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Livestock production Contract Checklist for South Dakota Producers

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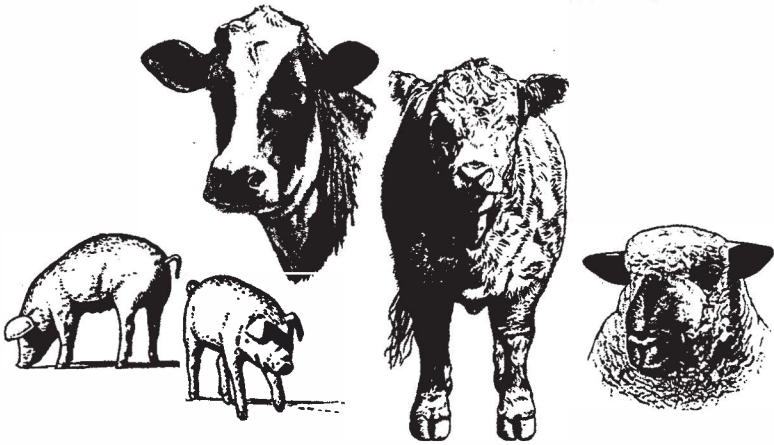
Extension Circular 906

Livestock Production Contract Checklist

FOR

SOUTH DAKOTA

PRODUCERS



South Dakota State University / U.S. Department of Agriculture

Introduction

Trends Toward Production Contracting / Definitions

Significant changes in the dynamics of the South Dakota livestock industry are providing producers an opportunity to evaluate new livestock care and feeding arrangements. Many of these arrangements involve livestock production contracts.

A livestock production contract can be defined as an agreement under which a producer feeds and cares for livestock owned by a contractor in return for payment. Production contracts should be distinguished from marketing agreements, cash forward contracts, and futures contracts which involve the sale of livestock produced and owned by the producer.

Use of Checklist

This checklist has been developed by Extension ag production specialists to serve as an educational tool for producers considering a livestock production contract. The producer is encouraged to ask the type of questions posed in the checklist before signing a contract. No checklist can raise every relevant question, and conversely, this checklist may raise questions that are not relevant to each producer.

References in Checklist

Note that the term “you” as used in this checklist refers to the producer or grower involved. The term “contractor” refers to the other party to the contract.

Adapted for use in South Dakota by Larry Tidemann, Extension ag program leader, from material developed by Iowa Attorney General Tom Miller's Production Contracts Task Force, Iowa Department of Justice.

For more information on livestock production contracts in South Dakota, contact one of these state Extension specialists:

- *Don Boggs, beef*
 - *E. Kim Cassel, dairy*
 - *Jeff Held, sheep*
 - *Bob Thaler, swine*
 - *Burton Pflueger, farm financial management*
 - *Doug Zalesky, beef -- West River*
-

Livestock Contract CHECKLIST

CONSULT EXPERTS. Before committing yourself to this contractual obligation, be absolutely sure you understand the entire document.

Attorneys

_____ If you do not fully and completely understand the legal terms in the contract or the legal consequences of the contract, consult an attorney.

Financial and technical experts

_____ If you do not fully understand the financial or tax consequences of the contract, consult your lender, a tax professional, the Cooperative Extension Service, an agricultural consultant, or others.

Other producers

_____ Talk to other producers who have had experience with contracts. They may be a good source of advice as either the leasor or lessee.

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

Exclusivity of use

_____ Can you have livestock other than the contractor's livestock in the facilities?

_____ Can you have other livestock on the farm?

Construction timing

_____ When does construction have to be completed?

_____ Are there penalties for construction delays?

Construction costs/depreciation

_____ Do you know the total costs of construction?

_____ Do you pay for all the material and labor?

_____ Who pays the costs of site surveys, engineering, and excavating?

_____ What are the depreciation costs? Depreciation claimable on your taxes differs with various types of livestock.

_____ Who "owns" the facility?

Construction specifications/modernization

- ___ Who provides the specifications for construction?
- ___ Who is responsible if there are defects?
- ___ Is the facility standard for the industry? Would the facility be acceptable if you wanted to enter into contracts with other contractors in the future? Could the facility be used for other purposes?
- ___ Are you required to pay for future modernization or upgrades in the facility or its equipment?

Government approval of facility

- ___ Who is responsible for obtaining governmental permits and/or county zoning approval?
- ___ Who pays permit fees?
- ___ What happens if the facility is not approved?
- ___ Does the facility have to be inspected by state or federal entities initially and/or regularly?

Miscellaneous facility costs

- ___ Who pays for maintenance and repairs on the facility?
- ___ Who pays for insurance for liability and property/casualty on the facility?
- ___ Will the facility require a new well or other source of water? Who pays for this?
- ___ Who pays for security?

