

# WHOLESALE SUCCESS

## Legal Best Practices for the Wholesale Farmer

Wholesale production can be a valuable marketing approach for farmers. Through a comprehensive risk management strategy that includes the legal aspects of wholesaling, farmers can build a stronger, more resilient operation. Wholesaling itself is not necessarily more legally risky than any other sales strategy, but the greater farm investment required to wholesale successfully can increase a farmer's total risk exposure. Additionally, if the wholesaling creates diversification, that itself broadens risk. Managing the risks of wholesaling is not difficult, however, and doing so may even result in better communication and more accurate financial management. These six basic risk management strategies will contribute to a stronger, more resilient wholesale farm:

- 1. Make the terms of your sale clear to buyers. Ideally, use a written sales agreement.**
- 2. Purchase an insurance policy that covers your risks.**
- 3. Write a food safety plan.**
- 4. Maintain regular, consistent, and clear records of your food safety practices.**
- 5. Be aware that employment laws may affect wholesale activities differently than other farm activities.**
- 6. Consider creating a separate business entity for the farm or wholesale enterprise.**

Each best practice is discussed in more detail below. More robust information is available in the additional resources recommended under each best practice.

### *1. Make the terms of your sale clear to buyers. Ideally, use a written sales agreement.*

Laying out the terms of the sale is a key step in laying a good foundation for a profitable sales relationship with a wholesale buyer. Farmer and buyer should agree on a set of procedures that they agree to follow when working with each other. This, fundamentally, is the definition of a sales agreement or contract. When an agreement is written down and discussed before the sales relationship begins, farmer and buyer establish clear communication from the start. Procedures create predictability and accurate expectations for everyone, which goes a long way to preventing problems.

While preventing problems may be the first goal in establishing clear terms of sale, the second goal is legal enforceability. If something goes wrong, the farmer needs the ability to protect his or her operation. If a buyer unfairly backs out of a sale, wrongly disputes the product quality, or simply fails to pay the farmer, written procedures are highly recommended for enforcement and may be essential if the sale is over \$500 in value. Farmers can use the small claims court system to enforce the agreement. In court, the judge will focus on figuring out what the parties had agreed to do for each other. The judge focuses on the agreement because the role of the court in contract law is to hold each party accountable to their agreement. The judge won't necessarily substitute his or her version of a fair agreement- the judge will simply try to enforce the parties' private agreement. If the agreement isn't clear (perhaps because it was never written down) the process will be much more difficult.

The procedure for creating a written sales agreement is quite straightforward:

- 1) Think through contingencies and draft terms to accommodate them

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- 2) Incorporate the terms into an agreement with the buyer
- 3) Maintain the agreement in practice

Beginning with the first step, it is a good practice to assume that the buyer knows very little about your product because we can't necessarily predict the experience and knowledge of any specific buyer. Start by writing down all the basic details about the products being sold. Then, anticipate things that might go wrong with the sale. Might the buyer cancel or change the order? Could the buyer need the product at a different time or location than usual? After brainstorming potential problems, the farmer should draft strategies to minimize the impact if cancellations, changes, and other contingencies occur. For example: Is there a timeframe where cancellations are less inconvenient for the farm? Would attaching a fee make changes more financially feasible to provide? Understanding your buyer's limitations and flexibility can help a farmer draft a procedure that will work for both parties. This process of writing down product information plus sales procedures and agreeing upon them with a buyer creates a sales contract.

Use the following checklist to draft a thorough assembly of product information and sales procedures:

1. Item information
  - Item name/description
  - Volume/weight/count of each item
  - Price
  - Packaging
2. Payment Details
  - Payment procedure (invoice? COD?)
  - Payment due date
  - Additional fees (minimum orders, fuel charges, etc)
  - Late fees
3. Quality Standards
  - Choose precise parameters for quality/condition that are objectively measurable.
  - What is the timeframe for the buyer to inspect for quality?
  - What notification procedures does buyer follow if she or he feels quality standards are not met?
  - Are there rules for how the buyer must hold the product while the quality dispute is being resolved? (for example, location and temperature standards)
  - Is there a specific dispute resolution procedure?
  - Is there a set compensation strategy if the parties disagree about quality?
4. Delivery and Shipment
  - Anticipated delivery date and time
  - Notification procedures if anticipated date and time are no longer accurate
  - Delivery mode. Is farmer delivering or does the farm use a distributor/shipper?
  - Who bears risk of loss during transit? (If the farmer, is it covered by your insurance?)
5. Is the product delicate, frozen, or potentially hazardous?
  - Specific holding requirements?
  - Washing or handling instructions?
6. Cancellation and changes
  - Order deadline
  - Are order changes are allowed after deadline?

