Contracting in Agriculture: Making the Right Decision

Information for Farmers from USDA

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Introduction

Today, a significant portion of livestock, poultry and other crops are being raised under production contracts, also known as grower agreements. Contracting has changed the shape of American agriculture. In the future, you may consider signing a contract to raise a crop under detailed specifications or to care for livestock or poultry owned by someone else. USDA cannot tell you whether or not to sign a production contract. Each farmer and every farm business is different and there are many different types of contracts available.

Making the important decision to enter a production contract should only be made after you consider how contracting may affect the future of your farm business.

This guide is designed to help you understand production contracts – and to help identify the questions you should consider as you decide whether contracting is right for you. At the end of this guide you will find a list of other sources of information about contracting, including the USDA website, which may help you decide whether contracting makes sense for you and your business.

Production Contracts – A Different Type of Business Decision for Farmers

Farming is a business. You already know this. Marketing what you raise on your farm involves entering into many types of business transactions. In many cases, these transactions involve people you know – friends, neighbors – and often begin with just a handshake. Deciding to sign a production contract is also a business decision but it is much different than traditional marketing. The key to understanding a production contract is that you are no longer selling or marketing production you own, instead you are being paid for your services in caring for animals owned by another party or for raising their crop. Often times, with a production contract, you may be dealing with people you don't know or who don't live nearby. The agreement will not be a simple handshake but will require signing a detailed binding legal agreement. In most cases, you will be offered the business arrangement on a "take it or leave it" basis with little opportunity to negotiate different terms.

A contract creates expectations and obligations between you and the contractor, for example, the company providing the swine or poultry you agree to raise . You expect to be paid for what you do and expect the contract will run for the agreed time period. The contractor expects you to meet the terms of the contract and to perform the services such as caring for livestock – in the manner described in the agreement. Signing a contract is a business decision – one that brings opportunities and challenges.

Why Do Companies Want to Use Production Contracts?

Basically, an agricultural production contract is an agreement – you agree to produce and deliver a specific agricultural commodity for the contractor, under the terms of a legal agreement signed before any seeds are planted or livestock are delivered. The contract might be a simple 1-page agreement or it may be many pages with detailed legal provisions. In any case, the contract creates a unique relationship and requires you to follow its terms in the production and delivery of the commodity involved. There are many reasons companies involved in agriculture use production contracts:

Quality Control – Contracts can provide control over the genetic technology, production methods, and inputs used, and help ensure uniformity and quality of the commodity produced.

Assuring Adequate Supply – Contracts offer a way to manage the quantity acquired to ensure an adequate supply.

Supply Management – Contracting can help lock in supplies for the contractor, but contracts may include terms limiting the amount the contractor actually is required to accept.

Marketing-Related Technology – Contracts can promote the use of related technologies, such as "packages" of seeds and chemicals. In other words, you agree to use the seeds and the chemicals provided by the contractor to produce the final product.

Intellectual Property Protections – Contracts can control access to new technologies, thus serving as a form of intellectual property protection.

Confidential Arrangements – Contracts offer a way for companies to preserve the confidentiality of their marketing arrangements and even the identity of end-users.

Pricing Confidentiality – Contracts often use non-public pricing which conceals the premium earned for any special trait or the amount paid for performing services. This can create higher profits for the contractor and may limit the ability of producers to bargain for higher payments.

Lower Risks and Higher Profits – Contracts offer companies a way to invest in technologies like improved breeding and extend operations into production without having to own farmland or production facilities. This can be important in states with laws prohibiting corporate ownership of farmland.

Move Capital Requirements from the Company to Farmers – Contracts allow companies to move the financial risk of building barns and buying equipment from their balance sheet to that of farmers. This reduces their financial risk in case market conditions call for reduced production: a loan must still be paid even if the building or equipment is not in use.

Lower Environmental Risk – Contracts allow companies to ensure the responsibility for manure and other waste, such as dead animals, remains with the farmer. Disposal of waste can be subject to local, state, and federal law.

Together these factors explain why many businesses, such as seed and chemical companies and meat and poultry processors, are contracting with farmers to produce commodities. Contracting offers them stable financial returns and supplies and reduces their risks.

How Do You Benefit from Production Contracts?

