



AGRICULTURAL PRODUCTION CONTRACT CODE AND GUIDELINES

Agricultural production contracts are becoming increasingly common in raising livestock and crops for contractors. Typically, production contracts provide farmers with favorable commodity prices and provide contractors with a reliable and predictable supply of grain and livestock.

As production contracts increasingly become a standard for the agriculture industry, some contractors have adopted the use of a variety of contracts that are often detailed and may include various provisions, such as confidentiality clauses, choice of forums, unilateral termination, contract alteration provisions, compensation matrices and in some cases investment requirements. Some of these provisions can require a producer to assume a certain level of risk. If the producer enters into a contract without fully understanding and realizing all the implications and potential risk, they may incur unnecessary expenses and in some instances face possible financial disaster. As a result, the Illinois General Assembly passed and the Governor signed Public Act 93-522 (HB 264)*, effective January 1, 2005 and provides producers with certain protections relative to production contracts. Public Act 93-522 establishes the Agricultural Production Contract Code to ensure fairness and clarity in the contracting process.



Recognizing that crop production and animal agriculture are a driving force of Illinois' economy and that farming is a way of life for many Illinoisans, Attorney General Madigan in conjunction with her Agricultural Advisory Council has developed these helpful guidelines for producers to use in protecting their interests and making informed decisions when entering into production contracts. Although Public Act 93-522 gives the Attorney General enforcement authority when certain provisions of the Act are violated, the guidelines in this checklist will help producers understand their rights before entering into a production contract.

The following checklist was developed based on the protections provided in Public Act 93-522 effective January 1, 2005. The guidelines apply to grain, seed, livestock and other commodity production contracts signed on or after January 1, 2005. The guidelines include: a basic definition of production contracts and a glossary of common words and terms used in contracts; and some details that producers should consider before entering into a production contract.

PLEASE NOTE: Because of the complex legal and financial implications and the impact production contracts have on farming operations, it is highly advisable that producers consult with their attorney and/or financial advisors regarding the terms and conditions in production contracts. The following information should not be construed to advocate or discourage producers from entering into production contracts. The information provided in the checklist below is not exhaustive and does not constitute legal advice on this topic. Rather, the purpose is to help producers make informed decisions.

* PA 93-522 was amended by PA 93-0815 (SB 2372) signed into law on July 27, 2004. The Amendments are incorporated into the foregoing information.

Production Contract Checklist

Below is a checklist of guidelines that any standard production contract should meet. Following is a more detailed description of these guidelines based on the Agricultural Production Contract Code of 2003. Please note that the Production Contract Code does not apply to: a production contract that requires a commodity to be delivered to the contractor within 30 days of the date of the agreement, documents attached to the contract if the contractor, affiliate, or subsidiary is not the original publisher of the document, and forward contracts.

Production contracts should:

- ✓ Have a minimum of 10 point type to ensure readability by the parties
- ✓ Be divided and captioned by its various sections and include an index of the major provisions
- ✓ Use common words and terms, but may also include industry terms commonly understood by producers
- ✓ Limit references to other sections
- ✓ Have a Flesch-Kincaid Grade Level score no higher than the twelfth grade
- ✓ Confidentiality clauses shall not prohibit a producer from discussing the contract with a spouse, children, attorney or relevant financial advisors
- ✓ Disclose special provisions
- ✓ Disclose basis of cancellation of contract
- ✓ Exclude unilateral termination (with exceptions)
- ✓ Prohibit unilateral alteration of terms
- ✓ Provide clear and concise information about any discount or increase in compensation to be paid to the producer
- ✓ Forbid contractor from terminating or cancelling a contract without sixty day written notice and reimbursement for value of remaining useful life of capital investment items.
- ✓ Provide exceptions allowing cancellation of a contract for voluntary abandonment, failure to meet or remedy contract provisions and/or a conviction of fraud or theft against the contractor.

This checklist is provided as an overview of the provisions that should be included in a standard production contract and is not meant to serve as legal advice when entering into a contract. We strongly suggest consulting with your attorney and/or financial advisor before entering into any type of contract.

SECTION 1 - READABILITY

- Minimum of 10 point type
- Divided and captioned with index
- Use of common words and terms
- Limit references to other sections
- Flesch-Kincaid Grade Level score no higher than twelfth grade

Production Contracts can be lengthy and use complex words and legalese. Readability requirements now require Production Contracts to be in a type-face at least as large as 10 point to ensure easy readability by the parties. A Production Contract must be divided and captioned by its various sections and may

include an index of its major provisions. If the Production Contract exceeds two pages in length, an index is required and must include the following information as well as the pages on which the information can be found:

- Names of the parties to the contract, definitions and provisions governing cancellation, renewal and amendment.
- Duties and obligations of each party.
- Compensation information.
- Any provisions subject to change.
- Special provisions relating to production guidelines.

The Production Contract should use commonly used and understood words and terms, but may also include technical and/or industry terms customarily used and understood by producers in the ordinary course of business. If the contract incorporates other documents, a copy of the document must be attached.

Lastly, the production contract must have a Flesch-Kincaid Grade Level score no higher than the twelfth grade. This provision does not apply to a document attached to the contract if the contractor, affiliate, or subsidiary is not the original publisher of the document. A Flesch-Kincaid scale is a widely used standard developed to measure the readability of a document based on High School Grade Level. More information on the Flesch-Kincaid scale is available at www.aellalei.com/resources/sample.html. Again, the purpose of these safeguards is to improve readability and eliminate complex and confusing provisions in contracts.