Access to facility

- ___ Who has access to the facility and when?
- ___ If the contractor or others have access, then do they have to give you advance notice?
- ___ What if there are damages, such as introduction of disease?

Recovery of investment

- ___ Is the duration of the contract adequate to recover your investment in the facility and equipment?
- ___ Can the contract be terminated before the investment is recovered? What if the contractor goes bankrupt?
- ___ Is there a guarantee of minimum occupancy for the facility?

Financing of facility/lender approval

- ___ Is the financing of the facility certain? Do you have a written loan commitment?
- ___ Does your lender need to accept the contract before financing of the facility is approved?
- ___ Does your lender require the contractor to provide assurances that the contractor can perform the contract?

OPERATIONAL ISSUES

Delivery of livestock

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

Feed

- _____ Who is responsible for providing feed and guaranteeing feed quality? Who pays for feed analysis?
- _____ Who provides balanced rations? Who decides on changes in rations due to weather, market conditions, development of new techniques, or other factors? Who is responsible for fees associated with this process?
- _____ Who is responsible if feed efficiencies (lbs gain/cwt, income over feed costs, milk) are below expectations?
- _____ If marketing is delayed and/or feed efficiency declines, then are you compensated for the extra feed costs or lost production?
- _____ If you use feed you raised, how is it priced? Is there a markup?
- _____ Whether you raised the feed or not, how are feed storage, drying, processing, trucking, and other handling costs allocated?

Livestock health

- _____ Who checks for livestock health at arrival?
- _____ Can you reject livestock you think are sick? Can you demand a veterinarian's certification of health? If so, then whose veterinarian is used and who pays?
- _____ Who is responsible for compliance with state and federal animal health regulations?
- _____ Who bears death loss risk while the livestock are at your facility?
- _____ Some contracts have a rebuttable presumption that death loss occurring soon after the arrival of livestock is the contractor's responsibility because unhealthy animals were supplied. Does the contract address this situation?
- _____ Who bears death loss risk due to failure of ventilation, heating, cooling, watering, or other equipment?

- _____ Who bears death loss risk due to extreme weather conditions such as heat, cold, floods, wind, lightning, etc.?
- _____ Who bears the costs if unhealthy livestock brought to the facility infect other livestock on the farm?
- _____ Who bears the costs of poor performance due to unhealthy or low-quality livestock? Can you renegotiate compensation terms?
- _____ Who determines and pays for programs for scheduled or unscheduled health care?
- _____ Who chooses the veterinarian? Who pays the veterinarian?
- _____ What are your responsibilities for cleaning and/or disinfecting facilities between turns of livestock?

Manure

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

Labor and management / record keeping

- _____ Who provides labor and management to raise the livestock? Can this be delegated or subcontracted? If you delegate or subcontract labor or management, what impact would this have on your cash flow or the profitability of the contract?
- _____ Who sets and monitors animal management practices?
- _____ Are you or your employees required to have special skills or training? Who pays for the training?
- _____ What records (health, feed, inventory, feed-bunk management, production, etc.) are you required to maintain?

Insurance and other costs

- _____ Who pays for liability and casualty insurance of the livestock?
- _____ Is there coverage for death loss of livestock due to equipment failure?
- _____ Who pays for workers' compensation, health, disability, and general liability insurance?
- _____ Do you have to provide certificates of insurance?
- _____ Who is responsible for utilities?
- _____ Who is responsible for dead animal removal?
- _____ Who is responsible for dust control? Weed control?
- _____ Who pays for roadway construction and maintenance?

PAYMENT

Payment terms

- _____ On what basis are you being paid?
- _____ What payment factors are out of your control?
- _____ Is the schedule of payments firmly set? Will this schedule satisfy your cash flow?
- _____ Are there penalties for late payment?
- _____ Can the payments be assigned to a lender?
- _____ Will the last payment be made before the livestock leave your facilities?
- _____ Will your lender's name be on the check?

Incentive payments

- _____ If production incentive payments (based on factors such as death loss, feed efficiency, rate of gain, or production quality) are involved, then exactly what do you have to do to receive the incentive payments? How are the payments calculated and when are the payments made?
- _____ Can you examine the computations used to determine these incentive payments?

Costs of production

- _____ Do you know your costs of production to determine the profitability of the contract?
- _____ If you don't have cost of production records, then you may want to consult with the Cooperative Extension Service or others to arrive at estimated production costs.

Custom feeding cattle liens

- _____ If the contract involves custom feeding cattle, can your payment be protected by perfecting a lien on the cattle? The lien would be superior to all other liens (except a veterinarian's lien) and would continue against the holder of the identifiable cash proceeds from the sale of the cattle or the processor who has purchased the cattle within three days after the cattle leave your feedlot.
- _____ Does the contract attempt to modify your right to this lien?

