Doing business on more than a handshake

Focusing on the terms of a contract is important, but neglecting important parts of the contracting process, is where serious problems often occur. Taking care of some simple yet critical steps can help you better understand the contracting process and reduce your counterparty risk.

There was a time when a firm handshake and a man’s “word” was all that was needed for conducting business. Well, those days are long gone, and it’s probably a good thing, too.

FEED & GRAIN visits with Attorneys Jacob D. Bylund and Kim J. Walker of Faegre & Benson LLP, who have extensive experience serving clients in the food, agriculture and biofuels industries, about ways to better manage contracts and disputes.

Because of the general nature of this discussion, it’s important to consult with counsel with respect to specific circumstances and state laws that may impact transactions and the parties’ obligations.

F&G: What fundamental elements must be in place to create a successful contractual arrangement?

Bylund: You can truly significantly reduce your risk of a dispute by focusing on three critical procedural issues common to legal proceedings. These include first and foremost knowing the party with whom you are contracting, having a signed contract confirmation and lastly, identifying the date of default of a contract. Doing right by these three tenets provides a clear understanding of the contract and its terms and helps protect the elevator or mill’s interests.

F&G: So why do I need to worry about “identifying the contracting party” when I played ball with them or go to church with them? They seem like a good person with whom to do business.

Walker: That’s a pretty common mistake many managers make when entering into a contractual agreement. While they may indeed know the “person” on a personal or social level, they may not know about the “busi-
It sounds like an elevator manager has a lot of legwork and paperwork ahead of them before this process gets started. Is all this really necessary?

**Bylund:** Without doing your due diligence up front, you expose your business, shareholders and yourself to a great deal of risk. Believe me, without proper attention to process your chances of recovery for the full amount of a bad contract plummet and what you do recover could be further diminished by legal fees.

**Walker:** The first step in your process should be to determine who you are really dealing with. In many cases, that means understanding the various business forms available for contracting parties. Several available options can effectively shield the assets of the business owner from third-party creditors and the use of those options has proliferated in their many forms in the last 10 to 20 years and range from sole proprietorships to limited liability entities popular in today’s marketplace.

**F&G:** What are some of the more common entities and what key characteristics make them unique?

**Bylund:** Sole proprietorships are rather common in the grain industry, especially for elevators who contract directly with producers for their grain, as they are owned and operated by one person. Contract characteristics for a sole proprietorship include the owner/operator, often referred to as someone “doing business as” or “d/b/a”; the owner is inseparable from the business and is personally liable for the debts of that business. For example, if the owner is Joe Smith his contract signature block would read “Joe Smith d/b/a Smith Farms.” So the block tells us the contract and liability is with Joe Smith alone.

**Walker:** A general partnership is an association of two or more persons who carry on as co-owners of a business for profit. While a general partnership is a legal “entity,” it does not require a filing with the Secretary of State. Also, they act like a sole proprietorship but with more than one person and partners share unlimited liability for the debts of the partnership irrespective of which partner incurs the liability.

In this case the contract signature block could read: Smith Farms, Joe Smith, partner. In that instance, the contract is with Smith Farms and the liability runs to: Smith Farms, Joe Smith and Tom Smith, partners. One caveat to remember is this: Partners in a general partnership may be limited liability entities too.

A limited partnership, on the other hand, has one or more general partners and one or more limited partners and must be filed with the Secretary of State. In limited partnerships the general partner(s) have unlimited liability for the debts of the limited partnership and limited partner(s) are generally not liable for debts incurred of the LP.

The contract signature block would read Smith Farms, LP, Joe Smith, general partner and the contract is with Smith Farms, LP. The liability runs to: Smith Farms, LP and Joe Smith.

**F&G:** Does a corporation need to be filed with the Secretary of State?

**Bylund:** Due to the more complex nature of its structure, and liabilities and powers, a corporation must be filed with the Secretary of State. So when dealing with a co-
poration you can get certain public information on that entity relatively quickly. Additionally, a corporation owns the corporate property, owes the corporate debt and is the debtor that gets sued or the creditor who sues.

A corporation has a unique operating structure in that it has a board of directors, officers, annual meetings and reports, etc., and, features double taxation — it pays taxes on earned income and shareholders pay tax on income from dividends. Its contract signature block would read: Smith Farms, Joe Smith, president; the contract and liability lies with Smith Farms, Inc.

**F&G:** It seems as though limited liability entities have become the popular choice for many seeking commercial and commodity contracts. Why are they so popular?

