CONTRACT FEED PRODUCTION ARRANGEMENTS

Joe Stellato
Crops and Soils Agent
Shawano County UW-Extension

Introduction

Economic necessity and a desire to manage risk are causing many Wisconsin farm operators to rethink their ways of doing business. All farm operators can reduce business risk by minimizing their investment in capital assets that do not produce a high rate of return. With ever-escalating field machinery prices, many dairy operators simply can no longer afford to own expensive machinery that will be used only several days out of the year. This problem is especially apparent on small and medium sized farms, although large farms need to watch their machinery investment as well. In addition, labor shortages on some dairies have made it very difficult for these operators to harvest high quality alfalfa, corn silage and feed grains in a timely manner. Finally and perhaps most importantly, some dairy producers have expressed a desire to specialize in what they do best --- that is, milking, feeding and managing cows, and to have more time available for family.

To deal with these realities, dairy operators might employ one or more of the following strategies:

- Using the services of a custom operator for planting and/or harvesting crops
- Equipment sharing
- Renting or leasing equipment
- Contract feed production arrangements (contracting with a nearby crop farmer to produce some or all of the corn, corn silage and alfalfa needed by the dairy herd)

Contract feed production arrangements have increased use in Northeast Wisconsin during the last few years. Contract feed production arrangements offer several advantages to both dairy operators and crop producers:

- They allow both dairy producer and crop producer to specialize and do what each does best, and have more time available for management activities.
- They free dairy producers from needing to hire and train workers for both dairy and cropping operations.
- Trucking costs are minimized if the farms are located relatively close
- Price risk is minimized for both parties since a guaranteed price is ensured for a set amount of feed delivered.
- The dairy producer obtains a secure source of feed inputs and the crop producer obtains a stable market and price for their production.
- Financing may be easier to obtain since lenders will know what the dairy operator's feed costs will be and what the crop producer's income will be.
- The dairy producer, having been relieved from some or all crop production duties might have more time available for family activities.

- Specialized crop producers can provide land for manure from expanding dairies. The crop producers save on fertilizer costs and reap the fertility benefits of organic matter supplied by manure.
- Dairy producers can place all or most of their investment capital into the business of producing milk, rather than seldom-used field machinery.
- Crop producers, if operating enough acres, can justify machinery investments needed to produce and harvest high quality forages and feed grains.

However, the following points also need to be kept in mind by both dairy producers and crop producers:

- **Prices set forth in the contract MUST be profitable for BOTH parties** for long-term arrangements to last over time.
- **In event of lower than expected yields, the crop producer will still be expected to deliver the contracted amount of feed,** unless the dairy operator allows a smaller feed delivery due to circumstances beyond the crop farmer's control (such as drought, flooding, frost, winterkill, etc.). To avoid this problem, the crop producer should NEVER contract his/her entire crop. Carrying crop insurance on the contracted amount is also strongly encouraged.
- **The dairy producer will still be obligated to purchase the amount of feed specified in the contract at the prices specified, even though opportunities to buy feed at lower cost may arise later.** Dairy operators who like to shop around for bargains might want to contract only a portion of their feed needs, allowing them to take advantage of future price drops if and when they occur. Remember that this strategy could also backfire if prices rise unexpectedly**!**
- **Crop producers MUST take special care to monitor corn silage and high moisture corn drydown rates!** They must also take care NOT to wilt haylage too long in the field. When feeds are ensiled too dry, digestibility declines. Also, heat damage and/or spoilage can become major problems. If the dairy operator specifies certain minimum moisture levels for haylage, high moisture corn and corn silage, crop producers should pay special attention to meeting those targets. The right to refuse feeds delivered below minimum acceptable moisture levels can also be written into contracts. Due to problems that have already occurred on a number of large dairy operations in Wisconsin, expect dairy operators to be extremely sensitive to the moisture content of feeds they purchase for ensiling.

Satisfactory feed production contracts have been negotiated and are being used by farmers in Northeast Wisconsin. This paper is designed to help both dairy producers and crop producers understand the elements necessary for developing a successful contract feed production arrangement.

