, bylaws, and all rules, regulations, policies and resolutions adopted or established by or under the authority of the Association's Board of Directors, by whatever name described, which provide for the governance, operation, or management of the affairs of the Association or the conduct of its members.<sup>7</sup>**

Another example involving a milk cooperative:

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<sup>7</sup>In the sample provisions provided in this report, the contracting parties will always be referred to as "the Association" and "member." Other common references to the parties include "cooperative," "grower," or "producer." In some agreements, these terms are always capitalized.

**The Board of Directors shall have the power to establish, from time to time, and to revise and amend the same from time to time, rules and regulations, which each member agrees to be governed by, with reference to the proper feeding, housing and handling of herds; the manner, time and method of milking; the proper time and manner of caring for cooling, storing and preparing such milk for shipment; and governing shipment and delivery.**

**Contract Style** In addition to contract format, the drafter also needs to consider language style. One option is to draft an agreement that it is quite general and policy oriented, with few explicit requirements.<sup>8</sup> Subject areas requiring more specific rules or regulations are left to board action. An agreement expressed in general terms is workable if membership is small and there is enough common self-interest and discipline among members to preclude enforcement problems.

A cooperative may be forced to adopt an agreement with few requirements due to an aversion by members to be legally bound. In such situations, a cooperative uses a marketing agreement that requires little from members other than agreeing to supply their product to the cooperative.

While some cooperatives deliberately keep their agreements simple, others find it necessary to go into much greater detail in drafting their contract provisions. For cooperatives in the latter category, receiving specific assurances of performance from members is vital. There also could be a greater need for market information, which a properly designed marketing agreement can help elicit.

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\*Generally, courts reject challenges of contract vagueness by members on the basis that the board of directors has broad discretionary authority. See Harl, § 133.02 [4].



Marketing agreements recite the obligations required of the member. Many marketing agreements, however, fail to specify the cooperative's reciprocal duties owed the member. In the long run, it is in the cooperative's best interests to make its commitments clearly known in the agreement. By doing so, the cooperative provides the committed member with a better appreciation of its services.

### **Type of Contract: Agency or Sales Contract**

With marketing agreements, it is important to understand the legal relationship that exists between cooperative and member. An agreement either calls for the cooperative to act as agent (agency contract), or requires the cooperative to purchase the goods outright from the member (purchase-and-sell contract).

In contracts where the cooperative acts as agent, title passes to the cooperative when the crop is delivered. If the marketing agreement calls for the member to sell his or her crop to the association, however, title passes to the cooperative (except in cases of recorded liens) at delivery unless some other time is specified in the contract.

Over the years, cooperatives used agency contracts if there was a need to preserve the identity of each member's crop and the time between delivery and sale was relatively short. A purchase-and-sell contract would be implemented if members' production was to be pooled, or processed into value-added items, or if considerable time was likely to elapse between delivery and sale.

Traditional distinctions between agency and purchase-and-sell contracts have become somewhat blurred over time.<sup>9</sup>

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<sup>9</sup>See Harl, §133.02 [2] for general discussion on agency/sales distinction. See also Mueller, W. and Tinley, J., *Membership Marketing Contracts of Agricultural Cooperatives in California*, at 17-19, California Agricultural Experiment Station, Bulletin 760, University of California, Division of Agricultural Sciences (1958) (hereinafter Mueller and Tinley).

Today, marketing agreements often embody elements of both agency and sale transactions. For example, a marketing contract that expressly creates an agency relationship may also empower the cooperative to commingle the member's goods. If a cooperative commingles, it is effectively taking full possession and making it impossible to return the same goods that the member delivered. Also in agency situations, it is quite common to include a provision that the member is no longer liable for losses after delivery of the crop. In essence, risk of loss has passed to the cooperative even though title might still technically rest with the member.

Similarly, in so-called purchase-and-sell contracts, the member will often not be paid in full immediately upon crop delivery, but will be paid at a later time based on an averaging of sales by the total membership.

Despite the potential ambiguities in the agency/sale characterization, it is still good form to entitle an agreement as one of agency if that is your intent (i.e., "Crop Agency Agreement"), or purchase-and-sell (i.e., "Agreement to Purchase-and-Sell"), as opposed to simply calling it a "Marketing Agreement."<sup>10</sup>

## Crop Agency Agreement

Four issues should be addressed in drafting a contract provision that establishes an agency relationship between the member and the cooperative.

First, the member (principal) must appoint the cooperative as agent. If a member's entire production is to be market-

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<sup>10</sup>The intention of the parties as expressed in the contract or bylaws usually (but not always) prevails in determining whether the relationship between member and cooperative is either principal and agent or seller and purchaser. For general discussion, see Harl, § 133.02 [2], at 133-23-25; and Hulbert & Neely, *Legal Phases of Farmer Cooperatives*, U.S. Department of Agriculture, Farmer Cooperative Service, Information 100, at 168. Washington, D.C. (5th ed. 1976) (hereinafter *Legal Phases*).

ed through the one cooperative, the contract should say also that the cooperative is to be the “sole” or “exclusive” agent, or some other words to that effect. **An example:**

**Each member hereby appoints the Association as the sole and exclusive agent of member.**

Second, the cooperative should require assurances that the member has full title to the goods being transferred to the cooperative. If any outstanding liens are on the member’s crop, the member must notify the cooperative in writing. (The subject of liens will be discussed later). A provision illustrating this point might state:

**Each member warrants that the title to the goods covered herein shall be good and the transfer rightful, that the goods shall be delivered free from any claim of any third party, security interest, or other lien of which the Association has not been informed by direct written communication from member prior to delivery each season.**

Third, the contract should declare that after transfer to the cooperative, the member can no longer exercise any control over the crop delivered. An example:

**No member by virtue of being the owner of or having furnished any products, shall exercise any control over the Association in regard to either handling or marketing said products or the conduct of the business of the Association other than as may be expressly provided in these bylaws or in any agreement with the Association.**

Fourth, an agency agreement should describe the extent of control an agent can exercise over a member’s goods. Such

an **explanation is necessary** since an agent derives all authority from the principal. The following examples show an agent's powers can be quite extensive:

**Agency authorizes, empowers, instructs, and directs the Association to receive, process, handle, pack, ship, and sell such products and by-products thereof in such form or forms as the Association shall determine.**

**All matters pertaining to the handling and marketing of products shall be transacted solely in the name of the Association, or in the name of any agent or agency to or through which said products may be consigned or shipped for marketing or ultimately marketed.**

Note the important right in the following example on the power of the cooperative to borrow **money, using the member's goods as collateral**:

**All handling of the products of members produced under agreement with the Association shall upon delivery to the Association be under the full and exclusive control of the Association and its agents and representatives. The Association shall have the full and unqualified right to take title to such products and process, sell, mortgage, pledge or otherwise encumber, dispose of or transfer them and to sue on, enforce and compromise any rights or claims arising out of any transaction involving such products.**

Fifth, due to the extensive authority it can exercise over a member's goods, a cooperative often releases a member from any potential liability after delivery of the goods to the cooperative. This is possible even though the member may still technically hold title. For example, a marketing agreement will include a provision similar to the following:

**No member of the Association shall be liable under any rules of agency on account of any contract or contracts made by the Association in carrying on its business of marketing.**

To summarize, the following is a sample agency provision that incorporates the five key elements:

