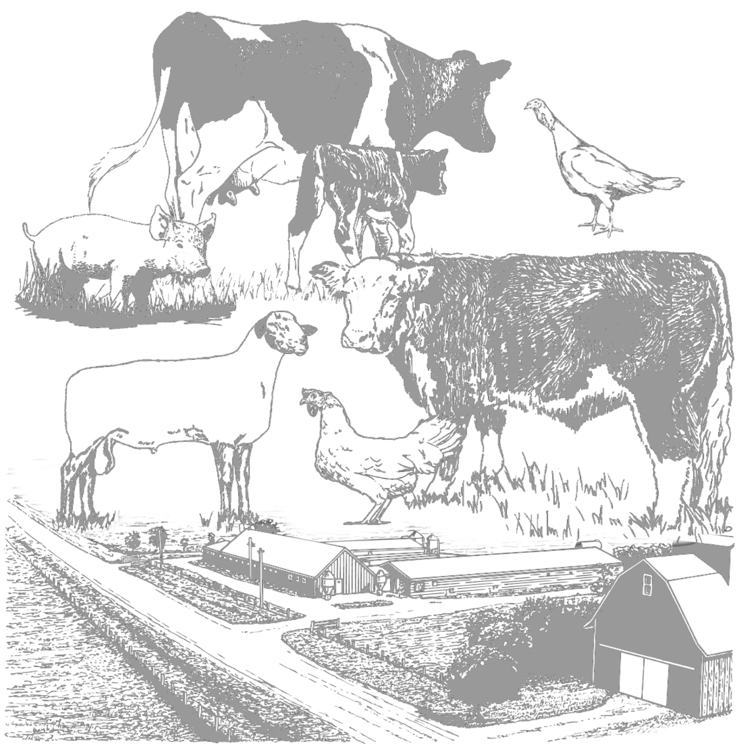
Checklist for Livestock and Poultry Production Contracts

Prepared by the Missouri Farm Bureau Task Force on Production Contracts

In cooperation with the Missouri Attorney General's Office



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Introduction

The following guide is intended to familiarize you, as a producer, with various questions and concerns regarding contract production of agricultural commodities. Before entering into such a contract, it is advisable for the producer to have any and all documents reviewed by an attorney. Nothing herein is intended to constitute legal advice, nor is the purpose of this guide to promote or discourage producers from entering into production contracts. Rather the purpose is to help producers make informed decisions.

The changing structure of agriculture, combined with the necessity for producers to take a greater role in managing their own risks, has encouraged many farmers to examine their options, opportunities, risks, and responsibilities with production contracts. Production contracts are agreements to produce crops and livestock, which are signed before seed is planted or before animals are produced. The exponential growth in production contracts, as a means of added revenue, has subsequently exposed many producers to risks that they have not consciously identified and developed plans to manage. While production contracts offer a wide range of advantages for both the buyers and sellers of specialty crops and livestock, there are downside risks as well. It is the intent of this document to help producers identify risks in contracts and become aware of the need to manage those risks.

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Remember…

- Generally speaking, a contract is written by the contractor to protect the corporate entity. In a broad sense, contracts are set up to minimize the contractor's risk and maximize their profits.
- Always calculate the cash flow to your operation created by the contract. Will it cover debt retirement and still provide additional funds for family living expenses?
- Your questions may be satisfactorily answered before you sign a contract but not afterward. Understand all aspects of the contract before signing.
- Don't sign a contract you do not like hoping to negotiate better terms later.
- Document everything you do.

Livestock Production Contracts

An increasing number of hogs, cattle, and poultry flocks are being produced under contract. While 90% of poultry production is under contract, the change is picking up speed in the swine industry. Many pork producers are considering contracting some aspect of the production cycle, either by networking with other producers of similar size, signing production contracts with suppliers of feeder pigs, or providing farrowing services.