A second question you might have is – why even consider entering into a production contract? Most farmers consider signing a contract to reduce exposure to risk or to make more money. Indeed, some contracts can lead to higher returns and serve as a form of risk sharing. For example, contracts can insulate growers from some market price fluctuations. The following are some ways production contracts may help you in your business operation:

Lower your Financial Risk – Contracts can reduce financial risks by providing a guaranteed source of cash flow while reducing your need for capital. For example, by raising hogs on contract, you will not need to purchase the animals but instead can use your labor and facilities to care for the contractor's animals. The contract will provide regular payments if contract requirements are met, and by not owning animals you may be protected from market price fluctuations if the contract provides for a guaranteed price.

Access to Credit– If you need to borrow, contracts may make you a more attractive borrower. In fact, some lenders may require contracts as a condition for a loan. By providing a steady source of revenue and reducing marketing risks, a contract may make banks more willing to lend you money to construct facilities. Some contractors may even offer direct financing for producers if new buildings are required.

Access to New Technologies – Contracts can provide you with access to new technologies such as improved livestock genetics. Entering into a contract may be the only way to acquire some technologies. By contracting you may get access to the technology and technical support from the company.

Access to New Markets and Higher Prices – Contracts can provide an opportunity to receive higher returns or price premiums for raising new crops or using certain production methods. It may only be possible to raise specialty crops by growing under contract with a processor.

What Do You Give Up in Contracting?

Every business decision has pros and cons associated with it, and the decision to enter into an agricultural production contract is no different. While contracts may offer ways to reduce your risks, they can also create new risks. In addition, you lose some of the independence you have as the sole decision maker in your business.

As you evaluate the terms of a contract, a good rule to keep in mind is if you expect higher returns or to gain a benefit under a contract, it will be in exchange for something you do. In contract law this is known as the "consideration." Depending on the commodity and the contract terms, the required action – your "consideration" – can take several forms:

- You might have higher production costs in order to comply with contract terms, for example, because you must use higher priced inputs or special equipment;
- You might need to invest large amounts, often secured by your land, in special-purpose buildings or equipment, of little use if you no longer have the contract;
- You may have less flexibility in how you farm if the contract provides guidelines on what practices must be followed.
- You may have less control over marketing decisions; in fact you may not really be marketing anything other than your labor and capital (money used for buildings and equipment).
- The crop being grown under contract may have lower yields than your traditional crop; although your contract may offer a higher potential price per unit (e.g., bushel) your total yield may result in lower revenue for the contracted crop;

- You might receive less for the production you raise if it does not meet quality standards specified by your contract. Remember, not all of what you produce may be eligible for the contract price;
- There is a risk you may end up financing the contractor for the time between when you deliver the production and when you are paid for your services.

The key to evaluating the economics of any agricultural contract opportunity is to pencil out the costs and expected returns and determine if the extra costs or risks are worth it.

Pencil It Out and Compare

To determine if a contract is a good economic opportunity, you should take these three steps. First, you need to "pencil it out." Try to figure what your economic return will be under the contract. Be honest with yourself. Don't just use the highest yield or the best performance, or the highest price and premiums you could earn. Of course this could happen, but you should also try to figure out the return based on average performance and occasional below average results. Above all, know what your break-even price is, evaluate the contract in that context, and don't rely on optimistic estimates from salespeople.

Second, you should also estimate the worst-case scenario – if a disaster does happen, such as a storm destroying the crop, the animals getting sick, an unexpected delay in delivery of animals, or physical structures being destroyed. Once you have determined your range of possible returns, you should consider any other costs or risks associated with the contract, such as any lengthy delays in payment or the cost of complying with necessary environmental requirements.

The third step is to compare the returns possible under the contract to your alternative marketing and production options. For example you might consider working with other farmers to form a cooperative to market or process your own production. USDA has the Value-Added Producer Grant program, which can help people explore alternative marketing options. The point is – don't consider the contract in a vacuum. Compare it to current markets for the commodity you produce and to your current costs of production and returns. If this is a new business venture, consider the alternative returns you could earn on money you will invest or borrow under the contract.

