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An Agricultural Law Research Article

State Regulation of Production Contracts

by

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I. Introduction

Increasingly, agricultural production in the U.S. occurs through production contracts – agreements through which producers (or “growers”) and contractors (typically agricultural commodity processors) detail an arrangement for raising agricultural commodities.¹ These agreements, like most commercial contracts, are subject to state regulation. As agricultural production contracts have become more common, several states have enacted legislation directly regulating production contracts and the process of creating them. This article collects and briefly analyzes existing state laws– from Arkansas, Georgia, Illinois, Iowa, Kansas, Minnesota, and Wisconsin – that directly regulate production contracts.²

II. Model Producer Protection Act

The trend toward state legislation regulating production contracts was accelerated in September 2000 when the attorneys general of sixteen states³ proposed a Model Producer Protection Act (MPPA) for state regulation of production contracting relationships. In a statement announcing the MPPA, Iowa Attorney General Tom Miller stated that the proposal was an effort to equalize bargaining power between producers and contractors.⁴ The MPPA would cover contracts for production of livestock (including poultry), raw milk, or a crop.⁵ Its provisions would:

¹ For further definition of production contracts, see NEIL D. HAMILTON, A FARMER’S LEGAL GUIDE TO PRODUCTION CONTRACTS 3 (1995); Christopher R. Kelley, *Agricultural Production Contracts: Drafting Considerations*, 18 HAMLINE L. REV. 397, 397 n.4 (1995).

² Other state laws, such as environmental requirements or laws relating to packer feeding operations or corporate ownership of agricultural land, may also have substantial regulatory impact on production contracts. This article focuses on laws and regulations that directly target production contracts. For a discussion of other categories of state legislation that may have an impact on production contracts, see Neil D. Hamilton, *State Regulation of Agricultural Production Contracts*, 25 U. MEM. L. REV. 1051, 1057 (1995).

³ The MPPA was sponsored by the attorneys general of Colorado, Indiana, Iowa, Kentucky, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, North Dakota, Oklahoma, Vermont, West Virginia, Wisconsin and Wyoming. See Press Release, Iowa Attorney General Tom Miller, *Iowa Leads States Pushing “Producer Protection Act”* (Sep. 13, 2000), available at http://www.state.ia.us/government/ag/latest/news/releases/producer_act.html.

⁴ *Id.*

⁵ See Model Producer Protection Act, § 2 (extending coverage to “production contracts that relate to the production of a “commodity” if certain conditions are met); § 1(e) (defining “commodity”), available at <http://www.flaginc.org/pubs/poultry/poultryp5.pdf>.

- Require that contracts be written in plain language and disclose material risks;⁶
- Guarantee producers three days to review contracts before signing;⁷
- Prohibit confidentiality provisions;⁸
- Provide producers with a priority lien for payments due under a contract;⁹
- Prohibit capricious or retaliatory termination of contracts where producers have made substantial capital investments;¹⁰
- Prohibit contractors from engaging in retaliatory or discriminative practices against a producer who exercises rights, including the right to join an association.¹¹

Miller described the MPPA as a “starting point” for state legislation, noting that the sponsoring attorneys general did not agree on all provisions and that the act was expected to be customized for each state.¹² Since the proposal of the MPPA in 2000, several states (Arkansas, Georgia, Illinois and Kansas) have passed legislation regulating production contracts, though, as anticipated, the terms of these laws vary significantly from the MPPA and from other state laws.

Critics of the MPPA have questioned whether it would have “unintended consequences” on markets, thus raising costs to contractors and driving industry to non-regulating states or to foreign markets.¹³ Defenders of the act, however, argue that the MPPA would merely provide access to information in the market and eliminate a few egregious abuses -- both strategies utilized in other areas of law, such as consumer protection, securities regulation, and antitrust, without undesirable market distortions.¹⁴

The existing state laws regulating production contracts reveal two differing philosophies about the role of state regulation, focusing either on substance or process. The first type, characterized by Iowa and the original provisions of the Minnesota law, (1) creates substantive rights and protections for producers, and (2) provides producers with broad license to police contractor behavior through private rights of action. The second type (and more recent trend), characterized by the Illinois law and the amendments to Minnesota’s law, focus on regulating contract formation and performance with provisions intended to equalize bargaining power (including comprehension and access to information) and the amount of financial risk to the parties in the event of termination or change in the relationship. While most state laws can be characterized by one of these two approaches – either predominantly substance- or predominantly process-oriented – all contain at least a few provisions reflecting the other approach.

