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Production Contracts in Agriculture

When, Why & How?

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RESEARCH & EXTENSION

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About the NALC

- Since 1987, the National Agricultural Law Center is the nation's leading source for agricultural and food law research and information.
 - The NALC is a unit of the University of Arkansas System Division of Agriculture
 - In close partnership with the USDA Agricultural Research Service, National Agricultural Library
- Objective, non-partisan research and information regarding laws and regulations affecting agriculture

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Corporate Transparency Act of 2021:



Upcoming
webinar



Additional
details

IOWA STATE
UNIVERSITY
Center for
Agricultural Law
& Taxation



- Why:
 - Regulations implementing the Corporate Transparency Act of 2021; goal: prevent money laundering/tax evasion
 - Written/implemented by United States Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN")
- What:
 - Corps/LLCs/LLP/LP/other businesses formed with the Sec of State must file a timely/accurate report with FinCEN*
 - *Unless excluded. No exclusion for ag/small businesses
 - Report will include:
 - Company identifying details
 - Personal identifying details of all "beneficial owners"
 - Beneficial owners include:
 - Indiv who own/control at least 25% of reporting company OR
 - Indiv who directly/indirectly exercises substantial control over a reporting company
 - President/CEO/CFO/manager/general counsel etc
- When:
 - *Companies created before 1/1/24*: Before 1/1/25
 - *Companies created during 2024*: 90 days after formation
 - Also must report "company applicants"
 - *Companies created after 1/1/25*: 30 days after formation
 - *Update subsequent changes*: 30 days after change
- Potential consequences for non-compliance (false info or failure to report):
 - < \$500 for each day in violation, max \$10k
 - < 2 years imprisonment
- **Ruling: Requirements ON HOLD?!?!?!?**

Outline:

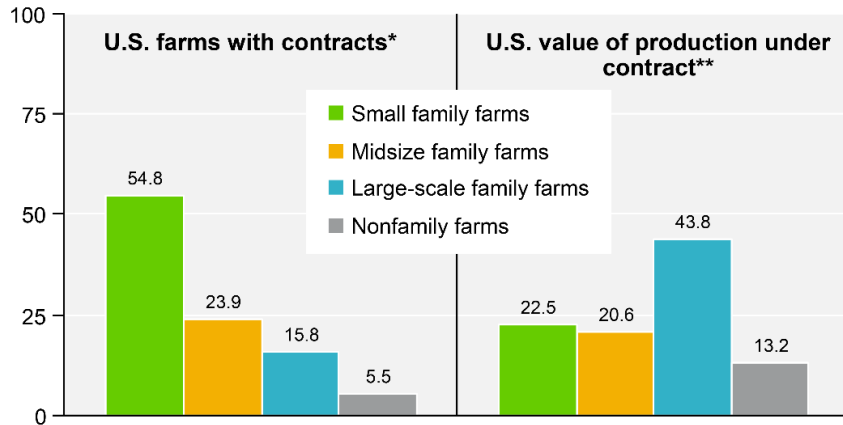
- ✓ *Production Contracts, Generally*
- *Issues to Consider*
- *Federal Oversight*

Relevance in Today's Markets: USDA ERS



Distribution of farms with contracts and value of production under contract, by farm type, 2020

Percent of U.S. farms with contracts and percent of U.S. value of production under contract



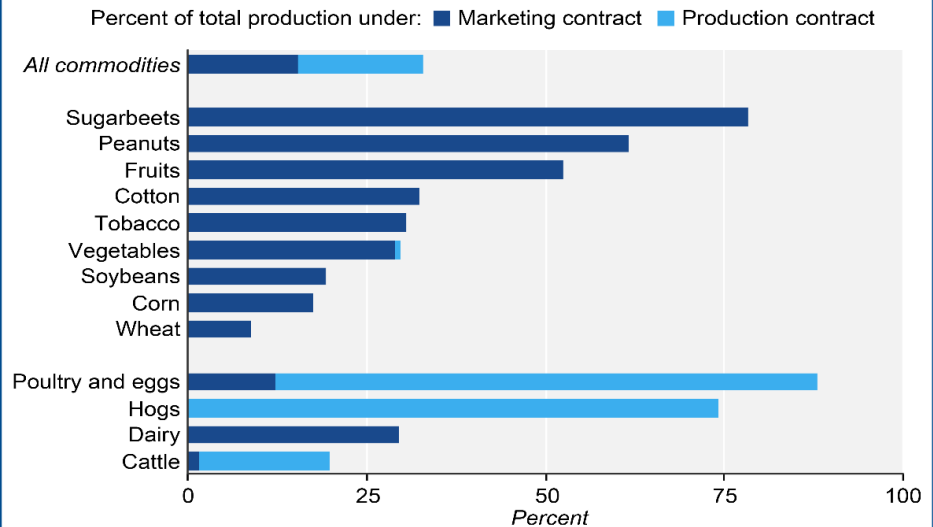
*Farms reporting production under production contracts, marketing contracts, or both.