Developing A Feed Production Contract

No standard contract or "form" currently exists for contract feed production arrangements. In fact, it would be extremely difficult to develop a feed production contract that would cover all possible mishaps, such as crop loss due to drought stress, flooding, wind, hail, fire, herbicide injury, insect damage, plant disease, vandalism, etc. Quality loss can be accounted for to some extent using forage analysis with a price premium/discount schedule for various quality levels. But any attempts to write a contract to cover any and all possible mishaps will likely result in a very lengthy, cumbersome document that few producers will want to read and much less sign! So the first rule of developing a good contract is to do business with another party that you know and trust. Any contract is only as good as the integrity of the parties who sign it!

Second, be sure to get your agreement in writing! Sit down and draft your contract together with an attorney, and get all your questions answered BEFORE signing. If your own attorney was not the one who drafted the contract, then have your own attorney review before you sign. It is also advisable to have your attorney review your contract before you sign. Attorneys are trained to ask “what if” types of questions, and may point out some potential problems or “gaps” in your agreement. Remember, it will be far cheaper to pay an attorney $100 - $200 to review your contract before you sign than it will be to hire one to defend you in a lawsuit!

Another important reason to get all agreements in writing is so that both parties have legal protection under state law. Wisconsin State Statute 402.201 Formal requirements; statute of frauds states under part (1) that “…a contract for the sale of goods for the price of $500 or more is NOT enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by the party’s authorized agent or broker.” In other words, sale transactions of $500 or more cannot be enforced by the courts unless the sale agreement is in writing.

Arriving at feed prices that are profitable for both parties may be a challenge. At this point, a detailed business analysis is recommended for both the dairy and crop producer. Some farmers have used recent average market prices for hay and grain to determine contract prices, but this method will not prove suitable for years in which commodity prices dip below one’s cost of production. Our suggestion is to have each party determine their cost of production, and use this to determine profitable purchase and selling prices. The dairy operator needs to know how much he/she can pay for feed and still earn enough profit to continue operations. The crop producer needs to know what his/her breakeven price is, and must charge enough over breakeven to replace machinery and continue operations over time. Arriving at prices that are profitable for both parties will protect each other from the wide price fluctuations that affect agriculture most years, thereby minimizing price risk for both. County Extension Agents can provide assistance with business analysis and determining your cost of production.

What Else Should Your Contract Include?

The following list identifies some, but not all, contract provisions that you should consider. Again, we suggest that you consult an attorney for more information.

- Names of all parties involved.
- What feed is to be delivered.
- Who is responsible for planting, fertilizing, spraying, harvesting, etc. of the crop.

- Base price per unit of feed at a specified moisture level. For example, "…Chocolate Milk Dairy Farm will pay $17.50 per ton of corn silage at 65% moisture."
- Specify how prices will be adjusted from the base price for varying moisture levels (see example corn silage contract attached to this paper).
- Acceptable quality, moisture range, test weight, etc. If you must have your alfalfa harvested above 65% moisture for proper packing in a bunker silo, then specify it in your contract. If you want high moisture shelled corn delivered at 25 to 30% moisture, then specify it in your contract. BE SURE TO SPECIFY MAXIMUM AND MINIMUM ACCEPTIBLE MOISTURE LEVELS OF FEEDS.
- Specify how prices will be adjusted for varying forage quality levels (how will prices increase or decrease with varying RFV levels in alfalfa?)
- "Right of refusal" clauses. If test weight, moisture levels or alfalfa quality are above or below a certain level, does the buyer have the right to refuse the feed?
- How will the feed be tested for moisture and quality? Will a grain probe be required for high moisture corn samples? Who will pull samples? Where will samples be analyzed --- at the local grain elevator, using a combine moisture tester, or at the Farm Service Agency Office? Who will pay for the moisture test?
- Who will be responsible for hauling the crop? Be sure to factor hauling distance into the final price.
- Specify use of preservatives, kinds and who will apply and pay for them.
- Determine how and where feed will be weighed. Must every load be weighed, or will every other load or every third load be enough? Who will pay any charges for weighing?
- Payment method and interest rates. Will it be cash on delivery or on installments? Will there be a late payment penalty or default interest rate?
- Cancellation clause --- what happens if the crop producer can't deliver?
- An arbitration clause --- in case of a dispute, you may wish to identify impartial third parties who can help resolve the dispute. Will the arbitrator's decision be binding?
- Date and signatures.