⁶ *Id.* § 4.

⁷ *Id.* § 5.

⁸ *Id.* § 6.

⁹ *Id.* § 7.

¹⁰ *Id.* § 8.

¹¹ *Id.* § 9.

¹² See Press Release, *supra* note 3.

¹³ See Michael Boehlje et al., *The Producer Protection Act – Will It Protect Producers?*, AGRIC. L. UPDATE, Jan. 2001, at 4.

¹⁴ See Neil E. Harl et al., *The Producer Protection Act – Will It Protect Producers? A Rejoinder*, AGRIC. L. UPDATE, Feb. 2001, at 1.

III. State Laws Regulation Production Contracts

Arkansas. The new Arkansas Livestock and Poultry Contract Protection Act, section 2-32-201 of the Arkansas Code,¹⁵ applies to production contracts for livestock and poultry entered into on or after September 1, 2005.¹⁶ The Act affects only a few aspects of production contracts and applies only to livestock and poultry contracts, but where it does apply, its terms appear to substantially alter the pre-legislation substantive rights of growers and contractors. Substantively, the Act requires:

- readability and disclosure requirements for production contracts, including disclosure of a list of “material risks” such as contract duration, termination provisions, and provisions affecting calculation of a grower’s compensation;¹⁷
- prohibition of unfair or deceptive trade practices or other violations of law;¹⁸
- prohibition of any terms (such as confidentiality clauses) that would inhibit growers from associating and comparing contract terms;¹⁹
- prohibition of any terms (such as confidentiality clauses) that would inhibit growers from seeking professional, legal, financial, or agricultural advice relating to the contract;²⁰
- guarantee of the right to file suit in court (allowing for voluntary arbitration only).²¹

The Act makes voidable any production contract provision that doesn’t comply with the Act,²² and provides for a private right of action, including damages and injunctive relief, for growers.²³

Georgia. Georgia’s production contract law, sections 2-22-1 through 2-22-5 of the Georgia Code,²⁴ provides some protection only for poultry contract growers through limited regulation of the bargaining process and of compensation determinations. First, the law regulates the bargaining process by requiring that a grower be permitted to review the contract with advisors for three days prior to execution, and, with limited exceptions, be entitled to cancel the contract for three days after execution.²⁵ Second, the law regulates the contractor’s actions under the contract by providing that the grower has a right to statistical information affecting compensation under the contract²⁶ and a right

¹⁵ ARK. CODE ANN. § 2-32-201 (Supp. 2005).

¹⁶ *Id.* § 2-32-201(e).

¹⁷ *Id.* § 2-32-201(b)(1).

¹⁸ *Id.* § 2-32-201(b)(2).

¹⁹ *Id.* § 2-32-201(b)(3).

²⁰ *Id.* § 2-32-201(b)(4).

²¹ *Id.* § 2-32-201(b)(5)(A) & (B).

²² *Id.* § 2-32-201(c).

²³ *Id.* § 2-32-201(d).

²⁴ GA. CODE ANN. §§ 2-22-1 – 2-22-5 (Supp. 2005).

²⁵ *Id.* § 2-22-2.

²⁶ *Id.* § 2-22-3.

to be present during weighing that affects compensation under the contract.²⁷ The law provides for a private right of action for violations, consistent with that provided by Georgia law for unfair or deceptive business practices.²⁸

Illinois. Effective January 1, 2005, Illinois' Agricultural Production Contract Code, title 505, sections 17/1 through 17/99, of the Illinois Compiled Statutes,²⁹ was intended to "ensure fairness and clarity in the contracting process."³⁰ The provisions of the Illinois law appear to serve two primary functions: first, equalizing bargaining power between contractors and producers; and second, redistributing the economic risk of changes in the relationship by providing legal protections for producers against some of the most potentially damaging unilateral changes by contractors. The law, which applies only to contract with a duration of longer than 30 days,³¹ includes the following protections:

- Provisions relating to readability³² and indexing³³ of the contract ensure equal understanding of the contract's terms by producers and contractors;
- The law permits confidentiality clauses but ensures that producer bargaining power will not be adversely affected by such clauses by requiring that the producer be permitted to discuss the contract with certain advisors, business partners and family members;³⁴
- To ensure full disclosure, the law requires "special provisions," such as requirements related to disease protocols or grain identity preservation, to be fully explained in the contract;³⁵
- Provisions strictly limiting unilateral termination or alteration by the contractor help equalize the risk of changes in the relationship for the contractor, which may have thousands of producers under contract, and the producer, which may depend on the contract at issue for his or her livelihood;³⁶
- In general, a contractor who terminates a contract must give notice and compensate the producer for any capital investments required by the contract. Like the termination or alteration provisions, this law is geared toward equalizing the parties' risk of loss in the event of termination of the relationship;³⁷
- The Illinois Attorney General has enforcement authority for violations relating to the contract structure, with fines of up to \$10,000 per violation. Producers have a private right of action

²⁷ *Id.* § 2-22-4.

²⁸ *Id.* § 2-22-5.

²⁹ 505 ILL. COMP. STAT. §§ 17/1-17/99 (2004 & Supp. 2005).

³⁰ Office of the Attorney General for the State of Illinois, "Agricultural Production Contract Code and Guidelines," available at <http://www.illinoisattorneygeneral.gov/environment/> (follow "Agriculture" hyperlink, then follow "Agricultural Production Contract Code and guidelines" hyperlink).

³¹ 505 ILL. COMP. STAT. § 17/10.

³² *Id.* § 17/20.

³³ *Id.* § 17/25.

³⁴ *Id.* § 17/30.

³⁵ *Id.* § 17/35.

³⁶ *Id.* § 17/40.

³⁷ *Id.* § 17/45.

relating to the contractor's performance of the contract (termination, alteration, and compensation for capital investments).³⁸

Iowa. Iowa law includes several separate provisions regulating the content and performance of production contracts. Chapter 202 of the Iowa Code prohibits use of confidentiality clauses in contracts for the production of livestock, raw milk, or a crop.³⁹ Under the law, a confidentiality clause in any form is unenforceable, but the clause is severable and any unaffected provisions of the contract may be enforced.⁴⁰ A contractor who executes a production contract with a confidentiality clause is guilty of a "fraudulent practice," classified as an aggravated misdemeanor under Iowa criminal law.⁴¹

Chapter 579B of the Iowa Code creates the first agricultural lien for contract producers.⁴² The lien creates a security interest for any producer of livestock, raw milk or crops under a production contract, and applies to the commodity or, if sold, to the proceeds from the commodity.⁴³ The lien is perfected by filing a financing statement with the secretary of state and terminates one year from the date the commodity is no longer under the authority of the contract producer.⁴⁴

Chapter 654B of the Iowa Code provides a mediation process for disputes arising out of livestock care and feeding contracts.⁴⁵ Voluntary mediation may be requested by the producer ("farm resident") for any dispute,⁴⁶ and mediation is mandatory before a producer may file suit in court (with exceptions for potential irreparable harm or claims included in a class action).⁴⁷ Judicial review is limited to whether, based on clear and convincing evidence, the mediator's decision is an abuse of discretion.⁴⁸

Kansas. Kansas has separate laws regulating swine production contracts (enacted in 1994) and poultry production contracts (enacted in 2002). The law regulating swine production contracts, sections 16-1501 through 16-1506 of the Kansas Statutes,⁴⁹ is modeled after legislation enacted in Minnesota in 1990, which applied more broadly to production contracts for crops, livestock and poultry. Like the Minnesota law, the Kansas swine production contract law created several substantive rights in favor of producers:

³⁸ *Id.* § 17/50.

³⁹ IOWA CODE ANN. §§ 202.1-202.3 (Supp. 2005).

⁴⁰ *Id.* § 202.3.