**Bylund:** Because they are so easy and affordable to create and do a good job protecting their members from outside liability. A limited liability company (LLC) or limited liability partnership (LLP) can be formed in a few hours for less than $1,000 and doesn’t affect the tax burden of its owners. Formation of an LLC or LLP doesn’t impact a business’ ability to obtain credit but does protect an owner’s liability for a tort committed by the owner (if LLC member is negligent in a car accident while on LLC business, the owner is personally liable). Most important for your readers, the formation of an LLC or LLP protects an owner from contract liability to third-parties that contract with them.

Bottom line, LLCs and LLPs very well may protect their owners from being liable to you!

**F&G:** How are LLCs and LLPs formed and what do they look like?

**Walker:** While both require filing with the Secretary of State’s office, an LLC is an unincorporated association having one or more “members,” and combines elements of both a corporation and a partnership. Like a corporation, LLC owners are not liable for the obligations of the business and like a partnership, income and losses of the company flow through the company to the owners thus avoiding double taxation. Its contract signature block will look like this: Smith Farms, LLC, Joe Smith, manager. The contract is with Smith Farms, LLC, not Joe Smith.

The LLP actually grew as a response to laws which created LLCs. Unlike general partnerships whereas individual partners bear liability for its debts and obligations, partners in a LLP are statutorily provided full-shield protection from partnership liabilities, debts and obligations.

The contract block for a LLP would read Smith Farms, LLP, Joe Smith, partner. Again, the contract is with Smith Farms, LLP, not Joe Smith.

**F&G:** Now that I have an idea of the various types of entities an elevator may be contracting with, what is the next step?

**Bylund:** Once you’re armed with the types of businesses out there, consider creating a master agreement reference. It sounds simple but you would be surprised how often this is overlooked. You do have some protection when dealing with individuals because of personal liability for default and individuals are often less likely to breach contracts than companies.

**F&G:** Once the entity has been properly identified and the contract process is underway, what is next?

**Walker:** When making a financial condition assessment you need to evaluate what information you know about that person or business. One easy step is to ask the person about their business and ask for references. It sounds simple but you would be surprised how often this is overlooked. You do have some protection when dealing with individuals because of personal liability for default and individuals are often less likely to breach contracts than companies.

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limited liability entities. Should they breach, they will personally suffer the consequences.

**FAQ:** What types of public information should I look for?

**Bylund:** Most states require limited liability entities to file documents with the Secretary of State’s office. These filings are commonly available via internet and include information such as filing dates (think twice about a group formed yesterday), the registered agent name and address which can be compared to the address you were given, and the officer’s names. Another good source of public information are lien filings. Uniform Commercial Code (UCC) lien filings are maintained by the Secretary of State’s office. Remember one thing, real businesses have real creditors. If you contract with a party that has no liens against it, you should raise a red flag. After all, it takes money to plant a crop. Additionally, check court records, conduct internet searches and use the phone book.

**FAQ:** Why is having a signed confirmation so important?

**Walker:** A confirmation signed by the counterparty to a contract is critically important for several reasons. First, an unsigned confirmation invites the other party to deny ever entering into the contract. Under UCC 2-201, a confirmation signed by the sender is sufficient to create an enforceable agreement if the counterparty is a “merchant.” However, in many states, the issue of whether a farmer is a merchant is unclear. An unsigned confirmation will often result in litigation as to whether the contract “exists” and as to whether it’s enforceable against the purportedly non-merchant producer even if it does exist. Legal proceedings as to these issues result in legal costs and create inherent litigation risk (risk that you will not prevail). Such costs, which may be considerable, are easily avoided through proper contracting procedures.

We would encourage your readers to make themselves knowledgeable of the NGFA Grain Trade Rules for everything from confirmation of an oral agreement to what procedures are involved in arbitration.

**FAQ:** If you suspect or know that a party has defaulted or non-performed on a contract, what should you do?

**Bylund:** Your first step is to document any statement or actions undertaken by the counterparty that lead you to believe a breach has or will occur. Be sure to inform your supervisor or owner of the situation and discuss action steps. Next I would recommend a consultation with your company’s legal counsel and consider the option of a demand for assurance pursuant to UCC 2-209 — essentially demanding written assurance of performance of a contract. Until that is received within a reasonable and mutually agreed upon timeframe, you may consider suspending performance of the contract — and, as a last resort, if assurance is not provided, terminate the contract. This would include closing out hedge positions related to the contract and proceeding with settlement discussions and/or actions for seeking damages against the breaching party.

Business can still be conducted with a handshake but we’d like to see that handshake occur after a well-constructed and researched contract is signed by both parties.

As legal advisors to many of the world’s leading food, agriculture and biofuel companies, Faegre & Benson lawyers have industry-specific knowledge in core areas important to these businesses. To leverage that knowledge effectively for clients, Faegre & Benson LLP offers a focused group of more than 100 lawyers out of offices in Denver, Des Moines and Minneapolis.

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