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Force Majeure – Is "Swine Flu" and/or Mandatory COOL An Excuse For Non-Performance Under a Hog Production Contract?

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Overview
A significant trend in the hog industry over the past couple of decades has been the increasing rate at which hog production occurs via contract.[1] These contracts generally provide for the raising of hogs with the farmer supplying the facilities and labor and the integrator supplying the hogs, feed and other supplies. The integrator generally retains title to the hogs with the contract generally establishing the amount paid to the farmer by the quantity and quality of the final product. Many of these contracts are forms drafted by the integrator, with no terms negotiated by the parties. One common provision in a hog production contract is known as a "force majeure" provision. Under such a provision, a contracting party is not liable for damages due to the delay or failure to perform under the contract because of an event that is beyond the party's control under the contract. Performance is excused until it becomes possible for the party to perform under the contract. But, does "Swine Flu" or the recently implemented mandatory country-of-origin (MCOOL) regulations constitute an event covered by a force majeure provision that would excuse a contracting party's performance. Recently, some hog integrators have claimed that they do, and have attempted to either terminate or renegotiate contracts with farmer-growers.

Force Majeure Clauses

"Force majeure" is a contractual clause that excuses the performance of an obligation under a contract by one or both parties. "Force majeure" is French for "greater force," meaning that there are circumstances beyond a party's control that excuses them from performing, such as an extraordinary event like war, riot, crime, etc. Most often, a "force majeure" event involves an "act of God" (i.e. flooding, earthquakes, or volcanoes) or the failure of third parties (such as suppliers and subcontractors) to perform their obligations to a contracting party. However, sometimes a contracting party will attempt to use the clause to extract themselves from a contract that has turned out to not be profitable for them.

The wording of a force majeure clause is critical and should be negotiated by the contracting parties so that it applies equally to all parties to the contract. Often, it is helpful if the clause includes examples of acts that will excuse performance under the provision. The following is a sample force majeure clause that is being used in some hog production contracts in Iowa:

> "Any party to this agreement shall be relieved of its responsibilities and obligations hereunder when the performance of those responsibilities and obligations becomes impossible because of, but not limited to, acts of God, war, disaster, destruction of the party's facilities not attributable to the action or inaction of the party, or change in governmental regulations or laws making this agreement illegal."

The provision's language is fairly standard force majeure language and includes examples of what events excuse nonperformance – acts of God, war, disaster, and change in regulations or law that make the contract illegal. But, is either "Swine Flu" or mandatory country of original labeling covered events? Some integrators think so, and have been sending letters to contract producers declaring a force majeure event effective upon the later of the grower's receipt of the letter or the date the existing pigs in the grower's facility are removed and sold.[2]

Are Tough Times in the Hog Industry a Force Majeure Event?

Clearly, economic conditions are poor in the hog industry at the present time. Profit margins have been negative for some time due to rapid increases in feed costs (partly caused by the demand for corn to produce ethanol) and production expenses. Iowa State University data demonstrates that sow operations have shown continuous monthly losses for almost the last year and one-half in both feeder pigs and finishing operations. Those losses predate the advent of both the "Swine Flu" and mandatory country-of-original labeling.

The integrators claim that "Swine Flu" has "devastated both cash live hog prices and hog future prices" supposedly because of consumer fear of eating pork. The argument is that some consumers apparently believe that eating pork will make them sick, so demand for pork has declined.[3] However, the hog industry was in serious financial distress before the current outbreak of the virus.[4] Also, given that previous outbreaks of "Swine Flu" have occurred – in 1918 and again in 1976 – involving the same strain of the virus that reappeared in 2009,[5] participants in the hog industry were certainly on notice of the potential for market disruption upon any reoccurrence of the virus. Thus, economic risks associated with the swine influenza (which is common in hogs)[6] can be dealt with in the terms of the hog production contract. It is not an "act of God" that constitutes a force majeure event.[7] Indeed, the Iowa Supreme Court has ruled that "a force majeure clause is not intended to shield a party from the normal risks associated with an agreement."[8]

Hog production suppliers have also cited the MCOOL (Mandatory Country of Origin Labeling) legislation, passed as a part of the 2002 and 2008 Farm Bills, requiring retailers to notify their customers of the country of origin of covered commodities.[9]

> **Note:** Covered commodities include muscle cuts of beef (including veal), lamb, chicken, goat, and pork; ground beef, ground lamb, ground chicken, ground goat, and ground pork; wild and farm-raised fish and shellfish; perishable agricultural commodities; macadamia nuts; pecans; ginseng; and peanuts.

Legislation delayed the implementation of MCOOL for all covered commodities (except fish and shellfish until September 20, 2008. On January 15, 2009, AMS published a final rule for all covered commodities combined which became effective on March 16, 2009.

