

WHAT'S IN A POTATO CONTRACT

by
Robert L. Sargent
Extension Economist
University of Idaho

Background

The rise in forward contracting of potatoes in the United States is closely tied to the rise in processing industry. To a large extent contracting arose from the desires of processors to assure themselves of a supply of potatoes that would fit their processing needs. Growers have received benefits from the contracts in that it also gave them an assured outlet for their production.

Some other benefits have also derived from the rise in contracting, particularly here in the Pacific Northwest. As I just mentioned, a contract does assure a grower of an outlet for his production. In addition, it gives him some assurance of the prices he will receive for that production. In turn, it has removed some of the vagaries of financing from the production of potatoes in that bankers are usually much more willing to go along with granting a loan for a crop if they can be assured that the grower will have an outlet. Contracts also enable processors to bid for markets for their processed products with the assurance they will be able to fill these commitments and with the assurance and with the assurance that they have a good idea of their costs in advance. I am perhaps getting a little ahead of myself here and maybe it would be best to back off and take a little closer look at what a contract is.

What is a Contract?

In its simplest terms a contract is an agreement by a seller to sell and a buyer to buy a given good or service for an agreed upon price. It does not have to be some long involved printed form to constitute a contract. As a matter of fact, many contractual arrangements are actually agreed upon over the telephone. Rather facetiously some contracts are formalized on the inside of a matchbook.

This brings out what is perhaps one of the most basic ingredients of the contract. Namely mutual trust and respect on the part of buyer and seller. Given these circumstances, a simple verbal agreement can often work out as sufficient to consummate a transaction even at a future date. The basic hang-up of reliance on the verbal contract, however, is that with changing circumstances memories sometimes become short. A well developed contract will go a long ways toward overcoming memory lapses and changed circumstances. It provides the seller with price assurance for the quantity of product contracted which can aid him in his planning. Likewise, it gives the buyer assurance that he will have a given quantity of potatoes of a known quality available to him at a known price and he can make futher commitments.

Basics of a Contract

There are certain basic provisions that are a part of almost any forward contract. At a minimum they should include:

1. Parties to the contract, that is, the buyer and seller.
2. Date of contract.
3. The commodity being exchanged or contracted for.
4. The quantity involved (tons, cwt. or whatever).
5. How it is to be packaged (bulk, sacks, or what have you).
6. Some additional specifications if applicable.
7. The price per unit (per ton or cwt.).
8. The terms of payment (the amount down and other conditions).

9. The point and method of delivery.
10. The time for final delivery.
11. Storage agreements if applicable.

The above constitutes somewhat the bare bones or bare essentials of a contract, but nevertheless can serve as a good point from which to initiate agreements. A contract that includes these essentials goes far beyond a simple verbal agreement, but those of you who have been dealing in potato contracts know that your contracts also go considerably beyond this point.

Additional Refinements

Over the years contracts that are as bare bones in nature as the one just described have proven inadequate to meet the needs of one or the other or both parties to the contract. As a result many clauses have become somewhat more refined and often comprise considerable detail. You are familiar with the biblical quote "the Lord giveth and the Lord taketh away." I am sure that many growers feel that some of the contract clauses fit this same general description, that is "the contract giveth and the contract taketh away." To a large extent this is true, but if properly understood it can prove advantageous. Various incentives, discounts, and other restrictions have been incorporated in order to assure that the product will come as near meeting the needs of the processor buyer as possible. Since adhering to these various constraints can often work to the advantage of the grower, it is important that he be thoroughly familiar with each of these additional clauses and their impact on the final net price. The base price is usually not enough to determine whether or not a grower will or will not have a profitable operation.

This being the case, it is appropriate at this point to review some of the supplemental clauses and to get a determination on what their impact may be. A good understanding of these constraints can certainly avert later misunderstandings and disagreements. First, a clear understanding that "a potato is a potato is a potato" does not necessarily apply when we look at many of the processed products. These products do have specific requirements and consequently if the processor is to have a satisfactory product it must meet those requirements in its raw state. This means, for example, that there will often be a stipulation of the variety which can be grown. Many contracts also have some restrictions and stipulations relating to farming practices. For example, they will insist on the use of certified seed.

Most of the contracts I have seen from Washington have a provision for inspection and sampling in the field. This provision can work to the growers benefit. Company representatives can often spot something that is going bad and there may still be time to take corrective action thereby saving the crop for ultimate delivery to the processor. Sampling in the field can also aid in getting a measure of the prospective size of the crop and in addition can give some fairly good clues as to the maturity and thereby the most opportune harvesting time.

Harvest Provisions

Harvesting is a critical point in the whole potato cycle in that this is where many of the marketing decisions ultimately rest. This applies whether looking at contract potatoes or "open" potatoes. Any of you who review your contracts will find many key clauses related very closely to the harvest of the potato. Disaster or inability to perform clauses often constitute a very important part of the entire contract in that this does provide a means of release from the contract for either the grower or the buyer. It is very important that clauses relating to this item be adhered to closely, however, to assure that undue liability is not assumed without knowledge of both parties.

Bruise clauses are often of utmost importance as related to harvest. Bruises can have a very adverse effect on the grade. Quite understandably bruises increase the expense of the processors in handling the potatoes and somebody is going to pay for this added expense. This cost usually falls on the grower and hence it behooves him to be very cautious to hold bruise damage to a minimum. I stood on the lines in Idaho this fall and watched many potatoes that would have

otherwise have been No. 1 moving into the cull bins as a result of bruises. This is a severe economic loss to growers and processors alike.

