USC | LAW
UNIVERSITY
of SOUTHERN
CALIFORNIA

ADVANCED CONTRACTS

Professor Gillian K. Hadfield

Fall 2009

CASE STUDY MATERIALS:

Yo-Go International

Yo-Go International

Yo-Go International is a successful manufacturer of yogurt products operated out of Santa Barbara, California. It ships yogurt products throughout North America. It was founded by Lilly Bach nearly forty years ago when she started making fresh yogurt in homemade yogurt boxes (Styrofoam boxes lined with foil and heated by a 100 watt bulb) in her kitchen, inspired by the health food craze of the late 1960s and early 1970s and books such as Adelle Davis' "Let's Eat Right to Keep Fit." Today Yo-Go is a multi-million dollar family business, still headed by Lilly with the help of a son and daughter.

We have received a call from Eleanor Reed, a trial lawyer in Los Angeles, seeking our advice on a case involving Yo-Go that is going to trial in a few days. Yo-Go was sued in August 2008 ago by its former milk supplier, Affiliated Dairies of California (ADC). ADC is the largest milk cooperative in California, accounting for approximately half of all milk marketed in the state. ADC alleges that Yo-Go breached when it cancelled their installment contract for daily milk deliveries earlier that month. Yo-Go claims that it was entitled to cancel the contract because ADC was in breach when ADC delivered a load of contaminated milk in January 2007. Yo-Go did not discover the contamination until after the milk had been added to a silo containing several loads of milk and all batches of yogurt produced from that silo quickly went rancid. ADC is seeking $16 million in damages for the allegedly wrongful cancellation. Yo-Go has filed a cross-claim for breach of contract as a result of contaminated milk deliveries, seeking $1.2 million in damages. In its answer, Yo-Go raised an affirmative defense of breach of the covenant of good faith and fair dealing, alleging that ADC had withheld information in the investigations undertaken to determine the cause of the contaminated delivery.

ADC brought a motion in limine to exclude evidence relevant to the good faith defense. The judge, the Hon. Whitley D. Marshall, treated the motion as a motion for a judgment on the pleadings and has recently ruled in ADC's favor. (The judge has held that Yo-Go has not stated a claim for breach of the covenant of good faith and fair dealing. See excerpt from Order attached.) Yo-Go has withdrawn its demand for a jury trial and the matter will now be tried to the bench. Judge Marshall, who will now be the fact-finder and who has just taken over the case following the death of the original judge to whom the case was assigned, indicated to the parties in a settlement conference a few months ago that he thought the case looked like a U.C.C. case. Neither party had prepared the case on U.C.C. grounds.

Reed has thus contacted us for assistance in rethinking the case as a U.C.C. case. She is worried in particular about the claim ADC has raised in jury instructions (attached), proposed before Yo-Go withdrew its jury demand, that U.C.C. §2-612(3) deprives Yo-Go of the right to cancel now for a breach related to a 2004 installment under a requirements contract given that Yo-Go accepted delivery and did not cancel until 2007. But she is also in need of assistance in getting up to speed on how the case is best defended under the U.C.C. As she explains there are two key issues:

<u>Yo-Go I (Liability)</u> Is Yo-Go liable for breach, specifically of the termination provision set out in the 1993 document that Yo-Go signed with the company Metro Area Milk (MAM) acquired by ADC in 1998? Now that the judge has thrown out the good faith and fair dealing claim, what defenses does Yo-Go have either under the UCC or the common law principles that apply?

<u>Yo-Go II (Damages)</u> ADC is claiming that Yo-Go owes damages equal to $16 million. This is roughly the total value of milk sales for six months that Yo-Go would ordinarily purchase in a year. Yo-Go is stunned by this number. It expected damages would not exceed at best $1 million given ADC's duty to mitigate and find new buyers for the milk Yo-Go was no longer going to purchase.

<u>The Short Version of the Yogurt Story</u>

Reed has sent us the following description of the case:

This is a commercial contract dispute between our client, Yo-Go, Inc., one of the largest producers of yogurt products in the U.S., and the opposing party, Affiliated Dairies of California (ADC), the largest supplier of milk in the U.S. In dispute is some $16 million, plus interest.

A basic question in the dispute is whether our client should have given six months notice to ADC before cancelling its contract with ADC, or whether our client was entitled to give ten days notice.

<u>The Parties</u>: Yo-Go was started about 40 years ago in the kitchen of its founder, Lilly Bach. Today, Yo-Go has a large modern facility, with some 250 employees in the Santa Barbara area. Yo-Go is still owned by Lilly and family members, and has annual revenues of about $150 million per year.