**Each member appoints the Association as the sole and exclusive agent of member for the purpose of marketing the products that member is obligated to deliver to the Association; and for such purpose authorizes, empowers, instructs and directs the Association to receive, process, handle, pack, ship and sell such products and by-products thereof in such form or forms (whether processed, manufactured or otherwise) as the Association shall determine. The Association shall have full power and authority to sell and transfer title to such products at such time or times, and in such markets and for such amounts as the Association shall deem best, and by and through such agent or agencies as the Association may select or provide. The Association may make such rules or regulations respecting the delivery of products by the members as the Association, in its discretion, shall determine.**

**No member by virtue of being the owner of, or having furnished any products, shall exercise any control over the Association in regard to either handling or marketing said products, or the conduct of the business of the Association. In all of such matters the Association may in good faith, use its own discretion and judgment, free from any direction from the member furnishing the products. No member shall be directly liable under any rules of agency on account of any contract, or contracts, made by the Association in carrying on its business or in marketing products.**

Agreement **to Purchase-and-Sell** If a marketing contract calls for the member's crop to be purchased by the cooperative, the cooperative not only takes possession, but also assumes title. Several conditions should be included in marketing agreements that involve purchase-and-sell situations.

Like a crop agency agreement, an agreement to purchase-and-sell should contain language whereby the member warrants having the legal authority to deliver full title to the goods. If the member does not have full title (due to an outstanding lien, e.g.), that fact must be communicated in writing to the cooperative.

Second, an agreement to purchase-and-sell should affirm the cooperative's right of complete control over the goods once in its possession. Such language may seem superfluous. Yet cooperatives frequently insert such a declaration. An example:

No member shall have any rights or shall exercise any control by virtue of having furnished any products, other than as may be expressly provided **in this Agreement or bylaws of the Association.**

Another example:

**The Association shall have the full and unqualified right to take title to such products and process, sell, mortgage, pledge or otherwise encumber, dispose of or transfer them and to sue on, enforce and compromise any rights or claims arising out of any transaction involving such products.**

Third, an agreement to purchase-and-sell needs to be abundantly clear as to when risk of loss in the goods passes from member to cooperative. Generally, risk of loss stays with the member until the cooperative takes delivery and title.

However, this is not always the case. Contracts may be drafted to pass title to the association before delivery of the crop.<sup>11</sup>

Following are some examples where title is passed at some point other than actual delivery of the goods:

**Title to said milk and dairy products shall vest in the Association when produced.**

Another example:

**Full legal title shall pass and vest in the Association contemporaneously with the harvest of \_\_\_\_\_ fproduct) \_\_\_\_\_ .**

In the following sample provision, title could pass at one of several points of delivery:

**Each member shall harvest and deliver \_\_\_\_\_ (prod-  
~~uct) either to the Association's warehouse, a ware-  
house approved by the Association, or some other  
warehouse suitable under the customs and conditions  
then prevalent in the trade. Ownership and title to  
~~dep (product) in and delivered to the~~  
Association shall pass to the Association at the time  
such product is deposited in the warehouse. Ownership  
and title to \_\_\_\_\_ fproduct) \_\_\_\_\_ deposited in other ware-  
houses shall pass to the Association, when such  
\_\_\_\_\_ fproduct) \_\_\_\_\_ is loaded for member's account on  
carriage provided by the Association, or when a ware-  
house receipt or a storage receipt evidencing such  
\_\_\_\_\_ fproduct) \_\_\_\_\_ is received by the Association. All  
risk of loss regarding such product shall be upon mem-~~**

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<sup>11</sup>If the marketing contract is to pass title to the goods prior to their delivery to the association, the contract should read so as to make plain that it is a contract of sale rather than a contract to sell. See *Legal Phases*, at 183.

**ber until such time as ownership and title pass to the Association.**

## **Sales Terms**

The sales or trade terms that appear in a marketing agreement should adequately alert the member to the conditions that govern the cooperative's handling of that member's crop. This includes requirements on proper delivery and acceptance as well as how and when a member is to be paid for the product delivered. Contract duration also needs to be addressed.

Delivery A contract provision covering delivery terms outlines the member's responsibilities in transferring the crop to the cooperative. Critical variables in delivery situations are when, where, and how much. A marketing contract, instead of specifying when or where delivery is to be made, often states that the member deliver the product at a time and place to be designated by the cooperative at some future date. A sample provision on delivery might read:

**All ~~the~~ product delivered by member at member's expense at the earliest reasonable time after harvesting, or at such time as called for by the Association, to the Association's principal place of business or to one of the Association's authorized buying locations as prescribed by the Association. The Association will use its best efforts to locate buying locations within a reasonable distance from member's farm.**

The other key variable in delivery situations, quantity, is usually expressed in one of three forms: full production, defined volume, or set acreage.

Full production is the most common mode in having members deliver their product. A marketing agreement with a



full production provision requires a member to convey his or her entire crop, harvest, or production to the cooperative. **An example:**

**Each member agrees to deliver to the Association all milk so produced and not used for home consumption.**

Another means is to require a member to deliver a defined amount or minimum quantity of product. Using milk again as an example:

**The every-other-day pickup shall be no less than 1,000 pounds minimum.**

A third method of specifying the quantity to be delivered is to state that only production from designated acreage be delivered to the cooperative. The applicable cropland or acreage is usually described in the appendix to the marketing agreement. A number of cooperatives handling fruits, nuts, vegetables, and other specialty crops employ this method. An example:

**During the term of this Agreement, each member agrees to deliver to the Association one hundred percent (100%) of his or her annual crop of       (product)       produced by the member upon the land described in Appendix A to this Agreement.**

Acceptance The terms dictating acceptance by the cooperative generally focus on two areas: the quantity and quality of goods to be delivered. Other conditions may be necessary to assure orderly marketing. In the following sample provision, a cooperative includes several qualifiers as part of its acceptance:

**The Association shall have the right, at its election, either (a) to reject any grain tendered or delivery that is in a non-marketable condition or (b) bring such grain into marketable condition at the expense of member.**

In the example that follows, certain inspection and grading standards must be met before the cooperative accepts:

**Inspection and Grading. Prior to acceptance by the Association, all ~~sh~~ product ~~e~~ i n s p e c t e d and graded by USDA in accordance with USDA standard rules and regulations.**

**All purchases and/or marketings of (product) received by the Association from members shall be based upon USDA grade, and each member agrees to accept the grading established by USDA.**

Cooperatives, particularly those involved in perishable crops, will sometimes draft acceptance terms that give the cooperative the option to increase or limit the amount of product it can receive from a member. For example, a cooperative might be faced with an unusually large surplus of product in a given season. If the crop is perishable, or if the cooperative lacks storage capacity, a cooperative might reduce the quantity of product it will accept from each member. The following sample provision gives a cooperative this option:

**The Association maintains the right to refuse certain quantities from members in times of surplus. Whenever the Board of Directors determines that the Association will incur a loss because of an industry-wide surplus in any of the products marketed by the Association, the Board of Directors may decide it is in the best interests of the Association's membership as a whole to reduce the amount of any one or more of such**

**surplus products to be marketed by the Association. The Association shall have the right, upon reasonable notice to member, to reduce the amount of such raw products that member shall be entitled to deliver, in accordance with a formula adopted by the Board of Directors. The formula shall fairly and proportionately reduce the amount of such raw products delivered by all members to the Association.**