Contracting Can Create New Risks

Only by considering the terms of the contract, your legal obligations, and the relation the contract creates between you and the contractor, can you decide if the contract is a justifiable risk for you to take. Consider these examples of how contracts can result in new risks for producers:

A Long-Term Investment but a Short-Term Contract – Most livestock growing contracts require you to build one or more new facilities to the company's specifications, which may require borrowing money and even mortgaging your land. However, some contracts may be for a shorter period than the length of the loan and many don't even guarantee delivery of animals on any schedule. This can create a serious risk if your contract ends before buildings or equipment are paid off. This risk is especially serious if the contractor is the only company contracting for livestock or poultry in your area so you can't easily find another company.

Similarly, many specialty crops are produced under 1-year contracts and may require access to expensive harvesting equipment. If you buy equipment expecting to continue raising the crop long enough to pay it off, serious problems can arise if the contract isn't renewed.

Quality of the Output is Set by the Contractor – Contracts often contain detailed terms for the quality of the crop or the methods of production desired. In most cases, the contractor alone decides whether the crop or your performance satisfies the contract. Experience shows market conditions can influence how strictly contract provisions are applied. Many court cases on contracts have involved claims that a farmer's crops did not meet the contract standards. Courts have often found the products to be in compliance, but instead the real disagreement arose because the market price had fallen and the contractor was obliged to pay a price higher than the current market price. Of course, these disputes can happen both ways. In some court cases farmers have refused to deliver

commodities produced under contracts when market prices rose. It is important to recognize that one of the purposes of a contract is to fix the price or premium to be paid. As a result, contracting reduces the flexibility the parties have to take advantage of price changes in the market.

Risk of Not Being Paid – Production contracts are a form of raising commodities and marketing services – and producers depend on contractors to be paid under the agreements. If a contract provides for a significant delay in payment after the crop is delivered or the service is provided, you are at risk. Until you are paid, you are an unsecured creditor essentially financing the contractor, meaning someone owes you money, but they have not put up any property as collateral. When poultry, livestock, or grain are sold in normal marketing channels to a warehouse, dealer, or packer, you are protected by federal and state laws which regulate buyers and which protect your right to be paid for the crops delivered. However, under most contracts you will have no such protection. While some states, such as Iowa, have enacted producer lien laws to allow growers to file legal claims in order to receive their agreed payment, the procedures are often cumbersome and rarely used.

Risk of Loss Because you Don't Own the Livestock or Crop – Under most common forms of production contracts, you do not have any legal title to the crop or animals being raised. This protects the contractor from claims by you or your creditors. But the contract may also state the risk of loss of the crop, such as by weather or disease, is yours. In other words, if you raise a crop, the contractor owns it; but if the crop is lost or the animals die, you own them and no compensation may be earned for your services.

Ten Legal Rules About Production Contracts for Farmers To Consider

Most farmers are not lawyers – although sometimes you may feel like you need to be. To read and sign a contract you don't need to be a lawyer but you do need to understand how the law might apply to your contract. It is always a good idea to get your lawyer's advice on major business decisions you make on your farm – and signing a production contract is no exception.

"Know Your Risk: Read the Contract"

When an Iowa seed company experienced financial difficulty and filed bankruptcy, many farmers who had grown and delivered soybeans to the company under contract were surprised to learn they weren't going to be paid. Worse yet, when the producers applied for payments from the Iowa grain bonding and indemnity funds, they were not eligible for several reasons. The contractor had never purchased a grain dealer's license as required. Further, because the production contract delayed payment until well after delivery, the state ruled the contracts were "deferred pricing" arrangements not covered by law under the indemnity fund. This news came as a surprise to the growers but if they had read the contract closely, it shouldn't have. Right at the bottom of the second page was the following statement in bold print: "Notice to Seller of Financial Risk. This Contract Constitutes a Voluntary Extension of Credit. This Contract is Not Covered by Any Grain Buyer's Bond." This situation illustrates how contracting can introduce new risks of payment and how the financial health of your contractor can affect you. It also shows how important it is to read and understand the contract.

Even if you decide not to consult your attorney – there are basic rules of contract law you should understand.

Here are 10 important rules to keep in mind -- before and after you sign the contract:

1. Remember the first rule of contracts: whoever writes the contract benefits most. Don't assume a contract protects you. It might, but you shouldn't assume so. The contractor who wrote the contract protected its interests. You have to protect your own. Contracts are "arms-length" transactions in which both sides try to maximize their advantages. The less bargaining power you have, the less "advantage" you have. The reality is most production contracts are one sided--the company controls the information and has much more power than any grower or producer.