The opposing party, ADC, is a milk "marketing cooperative" – that is, a large number of dairies pool their milk and marketing dollars into this cooperative, and employees of the cooperative act on behalf of the dairies in dealing with milk purchasers, including Yo-Go. ADC has annual revenues in excess of $500 million.

<u>Background</u>: In the early 1990s, Yo-Go had been buying its milk through a (much smaller) predecessor milk marketing cooperative (Cal-Dairy). In 1993, Cal-Dairy approaches Lilly and says, "We need to have something in writing." Cal-Dairy presents and Lilly signs a very short simple contract (attached) regarding Yo-Go's purchase of milk from Cal-Dairy. Importantly, that contract provides that it would renew from year to year, unless notice of termination is given by October 1 of a calendar year, to take effect on April 1 of the following year. Over the course of some years, through a series of mergers, Cal-Dairy is absorbed by opposing party ADC, and the contract is taken over by ADC without any comment or alteration.

Matters proceed without incident until January 2007, when Yo-Go discovers that a full silo of milk is testing outside of acceptable ranges for contamination. Yo-Go is able to eliminate any cause within its facility, and it becomes clear by inference (to Yo-Go anyway) that the cause must have been a bad load of milk that had been delivered by an ADC trucker and added to the silo. There is no direct way to prove which load of milk was involved, or indeed that it was the *milk, but all other causes are reasonably eliminated. Yo-Go has to dump the milk in the silo and replace it at a cost of approximately $1 million.*

Yo-Go approaches ADC, explains the situation, presents information that milk must have been the cause, and requests reimbursement of the cost of replacing the milk. ADC's response is "We'll look into this" and "We'll make it right" (ADC disputes this second statement).

Over the next year (through January 2008), there are exchanges of information between Yo-Go and ADC – for example, Yo-Go provides copies of the test results documenting the contamination and the tests it had conducted of other milk deposited into the silo and its facilities showing no contamination elsewhere to ADC. During this time, ADC's response continues to be "We'll look into this." After January 2008, however, there are no further communications about the problem.

Events of mid-2008

In mid-2008, two sets of events happen. In June 2008, Yo-Go is in discussions with a competitor of ADC (another marketing cooperative known as "MMC") and begins negotiations with MMC for MMC to become the milk supplier to Yo-Go. At about this same time, Yo-Go contacts ADC and says "We need to resolve the contaminated silo situation."

The negotiations with MMC progress to the stage that, in July 2008, MMC drafts, signs and delivers to Yo-Go a proposed agreement, with a start date of September 1, 2008. This proposed MMC contract is not initially signed by Yo-Go.

Separately, ADC learns about the MMC negotiations, and in a series of phone calls and correspondence in July and August 2008, ADC agrees that it will pay Yo-Go the $1 million, but places conditions on the payment – initially that the payment will be in installments over 12 months, and importantly, that Yo-Go has to sign a new, long-version contract, that commits Yo-Go to ADC for twelve months.

Yo-Go's response to ADC is "This is money that is unconditionally owed, and long overdue. Pay the money without conditions, and then we can talk about signing a twelve-month contract."

Finally, on August 16, 2008, there is a meeting between Lilly and two senior officials of ADC. In this meeting, ADC says that they agree to pay the $1 million in one payment, but still insist on a new twelve-month contract as a condition of payment. Lilly does not agree. Lilly says that one of the ADC people then says, "By the way, we've known for a while what caused the bad milk, it was a delivery tanker that hadn't been properly washed out before delivering the milk to you." This information infuriates Lilly and she says, "This meeting is over." The ADC people deny that any such statement was made, or if the topic came up, that it was simply said speculatively, as in, "Well, it might have been an unwashed tanker that was the problem."

On August 21, 2007, Yo-Go sends ADC notice that it would no longer be accepting milk effective September 1, 2007. In response, ADC sends Yo-Go a copy of the attached 1993 contract, pointing out the notice provision. On August 24, 2007, Yo-Go's lawyer replies that because of ADC's breaches of the contract, Yo-Go is entitled to immediately terminate the *contract, and that it would indeed stop accepting milk. Yo-Go then signs the new agreement with MMC, and ends the relationship with ADC effective September 1, 2008.*

<u>*Damages*</u>*: ADC has presented evidence that because it was not able to sell large amounts of the milk that it would have delivered to Yo-Go at the same price that Yo-Go was paying (or was not able to sell the milk at all), ADC suffered losses in excess of $16 million (plus interest).*

In its counter-claim, Yo-Go continues to seek the $1 million cost of replacing the contaminated milk.