⁴¹ *Id.* § 202.5; see also IOWA CODE ANN. §§ 714.8, 714.11 (2003).

⁴² IOWA CODE ANN. § 579B (Supp. 2005).

⁴³ *Id.* § 579B.3 .

⁴⁴ *Id.* § 579B.4.

⁴⁵ IOWA CODE ANN. § 654B.2 (2000 & Supp. 2005).

⁴⁶ *Id.* § 654B.2.

⁴⁷ *Id.* § 654B.3.

⁴⁸ *Id.* § 654B.10.

⁴⁹ KAN. STAT. ANN. §§ 16-1501- 16-1506 (1995).

- Parent companies are liable for claims against subsidiaries;⁵⁰
- An implied promise of good faith is applied to all production contracts;⁵¹
- Contracts requiring capital investments of at least \$100,000 and with a useful life of at least five years may not be cancelled without notice and time to cure to the producer, except in specific instances such as voluntary abandonment, material breach, or conviction of a related offense;⁵²
- Contractors must “pay a fair price” and “make all payments promptly.”⁵³

In contrast to rights of poultry growers, discussed below, the law requires that swine production contracts provide for disputes to be submitted to mediation or arbitration.⁵⁴

Kansas’ poultry production contract law, section 16-1701 of the Kansas Statutes,⁵⁵ closely resembles Arkansas’ production contract law, with a few important differences. First, the Kansas law applies only to poultry production contracts.⁵⁶ Second, while requiring a disclosure of “material risks,” the phrase is not defined in the Kansas law.⁵⁷ Third, Kansas expressly protects contractors from disclosure of trade secrets.⁵⁸ While these laws potentially limit the protections offered to contract growers, Kansas is also the only state that unconditionally prohibits contractors from terminating contracts with producers that have performed all their obligations under the contract.⁵⁹

Minnesota. In 1990, Minnesota became the first state to enact legislation directly regulating production contracts.⁶⁰ The law, as amended, is at sections 17.90-17.98 of the Minnesota Statutes.⁶¹ The Minnesota law applies to a wide range of production contract arrangements, including crops, livestock and poultry. In the 1990 provisions, the Minnesota law provided certain substantive assurances to producers against abuses by contractors:

- Disputes must be resolved by mediation or arbitration, and contracts must contain written disclosure of risks to producers,⁶²

⁵⁰ *Id.* § 16-1501(d).

⁵¹ *Id.* § 16-1501(e).

⁵² *Id.* § 16-1502.

⁵³ *Id.* § 16-1504.

⁵⁴ *Id.* § 16-1505.

⁵⁵ KAN. STAT. ANN. § 16-1701 (Supp. 2004).

⁵⁶ *Id.*

⁵⁷ *Id.* § 16-1701(b)(1).

⁵⁸ *Id.* § 16-1701(b)(3).

⁵⁹ *Id.* § 16-1701(b)(7).

⁶⁰ For a discussion of this and other early legislative efforts, see Hamilton, *supra* note 2, at 1074-83.

⁶¹ MINN. STAT. ANN. §§ 17.90-17.98 (Supp. 2006).

⁶² *Id.* § 17.91.

- Contractors must reimburse producers for capital investments required by the contract, with limited exceptions;⁶³
- Contractors may not terminate contracts for a producer's failure to perform the contract without providing the producer with notice and time to cure the breach;⁶⁴
- Parent companies are liable for debts of subsidiaries;⁶⁵
- A covenant of good faith is implied in all production contracts;⁶⁶
- Ombudsman oversight and review of complaints is established;⁶⁷ and
- Right to a letter of credit is provided for producer pre-payments for agricultural inputs.⁶⁸

In 1999, the Minnesota legislature enacted a provision prohibiting confidentiality clauses in agricultural production contracts.⁶⁹

In 2000, the Minnesota agricultural producer protection law was substantially amended to add provisions safeguarding the contracting process, similar to those in the Illinois law. Those additions include:

- grant of a right to the producer to cancel the contract within three days, or such other period as designated by the contract;⁷⁰
- a mandatory cover sheet to all contracts alerting producers of potential legal rights and obligations associated with the contract and indexing its provisions;⁷¹
- readability and terminology requirements;⁷²
- a process for Commissioner of Agriculture to review the contract;⁷³
- limitations on remedies and applicability;⁷⁴ and
- prohibition on waiver of rights pursuant to the Act.⁷⁵

Wisconsin. In 1993, Wisconsin became the second state to substantially regulate production contracts through regulations governing "vegetable procurement contracts," at sections 101.01-101.07

⁶³ *Id.* § 17.92.

