

# Production contracts: Using them to your advantage

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In recent years, changes in the structure and economics of agriculture have led to a greater amount of production being produced under contract for a processor, marketing firm, another producer, or other entities. The development of specific traits through selection, conventional breeding, and biotechnology are going to result in more identity preserved production in the future, most of which will be grown under contract.

Some view the prospect of increased contracts as a negative development for growers. However, in most cases these contracts will allow producers to grow crops for a premium price, and will help farmers manage risk. As contracts become more prevalent, it will be important for producers to understand contracts, and know how to thoroughly analyze them before entering into a contract agreement.

Following are factors that producers should keep in mind when entering into contract arrangements for crop production :

- **Type of contract**

Is the contract truly a production contract or is it a contract to provide services?

This could impact the legal protection available to the grower. It is also important to know how much flexibility exists for negotiating provisions of the contract or to add new provisions. The date, duration, termination, and renewal of a contract are also important in negotiating a contract.

- **Get the contract in writing**

It is very important that a crop production contract be in writing and that all provisions of the agreement be included in the contract. “Handshake agreements” are very difficult to defend if legal proceedings become necessary. If any items related to the crop being produced are omitted, it is preferable to add these provisions prior to signing the contract rather than after the contract is enacted.

- **Read the contract carefully**

It is extremely important that a producer, or someone designated by the producer, read the contract carefully before signing it. Make sure that all contract language and provisions are clearly understood. If not, request clarification or adjustments before signing the contract. Be aware of vague or ambiguous language that is included that may not clearly define a grower’s responsibility and liability in a contract. When in doubt on contract language, it may be best to consult an attorney. It may be less costly to use an attorney as a “preventive measure” before signing a contract than to secure the services of an attorney during contract disputes after the contract is enacted.

- **Production requirements**

Growers need to be aware of acreage or specified quantity requirements in a contract. They should also understand any certification requirements that may exist, specified seed varieties, pest management practices, field isolation requirements, and other special production practices. Natural disasters that significantly lower crop production do occur over time and should be accounted

for in a contract under an “Act of God” clause or by specified crop insurance provisions. It is important for a grower to know his or her risk and other consequence that could occur as a result of a crop failure.

- **Delivery terms**

It is important for producers to be aware of obligations for delivery of the grain or product and to know how much flexibility exists. This can be important relative to harvest management, adverse weather conditions, and potential market enhancement opportunities. It is equally important to know how much flexibility the contract writer has to change the date, location, or other provisions related to contract delivery.

- **Grading, dockage, weights, moisture, and quality factors**

It is extremely important for a contract grower to understand how grading will take place; how dockage, weights, and moisture will be calculated; and whether the measurements will be taken by a third party or by the contractor. It is also good to be aware of any other quality requirements listed in the contract and to make sure it is feasible to meet them. Many times, growers end up with less than desired returns from production contracts due to lower prices from grading, dockage, etc., or because they could not meet the quality specifications in a contract.

- **Responsibility for costs**

Producers should make sure that contract language specifies which costs are to be covered by the grower and which costs are to be incurred by the contractor. Some contracts also spell out procedures to negotiate or mediate unforeseen costs that are not included in a contract. Growers should be aware of vague language that could leave them liable for unplanned production costs.

- **Price terms and guarantees**

Growers should be aware of how prices will be determined, any discounts or premiums, and when payment will occur before entering into a contract agreement. Some contracts have flexible marketing schemes that allow a producer to have a “base price” with a “time window” to enhance that price, and again it is important to understand these provisions prior to signing a contract. It is also a good idea to talk to your Farm Service Agency office to find out if the crop being grown under contract is still eligible for the CCC loan program and loan deficiency payment benefits.

- **Relationship with the contract writer**

A good, trusting relationship with the firm or person writing the contract is always a good idea, but may not always be possible. If you are suspicious of the entity writing the contract, ask for references or a financial statement before you sign the contract.

Remember, most contractors check you out as a grower before they enter into a contract agreement. Also remember, a good working relationship is no substitute for a well written contract and does not mean that legal advice should not be considered.

- **Consult experts when necessary**

As mentioned earlier, it is probably a good idea to have an attorney review a production contract before signing it, especially if the contract is with a new firm

or contains language that you do not understand. It is also good to consult with your financial advisor on tax implications of the contract arrangement and ag lenders regarding impacts on the farm's annual operating budget. Other producers that have experience with contract production can also be a good source of information on contract provisions, but remember that contract language and meaning may vary among firms writing contracts.

The Minnesota Department of Agriculture has developed the publication, *"A Producer's Guide To Production Contracts."* It is available free of charge by calling **1-800-967-2474**. There is also resource information on agriculture contracts available in the National Ag Risk Education Library located at the following web site : (**[www.agrisk.umn.edu](http://www.agrisk.umn.edu)**).

Contracts can definitely be an important and useful tool for growers as long as they clearly understand the risks and obligations they are committing to. As Steve Taff, public policy economist with the U of M Extension Service has pointed out, contracts aren't inherently bad, but bad contracts are. Some people sign what someone waves in front of them, without reading it or taking it to their attorney. But contracts can be a good way for farmers to reduce risk. Instead of taking what the market will pay you down the road, a contract allows a producer to lock in a price that is acceptable.

Taff maintains producers just need to read the contract—or have an attorney read it—to see who is really taking the risk. And if terms aren't acceptable, just turn it down.