Their counterparts in vegetable and specialty grain production will sell the commodity to the contracting company. However, livestock production contracts are service agreements in which the producer provides facilities, labor, utilities, and daily management for the contractor, who owns the livestock. The contractor places the animals in the producer's facilities and provides feed and medication while he retains ownership from placement to slaughter. The service agreement establishes more of a legal relationship between the producer and the contractor than does the sales agreement in vegetable and specialty grain production. The producer is paid for his management services related to the weight performance of the animal, in such categories as feed conversion or rate of gain. The contracting company generally maintains more control over production methods, such as dictating the animal health program. Good animal health is important to the contractor since the livestock belong to him and is equally important to the producer since he may be compensated on a variety of performance factors as well as low death rates.

Producers who enter into livestock production contracts usually have a significant investment in fixed capital assets, such as facilities and equipment. An intensive livestock feeding program with rapid rates of gain and quick turnaround of facilities provides the return on assets that the producer is expecting. Meanwhile, the contractor has invested in the livestock and feed without having to acquire facilities and equipment.

Livestock production contracts come in as many lengths as there are animal species. For example, broiler contracts may be for only one flock, but others are for multiple production cycles. Producers must be careful to ensure that contract periods will be sufficient to allow normal amortization of any investment in capital assets.

Contracts will also frequently address environmental compliance issues, such as waste management and dead animal disposal. These issues can result in substantial costs to the producer who must weigh them against his compensation program.

Livestock production contracts specify the production practices demanded by the contractor. In addition to providing facilities and production management, producers must agree to certain standards that may or may not be common to their operations. Growers may also be prohibited from production of other similar livestock species. Contractors usually have right of inspection at anytime, and some contracts allow the contractor to hire new management personnel if they do not think the former producer is performing to required standards.

Contractor obligations are to provide the livestock, feed, and veterinary care; haul the livestock to market; and provide the producer with copies of production and sale records prior to payment. However, it is difficult for a producer to know if he has profited from the contract until after the livestock is slaughtered and the contractor pays for the services. The prime reason for the uncertainty is the implementation of weight performance factors, such as rate of gain and feed conversion.

Since producers must supply facilities and equipment, substantial investments can be made to be able to raise livestock under contract. For this reason, the length of the contract is quite important. It should be long enough for the facilities to be adequately amortized. Contractors may prefer shorter term agreements because it allows them the flexibility to use only the producers that have the best performance.

Some protection for livestock producers is provided by the Packers and Stockyards Act, which promotes fair trade practices in the meat packing industry. A major element requires "prompt payment" for livestock sold and creates a trust fund for the benefit of unpaid sellers. For protection under the Packers and Stockyards Act, producers may file complaints in several areas:

1. Slow or non-payment;
2. Unfair or deceptive practices, such as intentional misweighing; and
3. Anti-trust violations.

The telephone number for the "GIPSA Hotline" in the Washington, D.C. office of the Packers and Stockyards Administration is 1-800-998-3447. The regional office is in Des Moines, IA, and the phone number is (515) 323-2579.

Livestock and Poultry Contract Checklist

For definition purposes the term "livestock" in this document refers to both poultry and livestock.

A. Consult Experts. Before committing yourself to this contractual obligation, be absolutely sure you understand the entire document.

1. Other Producers
   - Talk to other producers who have had experience with contracts. They may be the best source of advice.

2. Attorneys
   - If you do not fully and completely understand the legal terms in the contract or the legal consequences of the contract, then you should consult an attorney.

3. Financial and Technical Experts
   - If you do not fully understand the financial or tax consequences of the contract, then you should consult your lender, a tax professional, the Extension Service, an agricultural consultant or others.

4. Veterinarians
   - Talk to veterinarians who have personally had experience with contracts or have clients who have production contracts. Their professional experience and expertise can be valuable information.

B. Facility Requirements (If you are required to construct a building, make improvements in an existing building, or purchase new equipment.)

1. Exclusivity of Use
   - a) Can you have livestock other than the contractor's livestock in the facilities?
   - b) Can you have other livestock on the farm or premises?
   - c) What restrictions apply to the presence of other domestic and/or wild animals?

2. Construction Timing
   - a) When does construction have to be completed?
   - b) Are there penalties for construction delays?

3. Construction Costs/Depreciation
   - a) Do you know the total costs of construction?
   - b) Do you pay for all the material, labor, plumbing, electrical, manure handling and other specialized equipment?
   - c) Who pays the costs of site surveys, engineering, and excavation?
   - d) How does the depreciation period for a single purpose livestock building relate to the contract length? Depreciation for tax purposes differs with various types of livestock buildings.

