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NF01-449 An Introduction to Agricultural Production and Marketing Contracts

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An Introduction to Agricultural Production and Marketing Contracts

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The structure of agriculture continues to change and evolve. Recently, there has been more emphasis on identity preserved production of grain and livestock that is produced in a specific manner for a specific end use. Examples include turf grass seed production, dry edible beans, white wheat, feeder pigs, and cattle for the natural beef market. Much of this identity preserved production occurs under contract. Many producers in the Nebraska Panhandle and other areas of the state are using these Agricultural Production Contracts to manage risk and enhance income. Frequently, producers can increase their gross farm income through these contracts; but at what cost? It is critical that producers understand their obligations under a contract and the costs associated with fulfilling those obligations. The purpose of this NebGuide is to help producers analyze and successfully use production contracts.

Contractors are usually processors of grains or livestock, i.e. grain millers or meat packers. Contracting production with a producer benefits the processor by assuring a stable supply of a uniform quality product. This enhances inventory management and likely reduces costs. Producers benefit from the contract by having a market outlet for their production. They also may receive a price premium for delivering a commodity with specific quality attributes.

Generally a contract is a marketing contract for grain and a production contract for livestock. A marketing contract sets a price, price range, or price formula for a commodity at or before planting. Generally, the producer retains most of the management decisions and bears the production risk. However, some management issues may be specified in the contract. The marketing contract shifts most of the price risk to the processor. With production contracts, much more of the management is specified in the contract. Who is to provide the inputs, the quality and quantity of those inputs, and the schedule of use of the inputs is generally stated in the contract. In return for following the contract provisions, producers receive compensation for their labor and management. With some of these production contracts, the processor may own the animals that are being produced, which will have Initiative 300 implications.

A contract might contain the following:

1. Who the contract is between - usually referred to as the parties.
2. The term of the contract - one production cycle or growing season versus multiple year.
3. Specifically how the crop or livestock is to be produced.
4. Acceptable and unacceptable conditions and quality of crops or livestock must be defined.
5. Delivery methods, location and timing.
6. Price determination and payment schedule with discounts and premiums.
7. Both parties must sign the contract, thus agreeing to all the conditions.

Each of the terms of a contract carry implied or implicit responsibilities. The producer must understand the risks and rewards associated with each of the terms of the contract. It is vital that producers read and understand all the terms and implications of the contract. Given the difficulty of understanding legal language, and of knowing the court's interpretation of that language, it is advisable to have an attorney review the contract with you, before you sign on the dotted line. This will likely be money well spent.

The box to the left contains a series of **sample** contract terms. For additional sample contracts and discussion, see : "A Farmer's Legal Guide to Production Contracts" by Neil Hamilton. Contact: Top Producer, 230 West Washington Square, Philadelphia, PA 19106 or phone (215) 829-4867.

Following are some additional items to consider before signing a contract:

1. Who has the legal claim to the crop or livestock - if you are treated as a contractor you may have limited your legal right to the crop or livestock?
2. If you do not own the crop or livestock under contract, how are crop insurance and farm program payments affected?
3. Specifically how the crop or livestock is to be produced.
4. What is specifically expected from you the producer and how are your costs and returns affected? Is the premium more than the added costs?
5. Who pays, how much, and when? If you are relying on another company to pay you, is that company financially sound?
6. What may cause non-performance and how are

Sample Contract Wording (Not to be used as a Blank Contract Form)

This agreement between XYZ, Inc., P.O. Box 123, Anywhere, NE, hereinafter referred to as "BUYER" and ___(Name)___ Address , hereinafter referred to as "GROWER".

BUYER will buy and GROWER will plant seed and grow said crop during the crop year 20XX in accordance with the following terms and conditions to wit:

BUYER will buy and GROWER will raise hogs during 20XX to 20XY in accordance with the following terms and conditions to wit:

All crop produced under this agreement must be inspected, certified, and approved as to its quality by the applicable State or Federal Agency.

All vaccines and antibiotics shall be administered according to product label and shall be in accordance with Beef Quality Assurance Standards.

Crop shall not exceed 15% moisture at delivery.

disputes and problems addressed?

7. How can you get out of the contract with minimal financial risk?
8. Be a pessimist and think through every conceivable problem and decided your course of action based on a worse case scenario.
9. Be assured that the company who created the contract has obtained legal advise and has protected itself.

References

- "A Farmer's Legal Guide to Production Contracts" by Neil Hamilton. Available through *Top Producer* Magazine.

- "Grain Production Contract Checklist". Available through Nebraska Department of Justice — Consumer Protection Division.

- "Official Text of Initiative 300" by J. David Aiken, NF95-209

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Cattle shall grade USDA Select or higher with no more than 5% of the carcasses grading USDA Yield Grade 4 or 5

All crop purchased by BUYER will be delivered to BUYER by GROWER at GROWER'S expense, in merchantable and salable condition and meet the specific test weights.

Price to be settled at a time selected by the GROWER between June 1st of the current year and no later than thirty (30) days after the delivery of the crop to BUYER.

Price at delivery shall be the prior five (5) day average price for the nearby CME Live Cattle Futures contract.

The parties herein, each individually bind their heirs, assigners, executors and devisees by this agreement.

DATED this _______ day of _________ 20XX

GROWER BUYER

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