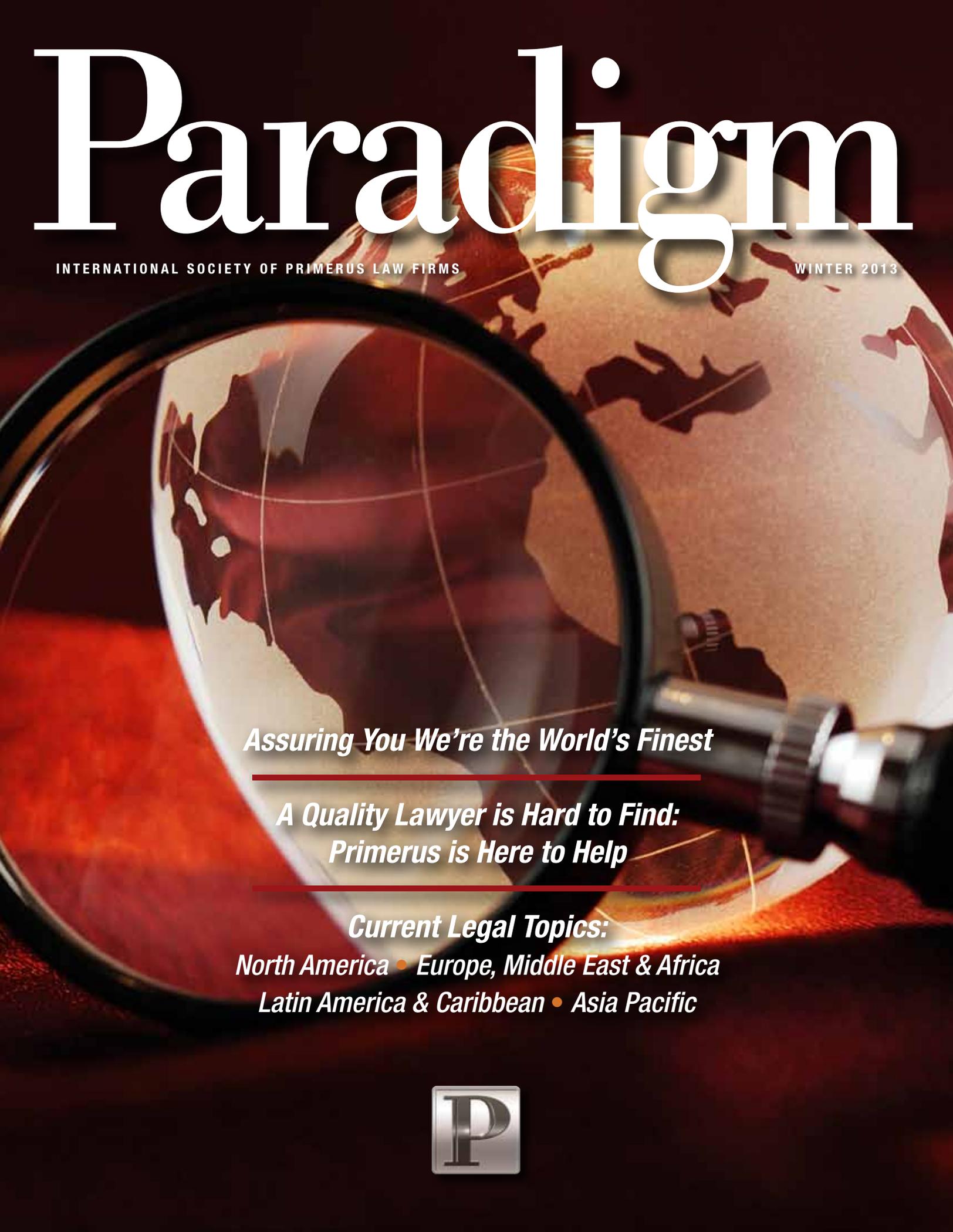


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Agricultural Contract Clauses for Supplying Energy Crops to the Biofuels Industry