**Includes commodities under production or marketing contracts.

Note: Small family farms have annual gross cash farm income (GCFI) less than \$350,000, measured before deducting expenses. Midsized family farms have GCFI of \$350,000–\$999,999. Large-scale family farms have GCFI of \$1,000,000 or more.

Source: USDA, Economic Research Service and USDA, National Agricultural Statistics Service, 2020 Agricultural Resource Management Survey (data as of December 2021). This chart was revised March 8, 2022; see errata for details.

Percent of production under contract, by contract type, for selected commodities, 2020



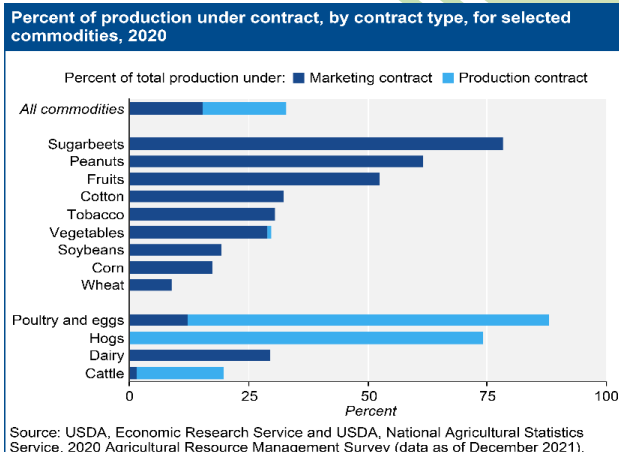
Source: USDA, Economic Research Service and USDA, National Agricultural Statistics Service, 2020 Agricultural Resource Management Survey (data as of December 2021).

• Marketing contract:

- Ownership of the commodity remains with the farmer during production.
- Contract sets a price (or a pricing formula), product quantities and qualities, and a delivery schedule.
- Contractor involvement in production is minimal, and the farmer provides all the inputs.
- For crops, the contract is finalized before harvest. For livestock, the contract is finalized before the animals are ready to be marketed.

• Production contract:

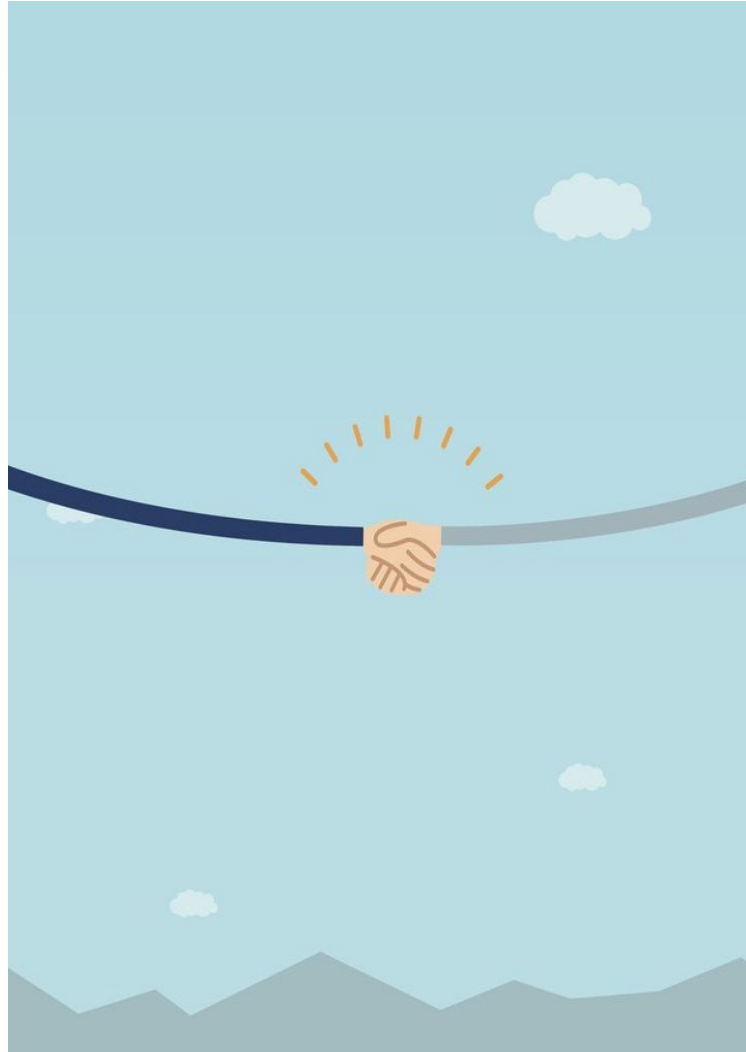
- Contractor usually owns the commodity during production, and the farmer is paid a fee for services rendered.
- Contract specifies farmer and contractor responsibilities for inputs and practices.
- Contractor often provides specific inputs and services, production guidelines, and technical advice.
 - Ex: Contractors in livestock contracts typically provide feed, veterinary services, transportation, and young animals.
- Contract is finalized before production of the commodity.