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- Do you have notification procedures for accepting late changes? Some buyers will try to change the order even if the deadline has passed.
- Is there a penalty for changes made after deadline?
- Can the order be cancelled? If so, when?
- What is the procedure for cancelling an order?
- As some buyers may try to cancel an order beyond the stated deadline, is there a penalty for cancellation beyond deadline?

The second stage of creating a sales agreement is to come to an agreement with the buyer. There are a couple of principles farmers should follow. First, a buyer should understand all the terms of the sale before the sale occurs. For example, if exchange or refund terms are listed on an invoice only, the buyer cannot read and agree to those terms before deciding to buy. The second principle is to seek specific confirmation of the terms. Farmers don't necessarily need a handwritten signature, but they should have something to show that the buyer agrees to the terms before going forward with the sale.

A farmer can arrive at a written sales agreement in a number of ways. The gold standard is a formal agreement with two signatures at the bottom - the farmer's and the buyer's - signed in advance of the sale. To be complete, a contract of this type should include as much of the information in the checklist above as is practical. Farmers and buyers may decide on unique terms that work for each of their businesses. For example, a buyer might commit to purchasing a minimum volume of product per week. Or, a buyer might pledge to use the farmer as the buyer's primary supplier and purchase from other growers only if the contracting farmer does not have enough. A farmer might commit to giving the buyer the first opportunity to purchase product or commit to offering product at pre-determined prices. The right agreement is the one that works for buyer and seller.

Some buyers and farmers are not interested in creating a formal sales agreement in advance. Farmers have other options for creating a written agreement, one of which is sending an email to a buyer confirming a verbal agreement. For example, say a farmer meets with a hospital buyer over the winter and the two agree that the hospital will

purchase 30 pounds of summer squash per week from July to October. The farmer may send an email to the buyer after a meeting that states, "Thank you for meeting with me. I'm thrilled that you will purchase 30 pounds of summer squash per week from July to October. Please let me know if this is not accurate. I look forward to working with you." This email creates a written contract that may serve as evidence in court.



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happens, the best practice is to send a quick note. This note establishes the written record that the parties agreed to something different in the specific instance and that the original agreement remains the same.

For more information on developing a sales agreement, including a model availability sheet, invoice, and sales agreement see the following resources from Farm Commons, available at [www.farmcommons.org](http://www.farmcommons.org)

“Writing a Simple Sales Agreement for the Direct Market Farm” Guide

“Sales Contracts for Farm Produce: Why and How” Recorded Webinar

## ***2. Purchase an insurance policy that covers your risks.***

Before accepting any product, many wholesale buyers want evidence that a farm carries liability insurance; often, buyers want \$500,000 with some expecting as much as 2 million dollars or more in coverage. Buyers insist on this for a couple of reasons. If a food safety incident were to occur, the farm and buyer can both expect to be sued. In part, all potentially responsible entities are sued to force everyone into the process of determining who is legally responsible. Buyers want to know that a farm will have a competent attorney in court, and insurance companies provide a qualified attorney to defend their policyholders from covered risks. If a farm owes a judgment at the conclusion of the lawsuit, the insurance policy will pay it, up to the limits of the policy. Where insurance covers a defense and a judgment, it can provide significant value.

Farmers new to wholesaling should have a conversation with their insurance agent about the best policy to cover the unique risks of wholesaling. Many farmers might be inclined to simply increase the liability coverage of their existing farm liability policy. However, a commercial policy combined with an existing farm liability policy may provide more robust coverage. Commercial liability policies cover a broader range of personal injury risks. Farm liability policies may cover a farmer only if a food safety incident materialized on the farm or, for example, if contamination occurred as a result of a tornado. Commercial policies cover a broader range of contamination vectors. A commercial policy will also likely include some coverage if the farmer recalls his or her products.

Although the cost may be prohibitive, farmers might consider adding product liability coverage to their operation. Product liability policies provide comprehensive coverage for food safety risks. These policies address government-ordered recalls, the costs of cleaning and restarting production after contamination, and even lost revenue. The right insurance policies for each farmer will depend on individual risk tolerance, cost, and availability.

Crop insurance may be another attractive risk management strategy. The vast majority of crop insurance policies sold in the United States are subsidized by the federal government and marketed through private insurance agents. As federal devices, detailed regulations accompany these policies. Farmers seeking to insure only one crop, such as just strawberries or only radishes, may find that the policies for their specific crops are not available in the county in which they are growing. For example, crop insurance for strawberries is available to growers in six California counties. In this situation, growers have a few options. They can work with their insurance agent to submit an application for a written agreement. A written agreement is a document created by

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RMA to provide specific insurance to a producer for a crop that is not otherwise insurable in the county. Producers also have the option to insure a crop not otherwise insurable through the USDA Farm Service Agency (FSA) Non Insurable Assistance Program (NAP). Producers can visit any county FSA office for assistance in signing up for NAP coverage.