⁶⁴ *Id.*

⁶⁵ *Id.* § 17.93.

⁶⁶ *Id.* § 17.94.

⁶⁷ *Id.* § 17.95.

⁶⁸ *Id.* § 17.97.

⁶⁹ *Id.* § 17.710.

⁷⁰ *Id.* § 17.941

⁷¹ *Id.* § 17.942.

⁷² *Id.* § 17.943.

⁷³ *Id.* § 17.944.

⁷⁴ *Id.* §§ 17.9441 and 17.9442.

⁷⁵ *Id.* § 17.9443.

of the Agriculture section of the Wisconsin Administrative Code.⁷⁶ Three sections expressly regulate production contracts: a list of requirements for vegetable procurement contracts,⁷⁷ which are primarily process-oriented, and lists of prohibited contract provisions⁷⁸ and prohibited practices,⁷⁹ which are more substance-oriented. The contract requirements include:

- a requirement that contracts be in writing;⁸⁰
- a 72-hour cancellation period for producers;⁸¹
- clear and conspicuous disclosure of terms, such as payment amounts and formulas;⁸²
- disclosures related to requirements not to harvest some acreage;⁸³
- identification of harvesting responsibilities;⁸⁴ and
- arbitration of disputes at the request of the producer.⁸⁵

The list of prohibited contract provisions and practices includes:

- charging producers more than fair market value for seeds or services;⁸⁶
- relieving the contractor from liability for its negligence or shifting contractor liability to the producer;⁸⁷
- failing to pay the producer according to the contract terms;⁸⁸
- misrepresenting contract terms as an inducement to the producer to sign an agreement;⁸⁹
- conspiring to fix prices or restrain trade;⁹⁰
- refusing to contract with a producer in retaliation for certain actions by the producer, such as filing a complaint with the government, seeking arbitration of a dispute, or associating with or organizing other producers;⁹¹ and

⁷⁶ WIS. ADMIN. CODE ATCP §§ 101.01-101.07 (Oct. 2004).

⁷⁷ *Id.* § 101.02.

⁷⁸ *Id.* § 101.06.

⁷⁹ *Id.* § 101.07.

⁸⁰ *Id.* § 101.02(1).

⁸¹ *Id.* § 101.02(2).

⁸² *Id.* § 101.02(3).

⁸³ *Id.* § 101.02(4).

⁸⁴ *Id.* § 101.02(5).

⁸⁵ *Id.* § 101.02(6).

⁸⁶ *Id.* § 101.06(1).

⁸⁷ *Id.* § 101.06(2), (3).

⁸⁸ *Id.* § 101.07(1).

⁸⁹ *Id.* § 101.02(3).

⁹⁰ *Id.* § 101.02(4).

⁹¹ *Id.* § 101.02(5).

- charging a producer for defective seed for which the contractor has been reimbursed.⁹²

Wisconsin law also includes a limited regulation of livestock production contracts (defined to include poultry).⁹³ The law, section 100.04 of the Wisconsin Statutes, requires that livestock production contracts contain provisions defining the distribution between the owner of the livestock and the possessor of the livestock of any payments received in the event of destruction due to “disease, fire or other unanticipated cause.”⁹⁴

IV. Conclusion

Since the first production contract laws were enacted in the early 1990s, the legislative trend has moved from regulating the substantive rights of producers to regulating the bargaining process and redistributing the risk of termination. If production contracting continues to increase, more states may propose or revisit legislative initiatives to regulate the contractor-producer relationship.

⁹² *Id.* § 101.02(6).

⁹³ WIS. STAT. ANN. § 100.04 (2004).

⁹⁴ *Id.*