<u>*Other important factual issues*</u>*: In discovery, Yo-Go received an internal ADC document dated in January 2008. In the margin of this document, a senior ADC official had hand-written "Tankers were NOT washed properly …" (emphasis in original). ADC says this was just speculation by the official.*

On a different topic, Lilly testified in her deposition that she "knew about" the 1993 agreement and the notice provision in the 1993 agreement at all times. However, the MMC negotiator testified in his deposition that in June 2008, she asked Lilly "Is there a contract with ADC that's going to cause a problem?" and the MMC negotiator testified that Lilly replied, "There's no contract." Also, the senior Yo-Go person who was negotiating with MMC also testified that he didn't know about the 1993 agreement while he was negotiating with MMC.

<u>*Important legal issue*</u>*: The position that has been taken by the Yo-Go lawyers is that ADC's entire course of conduct – from the delivery of the bad milk, through the year of stalling, to the refusal to pay, and finally the admission and cover-up that they knew that it was their fault – constituted a material breach permitting our immediate termination. Specifically, that ADC's conduct violated the implied covenant of good faith and fair dealing.*

In further discussions, Reed has provided additional details about what Yo-Go has determined about the cause of the contamination. Yo-Go has very stringent standards for the milk it is willing to accept and conducts its own monitoring and investigations before approving or "listing" a dairy as authorized to deliver milk to its facility. The milk that Yo-Go added to the contaminated silo came from the Arden dairy—an ADC member dairy—which had only recently been 'listed.' The bacterial levels in the milk shipped by Arden were unusually high over several shipments (Yo-Go tests all milk on delivery), although only one day's shipment resulted in contamination that exceeded acceptable levels when combined with the milk in an otherwise full silo. This led Yo-Go ultimately to conclude that the cause was elsewhere in the ADC supply and delivery chain. Based on the high bacterial counts, however, Yo-Go de-listed the Arden dairy by the end of January 2007.

Yo-Go's owner, Lilly, strongly believes that ADC had an obligation to fix the milk problem as soon as it became clear that the problem lay with ADC and not Yo-Go's facilities or handling of the milk. She has told Reed about another incident in 2006 in which a state inspector discovered unacceptable levels of antibiotics in ADC-delivered milk. In that case, ADC immediately compensated ADC by replacing an entire silo's worth of milk. Asked why she did not press the

January 2007 problem more aggressively, Lilly says that she thought ADC was "looking into it." This, she explains, is how milk handlers and suppliers manage problems and disputes in a long-term relationship. Up until the discovery in August 2008 that, as she recalls the conversation, ADC had known for a long time that it was responsible for the defective milk, Lilly says she had trusted ADC to work cooperatively with her to resolve any problems with milk quality. This is why she says she was so angry and cancelled the contract at that time. She felt betrayed and unable to trust ADC.

Damages—Some Trouble with Cows

Over the past several years, Yo-Go has typically ordered about 20 million pounds of milk per month (200,000 hundredweight or cwt). (ADC, which for our purposes can be thought of as acting on behalf of dairies as a milk marketing cooperative such that ADC stands in for the dairies in this lawsuit) markets over 4,000,000 cwt per month in the Western Area—California and Nevada. The price of milk in California is regulated by the California Department of Food and Agriculture: all buyers of milk for a given purpose must pay the same price. The milk Yo-Go buys is in Class 2 (milk used in heavy cream, cottage cheese, yogurt, and condensed products) and the price per month is tied to the price of butter on the Chicago Mercantile Exchange. In 2008, prior to Yo-Go's cancellation, the average price per cwt was approximately \$16.75. In the 7 months following Yo-Go's cancellation (that is, from Sept 1 through April 1) the Class 2 price averaged \$18.10. Yo-Go also paid ADC a service charge and assumed some freight charges on the order of \$0.50 per cwt.

California has had in place a milk pooling system since the 1930s. Under this system, dairy farmers are paid for their milk based not on their own contracts—delivering milk to a "handler" such as Yo-Go for specific uses such as bottled milk or cheese—but on the basis (roughly speaking) of the average price for milk received by all contracts for milk by all California producers. This system was designed to prevent what was seen as wasteful competition between dairy farmers as they all scrambled to sell their milk to the highest-price users (Class 1—milk used in fluid products). A dairy farm gets the same price for its milk regardless of whether it ships it to a milk bottling facility (Class 1) or a powdered milk facility (Class 4a).