Liens for other contracts

- _____ If the contract is not a custom cattle-feeding arrangement, then what recourse do you have if the contractor does not pay you?
- _____ Has the contractor already granted liens against the livestock to a lender or others? Will the contractor grant you a security interest against the livestock and take the steps to ensure that your interest is superior to prior liens? (This is very difficult to accomplish because the lender or other person holding the prior lien must approve.)

Contractor credentials

- _____ If you have concerns about getting paid, will the contractor provide you with a financial statement? Ask for it to include a list of producers the contractor has contracted with in the past.
- _____ Does it appear that the contractor is committed to contracting in the region? Has the contractor made investments in fixed assets or relocated management in the region? Is contracting the contractor's core business?

Your credentials

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

Parent company responsibility

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

LEGAL ISSUES

Dispute resolution

- _____ Does the contract require mediation of dispute resolution? Mediation is negotiation between you and the contractor facilitated by a neutral third party.
- _____ Does the contract require other forms of dispute resolution such as arbitration? Unlike mediation, arbitration is a process where a third-party arbitrator hears the dispute like a judge and renders a decision, usually binding on the parties. Arbitration often is much more expensive than mediation.

Termination of contract

- _____ Under what conditions can the contractor terminate the contract?
- _____ Who determines whether those conditions are met? Are there objective standards or is it at the discretion of the contractor?
- _____ How much notice does the contractor have to give you before termination?
- _____ Are you given an opportunity to cure a problem before termination? How much time are you given for this?
- _____ What are your rights after termination of the contract? Will you be paid for work down to date? Do you have an option to buy the livestock?
- _____ Under what conditions can you terminate the contract? What if you get sick, disabled, or die? What if you file bankruptcy?
- _____ Can you terminate if the contractor fails to deliver livestock or feed or fails to make payments on time?
- _____ Does the contract excuse non-performance caused by "Acts of God," meaning occurrences out of human control?

Renewal of contract

- _____ Under what conditions can the contract be renewed?
- _____ Are there standards for renewal, or is it up to the contractor?

Status of parties

- _____ What legal relationship does the contract establish between you and the contractor? Is it a landlord/tenant relationship, employer/employee relationship, independent contractor partnership, joint venture, or agency? The legal status of the relationship not only affects your rights and responsibilities under the contract, but it also has important tax consequences.

Approval of contract by others / assignment

- Do other parties have to approve the contract, such as your landlord, your lender, your spouse?
- Can the contract be assigned or transferred by you or by the contractor to others, such as a lender?

Choice of law / venue / change of law

- If the contractor is from another state, does the contract specify the state law that governs? Is this choice of law fair?
- Does the contract set a venue (location) for any lawsuit that might be filed? Is this location fair?
- Does the contract permit renegotiation or nullification of the contract if the laws governing production contracts are changed?

Duration of offer

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

Put it in writing

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

NEIGHBORS AND GOALS

Neighbors

- Have you talked with your neighbors about your plan?
- Will raising livestock under this contract affect your relationship with your neighbors?

Long-term goals

- How does this contract fit into your long-term goals for your farm?
- For your family?
- For your community?

OTHER SOURCES OF INFORMATION

There are several excellent sources of information on livestock production contracting in South Dakota. Publications on the topic include:

- Dairy Cow Leasing and Sharing Agreements. R.A. Luening. 1976. North Central Regional Extension Publication No. 41.
- Livestock Contract Feeding Arrangements. Larry Madsen and SDSU Extension farm financial management staff. ExEx 5032. August 1996. South Dakota State University Cooperative Extension Service.
- Livestock Facility Development Information Guide. South Dakota Department of Agriculture. Dean Anderson, Secretary of Agriculture. Pierre, South Dakota.
- So You Want to Lease Out Your Dairy? Robert B. Schwart, Jr., Chris G. Woelfel, and Brian Cummins. 1996. Internet. Dairy Database.
- South Dakota Livestock Waste Management Manual. Charles Johnson and Charles Ullery. EC 895. 1993. South Dakota State University Cooperative Extension Service.
- Dairy Handbook. Midwest Plan Service. Ag Engineering Department. South Dakota State University. Brookings, South Dakota.
- Beef Handbook. Midwest Plan Service. Ag Engineering Department. South Dakota State University. Brookings, South Dakota.
- Swine Handbook. Midwest Plan Service. Ag Engineering Department. South Dakota State University. Brookings, South Dakota.

Agencies that can assist you:

Governor's Office of Economic Development
South Dakota Cooperative Extension Service
South Dakota Department of Agriculture
South Dakota Department of Environment and Natural Resources

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