

Marketing Contracts

The Supply Contracts between Members and the Co-operative

James H. Gillis

Stevenson, Gillis, Hjelte, and Tangjerd

Introduction

The economic power of the New Generation Co-operative is its ability to provide value-added processing and marketing to the commodities supplied by its members, and to direct the financial benefit of these activities back to the members. In some cases, the members' products will be differentiated (or specialized) in some way from similar commodities sold on the open market, giving them a higher raw value when used in the co-operative's finished product than they would have in any other use. In other cases, the value added by the co-operative is a result of the technology possessed by the co-op or the skills and knowledge applied by the members. The patronage dividends from the co-operative's value-added activity, combined with the enhanced price reflecting the commodity's specialized value (where applicable), provide the members the return needed for their investment in setting up the co-operative and (where applicable) specializing their commodities.

The two legal relationships with the co-operative of economic value to its members are (1) their memberships, and (2) their marketing contracts with the co-operative.

The co-operative can function only if its members commit to providing it with a reliable supply of the commodity sufficient to meet its quality, quantity, and timing requirements. The marketing contract is the legal tool that secures this commitment.

The main difference between the marketing contract and a regular contract is that since the marketing contract comes automatically with membership in the co-operative, each party has a built-in interest in the success of the other. While the marketing contract deals primarily with the arm's length part of the relationship, it has features that one would not expect to see in a contract with an unrelated third party. For example, some marketing contracts will contain terms allowing the co-operative to unilaterally change certain terms from time to time to give it the flexibility it needs. Members are expected, within reason, to accept and work with these changes for the good of the organization. The degree of give and take required in some marketing contracts could not operate effectively in contracts where the parties function strictly at arm's length.

The purpose of this paper is to give some guidance to organizers of New Generation Co-operatives in designing their marketing contracts. As the business of every co-operative (and the way it does its business) is unique, there is no one format that will fit all co-operatives. This paper will identify the things that need to be covered in the marketing contract, and will show by example how particular issues affecting the business of a co-operative can be addressed.

Marketing Contracts—How Big? How Many? How Often?

In developing a general format for the marketing contract, the author has tried to combine the principle that simpler is better with the idea that the marketing contract should be a thorough, meaningful working document for guidance and clarification.

Some of the terms of the contract will be unique to each member, while others will be the same for all. Some will remain constant over time, while others will change periodically. Of the changeable terms, some will be reviewed on an annual or cyclical basis, while others will change on an irregular basis. The draft format attempts to minimize the number and frequency of contract documents, allowing as far as possible for a single document to cover years of dealings between the member and the co-operative, accommodating numerous transactions occurring under a variety of terms and conditions. Where periodic changes or fresh arrangements need to be documented, there has been an attempt to keep the amending document short and simple, while preserving its legally binding effect.

With these features in mind, the author has devised the following three documents, which are intended to work together to cover all the contractual aspects of the purchase/supply relationship between the member and the co-operative:

- The *Marketing Agreement* is a standard-form document that the co-operative enters with every member. It will be the same for everyone, and is not intended to change over time. It contains all the general rights and obligations of each side, and governs how the other two documents below operate in the overall context of the contract.
- The *Quality Standards and Management Practices Schedule* (Appendix A to the Marketing Agreement) is also a standard form applying to all members, but created with the intent that it will be modified from time to time to reflect better practices, new standards, technological innovations, or other changes required by the co-operative to sustain its competitive position. The Marketing Agreement will stipulate that the co-operative can “reasonably and in good faith” change the terms of the Schedule as may be required from time to time, and that the members agree in advance to such changes being made.
- The *Delivery Notice* is the document issued by the co-operative to individual members. Each one contains information specific to the member to whom it is

directed, specifying the prices, quantities, and delivery schedule for that member for the production period covered in the Notice. The Notice will establish a specific contract between member and co-operative for that production period, with the detail as stated in the Notice and the general terms as stated in the Marketing Agreement, as modified in the Schedule.

The author has resisted the temptation to provide a fill-in-the-blanks-model marketing contract, and has chosen instead a fictitious sample, so that the reader can better see how to address the issues that must be dealt with in any real-life situation.

Please note that the sample is in no way intended to recommend any business content, or to reflect any technical or commercial realities of such an operation, but merely to show a workable format in which those things can be addressed in the contract documents.

Real-life situations may be either more or less complex than the sample provided. In some cases, other Schedules may also be included, such as, for example, the contract between the co-operative and the purchaser of the finished product, which may contain pricing or other terms that impact on the members' contracts. If the commodity being supplied by the members is generic, it may be unnecessary to include any schedules or other stipulations as to methods or quality of production.