**A somewhat briefer version:**

**The Association may reduce or eliminate the right and obligation to market products if the Board of Directors determines that for reasons beyond the Association's control, the Association cannot market the committed quantity of products on satisfactory terms. Any such reduction shall be applied pro rata to all members subject to marketing agreement.**

**Note that in each of these examples, any changes in the quantity accepted are borne equitably by the membership.**

**To safeguard against impending supply shortages, some marketing agreements give the cooperative the choice to accept a greater amount of production than originally agreed to by each member. An example:**

**Whenever the Board of Directors determines that it would be in the best interests of the membership as a whole to increase the amount of any of the products marketed by the Association, the Association may, upon reasonable notice to member, increase the amount of such raw products that member shall be entitled to deliver to Association. This action shall be in accordance with a formula adopted by the Board of Directors that fairly and proportionately increases the amount of such raw products delivered by all members to the**

**Association. Member shall have the right to elect whether to deliver member's increased entitlement.**

**Notice that** in the above provision involving a supply shortage, the member could also sell any surplus outside the cooperative.

***Determination, Allocation, and Payment of Net Proceeds***  
The marketing agreement should address in some measure the allocation of net proceeds earned from the sales of members' products. The payment process should also be explained in the bylaws.

Most cooperatives use one of two methods in paying members for products sold: (1) the gross margin method, or (2) the pooling method.

*Gross Margin.* Here, the association pays the member the going market price for the product less deductions for operating expenses at the time of delivery or shortly thereafter. Any margin remaining at the end of the fiscal year is returned to producers as a patronage refund. Following is a sample provision:

**Payment to Member. The Association shall market member's \_\_\_\_\_ (product) \_\_\_\_\_ and member shall accept as payment for member's \_\_\_\_\_ (product) \_\_\_\_\_ a price based on the current market price in the area for ~~of (product) grade and quality.~~**

**The Association shall pay the amount due member, less deductions authorized in this Agreement, not more than \_\_\_\_\_ days after delivery of \_\_\_\_\_ (product) \_\_\_\_\_ to the Association or the Association's designated buying location.**

*Pooling.* A second payment method involves the use of pooling procedures. Pooling is essentially an averaging process with respect to the prices and expenses of products mar-

keted by a cooperative. A member delivers his or her crop to the cooperative without knowing what the final price will be. The cooperative will often provide partial payment (i.e., an advance) shortly after delivery. Final settlement is then made at the end of the season based on the average of prices for product of like grade and quality.

Some cooperatives take title to the goods pooled, though it is possible to pool receipts without taking title to products sold. For example, an association may combine the produce from several individual producers according to grade and quality and then sell all of the same kind as a single lot. In this arrangement, all proceeds above expenses are then returned to these producers on the basis of patronage. A sample agreement provision on pooling:

Payment to Member. The Association may at any time pool any or all o f (product)m b e r w i t h any **other** (vproduct) of a similar kind and grade. Member shall receive, for (vproduct) pooled, a unit price equal to the average net unit price obtained for the pooled (vproduct) less deductions authorized in this Agreement.

**The Association shall make an advance payment to member of percent of the current market price in the area for (vproduct) of like grade and quality not more than days after delivery of (vproduct) to the Association or Association's prescribed buying location.**

The following example illustrates the amount of detail some cooperatives provide in explaining how payments are calculated and allocated:

**Determination, Allocation and Payment of Net Proceeds. (a) Net proceeds shall be determined by the Board of Directors by deducting from the gross pro-**

**ceeds cash advance payments to members, the costs of receiving, processing, manufacturing, handling, storing, transporting, advertising, and all other expenses of marketing. Expenses shall include, but not be limited to, all costs of administration, reasonable allowances for depreciation and bad debts, interest, and losses (to the extent hereinafter provided). The Association may also retain amounts from such net proceeds for reserves or revolving funds created as hereinafter provided. If, at the end of the fiscal year of the Association, the sum of the costs and expenses to be deducted from gross proceeds shall prove to be in excess of the gross proceeds, the difference shall, upon demand therefor be paid by members to the Association in proportion to the value of products delivered to the Association by each member during such fiscal year.**

**(b) The net proceeds of the Association from business done with or for its members shall be determined by the Board of Directors within eight and one-half (8 1/2) months after the close of each fiscal year and shall be allocated among members according to the quantity or value or both of products delivered by each member in such fiscal year. The Association shall be obligated to pay the net proceeds in cash or qualified or nonqualified written notices of allocation not later than eight and one-half (8 1/2) months after the close of each fiscal year.**

**(c) The Association may pool the products of members in one or more pools pursuant to a pooling plan or plans to be prescribed by the Board of Directors. Any such plan shall specify the conditions of eligibility of products, the methods of operation, and all rules and regulations in connection therewith. Such pools shall open and close at such time as the Board of Directors may prescribe and the time for closing may be advanced or extended. Net proceeds from any such pool**

**may be separately distributed in conformity with the provisions of this section.**

**Some** of these more detailed provisions might just as well be placed in the bylaws as in the marketing agreement.

One final point on payment procedures. If a cooperative is in the practice of providing advance payments to members, it should include a stipulation in the marketing agreement that the cooperative will be entitled to recover any overadvances the cooperative might make to the member. An example:

**Member agrees to fully and completely indemnify the Association against further payment that exceeds the amount of member advances as hereinabove provided for in the Agreement.**

Some provisions give the cooperative the expressed power to recoup overadvances by canceling retained equities of the members or setting up accounts receivable to be settled with patronage refunds payable to members in subsequent years.

**Duration** of Marketing Agreement Cooperative marketing agreements usually handle the contract duration issue in one of several ways. Some cooperatives require a member to sign an agreement that remains in force for a specified time period. Other cooperatives may require new members to sign up for a longer duration, such as 3 years, with contract extensions thereafter for 1 year.

Some marketing agreements will not specify a duration period. The contract continues from year to year unless canceled by either party on or before a designated date.

From the cooperative's perspective, choosing the optimal length of time for a marketing agreement to remain in force is subject to a variety of considerations. **One** factor is the investment needs of the cooperative. A cooperative would likely require longer member commitment if the commodity market demands substantial capital investment.

Another factor is how long the cooperative has been an established, successful business. A new cooperative may need a longer commitment from members to ensure its viability during the difficult start-up period.

The competitive pressures from other cooperatives or processors in that market can also influence contract duration. Producers generally prefer shorter commitments. Cooperative leaders must ask themselves whether other cooperatives within the region or within the industry impose marketing contracts on members. If so, what duration do they require?

Finally, cooperatives should be aware of any legal time limits as expressed in their State cooperative statute.

Hopefully, once a cooperative has developed a track record, there will be other bonds between the cooperative and the member that make it less essential for the cooperative to use agreements with extended duration periods.

While committing members under long-term agreements has its advantages, some cooperative experts have questioned whether they are necessarily more effective. Mueller and Tinley note:

One-year marketing contracts are as effective in preventing such nonperformance as are longer contracts. Growers generally are unable to know at the time of signing their annual contracts whether or not supply is going to be abnormally short. Even if the grower anticipated a short supply, he might not be sure that he would be singled out by competitors for special price treatment. Consequently, he would probably sign a contract with his cooperative if past experience proved that it usually paid growers average market prices or better. This type of threat to member loyalty can usually be met as well by annual contracts as by longer-term ones.<sup>12</sup>

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<sup>12</sup>Mueller and Tinley, at 23.