4. Construction Specifications/Modernization
   - a) Who provides the specifications for construction?
   - b) Who is responsible if there is poor workmanship?
   - c) Is the facility standard for the industry? Would the facility be acceptable if you wanted to enter into contracts with other contractors in the future? Could the facility be used for other purposes?
   - d) Are you required to pay for future modernization or upgrades in the facility or its equipment?
   - e) Will the length of the contract be extended if you are required to invest in modernizing or upgrading the facility?

5. Government Approval of Facility
   - a) Who is responsible for obtaining governmental permits and/or county zoning approval?
   - b) Who pays permit fees?
   - c) What happens if the facility is not approved?
   - d) Are you knowledgeable about governmental regulations that will affect the facility?
   - e) What are the manure handling requirements of the Department of Natural Resources?

6. Miscellaneous Facility Costs
   - a) Who pays for maintenance and repairs on the facility?
   - b) Who pays for insurance for liability and property/casualty on the facility?
   - c) Will the facility require a new well or other source of water? Who pays for this?
   - d) Who pays for security?
   - e) Who pays for company mandated equipment upgrades during the life of the contract?

7. Access to Facility
   - a) Who has access to the facility?
   - b) If the contractor or others have access, then do they have to give you advance notice?
   - c) What if there are damages, such as introduction of disease?

8. Recovery of Investment
   - a) Is the duration of the contract adequate to recover your investment in the facility and equipment?
   - b) Will the cash flow of the contract cover debt retirement and provide additional funds for family living expenses?
   - c) Can the contract be terminated before the investment is recovered? What if the contractor goes bankrupt?
   - d) Is there a guarantee of minimum occupancy and/or payment for the facility based on holding capacity?

9. Financing of Facility/Lender Approval
   - a) Is the financing of the facility feasible? Do you have a written loan commitment?
   - b) Does your lender need to accept the contract before financing of the facility is approved?
   - c) Does your lender require the contractor to provide assurances that the contractor can perform the contract?
   - d) Is your contractor willing to provide cash flow statements for you and your lender?

C. Operational Issues

1. Delivery of Livestock
   - a) Who pays the cost of trucking livestock in and out?
   - b) Who decides when and how livestock will be delivered to the facility? Is there a set schedule for livestock deliveries?
   - c) What if deliveries are late or less than expected? Do you have a guaranteed minimum or maximum occupancy rate for your facilities? Is there compensation for non-compliance?
   - d) If applicable, when, where, and under what supervision will livestock be weighed coming into or leaving the facility?
   - e) Who bears the risk of death loss of livestock while trucked in or out?

2. Feed
   - a) Who is responsible for providing feed, guaranteeing quality, and formulating rations?
   - b) Who sets the rations? Who decides on changes in rations due to weather, market conditions, development of new techniques, or other factors?
   - c) Who is responsible if feed conversions are below expectations?
   - d) If marketing is delayed and feed efficiency declines, are you compensated for the extra feed costs?
   - e) If you use feed you raised, how is it priced? Is there a mark-up?
   - f) Whether you raised the feed or not, how are feed storage, drying, processing, trucking or other handling costs allocated?

3. Livestock Health
   - a) Who checks for livestock health at arrival?
   - b) Can you reject livestock you think are sick? Can you demand a veterinarian's certification of health? If so, then whose vet is used and who pays? Who is responsible for compliance with state and federal animal health regulations?

c) Who bears death loss risk while the livestock are at your facility?
d) Some contracts have a rebuttable presumption that death loss occurring soon after the arrival of livestock is the contractor's responsibility because unhealthy animals were supplied. Does this contract address this situation?
e) Who bears death loss risk due to failure of ventilation, heating, cooling, watering, or other equipment?
f) Who bears death loss risk due to extreme weather conditions such as heat, cold, floods, wind, lightning, etc.?
g) Who bears the costs if unhealthy livestock brought to the facility infect other livestock on the farm?
h) Who bears the costs of poor performance due to unhealthy or low-quality livestock? Can you renegotiate compensation terms?
i) Who determines and pays for programs for scheduled or unscheduled health care?
j) Who chooses the veterinarian? Who pays the vet?
k) What are your responsibilities for cleaning or disinfecting facilities between turns of livestock?
l) Who bears the costs (which would include lost income) associated with facilities being quarantined or shutdown by the contractor due to disease outbreak?