This system works well when the market is willing to buy all the milk California dairy farms produce at the prices set by the regulator (if sold in California) or market prices in unregulated out-of-state markets. This has been the case essentially throughout the history of the system. But the past year has been an extraordinary one. For several years leading up to last year, milk demand has been exploding worldwide and California dairies have, if anything, had trouble keeping up with demand. The worldwide recession, however, plunged the market in 2007 into a milk glut of unheard-of proportions. Huge quantities of milk have been produced that simply cannot be sold for human consumption at the milk prices established by regulation. This milk has been sold to calf ranches at drastically lower prices; large quantities have been dumped.

The oversupply of milk continues, and indeed, gets worse over time, because of the incentives created by the milk pooling system. Because producers get a share of total revenues on the basis of their share of total production, producers who produce more get more of the money being distributed—even if the additional production they add to the system is excess that finds no buyers at the regulated prices. [See the attached excerpts from a newsletter by the President of the Milk Producers Council for an extended explanation of how milk pooling works and the incentives it creates.]

Although ADC knew as of May or June 2007 that it was going to have difficulty handling the huge amount of milk that was coming, until March 2008 it took no significant steps to reduce milk production to combat oversupply. By July 2008, however, a supply management system which penalized individual dairies for producing beyond a base amount had been implemented to reduce production.

ADC is claiming that its damages from Yo-Go's cancellation are approximately $16 million dollars because oversupply conditions in the market meant that they were unable to sell the milk that they would otherwise have shipped to Yo-Go at the regulated price for Class 2 milk. They arrive at this number by taking the total volume of milk that Yo-Go purchased from its new supplier each month September 2007 through March 2008 (approximately 200,000 cwt per month) and multiplying that quantity by the monthly Class 2 prices then in effect, plus freight and service charges, they would have received from Yo-Go. They deduct from this amount the revenues they received that month from the worst outcomes they experienced. Reed has given us the following example:

Assume ADC would have gotten $20/cwt for 200,000 cwt if Yo-Go had bought from ADC in a certain month (that is, revenue of $4,000,000 for that month) and assume that ADC actually had the following total sales in a month

1 million cwt = $20/ cwt
250,000 cwt = $15/ cwt
150,000 cwt = $10/ cwt
100,000 cwt = $5/cwt
50,000 cwt = $0 cwt (i.e., dumped)

ADC is taking the worst 200,000 cwt and charging us the difference between that per cwt revenue and the full price revenue. So, they are charging us (going from the worst deal bottom up):

50,000 @ $0 = $0
100,000 @ $5 = $500,000
50,000 @ $10 = $500,000

"Actual revenue" (under this theory) from these worst deals is $1,000,000

ADC's "would have gotten" revenue would have been 200,000 cwt @ $20 = $4,000,000

Hence, Yo-Go owes (under ADC's theory)
$4,000,000 (would have received)
- $1,000,000 ("actually received" from worst deals)
= $3,000,000

Thus far Yo-Go has presented two arguments about contract damages, both under common law doctrines and not the UCC. First, they have argued that ADC failed to mitigate its damages by failing to put supply management practices into place sooner. Second, they have argued that ADC's damages were not foreseeable, appealing to Restatement 2d Contracts 351. They have emphasized that the extraordinary circumstances in the milk market in 2008—with unprecedented surpluses—were not foreseeable at the time of contracting. At that time, a breach of the termination provision would have caused minimal harm because all of the milk not sold to Yo-Go would have been sold to other Grade A purchasers at the regulated prices. They have also emphasized that the termination provision—which is sometimes erroneously referred to as requiring six months notice of termination—can potentially require up to 18 months between when concerns about the quality of milk or the reliability of a milk supplier arise and when the buyer can switch suppliers without penalty. Under ADC's approach to damages—holding Yo-Go effectively liable for over-supply in the milk industry—had the August 2007 discussion taken place on October 2, 2007 Yo-Go would have to pay as much as the full value of 18 months worth of milk purchases, in excess of $72 million, in order to switch when it lost confidence in a supplier. In other milk contracts, including one we have found online involving ADC, it is not unusual for a buyer to have a right to terminate even a long-term contract "immediately on discovery and confirmation by credible evidence of a breach related to the safety or health aspects of the [ ] milk being purchased." The brevity of the contract Yo-Go originally signed with a trusted supplier, prior to its acquisition by ADC, is apparently unusual.