There is also the possibility that long-term contracts without competent resource planning may leave the cooperative in a more vulnerable position. Schrader notes:

Longer term contracts may increase uncertainty rather than reduce it. When there are enough users and suppliers the mistakes or unknowns offset each other to at least some degree. What appears to be a tightly coordinated system may require more excess capacity than the spot price coordinated system.<sup>13</sup>

So there are certain tradeoffs in committing members to protracted contracts. Obviously, long-term member investment and commitment are crucial for many cooperatives to compete in an industrialized agricultural economy. However, in dedicating an organization to increased investment and business activity, the need for accurate planning becomes more critical as larger amounts of resources are put to use.

## **Modification and Termination of Contract**

***Modification of Marketing Agreement*** The association may need to modify the terms of its marketing agreement from time to time. A sample contract provision covering modification:

This instrument contains the entire agreement of the parties. No modification hereof shall be valid except in writing and executed with the same formalities as this Agreement.

If the proposed modification is substantive and affects a sizable portion of the membership, some cooperatives require formal member ratification. A sample provision:

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<sup>13</sup>Schrader, L., "Potential Coordinating Functions of Farmer Cooperatives: Discussion," *Farmer Cooperatives for the Future*, 62-63, at 63. Purdue University, Department of Agricultural Economics (1985).

**The Association reserves the right to alter any provisions of this Agreement provided any such alteration is first approved at any regular or special meeting at which a quorum is registered as being present or represented by mail vote, by a majority of the shareholders so present or represented by mail vote, where the notice of such meeting contains a statement of the proposed alteration.**

**If a cooperative anticipates the need to modify its marketing agreement on a frequent basis, it may be wise to isolate those provisions subject to frequent change and make them part of a separate set of rules and regulations to be approved periodically by the board of directors. Such rules can then be given the same force as the marketing agreement by inserting a provision:**

**Each member is to be bound by the marketing agreement, articles of incorporation, bylaws, and all rules, regulations, policies and resolutions adopted or established by or under the authority of the Association's Board of Directors, by whatever name described, which provide for the governance, operation or management of the affairs of the Association or the conduct of its members, all as each may exist from time to time whether by revision, adoption, amendment or other action.**

Rules or other policies that supplement the marketing agreement will be upheld by courts so long as their issuance is based on the board's best judgment without evidence of fraud, bad faith, or negligence.<sup>14</sup>

Instead of modification, a cooperative might need to institute a new marketing agreement altogether. However,

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<sup>14</sup>See *Hanson v. Ontario Milk Producers Cooperative*, 294 N.Y.S. 2d (1968).

**what happens to existing agreements still in force?**

**Customarily, a cooperative can enter into new contracts with members different in form from the existing contract. At the same time, however, the cooperative should extend to members under the old agreement the opportunity to switch over to the new agreement. If the association eventually wants to bring all agreements back to uniformity, it can do so during the next period for terminating existing agreements.**

**Several illustrations on the points just covered:**

**This Agreement is one of a series of agreements generally similar in terms between the Association and its members. It is mutually agreed that the cancellation of any agreement or agreements in this series shall not operate to invalidate this Agreement. The Association may enter into agreements with other members different in terms from those contained herein without invalidating this Agreement provided that any member, at his or her request, may sign an agreement containing terms used by the Association in future agreements with other members.**

**Another example:**

**The Association may enter into agreements with other members of the Association differing in terms from those contained herein, but consistent with the Association's bylaws, without invalidating this Agreement. On request, member may sign such an agreement as a substitute for this Agreement.**

**Whenever a member enters into a new marketing agreement with the cooperative, it is good practice to insert a provision similar to the following:**

**This Agreement supersedes and cancels any prior agreement entered into between the parties thereto.**

**It is also a good idea to declare that any modification to the bylaws effectively amends the marketing agreement. A sample provision:**

**The bylaws shall constitute a part of this Agreement and any amendment duly made to said bylaws shall automatically modify this Agreement to take effect as of the date of the bylaw amendment.**

**Similarly:**

**The bylaws, as presently amended, and any future amendments to the bylaws, shall constitute a part of this Agreement and are hereby incorporated herein by reference. Any duly adopted future amendment to the bylaws shall constitute an amendment to, and modification of, this Agreement.**

**Termination of *Marketing Agreement*** Termination of the agreement usually transpires in one of several ways. The member or the cooperative may give proper and timely notice to terminate as defined in the agreement. Another basis for termination is breach of the agreement by either party.

In discussing contract termination or cancellation, it is important not to confuse termination of membership with termination of a marketing agreement. In some cases, one's membership in a cooperative may continue despite termination of the marketing contract.

Cooperatives differ on how to handle a breach of contract. In certain instances, a cooperative will take no action at all. Other associations will terminate a member's agreement without notice. Still others will provide the member with a

hearing before the board of directors or some related committee. At the hearing, the member has the opportunity to present his or her case. The hearing committee then decides whether to terminate the agreement.

An agreement provision covering termination of a member's marketing contract should include several points.

First, the marketing agreement should state that the member and cooperative are not released from any indebtedness or other obligations still outstanding at the time the agreement is canceled or terminated. An example:

**The cancellation of this Agreement by either party shall not (1) affect any uncompleted sales or transactions between the parties hereto, (2) release either party from any indebtedness unpaid thereafter occurring under this Agreement, (3) relieve member from obligation to sell to the Association any product acquired or produced by him or her during the preceding season, or (4) relieve the Association from selling any product produced during that season.**

Second, termination of one member's agreement in no way alters the duties of other members under contract. A sample provision:

**No action taken by the Board of Directors against one member in terminating or modifying terms of this Agreement shall operate to release or discharge in whole or in part in any manner whatsoever the obligations of any member under any other agreement.**

Third, it is important to state that the member whose contract has been terminated does not possess any property rights in the cooperative itself. This does not diminish, however, the member's right to equity invested in the cooperative. Some State cooperative statutes provide specific requirements

**on how and when a terminated member is to be repaid. Otherwise, a terminated member's equity does not have to be paid back immediately, but should be returned at the same rate as paid to members still in the cooperative. An example provision on this point might read:**

**Each member is received into membership upon the express agreement on the part of member to that effect; and upon the express conditions that the value of the property rights and interests of each member in the general property of the Association (prior to dissolution) is nothing. In the event of termination of membership prior to dissolution, irrespective of how terminated, such member shall not be entitled to anything as or for the value of such property rights and interests.**

**However, this has no effect on member's rights to receive his or her share of assets, allocations, etc., in accordance with provisions of bylaws and articles, i.e., on the same basis, at the same time, and in the same manner, as members whose memberships have not terminated.**

**Another example:**

**Member upon termination shall be entitled to no compensation for any interest in the Association and shall forfeit all rights in the property of the Association. Such event, however, shall not limit or impair the obligations or liabilities of the Association or member to complete all transactions commenced prior to such event, or the rights of member under any allocation certificate or any other evidence of indebtedness or any credit to his or her account on the books of the Association.**

## Assignment of Rights and Duties

Assignment In discussing the concept of assignment, it is useful to first consider the different circumstances in which this situation can arise in a cooperative setting. For instance, it could mean assigning one's membership in a cooperative. Or it might involve assigning one's duties under a marketing agreement to another party. Or a member may take out a mortgage with a creditor. In return, the creditor is to receive any cooperative payments owed to member. This last situation typifies lien situations involving third party creditors.