Outline:

- ✓ *Production Contracts, Generally*
- ✓ *Issues to Consider*
- *Federal Oversight*

First Rule of Contracts



- ***Whoever wrote the contract took care of themselves.***
 - No reason to assume the contract being offered is fair or that your interests are protected.
 - Arm's length business transactions and must be considered as such.
 - Especially important b/c production contracts are often “take-it-or-leave-it” propositions without a real opportunity to negotiate terms.
- Read and understand any contract before signing it.
 - The written terms determine the rights and responsibilities of all parties



Tips for Contracting: Choosing Your Partner

Know the other party's financial situation and performance history.

- Especially important when the contract calls for the passage of legal title upon delivery or when there is a delay in the payment.

Before signing, consider what will happen if the buyer goes out of business or doesn't pay.

- Typically, you will become the other party's creditor- often as an unsecured creditor and low on the repayment list



Tips for Contracting: Before you Sign

Get it in writing: Do not rely on oral communications made by the company, either before the contract is signed or during performance.

- If what is being said is important to the relationship, be sure it is put in writing, signed by both parties and incorporated as an amendment to the contract.
- As a last resort, if you cannot get it in writing, keep copies of any documents, such as letters, payment sheets and checks, that you can use to show what was agreed.

Consider having your attorney review the contract, especially if it involves a sizable portion of your production or involves a long-term relationship or investment.

- Legal advice is an investment, not a cost, when it resolves confusion and helps you avoid unfavorable economic consequences.



Tips for Contracting: Negotiations

Proposed contracts are always subject to negotiation.

- While many production contracts will be printed or typed forms offered on a take-it-or-leave-it basis, you do have the freedom to try and negotiate
- The time to do that is BEFORE YOU SIGN
- Your ability to obtain more favorable terms will depend on your market power to negotiate with the company and whether other growers are willing to sign the contract.



Tips for Contracting: Question Everything

Don't hesitate to ask questions when you don't understand what is happening.

- You are committing yourself to performing under the terms of the written agreement!

If you do not fully understand what the language means or how the procedure will operate, ask questions.

- Either to the company representative or to your own advisers (lawyer, accountant etc.)
- Make sure the answers are reflected in the written contract



Tips for Contracting: Everything Changes (or not!)

In the course of the agreement, if there are any changes that develop or different instructions that are given, make sure they are in writing and separately signed by the company representative.

- The fact that you believe the contract was amended doesn't mean it was.
- Most contracts specifically provide that the only thing enforceable is what is in writing.



Tips for Contracting: Talk, Talk, Talk

Stay in touch with the other party to the contract.

- Communication is important in resolving uncertainty and in preventing misunderstandings.

Communicating with the other side about your performance, questions or concerns lets you help build a smooth, productive relationship.

- When long periods pass without communication, it is possible for circumstances to change and put performance of the agreement in a much different light.



Tips for Contracting: Compliance

Compliance with contract terms is required before the contract is performed.

- The price premiums you are expecting won't be paid unless the terms of the contract are satisfied.
- Failure to comply may subject you not just to lower returns but also to claims for damages, penalties for breach and other legal remedies.

Maintain records of your performance.

- Records of communication/ contact with the contractor, records of your actions in producing the commodity.
- Helpful in potential disputes over compliance with contract terms.



