

New Dimensions in Livestock Risk

Production and Marketing Contracts

Iowa Department of Justice

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GROWTH IN CONTRACTING IN IOWA AGRICULTURE

Livestock

1986 under 5% of hogs raised in Iowa raised under production/marketing contract.

2008 the highest estimates place only 15% of hogs raised in Iowa as being sold on the cash spot market.

Grain

In 1986 most grain elevators used two kinds of grain contracts

Today, many grain elevators offer 10 or more different kinds of grain contracting options that may include a cash, a credit-sale, a futures component and a production input commitment in the same document.

GROWTH IN CONTRACTING IN AGRICULTURE

Contracts used in new components of “farming”

- ▶ Technology agreements
- ▶ Wind easements
- ▶ Carbon credit agreements
- ▶ Investment in “value-added” enterprises
- ▶ OTC Grain Swaps

BIGGEST ISSUES IN PRODUCTION/MARKETING CONTRACTING

Is the production/marketing contract a good marketing decision?

Producers must compare their estimated returns under a given contract with expected returns under other similar contracts and with returns under traditional grower owned and controlled production.

The decision on whether a production or marketing contract is a good tool has to be considered in the time frame of the agreement since some production and marketing contracts can be for terms as long as 10-15 years.

BIGGEST ISSUES IN PRODUCTION/MARKETING CONTRACTING

A production or marketing contract is only a good deal for a producer if he gets paid.

Status as a secured creditor with an average recovery in bankruptcy of over 75% as opposed to an unsecured creditor with an average recovery in bankruptcy of under 10%.

Enhanced negotiating position of secured creditors.

BIGGEST ISSUES IN PRODUCTION/MARKETING CONTRACTING

A production/marketing contract is only a good deal for a producer if he knows how much he will get paid.

- More and more contracts used in agriculture include language that grants the “big guy” the express authority to unilaterally adjust the payment terms included in the contract.
- Agreement to this language means that farmers cannot count on the income stability often cited as the main incentive for farmers to enter production contracting.

BIGGEST ISSUES IN PRODUCTION/MARKETING CONTRACTING

Examples of these “Flex” payment clauses

- Cargill PorkWorks Multiple Fill Request
 - ▶ “Cargill reserves the right, in its sole discretion, to update or amend the matrix from time to time as market or other conditions may dictate.”

BIGGEST ISSUES IN PRODUCTION/MARKETING CONTRACTING

Examples of these “Flex” payment clauses

- Hormel Hog Procurement Agreement
- “The Contract Price shall be adjusted in accordance with our carcass merit buying program in effect at the time of delivery (“Carcass Buying Program”) to determine the amount paid to you. Carcass Buying Program premiums and discounts will be determined on the basis of the Adjusted Cutout, except as provided in paragraph 3(d). Our Carcass Buying Program is subject to change by us in our discretion from time to time.”

“FINE PRINT” LEGAL ISSUES

1. Cancellation
2. “Quality” Measuring
 - A. Who’s machine
 - B. Who’s protocol
3. Delivery Location
4. Assignment
5. Dispute Resolution
6. Liquidated Damages
7. Indemnity Clauses

“FINE PRINT” LEGAL ISSUES

Examples of assignment clauses

Hormel Foods Hog Procurement Agreement

“You do not have the right to assign this Agreement or any of your rights or obligations under this Agreement without our prior written consent. You may, however, assign this Agreement or any of your rights hereunder to your lender(s) as collateral security for any loan. If you desire to sell all or substantially all the assets constituting your hog production operation, then in addition to obtaining our consent, you shall cause the purchaser to expressly assume, in a writing acceptable to us, all of your obligations under this Agreement. This Agreement shall be binding on your heirs, successors and assigns and on our successors and assigns.”

“FINE PRINT” LEGAL ISSUES

Examples of assignment clauses

–Murphy Family Farms Contract Grower Agreement

–“This agreement shall be binding upon the heirs, executors, administrators, and assigns of the respective parties provided such person is acceptable to Murphy. This agreement cannot be changed, modified, or assigned without prior written consent.”

