AGRICULTURAL LEASES 101

Wednesday, September 8, 2021, 10 to 11 AM

Presenter: Denis Stearns, Attorney & Law Professor

1. The "Big Picture" — What is a lease agreement trying to accomplish? Goals? Expectations?

The success of both drafting and performing a lease agreement depends to a large degree on the parties being honest, in advance, about goals and expectations. If landowner is looking to make money from renting land, the primary goal may be to be paid the rent on time and not be bothered otherwise. Alternately, if a landowner is also living on the property, and is looking to share part of a property for agricultural purposes, maintaining peace and quiet may be as important—if not **more** important—than being paid the rent on time, or being paid any rent at all. Just remember that, when you sign a lease agreement, you are entering into a long-term relationship, and like all relationships, being honest upfront is a major key to success.

- Importance of Pre-Lease Discussions/Negotiations

  Having a meaningful amount of discussion before drafting and signing a lease is probably one of the more important things you can do. In particular, both parties need to discover if there are "red lines" or non-negotiables, things so important that a party would terminate the agreement if X or Y happened, or A or B did not happen. Just as important, is deciding if a potential landlord is someone with whom you can effectively communicate. As a professor of mine once said: If the parties to an agreement can communicate effectively, they are most likely to work things out, and the contract will stay in the filing cabinet. It is only when their communications breakdown that the contract gets pulled out and legal arguments begin.

- Using the "Recitals" or "Premises" Section to Clarify and Confirms Reasons for the Lease

  A "Recitals" section is technically not part of the contract—that is, nothing in this section is a promise or requirements. Instead, this section confirms the understandings of the parties, and the reasons for the agreement. (That is why I tend to call this section "Premises," since it describes the shared understanding of the parties in entering into the agreement.) The one thing that I usually always include, is a brief description of each party, something like—
  - Joan Smith, the landowner, is a former farmer who has owned twenty acres of land, part of which she now wants to rent to a new farmer to help her get a start.
  - Jill Smart is a single woman who worked in banking for ten years and now wishes to become a farmer, growing food for herself, and to sell at the Farmer's Market.

  You can also insert some additional facts you think are important, and that provide further explanation for the agreement, or that imply important limits, something like—
  - The Renter understands that the Owner is on a fixed-income, and she depends on rent being paid on time to cover basic expenses.
  - The Owner understands the Renter has a full-time job and that most of the work done on the leased property will be done in the evening, often as late as midnight.

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- Being Honest About the Nature of the Relationship

  As has already been emphasized, it is crucial to be honest about the relationship you will be entering into once the lease is finalized and signed. But if you invest needed time on pre-lease discussions, and drafting a Recitals/Premises section for the lease, it is highly likely at that point that both parties are seeing things sufficiently the same that future disputes will be less likely.

2. Terminology in a Lease Agreement— Using the "Right" Words and Avoiding "Wrong" Ones

There is not really any "magic" language that is necessary for a lease to be enforceable. Both parties must sign and date the agreement, and there are certain terms or provisions that <u>should</u> be in the lease, because omitting them may cause future problems. (More on the latter in a moment.) But if you decide to try drafting your lease yourself, you should not be worried about it not being "legal" enough in its language. In fact, simple, plain language is always better anyway.

- The Importance of Being Clear and Consistent, *e.g.*, Lessee, Tenant, or Renter

If you want a court to enforce a lease as written, it important to not create ambiguities. For the most part, the rule in Washington (and most other states), is that a court will give legal effect to the plain and unambiguous of the terms of an agreement. Thus, it is only if the court concludes that something in a lease is ambiguous that the court will take it upon itself to "interpret" the agreement, which could result in an interpretation that you strongly believe is not the correct one.

With that in mind, the easiest and most common way that an ambiguity is created is when an agreement uses terms inconsistently. For example, if you identify the person who is agreeing to lease property as the "owner," then <u>only</u> and <u>always</u> refer to the person in this way. When different terms are used to refer to someone, a court may conclude that you are referring to different persons, or the same person but in different roles. There is no requirement to use "lessor" and "lessee," or "owner" and "renter." But once you decide what to call the parties, stick with that term only.

The other way you can create ambiguity is by describing a duty or obligation in a way that is open to competing interpretations. Indeed, the very (legal) definition of an ambiguity is a phrase that can be reasonably interpreted in more than one, inconsistent way. For example, for a leased property where the owner also lives, there could be a problem if the lease stated: Renter agrees to not disturb the owner in the evening. Compare that with: The Renter agrees that all work on the leased property will occur within 8 AM and 6 PM only. The first provision is highly subjective, but the second is not.