4. Manure
a) Who is responsible for manure management?
b) If a manure management plan must be filed with the Department of Natural Resources (DNR), then who files it, updates it, implements it, and communicates with the DNR concerning it?
c) Who is responsible to respond if there are complaints, lawsuits, or alleged violations of law, involving odor, dust, water quality, or other types of nuisance? Who is ultimately liable for damages, penalties, or legal expenses from complaints, lawsuits, or enforcement actions?
d) Are there any cost-effective steps you can take to minimize the possibility of complaints involving odor, dust, water quality, or other types of nuisance, which may stem from the contract?
e) Who is responsible for compliance with new regulations?
f) Who, in fact, owns the manure? Can you sell the manure?
g) If the manure is to be spread on someone else's land, then is a manure application agreement in place? Does the agreement specify a method of manure application? Can you comply with this agreement?

5. Labor and Management/ Record Keeping
a) Who provides labor and management to raise the livestock? Can this be delegated or subcontracted? If you delegated or subcontracted labor or management, what impact would this have on your cash flow or the profitability of the contract?
b) Who establishes and evaluates husbandry practices?
c) Are you or your employees required to have special skills or training? Who pays for the training?
d) What production records are you required to maintain?

6. Insurance and Other Costs
a) Who pays for liability and casualty insurance on the livestock? Is there coverage for suffocation of livestock due to equipment failure? Who pays for workers' compensation, health, disability, and general liability insurance?
b) Do you have the opportunity to buy affordable income replacement insurance?
c) Do you have to provide certificates of insurance?
d) Who is responsible for utilities?
e) Who is responsible for dead animal removal?
f) Who is responsible for dust control? Weed control?
g) Who pays for roadway construction and maintenance?

D. Payment

1. Payment
a) Will the cash flow of the contract cover debt retirement and provide additional funds for family living expenses?
b) On what basis are you being paid? Are the terms clear?
c) What payment factors are out of your control?
d) Is the schedule of payments firmly set? Will this schedule satisfy your cash flow?
e) Are there penalties for late payments?
f) Can the payments be assigned to a lender?
g) Will the last payment be made before the livestock leave your facilities?
h) Will your lender's name be on the check?

2. Incentive Payments and Bonuses
a) If production incentive payments (based on factors such as death loss, feed conversion, or rate of gain) are involved, then exactly what do you have to do to receive the incentive payments? How are the payments calculated and when are the payments made?
b) Can you examine and understand the computations used to determine these incentive payments?

3. Costs of Production
a) Do you know your costs of production to determine the profitability of the contract?
b) If you don't have cost of production records, you should consult with the Extension Service or others to arrive at estimated production costs.

4. Contract Grower Liens

A producer may be able to place a lien on livestock produced under a contract but no Missouri statutes specifically authorize such a lien. Missouri law does authorize a lien for "labor or material" furnished on any animal provided there is a written agreement on the work or material to be furnished. It is not clear whether this lien would apply to animals raised under a production contract. Such a lien is not superior to a prior lien. In any event, you may have a right to place a lien on a contractor's animals. In addition, there is legislation pending this year that may address this situation.
a) Does the contract prohibit you from discussing your contract with others?
b) Does the contract request or require you to "waive"

statutory provisions in order to be accepted by the contractor?

c) When can you file a contract producer lien?

d) What are the legal requirements for preserving the lien?

e) Does the contract identify the animals by breed, size of flock/herd, and barn location? Without this information, a lien may be impossible even if authorized by law.

5. Contractor Credentials

a) If you have concerns about getting paid, will the contractor provide you with a financial statement or with a list of producers the contractor has contracted with in the past?

b) Is the contractor bonded for this type of obligation?

c) Does it appear that the contractor is committed to contracting in the region? Has the contractor made investments in fixed assets or relocated management in the region? Is contracting the contractor's core business?

d) Do other contract opportunities exist in your area?