Delivery is also a very important consideration. On the one hand it may be possible to work out a contract which calls for delivery direct from the field for immediate processing. This is a means that merits consideration and a weighing by the grower as to whether it is to his advantage to go this route. It has the advantage of releasing the need for storage and hence he would not have to worry about decay or loss of quality while in storage if the potatoes are delivered direct to the plant. Another factor that enters into this approach, however, is related to the possible slowdown at harvest time as a result of trucks being on the road or the need for additional trucks who take care of getting the potatoes delivered. A further factor that sometimes enters into this type of approach is that there can be delays for unloading which in turn may delay harvest.

The other alternative is to move direct from harvest into storage and here we look at two possibilities which are included in most contracts, that of processor owned storage or of grower owned storage. Most contracts provide that grower owned storage must be subject to the approval of the buyer. Movement to processor owned storage carries many of the same considerations as delivery for immediate processing and growers are going to want to watch these factors. Grower owned storage introduces some other dimensions to the whole picture. First, what are the allowances for storage in the contract? Are they adequate to cover the expenses and the added risk which a grower assumes by storing his crop for an extended period? He will also want to consider very closely the storage restrictions that are encompassed in whatever contract he happens to hold. Failure to adhere to these restrictions can be quite detrimental to his whole operation.

A key factor of contracts relates to inspection, weighing and grading. In most instances the contracts provide for inspection and grading by impartial federal-state inspectors. However, there are instances where a provision is made for inspection by a company representative. This particular clause merits very close scrutiny because in most cases payment that is ultimately received is based on the percent of No. 1's in the samples. Grading, therefore, is a very critical point in the whole process.

A number of other clauses also relate closely to inspection and grading. Many contracts contain disease refusal clauses which serve to protect the company from getting a bunch of unusable potatoes that will not process readily. Again, bruises enter into the picture and as was mentioned earlier can result in rather severe discounts. Also included in this section are clauses relating to "sugar ends" or "low solids" and some contracts include some incentives or decentives for the incidence of either of these situations.

Tare factors also become a consideration. The processor is not much interested in receiving a bunch of rocks or stones or other dirt and solid matter that are not potatoes. These things do not process, but instead increase the costs of handling the potatoes. Tare can constitute a reason for rejection of a load.

This section usually includes a clause relating to the payment of inspection fees and assessments that come with the handling of the potatoes. Allowance for culls and processing grade potatoes is another factor which needs to be watched. It is an important part of the entire contracting negotiations.

Hauling enters in as another consideration. Two or three questions are appropriate here. 1) Who does it? 2) What is the charge or allowance for whoever happens to be responsible for it? Adherence to hauling schedules can be very important in these situations and weather factors have to be considered. Of course, you are more fortunate here in Washington than we are in Idaho in that you usually do not get some of the severe cold weather that our growers in eastern Idaho are confronted with.

Payment Schedule

The schedule of payments can have considerable impact on the ultimate profitability of the grower's crop. This becomes more sharply true as we look at the somewhat higher interest rates with which we are confronted today. A little use of a pencil can be quite revealing in this sort of a situation. What is the actual cost of waiting for final settlement when it is delayed for 30, 60, 90, or even as much as 150 days as I have noted is provided in several of the Washington contracts. When interest is involved, time is money. Most of your contracts contain some other clauses which I will only touch on in the interest of trying to hold the time to a minimum. Some of these include clauses relating to pesticides, the collection of taxes and assessments, those relating to breach of contract, and clauses relating to successors and assigns. I would prefer not to go into these in any depth because they are generally quite self-explanatory. Failure to adhere to them, however, could prove very expensive.

The role of Bargaining

In discussing bargaining, it is only fair to point out that many of my remarks are based on a talk I heard last fall by Ralph Bunje, President of the California Canning Peach Assn. The contracts you presently use are the result of many hours of bargaining between grower representatives and processors. Bargaining is rather unique in that only farmers can get together to bargain for price under provisions of the Capper-Volstead Act. I think it is appropriate to point out, however, that often mutual benefits derive as a result of bargaining. This comes about because of clearer recognition by farmers of the desires and needs of the processors and clearer understanding by the processors of the comparable needs of their growers. The net result is that we often come up with a better quality material being developed, greater efficiency, and often there may be some supply responses generated as a result of the bargaining. Processed potatoes are a good example. They account for all of the increase in potato consumption in recent years. At the same time it must be recognized that some hazards also exist in that if growers are too successful in bargaining they may actually price themselves out of the market, thereby hurting both themselves and the processor who is buying their potatoes. They are also open to competition from foreign sources as well as within the United States and from competing products.

While it is possible for an individual farmer to bargain for a contract, this often meets with very limited success because in the process contacts can be made with a number of farmers and get them bidding against each other. Instead the type of development that you've had here in Washington is that a group of farmers assigns the responsibility for bargaining to a committee who hopefully will be some skilled bargainers. Working on a bargaining committee is indeed a frustrating but frequently very rewarding experience. It can be extremely frustrating if some on the committee tend to talk too much. In the end it will often wind up a one-to-one negotiations where the actual leader in the committee tends to negotiate one for one with the buyer representative.

Bunje suggests some important points to be considered by professional or amateur negotiators. First it is very important to develop skills in planning to lay-out the framework for bargaining. Second, bargainers must think clearly. Third, they must have good general intelligence. Fourth, they must have good verbal ability. Fifth, they must have good knowledge of the product, both the raw product and the finished product. Sixth, and this can become very important in many situations, is knowing who is bucking for what position in a corporation. Knowledge of his timing framework is also important. Seventh, personal integrity cannot be overlooked. It is extremely important. Eighth, there must be an ability to perceive and exploit power.

In closing I wish to emphasize that bargaining is a powerful tool and one which can work to the advantage of the entire industry. Trust and respect again form the corner stone of effective bargaining negotiations.

It has indeed been a pleasure to visit with you for these few minutes.