In hearings and settlement discussions, the judge has expressed doubts about the mitigation argument—along the lines of 'you can't just turn the cows off'—and ADC has vigorously argued that foreseeability does not apply as a limit to the recovery of ordinary lost profit damages. The judge does seem to believe that Yo-Go, if liable, is responsible for ADC having to dump milk or sell it in distressed markets to purchasers such as calf ranches, as ADC's theory assumes. On the other hand, the judge does seem inclined to believe that ADC cannot attribute the worst sales to Yo-Go and has advanced the idea that the proper approach is to average the price received on all "non-full price sales", those made at prices below the regulated prices obtained for Grade A human consumption milk. According to Reed, the difference in damages between the "worst sales" approach of ADC and the "average of all non-full price sales" the judge is suggesting is minimal, and she is very anxious to identify using the UCC a much lower number, if possible. Indeed, one of his damages experts has proposed that the proper measure of damages would be limited to the freight and service charges Yo-Go promised to pay ADC since the price established in the contract—the regulated Class 2 price—is the same price at which any milk sold for the same purpose would have to be sold. This would reduce damages to about $700,000.

In our initial discussions with Reed about the U.C.C. we have asked about ADC's apparent position about how its damage calculations accord with UCC requirements. Reed points out that their research thus far has identified section 2-703, 2-704, 2-706, 2-708 and 2-709 as the relevant damages provisions. ADC's most recent trial brief has mentioned only 2-706.

Attachments
Milk Purchase Agreement
ADC Proposed UCC Jury Instructions
Excerpt from Court Order re: Good Faith and Fair Dealing
Excerpt from Milk Producers Council Newsletter November 2008
Los Angeles Times "Dairy farmers in desperate straits" May 2009

Assignment

Yo-Go I: Prepare a memo (no more than 2000 words) with some suggestions for Reed on how to frame the liability issues in the case.

Yo-Go II: Prepare a memo (no more than 2000 words) with some suggestions for Reed on how to frame the damages issues in the case.

<u>MILK PURCHASE AGREEMENT</u>

January 31, 1993

SELLER: MILK MARKETING COLLECTIVE, INC.
1557 Main St.
Ventura, California 93772

BUYER: YO-GO INTERNATIONAL, INC.
5 Dairy Lane
Santa Barbara, California 95581

WHEREAS Seller is desirous of selling Grade “A” milk to Buyer and
WHEREAS, Buyer is desirous of purchasing “A” Organic milk from Seller for delivery and sales to others
NOW, THEREFORE, it is understood and agreed between the parties as follows:

1. **<u>Contract amount</u>** shall be all of the Grade “A” organic requirements of BUYER, the actual amount shall be agreed on a weekly basis on Thursday of the week prior to delivery.

2. **<u>Price</u>** shall be the component price for B.F., S.N.F. and Fluid as established by the California Department of Agriculture.

Seller retains the right to impose a service charge on Buyer in excess of legal minimums, the actual amount shall be negotiated between Buyer and Seller from time to time.

3. **<u>Quality</u>**. All milk purchased under this agreement shall meet the requirements of the appropriate health authority for use as Grade “A” milk for human consumption.

4. **<u>Testing</u>**. B.F. and S.N.F. shall be third party testing.

5. **Payment**. Milk delivered from the 1st through the 15th will be paid for on the 28th of the month in which the milk was delivered. Milk delivered from the 16th through the last day of the month will be paid for on the 13th of the month following delivery.

6. **Term**. The initial term of this agreement shall commence on April 1, 1993, and continue through March 30, 1997. After such initial term, this agreement shall continue on a yearly basis, commencing on April 1 of each year unless either party terminates this agreement after the initial term hereof by delivering written notice to the other party on or prior to May 1, 1996. Termination may thereafter be accomplished to be effective April 1 of any year by either party by delivery of written notice to the other party prior to October 1 of the preceding year.

ACCEPTED:	SELLER	BUYER
	Milk Marketing Collective, Inc.	Yo-Go International, Inc.
Signed:	George Neruda	Lilly Bach
Name:	George Neruda	Lilly Bach
Title:	President	President
Date:	2-25-93	2-25-93

Excerpt from Order Granting Motion in Limine re: Implied Covenant of Good Faith and Fair Dealing

Superior Court of Los Angeles, Hon. Whitely D. Marshall, Judge

****

According to Yo-Go, ADC knew from the start that it was responsible for supplying defective milk in January 2007 and its concealment of that knowledge materially violated the covenant of good faith and fair dealing implied in the Milk Purchase Agreement. Yo-Go alleges when ADC's breach came to light in August 2007, Yo-Go was justified in terminating the Milk Purchase Agreement because its performance was excused.