6. Your Credentials

If the contractor has questions about your ability to perform the contract, are you willing and able to release a financial statement and names of individuals who will verify your financial stability and management abilities?

7. Parent Company Responsibility

If the contractor is a subsidiary company, does the contract make the parent company responsible for payment if the contractor defaults?

E. Legal Issues

1. Dispute Resolution

a) Does the contract require alternative dispute resolution such as mediation or arbitration before the parties can go to court? Mediation is negotiation between you and the contractor facilitated by a neutral third party. Arbitration is a process wherein a third party arbitrator hears the dispute like a judge and renders a decision that is usually binding on the parties without the opportunity for appeal. Both mediation and arbitration are generally less costly than litigation, but arbitration is generally more expensive than mediation.

b) Does the contract specify how the mediator or arbitrator is selected? Who pays for their services?

c) Does the contract identify special rules under which the mediation or arbitration shall occur? How will any special rules affect you?

2. Termination of Contract

a) Under what conditions can the contractor terminate the contract?

b) Who determines whether those conditions are met? Are there objective standards or is it at the discretion of the contractor?

c) How much notice does the contractor have to give you before termination?

d) Are you given an opportunity to cure a problem before termination? How much time are you given for this?

e) What are your rights after termination of the contract? Will you be paid for work done to date? Do you have an option to buy the livestock?

f) Under what conditions can you terminate the contract? What if you get sick, disabled, or die? What if you file bankruptcy?

g) Can you terminate if the contractor fails to deliver livestock or feed or fails to make payments on time?

h) Does the contract excuse non-performance caused by "Acts of God," meaning occurrences out of human control?

3. Approvals and Renewal of Contract

a) Do other parties have to approve the contract, such as your landlord, lender, or spouse?

b) Under what conditions can the contract be renewed?

c) Are there any conditions under which you are guaranteed an opportunity to renew the contract or is it up to the contractor?

4. Status of Parties

a) What legal relationship does the contract create between you and the contractor? Is it a landlord/tenant relationship, employer/employee relationship, independent contractor, partnership, joint venture, agency? (The legal relationship involved will determine your rights and duties under the contract and will have important tax consequences.)

b) Does the contract refer to a bailment?

5. Assignment of Contract

Can the contract be assigned or transferred by you or by the contractor to others parties? This may have important tax consequences.

6. Choice of Law/Venue/Change of Law

a) Is the contract being interpreted under the laws of Missouri or the state in which the contractor is headquartered? Is this choice of law fair?

b) Does the contract set a venue location for any lawsuit that might be filed? Is this location fair?

c) Does the contract permit renegotiation or nullification of the contract if the laws governing production contracts are changed?

7. Duration of Offer

How long do you have to accept the contract? Is there an expiration date for signing?

8. Put It in Writing

You should not rely on oral agreements or interpretations of the contract. Reduce all understandings or modifications to writing.

F. Neighbors/Goals

1. Neighbors

a) Will raising livestock under this contract affect your relationship with your neighbors?

b) Have you talked with your neighbors about your plans?

c) Are you aware of state and local set back requirements?

2. Long Term Goals

How does this contract fit into your long terms goals for your farm, your family, your community?

Contract Production Glossary

Act of God–A fact situation unforeseeable by the parties due to circumstance out of the control of the parties, such as the circumstance of nature (flood, drought, tornadoes, storms, etc.) or of man (labor strife, wars, lack of supply, government restriction) which interferes with the party's intentions to perform a contract.

Agent–A representative of a contractor who looks after the interests of the company and can make oral or written changes in a contract.

Anticipatory breach–The indication by one party in a contract that he will not be able to carry out his obligation. This indication, whether written, oral, or an act, can be treated by the other party in the contract as confirmation that the agreement has been broken.

Arbitration–A non-court way of settling disputes in a contract. An arbitrator who is a neutral, disinterested person is chosen to hear both sides of the matter, formulate an appropriate settlement, and impose that decision on both sides.