Many cooperatives do not permit one's membership or duties under a marketing contract to be assigned under any circumstances. Other cooperatives will allow the duties of a marketing contract to be delegated to designated individuals, particularly in cases after the death of a member. Getting consent of the board of directors is usually a prerequisite to any assignment. Some examples illustrating the different cooperative approaches to assignment:

The rights and duties set forth **in this Agreement are personal to each member. Neither this Agreement nor the relationship established hereby may be sold, assigned, transferred, encumbered, made subject to a security device, or otherwise disposed of in any manner whatsoever by any member.**

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**No member may assign or transfer any right, title or interest arising out of this contract or to any property, for the purpose of avoiding this Agreement. This shall not prevent, however, any member from selling or transferring property in good faith for valuable consideration.**

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**This Agreement and the rights and obligations thereunder shall not be transferred or assigned without the prior written consent of the Association.**

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**This Agreement, and the rights and obligations hereunder shall not be transferred or assigned, whether voluntarily or by operation of law, without the prior written consent of the Association. In the event that all or any part of the land described in the Appendix attached hereto or, if not described therein, any land where the products which are subject to this Agreement are grown, shall be sold, leased or otherwise transferred, this Agreement shall nevertheless remain in full force and effect and member shall remain obligated hereunder unless and until the Association consents in writing to a transfer or a termination of this Agreement.**

In the following examples, assignment is permitted under certain circumstances following the death or legal incapacity of the member.

**This contract is not assignable; but upon death of member the contract will be binding upon the decedent's estate, personal representative, and heirs as to, and only as to, any planting of a contract product in being at the time of death.**

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**Transfer of Membership. No membership, nor any membership right, shall be assigned, transferred, alienated, or encumbered, either voluntarily or involuntarily, or by operation of law or otherwise, without the consent of the Board of Directors, to a person not qualified to be a member of the Association. However, in the event of the death or legal incapacity of a member, the**



**membership shall be deemed transferred to the personal representative of such member, and the personal representative shall continue to be bound by the deceased or incapacitated member's obligations, including the obligation of member to deliver agricultural products to the Association. The personal representative shall be entitled to represent the estate or incapacitated member as a member upon representation in writing, filed with the Association, of such proof of his or her capacity as the Association may require.**

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**Transfer of Membership. Subject to the proviso hereinafter set forth, no certificate of membership may be assigned, voluntarily or involuntarily, or by operation of law, and any purported or attempted assignment, transfer, alienation or encumbrance of either a certificate of membership or any purported rights reflected thereby shall be wholly void and confer no rights upon the purported assignee, transferee or claimant.**

**Provided, however, that in case of the death of a member who is a natural person, the membership of the deceased shall pass by operation of law, notwithstanding the foregoing provisions of this section, to the person or persons lawfully entitled thereto. Such transfer will be effective when it shall appear that said person or persons is or are eligible to membership in the Association and shall have concurrently with said transfer assumed, agreed to perform, and discharge each and all the undertakings, agreements, burdens and liabilities of the deceased to the Association at the time of the death of said member, pertaining to or arising out of said membership or otherwise. Membership in the Association shall entitle the executor or administrator of any deceased member to continue deliveries**

**under the provisions of the bylaws for and during the current year in which said death may occur and irrespective of the transfer of the membership by death of the deceased.**

**Sometimes the cooperative, and not the member, seeks to assign rights and responsibilities relative to the marketing agreement. This could be due to a cooperative merger or consolidation with another cooperative association. Consequently, some cooperatives include in either its bylaws or the marketing agreement a provision on the enforceability of the marketing agreement should the cooperative become affiliated with another association. An example:**

**Successors in Interest. This Agreement shall be binding upon and be for the benefit of the parties and the successors, assigns, heirs, executors, and administrators of member, as well as any association, trust, corporation, firm or organization with or into which the Association may be consolidated or merged, or to which all or substantially all of its assets may be sold or transferred.**

**Other examples:**

**This contract shall bind the heirs, executors, administrators, successors, assigns or grantees of the respective parties hereto; provided, however, that the same may not be assigned by the Association except to a non-profit, cooperative association organized and existing under the laws of the State of (name of State), or a corporation or organization of a cooperative nature that may be authorized by law.**

**Successor Association. Each member hereby agrees that this contract shall not only be binding with the Association but with any association similar in nature that may succeed the Association or that may be formed in its place and stead, of which member may become a member and to which this contract may be duly assigned in writing. Any association to which this contract may be assigned shall be cooperative in character and conform to the laws of the State of (name of State) relative to the organization and operation of cooperative organizations.**

**Third Party** Creditors While cooperatives are generally reluctant in allowing members to assign their membership rights or contract duties, they recognize the needs of farmers to obtain crop financing. Consequently, associations usually have procedures in place for making payments to third party creditors in situations where the member has mortgaged a crop, and thereby created a valid lien in favor of a third party that is potentially superior to the rights and interests of the cooperative.

In anticipating dealings with outside lienholders, a cooperative should include several items in its marketing agreement to protect the interests of the cooperative and the membership.

As discussed earlier, a cooperative should require assurances from the member that he or she has good title and that the crop is free and clear of all liens and encumbrances. If this is not the case, the member must notify the cooperative in writing of any liens on the crop prior to delivery. Some examples:

**Each member confirms that all (product) will at the time of delivery be free and clear of all liens**

**and encumbrances except those to which the Association has given specific written consent.**

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**Each member warrants that the title to the items covered hereunder each year shall be good and the transfer rightful, that the same shall be delivered free from any claim of any third party, security interest or other lien of which the Association has not been informed by direct written communication from member prior to delivery each season.**

**Second, a provision** on liens should state that any cooperative payments to the lienholder cannot exceed the amount currently owed by the cooperative to the member. In effect, the lienholder stands in the place of the member until the lienholder's interest is satisfied. Some sample provisions covering payment to lienholders:

**Nothing in this Agreement shall be construed to preclude member from obtaining production financing by placing a lien on member's growing crop. Such lien, however, is to be subject to the right of the Association to handle the crop covered hereby according to the terms of this Agreement.** In such event, lienholder **shall stand in the place of member as such lienholder's interest appears and until such interest is satisfied.**

Another example:

**Liens. Member shall notify the Association of any lien on any \_\_\_\_\_ (product) \_\_\_\_\_ covered by this Agreement. Member shall obtain permission from the lienholder for the Association to market such \_\_\_\_\_ (product) \_\_\_\_\_ and to retain any deductions from the payments to producer authorized hereunder and**

**under the articles of incorporation and bylaws of the Association. After any such deductions, member authorizes the Association to apply the balance of the sale proceeds, or so much thereof as necessary, for payment of the lien.**

**Third, a cooperative should declare its right to be indemnified by the member** in those situations where the cooperative pays the member, and is then forced to make similar payment to an outside lienholder due to a superior claim to that same payment. The following provision includes discussion on the cooperative's right to indemnification:

**Each member signing this Agreement warrants that he or she has full legal authority to deliver the commodity. Each member agrees to notify the Association of any and all ownership interest in liens against commodity delivered hereunder at or before time of delivery and of the respective interest of each interested party therein.**

**The Association hereby assumes and agrees to pay any lien indebtedness of member relating to the delivered commodity that has been duly perfected and of which the Association has actual knowledge. However, the Association's liability with respect thereto shall not, in any event, exceed the amount of member's proportionate part of the net proceeds of commodity delivered under the Agreement.**

**In the event that any advances are made to member and it later develops that a third party has an interest in a lien on said commodities delivered hereunder, member agrees to fully indemnify the Association against further payment that exceeds the amount of member advances as hereinabove provided for in the Agreement. Such indemnity to the Association includes**

**but is not necessarily limited to travel expenses, court costs, bonds, and attorney fees.**

## **Enforcement and Remedies**

A key **section** in any marketing agreement involves the enforcement alternatives available to a cooperative when a member violates the agreement. Marketing contracts generally do not discuss the remedies available to members or the conditions under which members may seek damages should the cooperative breach the marketing **agreement**.<sup>15</sup>

In the enforcement area, two competing interests need to be recognized. In one sense, a cooperative wants a choice of enforcement options at its disposal, yet at the same time desires simple and direct enforcement policies. In drafting sections on enforcement and available relief, a cooperative should envision those situations where possible conflicts with members will predominate.

A cooperative must also resolve what measures it is willing to take in enforcing its agreements with members. A cooperative may choose to treat a contract breach **as** grounds for termination of membership, or seek monetary damages, demand specific performance from the member to carry out the agreement, or seek to enjoin the member from delivering the crop elsewhere. A cooperative can always disregard a member's breach; but it then must consider the impact on the other members. The cooperative and its members ultimately

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<sup>15</sup>Despite the lack of discussion of member remedies in marketing agreements, members do have all the usual remedies under contract and related law to draw from in bringing a legal action against their cooperative. Some of the more common forms of relief sought by cooperative members include damages, rescission of the marketing contract, termination of membership, injunction, specific performance, and an accounting. See **Harl**, 5133.04 [3] for further discussion and case examples.

benefit from an enforcement policy that is applied in a consistent manner.

**State Statutes** State cooperative statutes, as a rule, authorize cooperatives to include certain enforcement measures as part of their marketing agreements. Remedies often cited by these statutes include liquidated damages, specific performance, and injunction.

State statutes merely authorize a cooperative to pursue these remedies. For example, a State cooperative statute that gives a cooperative the right to seek an injunction, does not relieve a cooperative from satisfying the actual procedural requirements for meeting an injunction (filing a verified complaint, etc.) like any other litigant.

It should be emphasized that cooperatives can pursue any other remedies available to them under the law; they are not restricted to those mentioned in State cooperative statutes.

**Liquidated Damages** Most cooperative statutes cite liquidated damages as a proper remedy for inclusion in the marketing contract. Liquidated damages are a sum agreed to by the parties at the time of contracting, and represent a measure of damages in case of contract breach. Liquidated damages are computed from a formula expressed in the marketing agreement. The formula usually appears in one of the following ways:

(1) a percentage of the market value (example: 20 percent of the gross sales price of such commodity sold in violation of the agreement);

(2) a fixed sum per unit of produce (example: \$1.00 per hundredweight of milk sold in violation of the agreement);

(3) a fixed dollar amount plus a fixed sum per unit of produce (example: \$1,000 plus \$0.05 per pound of product withheld);

(4) a percent of the market value or a fixed sum, whichever is greater; or

(5) an amount equal to the value of the commissions lost by the cooperative.

An injured party looks to liquidated damages when it is difficult or impractical to calculate the actual damages suffered. Liquidated damages must be reasonable and not disproportionate to the injury likely to be suffered by the cooperative.<sup>16</sup>

Marketing agreements with a liquidated damages clause usually include an explanation of the underlying rationale for seeking this remedy over others. A sample provision for liquidated damages:

Each member **agrees that if at any time while this Agreement is in force, he or she neglects or refuses to deliver ~~her~~ (product) contracted for to such person or persons, and at such price or prices as may be designated by the Association, then in that event, member will pay to the Association a sum of money equal to percent of the gross sale price of all \_\_\_\_\_ (product) that member sells in violation of**

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<sup>16</sup>“Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.” UCC 2-718 (1).



**this Agreement. Such payments shall not be construed as a penalty or forfeiture, but as liquidated damages.**

**It is expressly understood by each member that the Association and its members collectively will suffer damage difficult to ascertain by reason of such neglect or refusal inasmuch as this Agreement establishes an exclusive agency for the purchase and sale of personal property under special circumstances, and inasmuch as this Agreement is one of a series, dependent for its true value on the compliance by each and all of the contracting parties with each and all of such Agreements, and that an important element of the damages arising from default by member would be interference with the accomplishments of the purpose of the Association in respect to the Association handling and marketing of such products.**

**Another example:**

**Inasmuch as the remedy at law would be inadequate and it would be impracticable and extremely difficult to determine the actual damage resulting to the Association should member fail to deliver the products covered hereby, regardless of the cause of such failure, member hereby agrees to pay to the Association sum of \$ per \_\_\_\_\_ (quantity) for all products delivered or disposed of, by or for the member, other than in accordance with the terms of this Agreement.**

**Once breach of contract is proven, then liquidated damages can be assessed directly by the association without recourse to the courts (unlike such other remedies as specific performance or injunction). A cooperative should, however, provide itself with several collection options should a member fail to pay assessed damages. One example:**

**Any sums owed by member to the Association as liquidated damages or otherwise may be deducted from the amounts payable to the producer.**

A more comprehensive approach:

**In addition to the Association's right to liquidated damages as set forth herein, in the event of member's breach of this contract, the Association shall have no obligation to make further payment, shall have the right to withhold such payment, of any and all crop proceeds, appropriations and member's equity allocations as the payment of such become due. The Association shall have and is hereby given a prior lien upon such amounts otherwise payable to secure the payment of liquidated damages as herein set forth. The Association may at any time set off against crop proceeds, appropriations, and member's equity allocations such liquidated damages, for which the Association is given a lien, and such liquidated damages shall be deemed canceled and satisfied to the extent of such crop proceeds, appropriations, and member's equity allocations.**

Two final points on drafting a liquidated damages clause for a marketing agreement. A cooperative should assert its right to bring successive actions for each failure or breach. A cooperative should also declare its prerogative to pursue, in addition to liquidated damages, all other remedies available under the law. Such remedies shall be deemed cumulative and not exclusive.<sup>17</sup> An example covering this point:

**In addition to the foregoing right to recover liquidated damages, the Association shall have all other**

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<sup>17</sup>See UCC 2-719 (1)(b). When the agreement states that a particular remedy is to be exclusive, this means it is the sole remedy.

**remedies now or hereafter available at law, including, but not limited to, the right to obtain an injunction for enforcement of this contract. Such remedies shall be deemed cumulative and not exclusive, it being agreed by each member obligated to deliver under all circumstances.**

**Specific** Performance Given today's complexities in agricultural marketing, cooperatives increasingly must make earlier supply commitments to outside traders and processors. If members fail to deliver their crop as required, this could mean lost business to the cooperative in dollar amounts that exceed any recoveries of liquidated damages. For such reasons, liquidated damages may not always be an adequate remedy to pursue against members who fail to deliver their crop.