The implied covenant of good faith and fair dealing is generally defined as an implied agreement to refrain from taking any action that prevents the other party from performing or enjoying the benefits of a contract. In this case, however, Yo-Go's theory of breach is based on ADC's alleged conduct after it allegedly breached the requirements contract by providing sub-Grade A milk, and after Yo-Go accused ADC of breach and demanded reimbursement for the damages resulting from that breach. In other words, the alleged bad faith was in connection with post-breach discussions, including settlement discussions, between the parties.

There is no provision in the Milk Purchase Agreement requiring ADC to automatically pay damages if Yo-Go claims that ADC delivered defective milk. There is likewise no provision in the contract requiring ADC to engage in good faith negotiations with Yo-Go accuses it of breach. Therefore, when Yo-Go demanded payment of damages caused by the allegedly defective milk, it was demanding a remedy at law, not the performance of any clause under the contract. ADC's alleged bad faith in the meetings and negotiations that followed Yo-Go's claim for damages are not tied to any express or implied clause in the contract.

Since the evidence supporting Yo-Go's misguided implied covenant theory may be relevant to other claims and defenses in the action, the court does not exclude any evidence by this ruling. The court finds, as a matter of law, that Yo-Go's theory that ADC's alleged concealment of its responsibility for supplying defective milk after the alleged breach fails to state a claim for breach of the implied covenant of good faith and fair dealing under the Milk Purchase Agreement. Since Yo-Go has no viable claim for breach of the implied covenant on these facts, it has no viable defense of prior breach sufficient to excuse its performance under the Agreement.

ADC Proposed Jury Instructions

Installment Contracts

Authorities: Cal. Com. Code. Section 2612

Special Instruction No. 26

The Milk Purchase Agreement is an installment contract. An installment contract is one which requires or authorizes the delivery of goods in separate lots to be separately accepted. In this case each truckload of milk delivered by ADC was such a separate lot.

Under the Milk Purchase Agreement Yo-Go was permitted to reject any load of milk which was nonconforming if the nonconformity substantially impaired the value of that load and could be cured.

If a nonconformity or default with respect to one or more loads of milk substantially impaired the value of the whole contract there was a breach of the whole and Yo-G would be permitted to terminate the contract.

However if you find that Yo-Go failed to promptly notify ADC of its termination of the agreement or that Yo-Go accepted additional milk from ADC after the nonconforming load of milk, then you must find that Yo-Go waived any right it may have had to terminate the agreement based on the alleged nonconforming load of milk.

ADC Proposed Jury Instructions

Installment Contract: Nonconformity as Breach of Entire Contract

Authorities: Cal. Com. Code. Section 2612, Official Comment 6; *Gantry Const Co v American Pipe and Construction Co.* 49 Cal.App.3d 186 (1975)

Special Instruction No.__27

You must make a determination as to whether any delivery of defective milk by ADC in January 2007 "substantially impaired" the value of the entire contract or whether it merely impaired the value of that load of milk. If the only concern was as to that load of milk, then Yo-Go had a right to demand adequate assurances of proper future performance, but did not have the right to cancel the entire contract.

However, if you find that the delivery "substantially impaired" the value of the entire contract, then Yo-Go had a right to terminate the entire contract. If you determinate that Yo-Go did have a right to terminate the contract, you must also make a determination as to when Yo-Go informed ADC that it considered the nonconforming delivery to constitute a breach of the entire contract.

ADC Proposed Jury Instructions

Installment Contract: Meaning of "Substantially Impair"

Authorities: *Schreidel v American Honda Moter Co Inc.* 34 Cal.App.4th 1242 (1995); *Midwest Mobile Diagnostic Imaging LLC v Dynamics Corp of America* 965 F.Sup 1003 (W.D. Mich. 1997)

Special Instruction No. 28

Whether a defect constitutes a "substantial impairment" of the entire contract is a question of fact. A "substantial impairment" means a major defect. This means tha the defect cannot be minor or trivial. In making this determination you shold consider the cumulative effect of ADC's performance under the contract, based on the totality of the circumstances.

To find that Yo-Go had the right to terminate the Milk Purchase Agreement, you must find

(a) that ADC delivered a nonconforming load of milk in January 20007 and;

(b) that one nonconforming delivery of milk out of over 5000 deliveries made over a 14 year period constitutes a "substantial impairment" of the entire contract.