Bailment–An arrangement between two parties in which one takes care of the property belonging to the other, usually in exchange for a fee. The ownership of the property does not change, but the property manager is expected to take reasonable care of the other party's property.

Breach–The breaking of a contract in which one side does not perform his obligations. The other party in the contract has the right to, and frequently will, sue for damages.

Consideration–The payment to be received by someone providing a product or service in the performance of a contract.

Contract–An agreement between two or more legally competent parties to engage in an activity or conveyance of a product or service in which one party pays the other in return for the product or service.

Damages–A monetary payment awarded by a court or arbitrator as a result of a broken contract. The amount is determined by the loss suffered by the other party to the contract. Consequential damages are directly related to the loss sustained. Punitive damages are awarded to serve as a punishment for fraud.

Default–Non-performance of one's contractual obligations.

Disclaimer–Language used to protect a person or company from any liability should a problem develop with a product being sold. A disclaimer is usually in the form of a warranty indicating what the buyer should or should not expect the product or service to accomplish.

Encumber–To place a lien or other restriction on property in order to secure or protect a debt or an obligation.

Force majeure–A provision in a contract to protect the parties from being unable to perform their obligations as a result of unforeseen circumstances, such as an Act of God.

Goods–All things that are movable at the time of identification to the contract for sale, including the unborn young of livestock and growing crops.

Identity preserved–Action taken to keep separate one commodity from another because of its unique characteristics. The effort is usually made to separate grains which have traits that cannot be visibly detected and appear to resemble other grains of that commodity. The effort at preservation is made from planting to processing to insure the special traits are not adulterated.

Independent contractor–A party who agrees to perform certain duties specified in a contract but who is not an employee of the contractor.

Intellectual property rights–Rights maintained by the developer of a valuable product or process that can be confidentially protected by a patent or contract.

Joint venture–A partnership arrangement developed to conduct business while sharing risks and profits.

Mediation–A non-court dispute resolution process that involves a neutral, disinterested third party. However, the neutral party serves as a fact finder and assists the disputing parties come to an agreement without a binding settlement.

Merchant–Someone who sells goods or services and has knowledge of the expected success or failure of the performance of those goods or services.

Passed-acres clause–A contract provision that allows a contractor to not take (pass) on acres of production that are not needed by the contract. The contract provision usually establishes a payment procedure for the producer.

Release–A statement from one party in a contract that allows the other party to not have to perform certain obligations.

Rebuttable presumption–A presumption is a rule of law that requires the assumption of a fact from another fact and has the effect of shifting the burden of proof to the other party. A rebuttable presumption may be overcome through the introduction of contrary evidence.

Specific performance–A court order for a contract provision to be performed by the first party when the second party has been damaged but when a monetary damage would be insufficient to cure the problem.

Termination–Concluding a contract before the time initially agreed upon. Termination can occur when both parties agree or when one party defaults.

Title–The actual ownership of property. Title can be conveyed from one person to another.

Uniform Commercial Code (UCC)–A state law that defines and governs commercial transactions.

Vertical integration–The organization of production, processing and distribution systems all controlled by a single company in an effort to capitalize on certain economic efficiencies and working arrangements.

Waiver–The action of yielding a right or privilege established in a contractual relationship.

Warranty–A statement given by a seller to a buyer that the product or service will produce certain expected results. An express warranty is a written promise. However, an implied warranty is a perceived promise of expected satisfactory performance.

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Other Sources of Information

Hamilton, Neil D., A Farmers' Legal Guide to Production Contracts, Farm Journal, Inc., Philadelphia, Penn., 1995.

Guide to Contracting, National Pork Producers Council, Des Moines, IA, 1996.

Web Links of Interest

Agricultural Contracts
http://agebb.missouri.edu/mgt/agcontract/index.htm

Good Contract Swine Grower-Integrator Relations
http://www.ext.vt.edu/news/periodicals/livestock/aps-00_02/aps-0189.html

Legality and Contract Issues
http://www.agrisk.umn.edu/results1.asp?Keywords=Contract%20Arrangements

National Contract Poultry Growers Association
http://www.web-span.com/pga/

Swine Contracts – Pros and Cons
http://www.penpages.psu.edu/penpages_reference/28901/2890195.HTML