2. Read and understand a contract before signing it. Contract

terms determine your rights and responsibilities. Once you sign a contract it creates binding legal obligations. That is why it is critical to understand what you are agreeing to do and to get good legal advice. Do not assume the courts will protect you if something goes wrong. Courts have resolved many cases involving production contract disputes and are likely to enforce the agreements made under the contract, rejecting growers' claims that the terms were unfair or poorly communicated.

3. If you do not understand the contract, ask questions and obtain legal advice. This is especially important if the investment or action involved is significant or if the contract creates a long-term relationship. Several states, including Illinois and Arkansas, have passed laws requiring production contracts to be "readable" or easier to understand for growers. These laws require contracts to disclose material risks, such as the potential need to make additional investments.

4. You will be required to fulfill the terms of the contract before you are paid. Because you have signed a contract to obtain an economic advantage, you will have to perform whatever obligations are required before you can receive the benefits.

5. Never assume not performing an agreement will be excused. Some contract terms may be more important than others but all have legal effect. If something happens to make you unable to fulfill the contract – like bad weather or illness – the contractor might excuse your unfinished work, but not always. In some situations, like a crop failure due to weather, state law may even provide an excuse. But if the failure to perform is your fault, even when caused by conditions beyond your control, the contractor might choose to enforce the contract. If you believe you may have to default on or breach a contract, consider alerting the other side and negotiating a resolution.

6. Be aware of the contractor's (or whomever the contract says will pay you) financial situation. The biggest risk with contracting is not being paid once you have performed. You can minimize the risk by investigating the contractor's finances, by requesting financial guarantees, and by dealing only with those covered by public laws ensuring farmers get paid for crops or services.

7. Remember, any proposed contract is subject to negotiation. Even though most contracts are printed, they can still be amended, if both parties agree. If you don't like a certain term, ask that it be changed. Remember – you will never have more bargaining power in a contract than just before you sign. The reverse is also true – once you sign, it will be difficult, though not impossible, to alter a contract. In addition, once you enter into a production contract relation – and invest substantial sums, such as for new buildings – you may have even less bargaining ability in future negotiations. Remember to save documentation of any changes made to a printed contract.

8. Be sure any changes to a contract are made in writing. Never rely on oral communications to amend an agreement. Just because you believe a contract was changed by a conversation with the contractor or its representative, doesn't make it true. If you and the other party agree to amend the terms of a contract, get the new terms in writing and have the other party sign them. Be sure to determine whether the other person has legal authority to make the change. Most contracts include what are known as 'entirety' clauses, which state that only written terms are binding and "oral modifications" are not allowed -- unless reduced to writing. It is important to keep letters or other documents showing what was agreed to. Courts may allow oral testimony to alter contracts, but the burden of proof will be on you to prove the changes were made.

9. Keep good records of your performance under the contract. It is very helpful to keep records and documents concerning your performance --such as amounts you delivered and when payments were made. Also, keep notes about any communications with the contractor. If a dispute arises, your records may provide the answers a court will need in order to resolve it.

10. Stay in touch with the other party. Good communication between parties to a contract is important for resolving uncertainties and preventing problems. Do not hesitate to ask questions if you don't understand what is happening, such as why a payment is late. The other party may be unaware of the problem. Good communication is especially important when conditions – such as price changes or weather – make upholding the contract difficult.

Critical Issues in Contracting and the Questions to Consider

When you sign a contract, everything in it is part of your agreement. But experience shows some issues are more critical to the success of a contract. The following discussion concerns the most critical issues in contracting and can be used as a checklist of questions to consider about your contract.

Getting paid – The most important reason you sign an agreement is to gain an economic advantage:

- Do you understand how your payment will be calculated and what factors impact the amount?
- Do you know when you will be paid and who will pay you?
- Are there special rules relating to bankruptcy, or for filing a lien or security interest to protect your right to be paid if the contractor experiences financial difficulty?