ADC Proposed Jury Instructions

Installment Contract: Reinstatement of Contract

Authorities: Cal. Com. Code 2612(3); Official Comment 4 to Cal. Com. Code 2612; *Traynor v Walters* 342 F.Supp. 455, 461 (M.D. Pa 1972); *Datatrend Inc. v Jabil Circuit Inc.* 3 F.Supp.2d. 66,75-76 (D. Mass. 1998); *Mextel Inc. v Air Shields Inc* 2005 WL 226112 at *25 (E.D. Pa 2005)

Special Instruction No. 29

If you find that the January 2007 milk delivery by ADC was a "substantial impairment" of the entire contract that gave Yo-Go the right to terminate the tentire contract, you must also determine whether Yo-Go reinstated the contract by its conduct after learning of the nonconforming load of milk in January 2007. To determine whether Yo-Go by its conduct reinstated the contract after learning of the nonconforming load of milk in January 2007 you must determine whether Yo-Go did either of the following:

(1) failed to provide ADC with timely notification of cancellation of the entire contract; or

(2) demanded performance as to future installments.

To determine whether Yo-Go provided ADC with timely notification of its cancellation of the entire contract, you must consider whether notification of cancellation made in late August 2008, based on a nonconforming delivery made in Janaury 2007, was reasonable.

You must also determine where after receiving the January 2007 delivery of milk Yo-Go demanded performance as to future installments. If you find that Yo-Go continued to buy milk from ADC after learning of the nonconforming load of milk in January 2007 then Yo-Go waived its right to terminate the contract.

From Milk Producers Council Newsletter November 7 2008

Sybrand Vander Dussen, MPC President

My View on Milk Production Increases

The dairy industry in California continues in its addiction of over-production of milk. Dairy producers seem to have only one clear focus: produce more milk. As costs go up, as milk prices decline, we produce more milk. As coops battle to place milk and milk products, we produce more milk. With3x milking, rBST, advancing genetics, gender-specific semen, we produce more milk.

In a perfect world, where the milk we supply and the demand for those products remained somewhat in balance, this would be a strong sign of a vibrant and healthy industry. But the reality is, dairymen produce in an unrestrained fashion with no consideration of demand, leaving the industry in a perpetual state of overproduction which causes a myriad of problems, all of which should be unnecessary.

***

Apparently out of sheer frustration with the oceans of milk presented to our California coops, Land O'Lakes, California Dairies, Inc., and Dairy Farmers of America instituted base programs. This was done with little warning and apparently with little forethought, and certainly was not planned in concert with other coops. The only immediate accomplishment was the targeting of those dairies that just happened during that time frame to be in a growth mode, and after a small across-the-board fee, all costs to dispose of excess milk was charge to those 'over-base' producers. One Southern California dairy suffered a charge of over $600,000 for the period of March-July, 20-8. Because at all times, various dairies are undergoing expansion, the institution of bases at another point in time would have simply targeted other dairies, perhaps different than those punished now. Sort of like musical chairs—when the music stopped, for those without a seat, they got whupped. And hard.

***

So why do so many producers have as their primary goal to just produce more milk? The answer lies in the magic of pooling, which was instituted at the same time quota was issued. Pooling of milk is a brilliant, efficient method of valuing and distributing milk in California. Imagine two buckets: one, a large 'milk' bucket and the other a large 'money' bucket. All milk produced in California is 'poured' into the milk bucket. At the bottom of that bucket are 5 faucets. One faucet for each milk usage. Class 1,2,3,4a & 4b. As milk enters the bucket, it loses it producer identification and then, various processors, whether it be for their intended use of bottled milk, cheese, power, etc., tap into the faucet corresponding to that use. As milk is processed for those various uses, that identifies a value based on our pricing formulas, Class 1 price, cheese, etc. The payment for the corresponding usage value is then 'placed' into the money bucket.

At the end of the month, it will have been determined how much milk has been produced and what its value is, strictly according to how and where it was used. That amount of money is then reported as a pool total, which then has deducted from its transportation credits and allowances, the quote payout of $1.70 cwt (less the RQA) according to quota holds, and what is then left is divided equally according to volume of milk, and milk components to all producers.

This is a wonderful system. It establishes an equitable price to all, allows maximum availability of milk for higher-valued products, and allows a quota producer to ship to a powder plant or a non-quote producer to ship to a Class 1 bottling plant. All very efficient and equitable.