Included on the following pages are examples of contracts that have been developed and used by farmers in Northeast Wisconsin. The names have been changed to protect the privacy of the parties involved. These examples are provided to serve as a GUIDE ONLY. Use them as a starting point to develop your own contract during your own negotiation process.

Note that these example contracts do not attempt to cover all possible circumstances. They are not perfect or foolproof, but do set forth some major provisions for both parties to follow. To make such contracts effective, both buyer and seller must have a sincere desire to conduct business that will be beneficial to both parties.

EXAMPLE

CORN SILAGE CONTRACT

Between

CHOCOLATE MILK DAIRY

And

YELLOW DENT GRAIN FARMS

Yellow Dent Grain Farms will sell 2000 tons of standing corn for silage to Chocolate Milk Dairy during the harvest of 1999. Yellow Dent Grain Farms will be responsible for all costs, both fixed and variable, necessary to the production of this corn. These costs include, but are not limited to, the cost of seed, fertilizer, chemicals, crop insurance, tillage operations, fertilizer application, chemical application, planting, fuel, labor, land rent, interest charges, and overhead expenses. Chocolate Milk Dairy will be responsible for all harvesting, hauling and ensiling costs associated with converting 2000 tons of standing corn into corn silage.

The price of this standing corn for silage will be $17.50 per ton at 65% moisture. Final price adjustments for moisture will be made using the calculation procedure shown on Attachment 1 of this contract. A minimum of every third truckload of harvested silage will be weighed on a state-certified scale to be selected by mutual agreement of both parties to this contract. Scale tickets will be presented by Chocolate Milk Dairy to Yellow Dent Grain Farms for each load that is weighed. Any costs of weighing the corn will be shared equally by both parties. Corn testing below 61% whole plant moisture will not be accepted by Chocolate Milk Dairy Farm.

Both parties reserve the right to have moisture tests independently analyzed for the purpose of determining a final price per ton. If moisture samples taken by each party differ, an average will be computed to determine a final price. Corn silage samples will be submitted to the ________________ Soil and Forage Analysis Lab for final moisture determination. Each party to this contract will pay for the cost of having their own corn silage samples analyzed.

Payment for the corn silage will be as follows: Chocolate Milk Dairy will pay for the corn silage in twelve equal monthly installments, with the first installment due on October 1, 1999. Each successive payment will be due on the first day of each month for the following eleven months. The equal monthly installments will include accrued interest at an annual rate of 9% amortized over the eleven-month period. Interest will begin to accrue on the unpaid balance starting on October 2, 1999. In the event of late payment in any given month, interest will continue to accrue at the annual rate of 18% on the unpaid balance for that month.

If a dispute arises during the course of this contract that cannot be resolved by referring to the language of this contract, both parties hereby agree that an arbitration process will be used to resolve that dispute. The arbitration process will be as follows:

Each party to this contract will select one arbitrator of their own choosing to work on the dispute resolution process. Arbitrators so selected shall not have any ownership or investment interest in the farm business operations of Chocolate Milk Dairy or Yellow Dent Grain Farms. The two arbitrators selected will, in turn, select a third arbitrator to serve on a three-person arbitration board. Rulings made by this arbitration board will be accepted as final and binding upon both parties to this contract.

Signed this day of ______________________________________, 1999

______________________________ ______________________________

Yellow Dent Grain Farms Chocolate Milk Dairy

ATTACHMENT 1: PRICE ADJUSTMENTS FOR CORN SILAGE MOISTURE CONTENT

EXAMPLE: CORN SILAGE BASE PRICE IS $17.50 PER TON OF CORN SILAGE AT 65% MOISTURE (35% DRY MATTER)……………………..