Understanding your obligations – Every contract involves an agreement for you to perform some action. It is important to consider what risks might arise in satisfying the contract terms and how you are affected:

- What risks are associated with the crop you are agreeing to produce? For example, how are you affected in the event of sick or dead animals, bad feed, or poor weather?
- Do you know what you are agreeing to do? For example, does your contract provide for delivery of a fixed quantity of the crop produced on identified acres? Under an "acres contract" you are delivering production from certain fields, but under a "bushels contract" the agreement is to deliver a certain quantity regardless of where it is produced.
- Does the contract create any open-ended obligations such as the contractor requiring you to make new investments in equipment or imposing conditions you didn't anticipate or feel are unnecessary?
- Who sets the standards for how your actions are evaluated and are the standards and expectations clear? Will there be a company employee reviewing your actions on a regular basis?

Control and independence issues – By entering into a contract you agree to meet the obligations set by the other party. This means you agree to give up some independence in how you produce the crop or raise the livestock. Some contracts are more detailed in specifying your expected performance. Questions to consider:

- How much independence or flexibility in decision-making will be left to you?
- Do you have any right to appeal if you don't agree with a decision or action by the contractor?

Length and termination of the contract (and protection of investments) – Most contracts run for a length of time specified in the agreement. The length of the contract determines how long you will have access to the contract opportunity and how long you will be bound by the contract requirements:

How Will You Be Paid?

As growers and contractors have more experience with production contracts and each other, the business arrangements will evolve and should improve. For example, in recent years many contractors involved in swine feeding have adopted contracts making payments based on pig space and paying bonuses for better performance. Payments under these arrangements are easier to calculate and understand than payments based on performance factors relating to feed conversion, death loss, and animal health. Experience shows most serious disputes between contractors and producers often relate to distrust over how performance and payments are determined. In the broiler industry, the difficulty of growers to measure their performance and predict their payments creates tension and has led to litigation between growers and contractors. Because performance is often tied to factors beyond growers' control – such as feed quality and the health of the animals when delivered – payments based on building space or other objective and predictable measures may be less likely to lead to misunderstandings.

Read the Terms Carefully!

When drought cut his white corn crop in half, a Kentucky farmer assumed he could deliver 18,000 bushels he raised instead of the 35,000 bushels called for in the production contract. But the drought had pushed the price of white corn up from the contract price of $3.70 to over $5.50 a bushel. When the company sued for damages based on what it had to pay to replace his corn, the farmer argued the drought was an "Act of God" that made it impossible to deliver the amount he had promised. But the court ruled the contract did not specify the grain had to come from his farm and held the farmer liable for replacing the full amount at the higher price. The case was an expensive lesson in the difference between an acre contract – which is tied to production from specific land and generally includes an excuse for nonperformance due to crop failure – and a bushel contract that does not.

- How long does the agreement run and can it be renewed?
- What are the conditions for terminating a contract and who can terminate it? If the contract is terminated early, what happens to any long-term investments you make in buildings or equipment?
- If the contract runs for a given time, does it mean you will actually be earning income? For example, can your livestock or poultry facility stand empty for long periods between animal deliveries, leaving you without payments? Most production contracts provide the company with complete control over the timing and frequency of providing livestock or poultry. This could mean you will go weeks or months without the opportunity to earn a paycheck, and the number of animals you receive may fall well below what was originally projected.

Default and problems in performance – People sign contracts expecting everything to go as planned. State contract law generally requires contract parties to act in good faith. But experience and human nature show this doesn't always happen. Most production contracts contain a provision relating to "default" or what happens if either party breaks the agreement. Defaulting on a contract, which can give rise to a claim for damages by the other side, raises the following questions:

- Who decides when the contract has been broken? Does it go to a court or does the contractor reserve the right to make this decision?
- What happens if something goes wrong such as a crop failure or a disease outbreak? Are you excused if forces beyond your control prevent you from performing?

Liability and responsibility – A production contract involves a promise to produce a crop or care for animals but it may also establish other responsibilities you must meet. Contracts to raise livestock require growers to dispose of manure and dead animals pursuant to state and local laws. Production contracts typically provide that growers are "independent contractors," meaning the contractor has no liability for your actions. Identifying the potential liabilities in a contract raises these questions:

- What legal exposure or possible liability does the contract create?