However, for all the positives this system provides, it has a serious flaw. Because all milk is pooled, the common value established by usage and the equitable payout to producers means that when a lower value is created by overproduction that devaluation is shared by all producers simply by an across-the-bucket reduction in total proceeds. Stated differently, and simpler, if I produce one extra load of milk, which of course will go to powder (and possibly to the CCC) it will have a value of less than $10 to the pool, but I will receive a blend value of approximately $16.00 cwt for that load. But remember, the income to the pool is about $10.00! That $6.00 loss is shared by all! Stated in again another way, it is in the best interest of every producer to produce as much milk as he can, always, because the lower value for that excess product is borne by everyone. Indeed, the producer who hasn't expanded in recent years is sucking air. So many others have expanded, and that expansion, if it exceeds market demand, by definition has largely gone to lower or lowest value uses. This flaw in an otherwise brilliant system is described best by the two hikers in the forest being chased by a bear. Those two do not need to outrun the bear one just has to outrun the other! So my and your best business plan is to keep producing more, because the system, as designed, rewards individual growth but punishes producers industry-wide. The negative effect of me producing that 'one more load' will be picked up by you.

Los Angeles Times

Dairy farmers in desperate straits

Falling prices are forcing many to sell their cows for meat. Some are threatening to dump milk into sewers. Two have committed suicide. In California, the No. 1 dairy state, the pain is felt keenly.

By Jerry Hirsch | May 29, 2009

"It is a mess. The market just disappeared with the global economic crisis, and unfortunately for dairy producers, they can't simply turn the cows off to reduce the supply of milk," said Michael Marsh, chief executive of Western United Dairymen in Modesto.

"It's particularly tragic because these family farms are multi-generational operations, several of which will have a foreclosure or a bankruptcy as the last of their legacy to California agriculture," Marsh said.

Tom Marchy remembers learning how to milk cows from his grandfather on the family's spread in Stanislaus County. Now 48, he saw disaster looming in the industry last fall and called it quits.

His biggest customer had just canceled his milk contract, and "it was hard to find anyone else to ship to so I just got out."

He sold his herd, about 1,100 black-and-white Holsteins, to a farmer starting a dairy in Oklahoma. Marchy received $1,950 a cow, about $800 more than he would get if he were trying to sell now. Marchy then planted 140 acres of corn on his property in the rural town of Waterford east of Modesto. He continues to tend some heifers, waiting for those young females to mature to milk cows.

Those cows too will be shipped to Oklahoma. Marchy doesn't plan to resume the life of a dairyman.

"This is a young man's game. Unless you are big enough to hire people to do the work for you, it's a hard life," he said.

Collectively, U.S. farmers need to slash milk production by about 5% to bring supplies in balance with current demand, "but we have no good mechanism to do that," dairy owner Vanden Heuvel said.

One initiative will send about 103,000 milk cows to slaughter over the next several months, a move that will reduce the milk supply by about 1%. It is operated by Cooperative Working Together, a voluntary organization in Arlington, Va., that assesses members 10 cents per 100 pounds of milk to use for periodic herd retirement.

The current reduction is the largest ever by the group and buys out 388 farms.

The National Family Farm Coalition is calling for more emergency action to protect the nation's 57,000 dairy farmers. The NFFC is one of several farm groups urging Congress and the U.S. Department of Agriculture to set an emergency floor price of $18 per 100 pounds of milk.

So far, the main government action has been to buy up 238 million pounds of nonfat dry milk powder and 4.6 million pounds of butter since prices started to fall in October. Last week, the USDA said it would provide subsidies to export up to an additional 150 million pounds of nonfat dry milk, 46 million pounds of butterfat and 6 million pounds of cheese to help dry up the surplus. Cumulatively, these USDA actions will support milk prices by about 70 cents per 100 pounds of milk, said Roger Cryan, a National Milk Producers Federation economist.

Longer term, some farm groups want to change milk price regulations to better account for the cost of production in the system.

The price California farmers get for their milk is tied to sales of butter and cheddar cheese on the Chicago Mercantile Exchange combined with prices for dry whey and dry milk. Federal regulators and other states use similar formulas.

Farmers have faced low prices before, but what's different this time around is that their cost for feed and other expenses is high compared with what the milk sells for, said Bill Schiek, an economist with the Dairy Institute of California in Sacramento.

"They are just bleeding cash," Schiek said.

Some farmers now are thinking of doing the unthinkable -- dumping their milk as part of a national protest next week. "If they are not going to allow us to make a living, we will just dump it down the drain," said Arie DeJong, who owns several dairies and 20,000 cows in California and Arizona. "We just can't keep losing money like this."

Luis Bettencourt, an Idaho farmer who owns one of the biggest dairy companies in the nation, is considering dumping two days' worth of milk production -- about 8 million pounds.

"Why not?" he said. "We ain't getting any money for it anyway."