- Legal Terms of Art, *e.g.*, Default, Exclusive Possession, and Cure

As mentioned already, there is no legal requirement to use certain terms. So long as it is clear and consistent, and agreement can use whatever language upon which the parties agree. That said, it is important to realize that certain legal terms, if used, are presumed to have a specific meaning. An example is the term "default." A default is a failure of a party to meet an obligation that is set forth in the agreement. The term "breach" is sometimes also used, but usually in a more general way. But a "default" is usually understood to me a failure that is sufficiently serious that the other party can "terminate" the agreement without being subject to any damages or further obligation.

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For example, if a landowner promised as part of the lease that the renter would have access to water, but then the landowner fails to pay the water bill and water is turned off, the renter would probably be justified in declaring the landowner to be in "default" and the renter could not pay rent (among other things). Because the question of whether a failure is a "default" much disputed, in the leases that I draft, I usually include a provision like the following:

> **Default:** There shall be no default under this Agreement unless one Party provides written notice to the other Party stating that it considers the Party to be in default, and such notice shall describe in as much detail as is reasonably possible the condition, conduct, or other circumstance upon which the allegation of default is based. The Party receiving the notice of default shall have ten days to remedy or propose in writing a remedy for the alleged default. If the proposed or completed remedy is not accepted, the Party alleging default may seek whatever other remedy or protection available under the applicable law, including, for the Lessor, termination as set forth in Paragraph No. ----.

In short, what a provision like the above seeks to accomplish is to make the parties, as much as possible, try to work things out. By requiring that the alleged default be described in writing, there is natural limit imposed on a party just deciding to throw the term "default" around as a vague threat or to try to intimidate. Similarly, because the other party is given a specified period of time to fix, or offer to fix, a given situation, there is a greater likelihood of compromise being reached. Finally, as is discussed further below, because I recommend that leases have liberal termination rights (or "escape hatches"), if compromise is not reached, the parties can then go their separate ways.

3. How to Structure a Lease—Minimum Requirements.

- Identify the Parties and the Legal Form of Each Business, if any

  The first paragraph of a lease nearly always identifies the parties and states the intent to enter into an agreement as those parties. In residential leases, the parties the renter is most often an individual, and the landlord is sometimes an individual or a business. With an agricultural lease, the parties are either both businesses, or the landlord is an individual and the renter is a business. If a party is a business, it is important to state what KIND of business a party is, *e.g.*, sole proprietor, limited liability company (LLC), partnership, or corporation.

  > **<u>NOTE</u>**: There is much to consider when deciding the legal form of your business. But such considerations are beyond the scope of this seminar. At minimum, when deciding on the form of your business, get experienced advice, either from a lawyer, or from someone who has operated with a particular business structure for awhile.

- Identify Leased Property (by attached map or diagram works well)

  Perhaps nothing is more important than the parties agreeing on the boundaries of the leased property. If the leased property is within a larger piece of property, you also need to agree on access (ingress and egress). There may also be issues related to access to a barn, storage, or other things that might not be within the leased property. A map or diagram attached to

the lease is probably the best way to address these issues. On the other hand, if the lease is for an entire parcel of property, the legal description will suffice, or even the address.

- What Is and Is Not Allowed on Leased Property, *e.g.*, livestock, crops

  Here, what is NOT allowed is perhaps the most important, because sometimes what is to be allowed can be described in a general way, *e.g.*, fruits and vegetables. But here, again, is where pre-lease discussions are so important.

- Who Is and Is Not Allowed on Leased Property, *e.g.*, Renter, visitors, general public, etc.

  This issue is less important when the leased property is under the control of the renter in its entirety, in contrast to when you are renting only a portion of a larger property. But if you were hoping to have a farm stand, or CSA pickup, that necessitated the public coming on to the property, this is something you would definitely want to work out in advance. You also want to make sure that what you hope to do on the land is allowed by regulation or zoning.

- Rent—How Much Is to Be Paid, and When; Determining the "Right" Rent

  Perhaps the biggest mistake renters can make is in not being honest with themselves about cash-flow and the realities of a business plan. A landlord can insist on monthly rent, but if that is not going to work for expected cash flow, that is not something you can agree to. A majority of agricultural leases that I have drafted set an annual rent that can be paid in parts, or at the end of the year, with the renter being able to decide on timing.

