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AGRICULTURAL LAW AND TAXATION BRIEFS

DEPARTMENT OF AGRICULTURAL AND CONSUMER ECONOMICS, UNIVERSITY OF ILLINOIS AT URBANA-CHAMPAIGN

GRAIN CONTRACTS, HIGH PRICES, FLOODS AND FAILURE TO DELIVER

By Donald L. Uchtmann, A. Bryan Endres, and Stephanie B. Johnson*

Abstract: This article addresses important issues arising when a farmer's crop is lost to floodwaters or when market prices rise much higher than the contract prices negotiated when grain prices were lower. Is a grain contract binding if it was never signed by the farmer? Does the inability of a farmer to harvest a crop because of flood provide an excuse for the farmer not to deliver grain as required by contract? What if a farmer harvests a crop but prefers to sell it at a higher price than the contract price negotiated before a rise in grain prices? What damages might be assessed against a farmer who fails to deliver grain as required by contract? Is a farmer still liable for breach of contract damages if the farmer files bankruptcy? This article is part of a law-related educational program for Illinois family farmers made possible by a gift from the Illinois Bar Foundation. The assistance of the Agricultural Law Section Council of the Illinois State Bar Association in reviewing the article also is appreciated.

Introduction

The 2008 flood wreaked havoc on farmland throughout the Midwest. In addition to destroying thousands of acres of crops, the floods have contributed to an increase in grain prices compared to the fall of 2007. The flooding has some grain farmers wondering what to do if they cannot deliver on "forward contracts" to sell grain entered into before their crops were lost to the floodwaters.

Also, some elevators may be wondering what would happen if an unscrupulous farmer who contracted to sell gain to the elevator when prices were lower were to ignore these contracts for future delivery and, instead, sell the grain on a higher spot market. For example, what are the likely legal consequences if a farmer ignores a contract entered into in the fall of 2007 to deliver 2008 corn at harvest for a price under $4/bushel and, instead, sells the corn on the cash market after harvest at, say, $5/bushel?

Grain producers and elevators also may wonder if a prevailing party in a suit for breach of contract (e.g., a grain elevator) may shift its attorney fees onto the losing party (e.g., a farmer who breached the contract to deliver at a particular price).

In addition to answering these questions, this article provides a basic overview of contract law as well as suggestions for farmers facing hardship in the wake of the recent floods.

When Is an Agreement to Sell Gain, Even an Oral Agreement, Legally Binding?

Whether a particular agreement is legally binding depends on the specific circumstances. This general discussion may be helpful to the reader but is not a substitute for legal counsel in a particular situation.

The basic requirements for a contract are (a) the contract offer, (b) the acceptance of the offer, and (c) an exchange of something of value (in legal jargon this exchange is known as "mutual consideration", e.g., farmer's promise to deliver grain in exchange for elevator's promise to pay for the grain at a certain price). Generally, agreements with these elements are legally binding, but for the sale of goods, such as grain and livestock, Illinois' Uniform Commercial Code (UCC) imposes an additional requirement.

Under the UCC, contracts for the sale of grain, livestock, or other "goods" *for the price of $500 or more* are not enforceable unless there is (a) some writing signed by the party to be bound (e.g., a party who now wants out of the contract) or (b) a written confirmation as described below.

Writing Signed by the Party to Be Bound. A signed agreement satisfies the UCC if the writing states the essential terms of the agreement, such as price, quantity, and date of delivery. Therefore, if an agreement between a farmer and a grain elevator for the sale of grain contains the essential price and quantity terms as well as a delivery provision and is signed by each party, then each party can legally enforce the contract. (This would be true in most cases unless some "contract defense" could be proven, e.g., one party was forced to sign the agreement under threat of death or bodily harm.)

Written Confirmation of an Oral Agreement Between Merchants. If the parties to an oral agreement are merchants (as defined in the next paragraph), one merchant may send a written confirmation to the other merchant within a reasonable time, and if the other merchant does not object in writing within 10 days, the oral agreement usually is legally enforceable if the recipient has reason to know of the contents of the confirmation. The party seeking to enforce the alleged contract would still have the burden of proving all essential elements of the contract.