Step 1: Calculate price per ton of 100% dry matter corn silage:

$$\frac{\$17.50}{\text{ton 65\% corn silage}} \quad X \quad \frac{\text{ton 65\% corn silage}}{.35\text{ tons dry matter}} = \frac{\$50\ .}{\text{ton dry matter}}$$

Step 2: Calculate price per pound of 100% dry matter corn silage:

$$\frac{\$50}{\text{2000 lbs dry matter}} = \frac{\$.025}{\text{pound dry matter}}$$

Step 3: Corn silage harvested at 70% moisture contains 30% dry matter. Calculate total pounds of dry matter per ton of 70% moisture corn silage:

$$\frac{\text{2000 lbs 70\% corn silage}}{\text{ton 70\% corn silage}} \quad X \quad \frac{.3\text{ lbs dry matter}}{\text{lb 70\% corn silage}} = \frac{\text{600 lbs dry matter}}{\text{ton 70\% corn silage}}$$

Step 4: Multiply price per lb of dry matter from Step 2 times the lbs dry matter per ton of 70% corn silage:

$$\frac{\text{600 lbs dry matter}}{\text{ton 70\% corn silage}} \quad X \quad \frac{\$\,.025}{\text{lb dry matter}} = \frac{\$15.00}{\text{ton 70\% corn}}$$

EXAMPLE

HIGH MOISTURE CORN CONTRACT

Between

CHOCOLATE MILK DAIRY

And

YELLOW DENT GRAIN FARMS

Yellow Dent Grain Farms will deliver to Chocolate Milk Dairy 420 tons of high moisture shelled corn during the harvest of 1999. The 420 tons is equivalent to 15,000 bushels of dry shelled corn at 15% moisture, with a test weight of 56 lbs. per bushel. The targeted moisture level of the corn will be 25%. Corn testing below 22% moisture will not be accepted by Chocolate Milk Dairy. Yellow Dent Grain Farms will be responsible for all costs, both fixed and variable, necessary to the production of this corn. These costs include, but are not limited to, the cost of seed, fertilizer, chemicals, crop insurance, tillage operations, fertilizer application, chemical application, planting, fuel, labor, land rent, interest charges, hauling costs, harvesting costs and overhead expenses.

The base price will be $2.40 per bushel on a dried basis of 15% moisture, which equates to $75.65 per ton at 25% moisture. Final price adjustments for moisture will be made using the U.W.-Extension chart entitled "Equivalent Price Per Ton of High Moisture Shelled Corn" (Attachment 1). Every load of corn delivered to Chocolate Milk Dairy by Yellow Dent Grain Farms will be weighed on a state-certified scale to be selected by mutual agreement of both parties to this contract. Scale tickets will be presented by Yellow Dent Grain Farms to Chocolate Milk Dairy for each load delivered. Any costs of weighing the corn will be shared equally by both parties.

Both parties reserve the right to have moisture tests independently analyzed for the purpose of determining the final price per ton. If moisture samples taken by each party differ, an average will be computed to determine a final price. The sampling procedure for moisture testing will be as follows: Several grain probe samples of corn will be taken from each load of harvested grain to be delivered to Chocolate Milk Dairy. These probed samples will be combined into one 5-gallon pail or similar container and mixed. When an entire field has been harvested, one composite sample for moisture analysis will be taken from the pail to represent that field. Corn samples will be placed in a sealed plastic bag and submitted immediately to the ______________________________ (Soil and Forage Analysis Lab, local grain elevator, local Farm Service Agency Office, etc.). After a moisture test on the corn is completed, the moisture test results will be used to compute a moisture-adjusted price per ton for corn from each field harvested and delivered to Chocolate Milk Dairy. Each party to this contract will pay for the cost of having their own corn samples analyzed.

Payment for the grain will be made as follows: Chocolate Milk Dairy will pay for the corn in twelve equal monthly installments, with the first installment due on November 1, 1999. Each successive payment will be due on the first day of each month for the following eleven months. The equal monthly installments will include accrued interest at an annual rate of 9% amortized over the twelve month period. Interest will begin to accrue on the unpaid balance starting on November 2, 1999.