Assume a grower-member possesses the crop subject to the marketing agreement, but withholds delivery to the cooperative. Assume further that this contributes to the cooperative's failure in meeting a supply commitment. Instead of damages, the cooperative might consider the remedy of specific performance. If granted this relief, the grower-member would be required by court order to deliver the crop to the cooperative.

Specific performance is an equitable **remedy**,<sup>18</sup> in which one is compelled by court order to carry out their contractual obligation. Specific performance is available even if the agreement contains a liquidated damages clause. This remedy is especially useful for cooperatives that require member delivery on an ongoing basis, such as dairy associations.

Normally, if the personal property involved in the contract can be easily purchased on the open market, a court will not order specific performance in lieu of damages from the

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<sup>18</sup>Specific performance and injunction are "equitable" remedies.

Generally, one is not entitled to a decree for specific performance, an injunction, or other equitable relief where the remedy at law (e.g., monetary damages) provides adequate recovery for the injury suffered.

breaching party. Marketing cooperatives are unique, however, since they are subject to various legal restrictions as to how much business they can conduct with nonmembers or nonproducers. Given these constraints, a court may order specific performance by a member even if the commodity is available elsewhere on the open market.

**Injunction** Like specific performance, an injunction is an equitable remedy issued through court order. An injunction is an order to do or to refrain from doing some specified act, usually because of a threatened or actual harm to personal or property interests. For example, a cooperative might seek an injunction to prevent a member under contract from selling production to a third person. If issued, the terms of an injunction order cannot be broader than the obligation described in the member's contract.<sup>19</sup>

While most State cooperative statutes authorize a cooperative to seek an injunction, certain procedural prerequisites must also be satisfied before a court will grant a temporary restraining order, a preliminary injunction, or a full injunction order. A milk cooperative was once denied a preliminary injunction based on its failure to show that it was suffering irreparable harm as required under Federal procedural law.<sup>20</sup>

In seeking injunction relief, it is crucial to anticipate the possible problem and be prepared to go to court in a moment's notice, since success in court often hinges on filing the petition in a timely and convincing fashion.<sup>21</sup>

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<sup>19</sup>*Legal Phases*, at 256.

<sup>20</sup>*See* *Southern Milk Sales, Inc. v. Martin*, 924 F. 2d 98 (6th Cir. 1991).

<sup>21</sup>*See* Frederick, D., "Prompt Legal Action Protects Marketing Agreement," *Farmer Cooperatives*, U.S. Department of Agriculture, Agricultural Cooperative Service, vol. 51, no. 4, p. 23. Washington, D.C. (July 1984) .

**Arbitration** Only a few cooperatives expressly provide the remedy of arbitration in their marketing agreement. Quite possibly, more cooperatives practice some form of arbitration with their members, but have not formalized it in their marketing agreement.

There are a number of reasons why arbitration can be an appropriate option for settling disputes. The procedure can be as formal or informal as the cooperative and membership choose. Arbitration can reduce legal costs by avoiding court. Disputes may be settled more expeditiously. There is also the potential of improving goodwill among the membership if the arbitration procedure develops a track record of fairness.

Some examples of arbitration procedures used by cooperatives:

**Settlement of Disputes. All claims, disputes and other matters in question between the Association and member, which cannot be settled through normal channels, shall be submitted to the Board of Directors or a committee from the Board. The Association and member agree that a good faith effort will be made to arbitrate such dispute prior to the initiation of legal action.**

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**If a member disagrees with the Association's decision as to grade, quality, color or other standards, either party may request that the issue be settled by a majority vote of three (3) arbitrators. Each arbitrator shall be a member delivering to the Association. One (1) arbitrator shall be selected by each party and the third by the two (2) so selected. Any expenses of arbitration shall be shared equally by the Association and member.**

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**Should any disagreement arise as to performance of or the rights of the parties under this Agreement,**

**then either member or the Association may request the Arbitration Committee as established by the Board of Directors to rule on the disagreement. The ruling of the Arbitration Committee shall be final, except that any party may request that the decision be reviewed by the Board of Directors.**

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**The Association and member shall be obligated to submit to arbitration under the Commercial Arbitration Rules of the American Arbitration Association any controversy, claim or dispute arising out or relating to the following subjects: (i) this Agreement, including, without limitation, the negotiation, execution, validity, interpretation or breach hereof, (ii) grading or rejection of any of member's products by the Association, (iii) failure or refusal to accept any of member's products that are bought, or contracted to be bought from member by the Association or (iv) the price of any of member's products that are bought or contracted to be bought from member by the Association. Any arbitration demand shall be filed, and the arbitration hearing shall be conducted, at the offices of the American Arbitration Association.**

### ***Other Enforcement Options***

Contract Damages. Cooperatives often do not seek contract (actual) damages from members because of the availability of liquidated damages. In some situations, however, a cooperative might seek actual contract damages, especially if they can be computed with relative certainty, and would exceed amounts recovered as liquidated damages. Actual damages may be preferable also because the injury suffered is not of the type covered by the liquidated damages clause.

*Right to Enter Member's Property.* Some cooperatives include in their marketing agreement the power to enter a

**member's property to inspect the crop subject to the contract. In addition, a cooperative (especially those dealing with perishable commodities) may give itself the additional right to enter the member's premises and harvest the crop subject to the marketing agreement, if the member fails or refuses to do so. The following example gives the cooperative the right to harvest a member's crop:**

**Obligation to Care for and Harvest Crops. Each member shall use all reasonable diligence in caring for his or her land and all crops grown or to be grown thereon. If a member fails or refuses to properly harvest said crops, the Association may enter upon said lands, care for said crops, and harvest the same, and the cost thereof shall be assessed against member and shall be a charge to his or her account. There shall be no obligation on the part of the Association to perform any or all of the above enumerated conditions, and the failure to do so shall in no way be construed as failing in its duties.**

***Effect of One Member's Breach on Other Members'***

***Contracts*** Cooperatives should strive to enforce agreements with members in a manner that is thorough, consistent, and fair. However, for a number of reasons, cooperatives will sometimes not take action against a noncomplying member.

To protect itself in cases where members are allowed to breach their agreement without penalty, a marketing agreement should declare that the cooperative's lack of action against a breaching member does not alter the obligations of other members under agreement. An example:

**No release or discharge of any member's marketing obligation nor failure of the Association to enforce such obligation shall in any way affect the obligation of**

**any other member to deliver products in conformity with these bylaws or the marketing agreement.**

Note in the example that follows, a member's breach has been waived this one time. However, the member is still subject to the terms of the agreement for the remainder of the agreement:

**Waiver of the breach of any term hereof shall not be deemed to be a waiver of any other or subsequent breach of the same or any other term or of any liability for any subsequent breach.**

It is important to distinguish a cooperative not pursuing a breaching party in a particular instance from the legal concept of "release." There have been cases ruling that releasing the contractual duty of some members frees the other members as well unless the cooperative derives some benefit by releasing a particular member or members from their contract.<sup>22</sup>

**Legal Defenses for Noncompliance** Marketing agreements as a rule do not specify the possible defenses a cooperative or member might assert as a legal excuse for not complying with a contract. This does not suggest that traditional defenses associated with contract law are not available to cooperatives and members. Defenses for failing to fulfill one's duties under a contract may be based on fraud, duress, failure by the other party to meet certain conditions precedent, etc. These defenses are subject to waiver if not raised within a reasonable time period.