A merchant is a person who by his or her occupation generally deals in the kind of goods involved in the transaction. *Generally, grain farmers have been held to be merchants*, within the meaning of the UCC, *with respect to contracts for the sale of grain*. See the Illinois Supreme Court case of Sierens v. Clausen, 60 Ill. 2d 585, 328 N.E.2d 559 (1975).

For example, if a farmer and a grain elevator (both of whom meet the definition of a merchant) enter into an oral agreement for the delivery of a quantity of grain at a certain price on a specified date, and within a reasonable time the grain elevator sends to the farmer a signed written confirmation detailing the terms of the oral agreement, the farmer then has 10 days to object to the terms of the writing. If there is no timely written objection, the oral agreement becomes just as legally binding as it would have been if the original agreement had been in writing and signed by both parties.

As a practical matter, many grain elevators now mail written confirmations of their oral agreements with farmers for the sale of grain. Absent other contract defenses, these oral agreements, when followed within a reasonable time with written confirmations, are generally binding on both parties even though the farmer has not signed anything. Farmer's failure to provide a timely objection in writing to the elevator's written confirmation is, in effect, a substitute for the farmer's signature.

Special Rules May Apply in Bankruptcy or If Elevator Loses Its Grain Dealer License

If a party to a contract for future delivery of grain files *bankruptcy*, special rules regarding "executory contracts" may apply under federal bankruptcy law (see specifically 11 U.S.C. §365). These rules may allow an agreement for future delivery of grain at a specified price (the "executory contract") to be avoided by the trustee in bankruptcy.

Similarly, if an Illinois licensed *grain dealer surrenders or loses its license*, special rules regarding "anticipatory repudiation" may allow the agreement for future delivery of grain to be avoided (see, for example, the case *In the Matter of C & S Grain Company, Inc.*, 47 F.3d 233, 7th Cir. 1995).

Further discussion of contract obligations in such special circumstances is beyond the scope of this article.

The authors have attempted to describe, generally, when an agreement to deliver grain is legally binding. However, because of the potential for special circumstances, including the loss of a crop or a prize bull to flooding as described below, farmers and others with questions about whether a particular agreement is legally binding should seek legal counsel.

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What if the Crop Intended to Be Delivered Under the Contract Was Destroyed by Flood?

When a contract is for the sale of a "fungible" good like grain, delivery under the contract is still possible even though the crop the farmer intended to deliver cannot be harvested because of flood, drought, etc. How can this be true? The farmer can always satisfy the contract obligation by delivering other grain, instead of the grain lost to a flood. For example, the farmer could theoretically buy grain from a grain elevator at the current market price and use this grain to satisfy the forward contract.

As a general rule, contract law follows the logic described above. If a farmer agrees to sell grain (a 'fungible" good) and fails to deliver the grain because of flood, drought, etc., the farmer usually would be liable for breach of contract unless there is a settlement with the elevator.

A different result could be present if the contract were for the sale of a prize bull, rather than for the sale of grain. A prize bull is unique, unlike a fungible good such as No. 2 Yellow corn. If a farmer has a contract to sell the bull at a particular price but the prize bull is lost in a flood, it would be impossible for the farmer to meet the farmer's contract obligation. As a general rule, such impossibility of performance excuses a party's failure to perform an obligation otherwise required by a contract. A farmer whose prize bull is lost in a flood would need to return any down payment collected from the contract buyer of the prize bull, but the farmer probably would not be liable for other damages. This result (where the contract obligation is to sell something truly unique) is clearly different from the result where the contract is to sell grain (something "fungible").

To avoid litigation and other costly remedies for breach of contract, farmers should consult with an attorney before disregarding any business agreement, oral or written. This is true whether the farmer's crop has been lost to flood or drought or whether the farmer simply would prefer to sell the grain elsewhere for a higher price. If the farmer is on the brink of insolvency, consultation with a bankruptcy attorney may be especially warranted.

Remedies for Breach of Contract

If a farmer breaches a contract by failing to deliver, the elevator can seek a legal remedy. One option is for the elevator to "cover," that is, to purchase substitute grain from another source and then initiate a lawsuit against the farmer for "damages," which usually include the difference between the contract price and the cover price.