- Responsibilities of the Parties—Do's and Especially Do Not's

  Here is where good pre-lease discussions are an absolute necessity. And, as with nearly all aspects of a lease, you want to think of this in terms of where the potential disputes are. If you are renting from a former farmer, and planning on doing on the leased property what the former farmer did before, there is probably a good "meeting of the minds," and you only need a brief description. But if you are seeking a lease to raise livestock, you probably need a detailed discussion about noise, smells, and what "harvesting" (slaughter) entails.

  There is no one-sizes-fits-all form lease that can help you here; you need to make sure, in advance, that the owner understands the reality of the operation and approves. And if that requires a detailed description in the lease, so be it. Just remember that the more detail there is, the more restrictive the lease, because if something is not specifically included, a court will assume that what is not included is not allowed. So, aim for a good balance of detail, with an open-ended statement that provides some "wiggle room." For example: The renter will grow and harvest tomatoes <u>and **other salad vegetables**</u>. Or: The renter will raise and harvest pigs, <u>along with other activities reasonably necessary to support these efforts</u>, including, but in no way limited to, X, Y, and Z.

Finally, keep in mind that for a multiyear lease, things may need to change from year to year. Or perhaps something will come up that requires a change of plan. I sometimes address this by stating in the lease that the parties will agree on an annual work-plan signed by each party and then attached to the lease as an appendix.

- Duration and Renewal

In Washington, any contract (including leases) that is intended to last longer than one year must have notarized signatures. You can get around the notary requirement by having a lease renew automatically at the end of each year unless one or the other party provides notice of non-renewal. But this is no solution where a renter or landlord wants an enforceable multiyear lease, in which case you need to get the signatures notarized, which is not really that big of deal, actually. For leases that are for longer than three years, I also recommend getting the lease recorded, just like a deed or other public record of ownership. Finally, for multiyear leases, you need to deal with the issue of whether a renter can sublet or assign rights under the lease, something most landlords will not accept.

- Termination—Voluntary, Involuntary, and "Escape Hatches"

There are competing views on the lease termination, with one view being that termination is to be "for cause" only, and that termination should, in general, be difficult and expensive. This view is based on the idea that once deal is made, it should be difficult to break. Another view, which is my view, is that making it easier for either side to walk away is the best way to avoid long and expensive fights breaking out, fights that hardly ever benefit either side. For that reason, I favor making it easy to terminate a lease, but with some conditions, *e.g.*, providing plenty of notice, and making sure that neither party is left "holding the bag" (so to speak). Here is an example of a termination clause that makes it easier for the lessee (renter), but allows the lessor to terminate based on "mutual consent."

> **Termination:** This Agreement may be terminated the mutual consent of the parties, in writing, with agreed upon conditions, if any. In addition, the Lessee may terminate for any reason, without penalty, as follows: (a) giving written notice at least ninety days prior to the intended termination date; (b) paying in full any rent, costs, and penalties, if any, owed up to and including the time of termination; and (c) so long as the condition of the leased areas, at the time of termination, are found to be consistent with the Lessee's other obligations and duties.

In this example, the renter can walk away after giving 90 days' notice, being paid up in rent, and returning the leased property to an acceptable condition. I have also drafted leases that expressly stated the landlord could not terminate until planted crops had been harvested, unless the landlord is willing to pay for the value of the crops. Finally, in general, either party is allowed to terminate "for cause," which usually means that a crime of some kind has been committed. But some leases go on at great length about what constitutes "cause," an approach I have never favored.

- Other Potential Items—Dispute Resolution, Insurance, Indemnity/Hold Harmless

There is no end to other provisions that can be included in a lease, and it is helpful to take a look at example to get ideas. Leases commonly include a mediation or dispute-resolution clause, but that is less necessary when you go with the easy-termination approach. Also, landlords nearly always

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require a renter to get insurance, and to agree to "hold harmless" the landlord for any damages that result from the negligence of the renter. And if a security deposit is to be paid, the amount should be included in the lease, and the "rules" on how (or if) the renter gets the deposit refunded.

4. Being Creative—Work-Trade for Rent or Shared Crops

You have been given an example of a "creative" lease that does not involve the payment of rents. A lease can be as creative as the parties desire, so long as an agreement is reached.

5. When Do You Really Need a Lawyer?

I believe that anyone of reasonable intelligence and common sense can negotiate and draft a lease that will work and be enforceable. That said, if one side is getting advice from an attorney, it is usually a good idea for the other side to consult an attorney too. Also, if you are wondering, "will a court really enforce this?" it is probably a good idea to ask an attorney for an opinion. Finally, if you are considering a lease-to-purchase arrangement, of a right-of-first-refusal that limits the right of the owner from selling the leased property, those are the kinds of that need an attorney's involvement.