Tips for Contracting: Failure to Perform

Never assume that your failure to perform the contract will be excused.

- Under certain circumstances, you might think it reasonable to assume the other party will not require you to perform the agreement.
- Never make this assumption, especially if your failure to perform can be expected to cause the other party damages.

If you do not think you will be able to perform or if you would like to amend the terms of the agreement, communicate with the other party rather than surprising them.



Tips for Contracting: The Bitter (or Better) End

How are disputes resolved?

- If the integrator is from another state-- does the contract specify the state law that applies? Or location where lawsuits might be filed?
- Does the contract permit renegotiation or nullification if the laws governing the contract changes?
- Does the contract provide for dispute resolution? A mediator? Arbitration?

Under what conditions does termination occur?

- Who determines if conditions are met?
- Are the conditions objective or at the contractor's discretion?
- Can the contract be terminated for minor breaches?
- When can the grower terminate the contract?
- Is the grower given the opportunity to correct the problem?
- How much notice is given?



In a Nutshell:

Negotiate contract terms that you are comfortable with.

Read & understand contracts before signing them.

Make sure that the written contract accurately reflects the **entire** agreement.

- If the parties later agree to changes to the contract, make sure the changes are in writing and signed/dated by both parties.

Keep a copy of the contract in a safe, easily remembered place.

Do not agree to a contract if you do not understand all of its terms.

An attorney can help you understand what you are signing.

Issues to Consider: Investments

Facilities and Equipment

- Does the contract require an investment in additional equipment or facilities?
- Is the equipment certified?
- Who owns the facility?
- Are there terms governing exclusivity of use?

Additional Investment

- Does contract duration cover investment?
- Contract termination before cost recovery?
- Who get permits and pays fees?



Issues to Consider: Management

Know Yourself:

- Are you *able* to meet contract specifications?
- Are you *willing* to meet contract specifications?

Know the Relationship:

- Under what circumstances can the contractor/integrator enter your land?
- Do other parties (e.g., spouse) need to approve?
- In unforeseen circumstances, who retains control over the decision making process?



Issues to Consider: Price Determination

Clarity:

- Are the terms of payment clearly specified?

Timing:

- When is the commodity priced?
- Is the schedule of payments firmly set?
- Does the schedule meet cash flow requirements?

Premiums/Bonuses:

- How are premiums/bonuses calculated?
- When are premiums paid?
- Can you examine the premium/bonus calculations?

Taxes:

- How is tax liability affected by contract type?



Issues to Consider: Production

Costs:

- What are the production costs?
- Where are cost estimates available?
- Don't forget additional managerial time!

Inputs:

- Must inputs come from a particular source?
- Are inputs more expensive than normal?
- Who provides feed? Balanced rations?



Issues to Consider: Livestock and Poultry Specifics

Feed:

- If integrator supplies feed, how is it priced?
- Who sets rations?

Health:

- Who is responsible for animal health?
- How is death loss handled?

Facilities:

- How are repairs made?
- Liability insurance required?
- What are the depreciation costs?

Manure:

- Who handles manure?
- Who is responsible for potential Clean Water/Air Act violations?



Grain Production Contracts



Checklist for Grain Production Contracts

Prepared by the Missouri Farm Bureau
Task Force on Production Contracts

In cooperation with the
Missouri Attorney General's Office



May 2000

- Most typically seen:
 - *Identity-preserved*- usually grains, such as organically produced grains or those with special traits needed in livestock feeds.
 - *Specialty crops*- production of untraditional crops, such as food grade soybeans, white corn, popcorn, and other crops with niche markets.
 - *End-use tailored varieties*- usually grains genetically designed to provide special traits, such as low saturated fat soybeans for the consumer market, high oil corn for poultry feed markets, and others with a genetic value added.
 - *Value-added production*- commodity that sells for a premium price based on a physical change in the commodity made by the producer.
 - *Composition-based grain marketing*- usually grain sold on the basis of its nutritional components, such as evaluating soybeans for oil and protein content, the starch content in corn, or the protein content in wheat.
- Grain Contract Checklist
 - Consult experts
 - Production issues
 - Payment and delivery issues
 - Glossary of terms



Outline:

- ✓ *Production Contracts, Generally*
- ✓ *Issues to Consider*
- ✓ *Federal Oversight*