New in 2015, farmers who grow more than one crop may qualify for Whole Farm Revenue Protection (WFRP). WFRP is a valuable insurance option for farmers as it covers all commodities produced on the farm together under one policy (excluding timber, forest and forest products, animals for sport, show or pets). Also, the federal government subsidizes 50 – 85% of the insurance premium, so the premiums are quite affordable even for small to mid-sized farms. WFRP will compensate a policyholder for lost revenue if covered crops experience an unavoidable, natural loss. To qualify, a producer must have had five consecutive years of production with the accompanying Schedule F or equivalents.

When evaluating insurance options, it is important to understand two numbers about your farm operation. The gross sales needed in a given year to stay in business, and the net income desired to reach *Quality Of Life* goals. Purchasing crop insurance that covers at a minimum the “stay in business” number can help prevent the farm from going out of business after a difficult year.

For more information on crop insurance visit the USDA Risk Management Agency website:  
<http://www.rma.usda.gov/policies/wfrp.html>

To use the USDA RMA Insurance Quick Cost Estimator:  
<https://ewebapp.rma.usda.gov/apps/costestimator/Estimates/QuickEstimate.aspx>

For more information on farm insurance, generally, see the following resources from Farm Commons, available at <http://www.farmcommons.org>:

“Understanding Insurance Policies for the Farm” Chart  
“Efficiently Manage Your Farm’s Risks With Insurance” Recorded Webinar

### 3. *Write a Food Safety Plan.*

Writing a food safety plan will help you systemize and implement your food safety practices. It can provide assurance to wholesale buyers that your product is safe, serve as a training tool for yourself and your employees, and guide efficient delegation of responsibilities. Some insurance providers may require it, as well.

Having a food safety plan is more than just a good idea or even a buyer demand; it’s a best legal practice for any farm. A food safety plan can help protect your farm’s security, finances, and reputation if a foodborne illness occurs. If a foodborne illness does occur, having a food safety plan and traceable records puts your farm in a better position than a farm without a plan. A food safety plan proves that the farmer is aware of the risks

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and causes of foodborne illness. Records showing the farmer followed the food safety plan are evidence that a farmer did not negligently cause the foodborne illness to occur. As a result, farms with a food safety plan have an easier time defending their business in court after a food safety lawsuit is filed. Before a lawsuit, a food safety plan and records demonstrating compliance with the plan can guide food borne illness investigators to other parties as they search for the source of an outbreak.

The *On-Farm Food Safety Plan Tool*, developed by FamilyFarmed, is a valuable web-based resource for developing your farm's food safety plan. Since your food safety plan must be specific and scaled appropriately to your individual farm, this tool takes farmers through a series of questions, collects the information, and then generates a customized on-farm food safety plan based on user input. The tool is designed for use by small to mid-scale growers and is available in Spanish and English.

For more information on developing a plan with the On-Farm Food Safety Plan Tool, please visit <http://www.onfarmfoodsafety.org>

#### ***4. Maintain regular, consistent, and clear records of your food safety practices.***

To protect the business from food safety incidences, farmers should create a food safety plan and purchase an insurance policy that will defend the farm in court. A third step is also necessary to protect the wholesale farm operation. Farmers must keep regular, clear records of their compliance with an established food safety plan.

The significance of good records is perhaps best explained with a timeline. After a food safety incident occurs, anyone who handled the contaminated product along the food chain is likely to be sued: farmer, warehouse, distributor, and so forth. The sued parties then file a claim with their insurance company. Each party's insurance company in turn appoints an attorney to handle the case for their insured. In the case of the farmer, the appointed attorney will quickly ask, "What kind of food safety records do you keep on your farm?" The attorney will be interested in records that are regularly and consistently kept in the course of business. Only regular records will make the best evidence in court.

Records kept occasionally (or worse, made only when the business has cause to worry) make poor or even inadmissible evidence of a farmer's food safety practices. If a farmer can't show that he or she followed the food safety plan, the plan itself may not prove much in court.

For more information on farm recordkeeping, see the following resources available from FamilyFarmed:

Watch "Food Safety Record Keeping Basics," a video on recordkeeping including examples of time saving record keeping systems at <http://www.onfarmfoodsafety.org>

Download over 50 different food safety record keeping templates at <http://www.onfarmfoodsafety.org/forms-and-templates/>

#### ***5. Be aware that employment laws may affect wholesale activities differently than other farm activities.***

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In some states, farms are allowed to pay less than the minimum wage while many more farms are not required to carry workers' compensation for employees. Almost every other non-farm business is required to pay minimum wage and provide workers' compensation to all employees. This can be an advantage to farmers, especially start-up operations with limited cash flow, but it can also create an inadvertent liability. If the farmer doesn't know the precise outlines of the minimum wage and workers' compensation rules, he or she may accidentally violate those rules as the business grows.