Nature of the Legal Relation: Independent Contractor

It is important to understand the legal relation between the parties in a production contract. Typically, production contracts will describe the grower as an "independent contractor". This means the relation is not that of an employee, agent, partner or some other business relation. Instead, it means you are legally responsible for all your own decisions and actions, even though the contract may involve detailed guidelines. Companies use independent contractor status to shield them from claims of liability, such as if you or your employee get hurt, or when there is a violation of public health (dead animal disposal) or environmental laws (animal waste disposal). While there are exceptions, most courts that have considered this issue have upheld this approach.

- Does the contract require you to obtain insurance to meet your responsibilities?
- Does the contract provide you are an "independent contractor" and if so, what is the effect?

Legal protections – The increasing use of production contracts has led several states to enact laws protecting rights of farmers. Some federal and state marketing protection laws also apply to contracting:

- Is your contract subject to state or federal rules establishing additional rights or protections for you?
- Does state or federal law require certain terms be disclosed or included in your contract?

Legal issues – Most production contracts contain provisions relating to the rules of law governing the agreements. These provisions determine which state law applies and the procedures to follow if disputes arise. These "choice of law" and venue provisions raise the following questions:

- Which state's law applies to your contract? (It may not be the state where you reside!)
- Where will any disputes be resolved? Will it be in state or federal court? How will disputes be resolved? For example, is alternative dispute resolution, such as mediation, required or allowed? Under Iowa law, disputes involving contracts for care and feeding of livestock must go to mediation, meaning a neutral third party works with the parties to resolve the dispute.
- Does the contract include a clause requiring disputes to go to arbitration? Arbitration usually involves a panel of industry experts who hear the facts and enter a binding decision, which typically cannot be appealed to a court of law. In the 2008 Farm Bill, Congress included an amendment that if a livestock or poultry production contract includes an arbitration clause, the contract must inform growers and give them the option to choose not to use arbitration.
- Do any special "trade" rules apply, such as those established for members of the grain industry? If special rules apply, do you know what these rules mean for your rights and obligations?

How Do You Recognize a Good or Bad Contract?

The success of any production contract relation depends on the people involved as well as the agreement used. Contracts are written to address varying circumstances and as a result need to have some flexibility in their terms. Certain contract provisions can create more balance between the parties; however, other terms can create uncertainty. For example, when you see open-ended phrases such as: "At all reasonable times"; "Any other actions as required"; or "Reserve the right to ... at the producers' expense," you should consider how those terms might be applied to alter your expected obligations.

Because contracts are written for individual situations, it is hard to predict if a contract will turn out to be a fair deal. But there are basic rules to keep in mind. Remember the old saying, "if it sounds too good to be true, then it probably is" when thinking about a contract. You should be realistic – both about the financial opportunities and about why someone wants you to sign a contract.

Contracts more likely to result in problems often have these problematic features:

Little detail – The contract is written in very general terms that may allow the contractor to impose or avoid obligations as it feels necessary.

Delays in payment – Anytime a contract allows a significant delay in when you are paid, it raises the risk of never being paid and adds to your costs.

Lack of clear language explaining how your pay will be determined -- Many contracts use a variety of "performance" factors to determine how much you will earn. Many of the performance evaluations will be based on factors over which you have no control, such as the health or weight of the animals or the quality of the feed provided. While these factors may be a convenient way to evaluate your work, they make it difficult to predict whether a contract will be a good economic opportunity for you.

Confidentiality provisions – Some contracts contain provisions prohibiting farmers from revealing the contract terms to anyone. Some pricing terms may be market sensitive, but no one should be able to stop you from getting legal and business advice about a contract. This is why some states, such as Iowa and Minnesota, make confidentiality provisions illegal. It is also why Congress included an amendment in the 2002 Farm Bill to prohibit the use of such confidentiality provisions in production contracts involving livestock and poultry, and to allow growers to share their contracts with advisors and family members.

Contracts giving you little authority to make decisions – If the contract says you can only act on direct orders of the contractor, then you will have little flexibility in managing your farm.

Provisions shifting risks to you -- Contracts are often used to shift responsibility between parties. If your contract appears to make you responsible for anything that might go wrong – for example, bad weather, sick pigs, environmental problems, worker protections – and does not provide you with any compensation for taking these risks, you should be concerned.