“FINE PRINT” LEGAL ISSUES

Examples of assignment clauses

- Local Cooperative/Farmland Grow Finish Agreement
 - “This Agreement is binding on the heirs, executors, and assigns of the parties. This Agreement can only be changed, modified, or assigned by the execution in writing of such change, modification, or assignment by both parties.”

“FINE PRINT” LEGAL ISSUES

Examples of alternative dispute resolution clauses

Cargill PorkWorks Multiple Fill Request Agreement

– “Any and all controversies, disputes, and claims arising out of or relating to this Request shall be settled by arbitration in Little Rock, Arkansas, or such other location as the parties may agree in writing. The arbitration shall be before a panel of three arbitrators, with each party to choose its own arbitrator, and the third being chosen by agreement between the two party-appointed arbitrators. In the event the two party-appointed arbitrators cannot agree on a third within 60 days of the appointment of the second arbitrator, then both parties shall apply to the American Arbitration Association (“AAA”) for the appointment of the remaining arbitrator. Any arbitration is to be conducted in accordance with the existing general arbitration rules of the AAA, and the judgement upon the award of the arbitrators may be entered in any court having jurisdiction.”

“FINE PRINT” LEGAL ISSUES

Examples of alternative dispute resolution clauses

Iowa Select Grow-Finish Agreement

– “In the event of any dispute between ISF and the Grower under this Agreement, the parties acknowledge that the mandatory mediation provisions of Chapter 654B of the Iowa Code (1997) apply. The parties agree that if such mandatory mediation does not result in the resolution of the dispute, the parties will submit such dispute to binding arbitration under Chapter 679A of the Iowa Code (1997). In such event, the arbitration shall be conducted expeditiously in accordance with the Center for Public Resources Rules for Nonadministered Arbitration of Business Disputes. The Center for Public Resources shall appoint a neutral advisor from its National CRP panel. Judgement upon the award rendered by the arbitrators shall be entered in the Iowa District Court with jurisdiction over the Facilities. The place of arbitration shall be Des Moines, Iowa. Any arbitration proceedings shall be administered by the neutral advisor in accordance with the CRP rules as he/she deems appropriate, however, the following procedures shall in all events be followed: (1) mandatory exchange of all relevant documents within 45 days after initiation of arbitration; (2) no other discovery; (3) hearing before the neutral advisor which shall consist of a summary presentation by each side of not more than four hours; and (4) the final decision to be rendered within ten days following the conclusion of the hearings.”

“FINE PRINT” LEGAL ISSUES

Examples of alternative dispute resolution clauses

Hormel Hog Procurement Agreement

– “The parties waive any right to a trial by jury in any action or proceeding to enforce or defend any rights under this agreement, or under any related document or agreement and agree that any such action or proceeding shall be tried before a court and not before a jury.”

“FINE PRINT” LEGAL ISSUES

Example of liquidated damages clauses

Cargill PorkWorks Multiple fill Request

- “The canceling party shall pay to the non-canceling party liquidating damages equal to the amount as calculated pursuant to the formula below:
 - $\$9.31/\text{head} \times \text{the number of pigs per fill} \times 2 = \text{liquidated damages for non-canceling party}$

“FINE PRINT” PRINT LEGAL ISSUES

Examples of liquidated damages clauses

- Hormel Hog procurement Agreement
 - ▶ “If you are in default or we terminate this Agreement for your Default, then we shall be entitled to recover from you direct damages pursuant to this paragraph 9. Our direct damages shall be an amount equal to the total number of contracted hogs to be delivered for the remaining term of this Agreement multiplied by five dollars (\$5.00) per hog plus any excess of the Monthly/Quarterly Western Cornbelt Price over the Monthly/Quarterly Adjusted cutout for each period up to the date of our demand multiplied by the number of contracted hogs to be delivered for such period. Upon our demand, you shall pay us cash in the amount of such direct damages within thirty (30) days of the date of our demand or as otherwise agreed to us in our discretion. Our demand may be made at any time of our choosing within four years of the date of your Default. ... Such Direct damages shall not preclude our recovery of other damages and shall be in addition to all other remedies we may have.

