Contracts: Practical Legal Advice - Starting with "Read It"

Contracts are as much a part of pork production today as feed rations and herd health. From contract feeding agreements, to weaned and feeder pig purchase contracts, to manure easements, as well as marketing contracts, today's pork producer is regularly faced with written agreements that play a crucial role in the operation's success.

Despite the importance of contracts, too often producers entering into a contract rely on the other party's standard form contract and that party's verbal interpretation of the contract. Another common scenario is where one party obtains a copy of a contract that has been used in another totally unrelated situation, but believes it will work in this case without review or modification. Admittedly, contracts developed under these scenarios may work just fine. But, this is usually because the parties have a strong enough relationship that they handle most of the agreement verbally and, in effect, no written agreement is necessary.

While written agreements are only as good as the parties behind them, a well-drafted written agreement is essential in instances such as where one party's understanding of the agreement turns out to be different than the other party's or if the person who contacted you is no longer the person you are dealing with. And probably the best reason to have a written contract - if there is a dispute over a verbal contract proving to a judge, jury or arbitrator which party's version of the verbal agreement is correct is extremely difficult and expensive in the form of damages if a court rules against you and legal fees, whether you win or lose.

This article will focus on the fundamentals applicable to all types of contracts. Articles in future issues of the Iowa Pork Producer will cover issues particular to specific types of contracts such as contract feeding agreements, hog marketing contracts, weaned and feeder pig purchase contracts, manure easements and swine building leases. Related topics such as insurance on pigs fed under contract and Uniform Commercial Code liens also will be covered.

While it may seem so basic that it does not even need to be said by anyone, much less an attorney, probably the most critical mistake is failing to read and fully understand a contract before signing it. Yes, it is important to have your attorney and other advisors review the contract. But, you are the one who will live with the contract and therefore it is more important that you understand what the contract says and how it works. Read it closely and think through various situations that could happen. When entering into a contract, it is too easy to think that everything will go exactly as planned. We all know that most likely there will be glitches. Think about what those could be and how they would be dealt with by the contract language. Ask your advisors how those scenarios and any they can think of would be handled under the contract. Then, talk with the other party to the contract. If it is not clear how the contract language would apply, revise the contract. If the other party refuses to revise the contract and it is not a "deal killer," at least you know how the contract will work and can be ready.

Other common principles to keep in mind when entering into a contract are:

- There are always a lot of discussions that occur between the parties when a contract is being negotiated. Not all of those verbal discussions end up in the written agreement. However, most written contracts have a clause that states that the written agreement supersedes all previous oral agreements. Thus, if the other party says something different than what is in the written contract, insist that the written contract be revised to include what was told to you.

- Likewise, if a contract states you must do something but you are told that that clause won't be enforced, insist that the contract be revised. Otherwise, assume that the clause will be enforced.

- Everything is negotiable, including whether to sign the contract. Even if you are told the contract is "take it or leave it," discuss all details of the contract before you sign it. You may be surprised

at how much negotiating power you have. And, if you decide to sign the contract without any changes, you at least know how the contract will be handled and can plan for that. Also, the other party knows you understand and pay attention to details.

- As you negotiate a contract, make it clear that there is no contract until everything is in writing and signed by everyone. In some cases, parties will begin to operate before the contract is signed. You now have a verbal agreement and a pending written contract. That is okay if negotiations proceed as planned. But, if a problem in the final terms of the contract develops, you have lost a lot of negotiating power in finalizing the written contract.

- Be aware of legal procedure clauses such as in which state a lawsuit or arbitration action must be filed if there is a dispute. Being required by the contract to travel to another state and hire an attorney in that state for a lawsuit puts you at a disadvantage if a dispute develops. The contract may require arbitration instead of going to court. This may or may not be in your best interests, so discuss this with your attorney.

- Another legal "fine print" type clause in many contracts is a force majeure clause. This means that if an event beyond either party's control occurs that makes it impossible for the party to perform under the contract (most often, events such as fire, storm, government intervention), the party is excused from the contract until it is once again possible to perform the party's duties under the contract. Read this clause carefully and don't assume it will apply unless the language in the contract clearly applies to the situation. In most cases, market conditions (such as the market price of hogs or the price of corn) or herd health problems do not qualify as force majeure.

- Negotiating contracts is an art that many producers are very good at. However, if you negotiate a deal that seems too good to be true, it probably is. No matter how "air-tight" a written contract is, if it isn't workable for both parties, there will likely be problems in enforcing the contract.

Once a contract is in place, there are number of basic principles that producers should keep in mind:

- Although the original contract should be kept in a secure place, keep a copy of the contract handy and review it periodically to make sure you know what you are required to do, such as keeping records and making written reports to the other party. Make a list of these requirements.

- Contracts often have a clause that provides upon expiration of the original term of the contract it will continue for a specified period of time unless either party terminates it by notifying the other party in writing by a certain date. This date, and other deadline dates in the contract, may be several years away and are easy to forget. If you use an electronic calendar program, enter this date with a few months lead time to remind you early enough to take action by the deadline. If you don't have such a system, use some other system that works for you or ask a consultant to help you keep track of contract deadlines.

- A written contract that is not verbally modified in some way by the parties as time goes on is rare. Most contracts, however, have a clause that states any changes must be in writing to be enforceable. To avoid disputes, these verbal modifications should be put in writing, signed by both parties, and attached to the original. Again, it is advisable to have an attorney prepare the amendment to make sure there is no misunderstanding in the language of the amendment and how it affects the original contract.

- If you discover that you cannot perform a requirement in the contract, let the other party know as soon as possible and explain why. Communication will avoid surprises for the other party and may go a long way in avoiding legal disputes. Never assume that you won't have to comply with the contract.

- If either party breaches/defaults under the contract, the other party has a right to money damages to compensate them for their losses. Courts rarely order a party to a contract to perform, but

rather consider money damages in most cases as sufficient to compensate the party who has not defaulted. However, our legal system requires the party who has not defaulted to mitigate their damages by taking all reasonable steps to maximize income in the face of the breach. And, keep in mind that after a default occurs, state commercial law and most contracts allow the party a period of time to correct the default (called a right to cure) before any action can be taken to seek damages and/or terminate the contract.

- One very common situation is where one party defaults and the other party wants to terminate the contract because they have lost trust in the person who defaulted. To be able to terminate a contract because of a default, courts require that the default be a substantial part of the contract or that the default substantially defeats the purpose of the contract. In other words, a default of a relatively minor clause in a contract cannot be used as a basis for terminating the contract.

These contracting principles may seem very elementary, but most contract disputes start with a misunderstanding of these basics and can result in long and expensive legal battles where neither party feels like it won, regardless of the outcome.

As with all legal issues, producers should consult individual legal counsel for advice tailored to each individual situation.