In the event of late payment in any given month, interest will continue to accrue at the annual rate of 18% on the unpaid balance for that month.

If a dispute arises during the course of this contract that cannot be resolved by referring to the language of this contract, both parties hereby agree that an arbitration process will be used to resolve that dispute. The arbitration process will be as follows: Each party to this contract will select one arbitrator of their own choosing to work on the dispute resolution process. Arbitrators so selected shall not have any ownership or investment interest in the farm business operations of Chocolate Milk Dairy or Yellow Dent Grain Farms. The two arbitrators selected will, in turn, select a third arbitrator to serve on a three-person arbitration board. Rulings made by this arbitration board will be accepted as final and binding upon both parties to this contract.

Signed this day of ____

______________________________ ______________________________
Yellow Dent Grain Farms Chocolate Milk Dairy

EXAMPLE

HAYLAGE CONTRACT

between

CHOCOLATE MILK DAIRY

and

YELLOW DENT GRAIN FARMS

Yellow Dent Grain Farms of Green Bay, Wisconsin agrees to provide Chocolate Milk Dairy of Shawano, Wisconsin with the entire haylage harvest from 110 acres of first cutting, 140 acres of second cutting, and 140 acres of third cutting alfalfa during the 1999 growing season. Yellow Dent Grain Farms will be responsible for all costs, both fixed and variable, necessary to the production of this alfalfa. These costs include, but are not limited to, the cost of seed, fertilizer, chemicals, crop insurance, rent, interest charges, and overhead expenses. Chocolate Milk Dairy will be responsible for all harvesting, hauling and ensiling costs associated with converting the specified standing alfalfa crop into alfalfa haylage.

Chocolate Milk Dairy will pay a base price of $90 per ton of 100% dry matter haylage at RFV of 140 to 160, which includes mowing, raking and chopping costs. Chocolate Milk Dairy agrees to pay all transportation and bunker silo packing costs to contractors within 30 days of receipt of invoice. The price will be adjusted by a deduction of $1.00 per ton (100% dry matter basis) per point of RFV for haylage testing less than 140 RFV. The price will also be adjusted by a premium of $1.00 per ton (100% dry matter basis) for haylage testing greater than 160 RFV, up to a maximum RFV of 180.

Both parties reserve the right to have forage samples analyzed by the _____________ Soil and Forage Analysis Laboratory for the purpose of determining a final price per ton according to forage quality. If forage sample RFV taken by each party differs, an average will be computed to determine a final price. A minimum of every other truckload of harvested haylage will be weighed on a state certified scale to determine final tonnage harvested. In the event that dry hay is harvested, every load shall be weighed on a state certified scale.

Payment for haylage (or dry hay) will be made as follows: Chocolate Milk Dairy will pay in 12 monthly installments. Monthly installments will begin on June 5, 1999 and will be $5000 per month for the first 3 months, to be adjusted upon completion of harvest. Each successive payment will be due on the fifth day of each month for the following eleven months. Interest shall accrue on the unpaid balance starting on June 6, 1999 at the rate of 12% amortized over a period of one year. In the event of late payment in any given month, interest will continue to accrue at the annual rate of 18% on the unpaid balance for that month.

If a dispute arises during the course of this contract that cannot be resolved by referring to the language of this contract, both parties hereby agree that an arbitration process will be used to resolve that dispute. The arbitration process will be as follows: Each party to this contract will select one arbitrator of their own choosing to work on the dispute resolution process. Arbitrators so selected shall not have any ownership or investment interest in the farm business operations of Chocolate Milk Dairy or Yellow Dent Grain Farms. The two arbitrators selected will, in turn, select a third arbitrator to serve on a three person arbitration board. Rulings made by this arbitration board will be accepted as final and binding upon both parties to this contract.

Signed this day of_______________________________________, 1999

______________________________ ______________________________
Yellow Dent Grain Farms Chocolate Milk Dairy