As important as technology advancement and biorefinery business formation are to the future of the biofuels industry, success is also wholly dependent on enormous quantities of biomass being produced by America’s farmers. The purpose of this article is to further thinking and discussion on the essential terms of biomass supply arrangements among all parties – farmers, biorefinery owners, seed suppliers, feedstock supply companies, bankers, lawyers and public officials. Many interests must be balanced:

- Contracts for energy crop supply must be competitive and fair to farmers in the short- and long-term to attract the required quantities and quality of switchgrass, miscanthus, sorghum, agricultural residues and other energy crops.
- Biomass conversion facilities are dependent on reliable, uniform, and economical feedstock, and energy crop supply arrangements must address those requirements over the life of the facility.

- Bankers and investors providing biomass conversion project financing demand assurance of feedstock supply for the life of the project, and agricultural contract arrangements must provide confidence in the availability of feedstock over the long-term.
- Mother Nature dictates requirements and introduces uncontrollable variables into all parties’ contract expectations. Supply contracts will fail unless they: take account of drought, storm, or other acts of God; are adapted to realistic agricultural, capital and labor input cycles, as well as requirements for planting, cultivating, and harvesting; and fit the particulars of the specified crop, for example, whether it is an annual or a perennial, or grows from a seed or a rhizome.

Traditional agricultural contracts include agreements between farmers and those that purchase or market the farmers’ crops, agreements between producers and suppliers, and agreements concerning land use. Some common

forms of agricultural contracts, elements of each, varying responsibilities of the parties, Uniform Commercial Code (“UCC”) considerations, and other state statute considerations are summarized below.

Production Contracts

Generally, a production contract is an agreement by which a farmer agrees to sell or deliver a designated crop grown on identified acreage to a purchaser in a specified manner. The contract specifies production conditions,¹ quality of product, acceptable production inputs and management requirements.² More specifically, production contracts contain provisions covering the crop’s entire production process from beginning to end, often specifying planting periods, cultivation practices, and other matters intended to ensure delivery of a certain quality and quantity of the crop to the purchaser.³

The farmer in a production contract provides growing services and supplies a small part of the total production input. He or she usually does not own the crop during production; in fact, under some agricultural production contract models, title to the growing crop and to the har-

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vested crop is never held by the farmer.⁴ The farmer in a production contract has a reduced production risk which may lead to lower compensation.

The purchaser in a production contract supplies and finances nearly all of the production input and usually owns the crop during production as well as after harvest and delivery. The purchaser makes all or most production decisions and maintains a managerial position, often including the right to make field visits.

Depending on the biorefinery's specifications for biomass feedstock, the project owner might take on less overall business risk if it specifies, or actually provides to the farmer, the high biomass sorghum seed to be used to establish the

Marketing Contracts

Generally, a marketing contract is an agreement by which a farmer agrees to sell or deliver all of a specifically-designated crop grown on identified acreage to a purchaser. The contract usually specifies only the price for an established quality of crop and delivery procedures for the harvested crop.⁵

A farmer entering into a marketing contract obtains a buyer and a price for the crop before it is harvested. The farmer supplies and finances nearly all production input and owns the crop during production. The farmer makes production decisions and assumes production-related risks. Because the farmer undertakes production risks, compensation is usually reflective of the

be fixed, or could be set by a formula that, for example, includes a factor based on the price of diesel fuel. Some cellulosic technology conversion processes are designed to handle biomass derived from a specific energy crop or with other specified delivery requirements. In that case, the marketing contract might specify that crops must be grown from a specified seed, or that the biomass must be delivered to the supply contractor with no more than a certain percentage of moisture content, or that it must be delivered in square bales.