Provisions making it hard to seek relief – Contracts with provisions giving courts in a far-away state jurisdiction over your dispute or that apply special trade rules you are not familiar with may make it difficult or impossible for you to seek relief.

Contracts that are more likely to operate smoothly often have provisions opposite of those described above. Grower friendlier contracts typically feature:

Clear payment terms that make it easier to know when you will be paid and to predict how much you will earn or which set a minimum payment, and include terms making it possible to verify the accuracy of payments you receive.

Jurisdiction in the local courts and under the laws of your state.

Federal Protections for Production Contracts

Issues concerning the operation of production contracts were addressed in both the 2002 and 2008 Farm Bills. In the 2002 Farm Bill, Congress amended the Packers and Stockyards Act to include swine production contracts. The bill also included a new provision which protects the ability of producers to share production contracts with lawyers, financial advisors, and family members. The effect is to prohibit confidentiality clauses limiting the ability of growers to get input on contracts.

Congress also addressed production contracts in the 2008 Farm Bill, which added provisions to federal law concerning swine production contracts and poultry growing arrangements. The law now requires:

- Growers be given 3 days to cancel a contract once it is signed and be notified of this right
- The potential for "large" capital investments under the contract must be disclosed
- The venue for legal disputes is in federal court in the state where the principle performance occurs (most likely where the animals are located)
- The choice of state law used for disputes can be chosen by the contractor
- If an arbitration clause is included it must be disclosed to the grower and the grower must be given a chance to opt out of arbitration. The contractor cannot act to inhibit growers in this choice

In 2008, Congress considered adding other contract protections including: definitions of "capital investments," "contractor," "contract producer," "production contract," and "investment required," but these additions did not make it into the final bill. Nor did a requirement that growers be given 90 days to correct any breach of an agreement.

The law did give the Secretary of Agriculture authority to develop more regulations in relation to various production contracting issues. The development of these GIPSA rules has been a lengthy process which continues today.

The contract runs for a sufficient period to provide a return on your investments.

Understandable legal obligations which help you know exactly what is required of you.

The opportunity to appeal decisions that impose costs on you or reduce your payments.

The ability to use third parties to supervise or review actions such as quality determinations.

If You Have Concerns

If you have considered this information and asked yourself the questions identified, you will be in a better position to make an informed decision about whether signing a production contract is the right business choice for you. If you still have questions or doubts about the contract, consider the following steps:

Slow down – Don't be in a hurry to sign a contract. This is a major decision and no one should pressure you into signing until all your concerns are addressed, and you fully understand all of the terms of the contract. In fact, Congress included an amendment in the 2008 Farm Bill giving producers a three day-period in which to cancel any newly signed production contract for livestock or poultry.

Ask questions of the person offering the contract – The contractor should be able to answer your questions and if they won't or can't, this is reason for caution.

Talk with your attorney -- Have your attorney review the contract and get advice about its legal effect and tax implications. Remember, contracts are always negotiable and you will never have more bargaining power than just before you sign.

Talk with other producers – Visit with other farmers who have experience with production contracts, especially producers who have worked with the contractor you are considering, and ask about their experience and if they would do it again.

Talk with other advisors – Visit with your banker or others who have experience with contracting and see what they think about the contract you are reviewing.

Pencil it out – Work through the checklist of issues and do the calculations to see if the contract will benefit your farm.

Visit the website of the USDA Grain Inspection, Packers and Stockyards Administration (GIPSA) to learn more about contracting and compare your contract to other agreements (see address below).

Talk with officials from USDA or your local Extension agent – More people within federal and state agencies are gaining experience with agricultural contracts. Contact them for advice.

Consider your options – For some commodities, production contracts are increasingly necessary. But for other crops, there are many options for production and marketing. For example, it may be possible to join with other producers in a cooperative or bargaining association. Determining which option works best for your farm is the key.

Remember, no one can force you to sign -- You must decide whether or not to sign a contract, but remember once you do so, you have accepted binding legal and financial obligations and risks which may run for many years.

For More Information

Check out the website used to address contracting issues at GIPSA in USDA: http://www.usda.gov/gipsa/.

This site includes Frequently Asked Questions (FAQ's) on the Swine Production Contracts Provisions of the Packers and Stockyards Act, information about Livestock and Poultry Contracts and about the Swine Contract Provision of the 2002 Farm Bill.

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