RISK

Risk is a given, especially in production agriculture. Therefore, there is no such thing as risk management. What really happens is **risk shifting**. The emphasis for producers in production/marketing contracting should be making sure that their portion of the risk under their production/marketing contract reasonably relates to their potential for economic return under that agreement.

EQUITY MINING

The “Company Store” Model

A contract should provide enough return to pay all of the following:

- Fixed costs (building)
- Variable costs (feed, seed, etc....)
- Real cost of capital asset replacement (money to put up new building when present one wears out)
- Profit.

If a contract does not pay for all of the above, then a farmer must pay for them using his equity which results in the contracting company being able to gain access to production assets by taking/mining the farmer’s capital as opposed to paying the farmer his actual cost of providing those assets.

Iowa Code section 202.3(1)

PRODUCTION CONTRACTS - CONFIDENTIALITY PROHIBITED

- 1. A contractor shall not on or after May 24, 1999, enforce a provision in a production contract if the provision provides that information contained in the production contract is confidential.

Iowa Code section 202.3(2)

PRODUCTION CONTRACTS -CONFIDENTIALITY PROHIBITED

2. A provision which is part of a production contract is void, if the provision states that information contained in the production contract is confidential. The confidentiality provision is void whether the confidentiality provision is express or implied; oral or written; required or conditional; contained in the production contract, another production contract, or in a related document, policy, or agreement. This section does not affect other provisions of a production contract or a related document, policy, or agreement which can be given effect without the voided provision. This section does not require a party to a production contract to divulge the information in the production contract to another person.

Iowa Code section 202A.4(1)

Confidentiality provisions in (livestock marketing) contracts prohibited

1. A packer shall not include a provision in a contract executed on or after April 29, 1999, for the purchase of livestock providing that the information contained in the contract is confidential.

Iowa Code section 202.4(1) and 202A.6(2)

ENFORCEMENT

- 1. The Attorney General's office is the primary agency responsible for enforcing this chapter.
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Commodity Production Contract Lien (Iowa Code chapter 579B)

- A contract producer who is a party to a production contract to raise crops or livestock (excludes seed and poultry) executed pursuant to 579B.2 shall have a lien as provided in 579B.3.
- The amount of the lien shall be the amount owed to the contract producer pursuant to the terms of the production contract.

Commodity Production Contract Lien

The lien on livestock or raw milk is created at the time the livestock arrives at the livestock facility. The lien continues in the livestock or cash proceeds decried from the sale of the livestock for one year after the livestock leaves the control of the contract producer.

The lien on crops is created at the time the crop is planted. The lien exists on the crops or proceeds for one year after the crops leave the authority of the contract producer.

Commodity Production Contract Lien

Except for the Vet's lien, a contract producer's lien shall have priority over a conflicting lien or security interest in the commodity, including a lien or security interest that was perfected prior to the creation of the lien under 579B.

Iowa Code section 579B.6

WAIVERS UNENFORCEABLE

A waiver of a right created by this chapter, including but not limited to a waiver of the right to file a lien pursuant to this chapter, is void and unenforceable. This section does not affect other provisions of a contract, including a production contract or a related document, policy, or agreement which can be given effect without the voided provision.

Please Submit a Copy of Your Ag-related Contract

To keep our website regarding the various contracts available to growers as up-to-date as possible, WE NEED COPIES OF YOUR CONTRACT. To submit your contract:

1. “White-out” or otherwise eliminate your name from the copy you send to us.
2. Leave all other information, including the contractor’s name and payments owed, in our copy.