For example, if a farmer fails to deliver corn under an agreement specifying a sales price of $4/bushel, and the elevator purchases substitute corn on the market for $6/bushel, the elevator will be able to collect the $2/bushel difference from the farmer. The elevator also may seek to recover incidental or consequential damages incurred in remedying the farmer's breach of contract, such as the costs involved in finding substitute grain. Thus, the monetary risks of ignoring a contract obligation or failing to deliver on a contract are substantial.

In order to avoid a breach of contract lawsuit, a farmer who has lost some or all of a grain crop in a flood or other disaster could, with the assistance of legal counsel, seek a settlement with the grain elevator. Alternatively, the farmer could begin seeking substitute grain to deliver to the elevator, hopefully at a price that will be lower than the "cover" price that would be paid by the elevator. Reaching a settlement with the elevator before the agreed upon date of delivery, or purchasing substitute grain to avoid a breach of contract action, also may allow a farmer to avoid the incidental damages incurred by the elevator in covering and, as noted below, the attorney fees incurred by the elevator.

Attorney Fees

The state of Illinois follows the "American Rule" regarding attorney fees. The American Rule provides that each party shall bear its own attorney fees, regardless of the outcome of the litigation. Although the losing party in a lawsuit cannot ordinarily be required to pay attorney fees to the winning party, there is an exception to the rule. A leading court case on this point is Chapman v. Engel, 372 Ill. App. 3d 84, 87, 865 N.E.2d 330, 332 (Ill. App. Ct. 2007).

The exception to the American Rule states that contracts may contain provisions awarding attorney's fees to the prevailing party. Without a fee-shifting provision in the contract, a prevailing party usually cannot expect to have its attorney's fees paid by the losing party in a breach of contract action. Before entering into litigation, it is important to review the contract to see if it contains any language about the shifting of attorney fees to the losing party. In the absence of contractual language to the contrary, each side normally should expect to pay its own attorney fees.

Summary and Recommendations

As a general rule, the loss of a crop to flood will not excuse a farmer's obligation to deliver grain at harvest under a forward contract otherwise legally enforceable. Even if the farmer has not actually signed the forward contract, it may still be enforceable if the elevator had sent a written confirmation to the farmer and the farmer did not object in writing within 10 days. Farmers who, in the aftermath of the Flood of 2008, cannot deliver their own gain in satisfaction of a contract obligation should seek legal counsel.

The best way to avoid a breach of contract lawsuit may be to negotiate a settlement with the elevator. Alternatively, a farmer could deliver grain originating from another source, thereby fulfilling the famer's contract obligation. Through such actions, farmers may avoid litigation costs, the elevator's incidental costs of covering, and perhaps the elevator's attorney fees that otherwise would be incurred.

Despite the temptation to take advantage of higher grain prices, farmers should remember that ignoring less favorable forward contract obligations and selling one's grain elsewhere at a higher price can ruin a farmer's business reputation. Furthermore, it is financially risky to ignore one's less favorable contract obligations and, instead, to sell the grain to a new buyer at a more favorable price. Such a plan can easily backfire if the elevator covers at a price higher than the farmer's new sales price, especially if the original agreement also provides that the elevator's attorney fees must be paid by the defaulting farmer.

In general, a farmer should not breach a contract, purchase substitute grain, or enter into a settlement with a grain elevator without seeking legal advice. Consulting with an attorney will help a farmer select the best course of action, based on the terms of the individual contract and the particular circumstances. Legal guidance may result in a more favorable settlement with an elevator and can help to avoid a lawsuit for breach of contract.

In some circumstances, a farmer's financial losses from a contract settlement where the grain has been lost to flooding, or from delivering grain at a low contract price while also bearing unanticipated increases in production costs, may be so devastating to the farmer that filing bankruptcy may be warranted. *Contracts for the future delivery of grain may be treated differently in bankruptcy than in the normal situations describe above*. In circumstances potentially involving bankruptcy, legal counsel may be especially helpful to a farmer.

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**Uchtmann is a Professor Emeritus and Endres is an Assistant Professor in the Agricultural Law Group of the Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign. Johnson is a University of Illinois Law Student and researcher in the Agricultural Law Group.* *The authors thank attorneys William J. Bolotin, James R. Grebe and Jerry Quick, members of the ISBA Agricultural Law Section Council, for their helpful suggestions. AGRICULTURAL LAW AND TAXATION BRIEFS are available at www.farmdoc.uiuc.edu/legal/.*