Packers and Stockyards Act

- Federal law passed by Congress in 1921 with the goal of ensuring fair business practices and competitive markets for livestock, meat, and poultry.
 - Applies to persons engaged in the business of marketing livestock, meat, and poultry in interstate or foreign commerce- packers, swine contractors, stockyard owners, market agencies, dealers, and live poultry dealers.
 - *Does not* apply to persons marketing their own livestock or buying livestock for their own stocking or feeding purposes, and does not apply to producers raising hens that lay table eggs, or to breeder flocks for the egg industry
- Additional requirements are placed on contractors and contracts subject to the PSA.
- Enforced by USDA
 - Specifically, the Packers and Stockyards Division located within the Agricultural Marketing Service



Examples of PSA Protections

- Requires that poultry growers are entitled to observe the weighing and recording procedures of their birds.
- Requires stockyards to register with the government, maintain accurate weights, and pay shippers promptly
- Requires meat packers with annual livestock purchases of over \$500,000 to be bonded
- Trust protection for producers in the event of nonpayment for livestock by a meat packer



PSA Protection: Prompt Payment

- Market agencies, dealers, and packers are required to pay promptly for livestock, usually by the close of business on the day after transfer of possession.
- For livestock sold on a grade-and-yield basis, payment is due by the end of the next business day after the final purchase price is determined.
- Live poultry obtained under a poultry growing arrangement must be paid for by the close of the 15th day following the week in which the poultry is slaughtered.
- Integrators must pay before the close of the next business day for live poultry obtained in a cash sale.



PSA Protections: Packers & Poultry Trusts

- Trust protection extended to
 - Cash sellers of livestock
 - Applies to slaughtering packers with average annual purchases above \$500,000
 - Poultry growers who raise and care for live poultry (1) for delivery, in accordance with another's instructions; (2) for slaughter, or (3) sold on a cash basis for slaughter
- Protections:
 - If a packer or integrator doesn't pay for livestock or poultry, the receivables, inventories, and proceeds derived from such purchases become trust assets.
 - The packer/integrator must hold these assets for the benefit of all unpaid cash sellers and/or poultry growers.
 - Cash sellers and poultry growers are legally in priority payment position in bankruptcy or in claims against trust assets in the event of a business failure.
- Limitations
 - Prompt payment provisions allow livestock buyers and sellers to agree, in writing, to different payment terms. This would void the trust protection.
 - Ex: You may agree, in writing, to give the packer time to cover a check that you know is not good or to allow the packer more time to make payment than permitted under the P&S Act.
 - Protections do not apply for sellers of livestock or poultry on credit.
 - Read all documents carefully before signing. Credit agreements may be included in small print on stockyard receipts, scale tickets, and other documents, and would void PSA trust provisions.



PSA Trust Provisions

- **What to do if you're not paid?**

- Give written notice to both the integrator and the closest P&S regional office
 - The notice must be in writing.

- **How quickly do you have to give notice?**

- If a payment instrument is not honored for any reason – notice must be given within 15 days of receiving notice that the instrument is dishonored
 - Ex: A check bounces
- If no payment instrument is received- notice must be given within 30 days after payment is due
 - Ex: No check is given
 - When is payment due?
 - If you produce poultry under a growing arrangement, payment is due 30 days from the close of the 15th day following the week in which the poultry is slaughtered
 - If you sold poultry on a cash basis, payment is due by the close of the next business day following purchase.
 - If you sell livestock to a packer on a live basis, payment is due by the close of the next business day following purchase and transfer of possession.
 - If you sell livestock to a packer on a “grade and yield” basis, payment is due by the close of the next business day following determination of the purchase price



PSA Protections: Swine Contract Library

- Large swine packers are required to file swine marketing or purchase contracts (written and verbal) and monthly reports about expected swine deliveries under contract
 - Not required to file information on swine production contracts
- Information is anonymized and posted online. Includes
 - Contract terms including base price determination formulas, carcass merit premium/discount schedules, and non-carcass premiums/ discounts.
 - Packers' expected contract purchases



Production Contract Protections: Before Signing

- Growers must be given copies of the (proposed and final) contract
- Contracts must include
 - Duration of contract and conditions for termination by each of the parties;
 - All terms related to the payment to be made to the poultry grower;
 - Whether a performance improvement plan exists for that grower, and, if so, any relevant performance plan guidelines.
 - The grower's right to cancel the contract;
 - The method in which the grower may cancel the contract;
 - When large capital investments may be required over the life of the contract; and
 - The deadline for canceling the contract
- Growers are allowed to discuss terms of potential contracts with advisors, members of the family, and other growers for the same integrator
- Growers have the right to cancel contracts within 3 days after signing
- Growers have the right to decline arbitration before entering into contracts