Exceptions from minimum wage and workers' compensation are narrowly defined. In some states, wholesale activities such as sorting melons or icing broccoli may not be considered commercial tasks as opposed to agricultural tasks. When that is the case, workers doing commercial activities will fall under regular, non-farm employment laws, which require minimum wage and workers' compensation in almost every instance.

Farmers need to be aware of the exact contours of any agricultural employment law exception. Because of the complexity, speaking with an attorney may be the most cost-effective way to manage employment law obligations. A qualified attorney should be able to deliver a clear answer in a minimum of time. Alternatively, farmers might consider calling their state labor regulation agency for more details.

For more information on farm employment law, see the following resource from Farm Commons, available at <http://www.farmcommons.org>:

“Making Employment Law Work for your Farm” Recorded Webinar

## ***6. Consider creating a separate business entity for the farm or wholesale enterprise.***

The majority of farms are formed as sole proprietorships. The reason most farms are organized this way may be because the entity is easy to create and because newer options such as the LLC are not as well known in rural areas. Under a sole proprietorship, the law treats the owner and the business as one and the same. All the resources the business uses, such as tractors, supplies, and equipment, are fundamentally the owner's personal assets, as well. This is why a sole proprietorship is so easy to form- a farmer has created a sole proprietorship the moment he or she sells a product or service. Only one person can own a sole proprietorship, although some states consider a married couple to be “one person.”

If multiple owners are involved, and the owners have not created a separate entity, they have a partnership. Just like a sole proprietorship, a partnership leaves the partners' personal assets exposed to business liabilities. In fact, one partner's actions can put the other partner's personal assets at risk. For example, if the first partner purchases business items on credit, the second partner's personal assets could be taken to satisfy that debt, even if the second partner wasn't involved in the actual purchase.

The convenience of a sole proprietorship or general partnership comes with drawbacks. Because there is no distinction between the business and the individual, the owner is personally responsible for the liabilities of the business. If a creditor has a successful judgment against the farm business, the creditor can reach the farmer's personal assets to pay off the debt. Bankruptcy laws and the nature of liability somewhat limit the extent to which the farmer's personal assets might actually be taken, but the principle remains. Some farmers are

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comfortable relying on the bankruptcy and liability protections to protect their personal assets while other farmers prefer to minimize their risk as much as possible and choose to avoid the sole proprietorship.

A limited liability company or corporation, when properly established and operated, protects the owners' personal assets from the business's liabilities. If the business is unable to meet its debts, creditors cannot (absent special circumstances such as a personal guarantee) go after the owners' personal assets to pay off business debts. Creditors can reach all the business assets of the business, though. Because business assets can still be lost, an LLC or corporation is not a substitute for robust insurance coverage; insurance provides a legal defense and pays out on a resulting judgment. For beginning farmers who are not yet earning a reasonable income, the tax differences between a sole proprietorship and an LLC or corporation are minimal. Once the farm is profitable enough, the farm owners may find tax savings from forming an LLC or a corporation. An accountant can help determine where that line exists for an individual farm business. Any farmer considering moving the business from one LLC or corporation to another LLC or corporation should make certain to consult their accountant, tax preparer or attorney to manage the tax implications.

A farmer who forms an LLC or a corporation must follow best business practices if the farmer hopes to preserve the personal protection offered. If the owner has mismanaged the operation, courts will disregard an LLC or corporation and allow creditors to go after personal assets. Primarily, farmers must keep separate bank accounts for business and personal money, adequately capitalize the LLC or corporation, and keep solid records of business financial matters.

For more information on forming a business entity, see the following resource from Farm Commons, available at <http://www.farmcommons.org>:

“Farm Sole Proprietorships, LLCs, S Corps, C Corps, and Coops: Which? Why? How?” Recorded Webinar.

## *Conclusion*

Following the **six legal risk** management strategies above will help farmers build wholesale markets that contribute to a strong, resilient farm business. Not only do these strategies address legal risks, they can facilitate better communication and more accurate financial management. Wholesale farmers who assemble a solid network of supporters including an insurance agent, an accountant, and perhaps an attorney may have the easiest time implementing these solutions. Even farmers who prefer to do their own research into things like insurance policies and employment laws will find these solutions approachable, if a little more time consuming. In the end, wholesale farmers will come away with a greater understanding of wholesale markets, overall.