Readers should keep this note of caution in mind when reviewing the following guide to the sample.

The Recitals

To provide a contextual understanding of the contractual relationship created in the Marketing Agreement, it is important to say something of a general nature about the type of activity that the co-operative will be undertaking, the roles of the participants, and the overall objectives of the business venture. The sample gives an example of how to do this.

Terminology

While it may seem overly legalistic to begin an agreement with definitions, it is useful to define key concepts in order to maintain precision and consistency throughout the document. The idea of “Delivery Obligations,” for example, is central to the sample contract because of the co-operative’s need to be able to enforce them. The enforcement provision in Section 13.1 is clear and straightforward because the defined term is used there and in every other relevant part of the document.

The drafters of any real-life contract should identify the ideas that are key to their business relationships, develop careful and complete descriptions of these ideas, and have them appear first in the contract as definitions, with the defined terms then used in every other place in the document where they need to be addressed. Some of the defined terms in the sample, such as “Quota,” will be useful in most real-life situations, while others in the sample may not. As a rule, a term should not be defined unless it encompasses a fairly specific idea and will be used at least twice in the body of the document.

Drafters should consider introducing the idea and definition of “Rules” into their contracts, as the sample does. This allows the co-operative some flexibility to control the quality of the product it receives from its members.

Using the Delivery Notice as a feature and defined term of the Marketing Contract is also recommended. This allows the co-operative to create future legally binding delivery obligations without the need of entering into further agreements with the member. The recommended form of Delivery Notice provides for signature and return by the member, but this is for acknowledgment purposes only. The delivery obligation exists whether or not the member signs or accepts it.

Obligations of the Member and the Co-operative

The details of such obligations will be specific to the co-operative's business. The key things to be included for the member, however, are:

- a clear and specific statement of his/her delivery obligations (see 2.1 of the sample); and
- warranties as to quality, tying these to the Rules and Delivery Notices if these are used (see 2.3 of the sample).

The key things to be included for the co-operative are statements of its obligation:

- to adequately perform the service it undertakes for its members (see 3.1, 3.2, 3.4, and 3.5 of the sample);
- to accommodate all members fairly in their deliveries (see 3.3 of the sample); and
- to pay the members for their deliveries in a well-defined way (see 3.6 and 4 of the sample).

Price and Payment

The method of calculating the payments due to the members, and the terms of payment, should be specified (see 4 of the sample).

Duration and Termination Provisions

The provisions in the sample (Sections 5 and 6) are fairly common-sense and will likely be directly usable in any real-life marketing contract. It is important to include them, as failure to do so will leave scope for great difficulty in the event of a dispute with a member.

Other Documents Being Part of the Agreement

It is particularly important in the co-operative/member relationship to ensure that the mutual duties and responsibilities of both parties under the Articles and By-Laws are also contractual duties owed to one another in their business dealings. A provision such as 7.1 is thus recommended.

If Rules and Delivery Notices are features of the Marketing Contract, then terms such as 7.2 and 7.3 are necessary to ensure that they remain contractually binding over time.

Default and Remedies

The ideas behind these provisions are recommended for all co-operative situations.

Dispute Resolution

Sections 15 and 16 of the draft provide for arbitration, a form of ADR (alternate dispute resolution), for day-to-day disputes that may arise between the co-operative and a member. These will typically involve a member's failure to deliver as required, or the co-op's rejection of a delivery. Arbitration of these types of matters will in most cases provide a faster and more inexpensive resolution than if they were taken to court. If the drafters wish to provide for this method of ADR, they might also consider identifying a bank of arbitrators acceptable to all members to create confidence in the level of fairness and expertise that will be brought to bear if disputes of this nature arise.

If the Marketing Contract includes a provision such as Section 15, then court will not be an option for the kinds of disputes it covers. There will be some disputes, however, where access to the courts is necessary. A co-operative needs the right to get an injunction, for example, if a member is refusing to deliver. A member will need court intervention if the co-operative is behaving in an unfair or oppressive

manner towards him/her on a matter other than day-to-day operation under the contract (e.g., if the co-operative changes the Rules in a way that is unfair to the member, or issues a Delivery Notice that places the member under a hardship not experienced by others). The sample exempts matters of this nature from the arbitration process (see Section 16).

General Terms

Please refer to the comments made above in relation to the Duration and Termination Provisions.

Final Comment

While the sample may be useful as a guide, and while some parts of it may be applied unchanged in a variety of situations, the drafters of each co-operative's marketing contract documents must carefully consider the nature of the business it is in and the specific needs and concerns of its participants. They must be ready and willing to customize these documents to meet those needs and concerns.