Uniform Commercial Code vs. Other State Law

The UCC governs the sale of goods, including agricultural products.⁶ Both



crop, requires the farmer to follow specified agricultural schedules and practices in planting and cultivating the crop, specifies the fertilizer to be applied and its schedule, and provides a harvesting contractor to cut, weigh, and retrieve the biomass from the field. Due to the purchaser's extensive control over the details of the farm operation, the farmer has reduced risk of production as well as significantly less investment, and is therefore less likely to be subject to loss in the event of drought, flood or other crop failure.

market value for the crop.

The purchaser in a marketing contract buys a known quality and quantity of a crop for a negotiated price. The purchaser does not own the crop until it is harvested and delivered and exerts little influence over production decisions.

A biomass supply contractor for a cellulosic ethanol plant might enter into a marketing contract with area farmers. A farmer would agree to sell the entire crop on a particular 500 acres to the supply contractor for three years for a specified price per ton. The price could

production and marketing contracts are for the sale of agricultural products and are therefore governed by the UCC. State statutes may also specifically govern agricultural contracts, which provides for the possibility of conflicting laws.

State statutes that are consistent with the UCC may supplement, but ordinarily do not supplant, its provisions. To be consistent with the UCC, a state statute must be consistent with the text as well as the purposes and policies of the UCC, which are: (1) to simplify, clarify and



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modernize the law governing commercial transactions; (2) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties; and (3) to make uniform the law among the various jurisdictions.⁷

If a state statute conflicts with either the UCC's text or its purposes and policies, the UCC ordinarily supersedes the statute. However, if the state statute was specifically enacted to provide "additional protection to a class of individuals engaging in transactions covered by the UCC," a court may allow the state statute to supersede the UCC.⁸ The question of whether the UCC or the state statute should apply is a question of law.

For example, a Tennessee statute limits the duration of certain agricultural contracts to three years.⁹ The statute was apparently enacted during the Great Depression to protect farmers. However, the statute could be construed to be contrary to the UCC's text, purposes and policies: the UCC does not limit the duration of contracts, and the limitations imposed

by the Tennessee statute are neither modern nor uniform with other jurisdictions.¹⁰ There are advantages to farmers in longer-term contracts: establishment of a base farm income over a number of years; the ability to amortize investment in land, equipment or crop establishment; some assurance that the contract price would cover costs; and an opportunity to develop expertise in the management of a particular crop.

A state statute that limits the duration of agricultural contracts could be problematic for the developing biomass industry. A single season, or a two- or three-year term, contract does not provide a biorefinery owner with feedstock assurance. Because of the magnitude of the investment, a biomass supply contractor will likely seek to contract for a significant percentage of the facility's biomass feedstock requirements during the development phase of the facility. A three-year contract term, even with the possibility for renewal, is probably not sufficient. Balancing of the various laws

that may apply to a contract for biomass supply is an important consideration.

The discussion of appropriate terms to include when contracting for biomass is one that must be continued among farmers, feedstock suppliers, bankers and biomass conversion facility owners as the industry progresses, to eventually find a middle ground on which all parties can agree. 

- 1 Examples of production conditions include: requirements for type and condition of soil for successful production, a precise schedule for the use of acceptable inputs, and specific production practices to be used by the farmer.
- 2 Agricultural production inputs refer to items such as seed, fertilizer, chemicals, pesticides, fuel, machinery, etc.
- 3 Christopher R. Kelley, *Agricultural Production Contracts: Drafting Considerations*, 18 Hamline L. Rev. 397 (1995).
- 4 Id. at 398.
- 5 Production Contracts, <http://www.farmfoundation.org/news/articlefiles/105-May2004ProductionContract.pdf> (last visited Oct. 13, 2012).
- 6 U.C.C. § 1-203(1)(k) (2004) and U.C.C. § 2-102 (2004).
- 7 U.C.C. § 1-103(a) (2004).
- 8 U.C.C. § 1-103, cmt. 3 (2004).
- 9 Tenn. Code Ann. §43-15-101 (2012).
- 10 The Tennessee statute was enacted in 1932 and has not been cited in any case since its enactment; no other state has a similar statute limiting the duration of agricultural contracts.