SEND OUR COPY OF YOUR CONTRACT TO:

Iowa Attorney General's Office

Attn: Farm Division

Lucas State Office Building

Des Moines, IA 50319

(515) 281-5351

**THANKS FOR YOUR HELP IN THIS
IMPORTANT MATTER!**

Iowa Attorney General's Contract Website

Address

<http://www.iowaattorneygeneral.org>

THE “FEDS” ALTERNATIVE

Livestock Mandatory Price Reporting Act, Swine Contract Library

Packers are required to provide GIPSA example contracts and monthly reports specifying the number of swine committed and the maximum number of swine to be delivered over the next twelve months by contract type.

However, the contracts themselves or other proprietary information will not be made available in conformity with the confidentiality restrictions of the Act.

WORKING TOGETHER

STRUCTURE

1. Oral Agreement
2. Contract
3. Cooperative
4. Partnership/L.L.P.
5. Corporation/L.L.C.

WORKING TOGETHER

STRUCTURE

- 1. Must retain professional expertise
 - Lawyer
 - Accountant
 - If over 250 potential investors, may need to identify potential security issues

WORKING TOGETHER

FACTORS THAT AFFECT CHOICE

1. The more money involved, the more formal the structure.
2. All the participants need to understand the flow of income and expenses.
3. All participants need to understand the scope and extent of limited liability protection provided by the selected structure.

WORKING TOGETHER

VALUE PRODUCER GROUP BRINGS TO TABLE

– 1. Producer group's real value is to assure that they will be able to deliver as promised.

–Quantity

–Quality

WORKING TOGETHER

VALUE PRODUCER GROUP BRINGS TO TABLE

1. Delivering the “Goods”.

- Protocols

- Testing

- Monitoring

- Inspections

- Goal is to discover an individual failure **before** product is commingled

WORKING TOGETHER

VALUE PRODUCER GROUP BRINGS TO TABLE

– 1. Discipline

- Agreement
- Non-compete clauses
- Liquidated damages agreements
- Insurance
- Bonds
- Letters of credit
- Security interests
- Expulsion
- Anything else that really hurts

WORKING TOGETHER

WHAT PRODUCER GROUPS HAVE DIFFICULTY DOING

– 1. INTELLECTUAL PROPERTY

–Brands

–Trade marks

–Copyrights

–Patents

WORKING TOGETHER

WHAT PRODUCER GROUPS HAVE DIFFICULTY DOING

- 1. Reasons for difficulty
 - Cost to develop
 - Cost to obtain formal legal protection
 - Cost to promote
 - Cost to obtain access to consumers, shelf space
 - Cost to enforce

WORKING TOGETHER

BARGAINING AS A GROUP

- 1. Formal organization better
- 2. Potential problems if organization does not have title in product before it bargains
 - Potential price-fixing concerns
 - Cooperative exception exists, but only to extent Coop does not attempt to “unduly” impact price
 - Farmers do not have worker organization protection

WORKING TOGETHER

BARGAINING AS A GROUP

- 1. KEY IS ABILITY TO DISCIPLINE MEMBERS THAT ATTEMPT TO UNDERCUT**

WORKING TOGETHER

BARGAINING AS A GROUP

1. In September 2005 the U.S. District Court for the Southern District of Iowa approved a Consent Decree which resolved litigation between Smithfield Foods and the State of Iowa involving Smithfield's constitutional challenge of the portion of Iowa's Corporate Farming Statute that prohibited swine processors from contracting for the care and feeding of their pigs in Iowa.

WORKING TOGETHER

BARGAINING AS A GROUP

1. In late January, 2006 the U.S. District Court for the Southern District of Iowa approved a similar Consent Decree resolving Cargill's constitutional challenge of the same prohibition.

WORKING TOGETHER

BARGAINING AS A GROUP

1. One of the most important provisions of these Consent Decrees is an agreement by the processors that they recognize the right of their contract producers to form an association to negotiate with the processor.
2. The processors agree to negotiate in good faith with such producer associations.
3. The processors agree that they will not pursue litigation to prevent such associations from negotiating on behalf of their members.