Production Contract Protections: After Contracting

- Venue for resolving a dispute with a company is the federal judicial district where the poultry is raised under the contract.
 - However, the contracts may specify which State's law is to apply to any contract dispute.
- Growers must give an accurate settlement sheet to the growers at the time of settlement. Must contain all information necessary to compute the payment



**USDA Factsheets on PSA
Protections**



PSA Recent Events: Unfair Practices



- Several PSA regulations have been published outlining new requirements, part of a broader initiative by the Biden administration to promote competition and transparency in agricultural markets
 - [Inclusive Competition and Market Integrity Under the Packers and Stockyards Act Final Rule](#)
 - [Transparency in Poultry Grower Contracting and Tournaments Final Rule](#)
 - [Poultry Grower Payment Systems and Capital Improvement Systems](#)
- USDA has also indicated it is planning on releasing another rule codifying the administration's position that injury to competition is not required when bringing an action under PSA §202.



Transparency in Poultry Grower Contracting and Tournaments

- Effective February 12, 2024
- Requirements
 - Requires live poultry dealers to include minimum annual placements and minimum stocking density for each flock in the written broiler growing arrangement.
 - Minimum number of placements means the least number of flocks of poultry the live poultry dealer will deliver to the grower for growout annually under the terms of the poultry growing arrangement.
 - Minimum stocking density means the ratio that reflects the minimum weight of poultry per facility square foot the live poultry dealer intends to harvest from the grower following each growout.
 - Rule requires a contract modification, which requires assent by both parties

Poultry Grower
Fact Sheet (USDA):



Inclusive Competition and Market Integrity under the Packers and Stockyards Act

- Effective May 6, 2024
- Requirements:
 - **Discrimination.** Prohibits actions that inhibit market access or actions that are otherwise adverse to covered producers on the following basis:
 - Race, color, religion, national origin (including ethnicity), sex (including sexual orientation and gender identity, as well as pregnancy), disability, marital status, or age.
 - The covered producer's status as a cooperative.
 - **Retaliation.** Prohibits retaliatory and adverse actions that interfere with lawful communications, assertion of rights, associational participation, and other protected activities. Specifically:
 - *Communicating with a government entity or official* for redress of grievances with respect to livestock or poultry.
 - *Refusing a request of the regulated entity to engage in a communication* with a government entity or official that is not required by law.
 - *Asserting the right to form or join*, or to refuse to form or join, a producer or grower *association/organization/cooperative*.
 - *Communicating with a person* for the purposes of *improving production or marketing* of livestock or poultry.
 - *Communicating with a regulated entity, another covered producer, or with a commercial entity or consultant*, for the purpose of *exploring or entering into a business relationship*.
 - *Supporting or participating as a witness* in any proceeding under the Act or in any proceeding that relates to an alleged violation of any law by a regulated entity.
 - *Asserting any of the rights granted under Act* or this part or *asserting contract rights*.
 - **Deception.** Prohibits regulated entities from employing *false or misleading statements or omissions of material information* in contract formation, performance, and termination; and prohibits regulated entities from providing *false or misleading information* about refusal to contract.



Poultry Grower Payment Systems and Capital Improvement Systems (PROPOSED RULE)

- Published June 10, 2024; **Comments due Aug 9, 2024**
- Requirements:
 - Prohibit an integrator from discounting or reducing a broiler grower's contractually stated compensation rate, implementation of a grower payment method using only positive performance adjustments (bonuses, rather than reductions).
 - Ranking systems for broiler growers must be "fair" and must include
 - Processes for the selection and distribution of inputs that affect grower performance
 - Processes for the flock production practices that affect grower performance, such as target weights and stocking density
 - Processes for determining an LPD's comparison flexibility, including when to remove a grower from the ranking group comparison and compensate by a non-comparison method(ex: by a five-flock average), and the appropriateness of the time period used for comparison.
 - Processes for resolving grower concerns in a timely manner
 - Before being required to make additional capital improvements, integrators must provide disclosures to the growers, including
 - The purpose of the investment
 - Construction schedules
 - Housing specifications
 - Required or approved manufacturers or vendors
 - Financial incentives and compensation for the grower
 - An analysis of projected grower returns



Comment portal





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