One available contract defense that does appear in marketing agreements is impossibility of performance. This concept covers situations such as fires, floods, or other similar disasters (i.e., acts of God). Some sample provisions on impossibility of performance:

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<sup>22</sup>See *Legal Phases*, at 202-203; and Harl, § 133.03 [3][b].



**Impossibility of Performance.** In the event performance of this Agreement is prevented or delayed by act of God, war, civil insurrection, fire, flood, storm, strike, lockout, or by law, regulation or order of Federal, State or local authority or by any other cause beyond the control of either party, then such performance, to the extent it is so prevented or delayed, shall be excused.

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**Impossibility of Performance.** The Association shall not be obligated to receive, process, or otherwise handle the products of its members in the event that the Association is prevented from doing so by strikes, lockouts, labor disturbances of any kind, riots, insurrection, war, fire, shortage of any supply, earthquake, acts of governmental authority, breakdown of facilities, or any cause whatsoever that is beyond the Association's control.

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**Excuse of Performance.** In the event that the performance of this Agreement by either the Association or member is prevented or delayed by act of God, war, civil insurrection, fire, flood, storm, strike, lockout, failure of machinery, equipment or material, or by law, regulation or order of Federal, State, or local authorities, or by any other cause beyond the control of the Association or member, as the case may be, the performance of such party under this Agreement shall be excused to the extent it is so prevented or delayed.

**Attorney Fees** Some marketing agreements include a provision for the payment of attorney fees to the cooperative should the association have to engage in any type of legal action against a member. An example:

**If the Association brings any action against member by reason of a breach or threatened breach of this Agreement and prevails, member shall pay to the**

**Association all court costs, costs for bonds, travel expenses and other expenses arising out of or caused by the litigation, including reasonable attorney's fees expended or incurred by the Association in such proceedings. All such costs and** expenses shall be included in the judgment.

## **Emerging Issues Affecting Marketing Agreements**

As discussed earlier, the content of marketing agreements has not changed dramatically over the years. However, recent developments have prompted cooperatives to consider agreement provisions that reflect some of the changing forces in agribusiness. This includes matters involving food quality and the environment, as well as labor concerns.

**Food Quality/Environment** Food quality and related environmental concerns are starting to be addressed in some marketing agreements, particularly by those cooperatives that handle or process crops treated with chemicals. Particular attention has been directed toward pesticide residues, which are regulated under both the Federal Insecticide, Fungicide, and Rodenticide Act (FIFRA)<sup>23</sup> and the Federal Food, Drug, and Cosmetic Act (FFDCA).<sup>24</sup>

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<sup>23</sup>The Federal Insecticide, Fungicide, and Rodenticide Act (FIFRA) regulates residues by forbidding the use of a pesticide in a manner inconsistent with its label, and by denying registration to pesticides found to cause unreasonable adverse effects to man or the environment. 7 U.S.C. § 301 et seq. (1988).

<sup>24</sup>The Federal Food, Drug, and Cosmetic Act (FFDCA) prohibits the distribution of agricultural commodities that contain levels of pesticides beyond federally determined maximum tolerance levels. Both acts are interrelated as the Environmental Protection Agency will not register a pesticide for use under FIFRA until maximum residue levels have been established under FFDCA. 21 U.S.C. § 301 et seq. (1988).

**Following are sample provisions appearing in current marketing agreements that attempt to delegate or at least forewarn the member of the responsibilities implicit in some of the Federal and State environmental laws. Note that some of these provisions set stricter standards than required by law:**

**No milk sold, shipped, consigned or delivered by member to or on the order of the Association, during the period in which this Agreement is effective, will be adulterated or misbranded within the meaning of the Federal Food, Drug, and Cosmetic Act of June 25, 1938, as amended, or within the meaning of any State food and drug law, the adulteration and misbranding provision of which are identical with or substantially the same as found in said Act. Such milk will not bear or contain any penicillin, pesticide chemical, antibiotics, chemotherapeutic drugs or other food additive that is unsafe within the meaning of Section 408 or Section 409 of said Act, and such milk will not be such article as may not, under the provisions of Section 408 or 409 of said Act, be introduced into interstate commerce. However, member does not guarantee against such milk becoming adulterated or misbranded within the meaning of said Act or Acts, after shipment by reason of causes beyond member's control.**

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**Member warrants that no product to be delivered has been, or will be treated with, and when delivered to the Association will be free of, any and all "economic poisons" as defined in the Federal Insecticide, Fungicide, and Rodenticide Act, or any other deleterious substances prohibited or regulated under any Federal, State, or local law other than those that, under applicable law and canning industry practice, are permissible for treatment of such products.**

**At least 72 hours prior to delivery of the crop, each**

**member shall furnish the Association with a complete and accurate written statement of all pesticide treatments of the crop to be received. Should member breach any of these provisions, in addition to other remedies, the Association may refuse to accept delivery of any portion or all of the affected crop. In such event, the Association shall have no obligation to pay for said crop.**

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**Each member represents and warrants that as of the time of delivery, all ~~s h~~(product) ~~h~~ a v e been grown and delivered in compliance with all Federal and State laws and regulations, including among other, the Federal Food, Drug, and Cosmetic Act, the Federal Insecticide, Fungicide and Rodenticide Act, as well as the Rules and Procedures of the Association, and shall be suitable for sale in interstate commerce. Member will not be entitled to compensation if not in compliance with these requirements.**

**In addition, the Association provides an important corollary: each member shall follow practices, rules and regulations that protect the environment. If, in the judgment of the Board of Directors of the Association, an unreasonable action or inaction by member has resulted in a failure to protect the environment, member shall be considered to have committed a material breach of this Agreement.**

***Labor* Some cooperatives have included provisions in their marketing agreement or bylaws that attempt to protect the cooperative and the member from potential liability arising from labor practices carried on by the other party An example:**

**Anything contained in these bylaws or any agreement between the Association and its members**

**notwithstanding, the Association shall have no control whatsoever over the labor relations policies or conduct or direction of its individual members. Likewise, the individual members of the Association shall have no control whatsoever over the labor relations policies or the direction of labor relations of the Association and its employees.**

## **CONCLUSION**

**Obviously, no single strategy or format is appropriate for every cooperative** using a marketing agreement. Each cooperative faces unique external (market) and internal (organizational) influences that shape its response to the competitive marketplace.

A cooperative must first identify its economic objectives, and from that point craft a marketing agreement in legal terms that facilitates achieving those economic objectives as efficiently as possible. This is easier said than done, since economic expedience can sometimes clash with legal prudence.

The members' role in an effective marketing agreement program should not be minimized. Successful marketing cooperatives usually include a membership that is willing to give up more of its individual control for the betterment of the association. Members exemplify this by subjecting themselves to more demanding agreements in order to realize greater efficiencies as a collective unit.

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Agricultural Cooperative Service (ACS) provides research, management, and educational assistance to cooperatives to strengthen the economic position of farmers and other rural residents. It works directly with cooperative leaders and Federal and State agencies to improve organization, leadership, and operation of cooperatives and to give guidance to further development.

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