Termination letters issued by integrators that reference a disruption in Canadian origin pig flow is simply an attempt to portray MCOOL as resulting in a contractual impossibility for the integrator.[10] In reality, however, the integrators appear to be trying to use MCOOL to renegotiate these contracts at a lower pig space price. This also demonstrates that the company is not financially insolvent and could honor the terms of their contracts, even if the situation is difficult for a period of time. That clearly does not fit within the definition of a force majeure event.

How Can Growers Protect Themselves?

Iowa farmers looking to become contract growers are who have already entered into a production contract with an integrator are negotiating hog contracts with potential suppliers need to be aware of a special Iowa law that is designed to protect contract growers from contract termination or non-payment. The provision allows the filing of a "Commodity Production Contract Lien" with the Iowa Secretary of State's office (commonly referred to as a "contract finisher's lien.)[11] The law applies to a "contract livestock facility" which is defined as an animal feeding operation where livestock is produced according to a production contract by a contract producer who owns or leases the facility.[12] A qualifying "production contract" is an *oral or written* agreement that provides for the production of a commodity by a contract producer that is in force on or after May 24, 1999.[13] A lien of this type is an agricultural lien and a contract producer who is a party to a production contract, if properly executed, automatically has a lien and the contractor is automatically a debtor, owing the amount under the contract in the event of a default.[14] However, the most important protection offered by the production contract lien is the ability to establish a priority against the debtor. Thus, a lien of this type must be perfected. The lien becomes effective the day the livestock first arrive at the contract livestock facility.[15] In order to perfect, the contract producer must file a financing statement in the office of the secretary of state within forty-five days of the livestock's arrival.[16]

> **Note:** If the contract provides for "continuous arrival," the contract producer must file the financing statement for the livestock within one-hundred-eighty days after the livestock's arrival. The lien terminates one year after the livestock is no longer under the authority of the contract producer.

Conclusion

Farmers who find themselves in the situation of contract termination on the basis of "force majeure" would be well-advised to seek legal counsel immediately. By accepting a contract termination or failing to respond to an attempted termination, a contracting party implicitly agrees to mitigate their own damages. Mitigation of damages requires a reasonable effort to contract with another source. The doctrine of "force majeure" does not apply to the current economic situation in the hog industry, regardless of the MCOOL regulations and the advent of the H1N1 virus. Responding to these notices of termination immediately and, preferably, through legal counsel, may be the solution to a positive outcome for growers.

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[1] In 1999, 35.8 percent of hogs were sold on the spot market. Ten years later, in 2009, that percentage had dropped to 8.1 percent. See Glenn Grimes and Ron Plain, "U.S. Hog Marketing Contract Study," University of Missouri Department of Agricultural Economics Working Paper No. AEWP 2009-01, Jan. 2009.

[2] Some of these integrators are having their suppliers allege force majeure on them, citing current regulatory and market conditions allegedly caused by the implementation of country-of-origin labeling of pork.

[3] In many parts of the world, "Swine Flu" is referred to differently. In Europe and Thailand, for example, it is termed "Mexican Flu." U.S. government officials have gone out their way to refer to the virus by its scientific name – H1N1. In addition, proper cooking techniques eliminate the possibility of contracting the virus from eating pork.

[4] "Swine Flu" is an infection caused by a type of swine influenza virus. The current strain, H1N1, first appeared in 1918, reoccurred in 1976 and again in early 2009 as a new subtype of H1N1.

[5] The strain of the virus that appeared in 2009 is a slight variant from prior strains (a subtype of H1N1) that had not previously been reported in pigs.

[6] Indeed, about half of the breeding pigs in the U.S. have been exposed to the virus. See "Influenza Factsheet," Center for Food Security and Public Health, Iowa State University, located at http://www.cfsph.iastate.edu/Factsheets/pdfs/influenza.pdf.

[7] In their letters to suppliers, some integrators are stating that they will continue to fill a grower's hog buildings on a "load-by-load" basis. That indicates that the integrator can still perform under the contract.

[8] The Pillsbury Company v. Well's Dairy, Inc., 752 N.W.2d 430 (Iowa 2008).

[9] In their letters to suppliers, some integrators are stating that "…U.S. government interference in the markets, through MCOOL, has and will continue to seriously disrupt Canadian origin pig flows to the U.S.…"

[10] Integrators typically overstate the cost of MCOOL regulations on the hog industry. An academic study has shown that MCOOL costs translate into less than one-tenth of one cent per pound for the covered

commodities as consumed by U.S. citizens. See J. VanSickle, R. McEowen, C.R. Taylor, N. Harl and J. Connor, "Country of Origin Labeling: A Legal and Economic Analysis," International Agricultural Trade and Policy Center, University of Florida Institute of Food and Agricultural Sciences, PBTC 03-5, May 2003.

[11] Iowa Code §579B.

[12] Iowa Code §579B.1(4).

[13] Iowa Code §§579B.1(16), 579B.2(3).

[14] Iowa Code §579B.3.

[15] Iowa Code §579B.4(1)(a).

[16] *Id.*