SECTION 2 - CONFIDENTIALITY CLAUSES

- Restrictions on confidentiality clauses
- Allows for privileged communications to protect proprietary information

Production Contracts may include confidentiality clauses in order to protect the contractor's legitimate trade secrets, intellectual processes, and/or production processes. However, confidentiality clauses cannot prohibit the producer from discussing the terms of the contract with (i) the producer's spouse; (ii) a producers parents, siblings, and children 18 years of age and older if these persons are partners, shareholders, officers, or directors of the producers agriculture operations; (iii) accountants; (iv) attorneys; (v) bankers/financial institutions; (vi) farm managers; (vii) trust or trust beneficiaries; or (viii) the partners, officers, or directors of the producers agriculture operations.



When a producer discusses and reviews the terms of a Production Contract with the above-mentioned individuals, they must request each person to treat the information as privileged and confidential. Legally, this means that those discussions and the information discussed among the parties must **not** be disclosed outside the scope of that particular relationship cited above.

The confidentiality provisions in this area are included to allow producers to consult with professional advisors and stakeholders on the contract to understand legal and financial ramifications for the producer. It is important to remember that the contractor has a protected interest in legitimate trade secrets, intellectual processes and/or production processes, which prohibit divulging the terms and conditions of the contract outside of the relationship cited above.

SECTION 3 - SPECIAL PROVISIONS

- Disclosure of special provisions

Any special production or handling guidelines such as disease protocols or grain identity preservation must be fully explained and disclosed in the contract so that the producer is aware of the special provisions included in the contract and knows that he or she must adhere to those processes and protocols in fulfilling the obligations of the contract.

SECTION 4 - TERMINATION OR ALTERATION OF THE CONTRACT

- Disclosure of basis of cancellation of contract
- Prohibition of unilateral termination provisions (with exceptions)
- Prohibition of unilateral alteration of terms
- Disclosure in clear and concise information about discounts or increases in compensation

Contractors are prohibited from offering a Production Contract that allows the contractor to unilaterally terminate the contract. However, the contract may include provisions for cancellation in the following instances: (i) termination is the result of a legitimate unexpected or uncontrollable event applied to the contractor; (ii) the producer breaches a material term of the contract or voluntarily abandons the contractual relationship. A contractor may not alter the quality, quantity or delivery times of contract inputs provided to the producer unless the producer agrees to the changes. Any cancellation or termination provisions of the contract must include specific causes for the cancellation or termination and any circumstances under which the commodity produced under the contract might be rejected in whole or part by the contractor. Also, in cases where a specific cause may result in a discount or increase of compensation paid to the contractor, that cause should be clearly and concisely stated.



SECTION 5 - INVESTMENT REQUIREMENTS

- Forbids contractor from terminating or cancelling a contract without sixty day written notice and reimbursement for value of remaining useful life of a capital investment item, if the capital investment was specifically required to be provided by the producer under the terms of the contract.
- Exceptions to that requirement allowing cancellation for voluntary abandonment, failure to meet contract provisions and any conviction of fraud or theft committed against the contractor by the producer.

If the Production Contract has capital investment requirements, a contractor is prohibited from taking action to terminate or cancel that contract until the contractor complies with the following requirements: 1) Provides the producer with written notice of the intention to terminate or cancel the contract at least sixty days before the effective date of the termination or cancellation. 2) Reimburses the producer for the value of the remaining useful life of the capital investment items. When calculating the reimbursement amount to the producer, the contractor may take into account the producer's ability to use the capital investments in other business enterprises of the producer and the opportunity to recoup the cost of the capital investments by either sale or lease of the assets.



If the basis for the above described termination or cancellation is any of the following, the contractor may terminate or cancel the production contract without remedy.

- If the producer voluntarily abandons the contractual relationship with the contractor. Complete failure by the producer to perform under the terms and conditions of the Production Contract shall be deemed to be abandonment.
- Failure of the producer to meet the specific provisions of the contract and failure to remedy his or her default.
- Conviction of a producer of an offense of fraud or theft committed against the contractor.

SECTION 6 - ENFORCEMENT

The Attorney General is primarily responsible for enforcing the provisions of the Agriculture Production Code in the areas of contract formatting. Specifically, the Attorney General will have enforcement authority in the areas of violations of the readability provisions, indexing provisions, confidentiality clauses, and special provisions. Violations of these areas are business offenses with a fine in excess of \$10,000.00 (730 ILCS 5/5-1-2).

Through a private right of action in Civil Court, producers may recover their actual damages for a contractor's improper termination or alteration of an Agriculture Production Contract as well as the violation of the investment requirements if the claim is raised within four years after the date on which the party claiming the violation knew or should have known of the existence of the violation.

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CONTRACT PRODUCTION GLOSSARY

Capital Investment - A purchase or lease of a structure or machinery used for producing or storing a commodity required to be provided by the producer under the terms of the Production Contract if the structure or machinery has a useful life in excess of three years. Structures include, but are not limited to, swine farrowing buildings, grain storage facilities and manure storage facilities. Machinery is all equipment used for producing a commodity and includes, but is not limited to trucks, tractors, combines, wagons, augers and planters.

Commodity - Livestock, raw milk, fruits, vegetables or a crop.

Contract Input - A commodity or an organic or synthetic substance or compound that is used to produce a commodity, including but not limited to, livestock, plants, agriculture seeds, semen or eggs for breeding livestock, fertilizer, pesticides, or petroleum products.

Contractor - A person who offers, provides, or enters into a Production Contract with a producer for the production of commodities in the state by the producer.

Crop - A plant used for food, animal feed, fiber, oil, pharmaceuticals, nutraceuticals, industrial uses, or seed, including but not limited to, alfalfa, barley, buckwheat, canola, corn, flax, foliage, fruits, millet, oats, popcorn, rye, sorghum, soybeans, sunflowers, tobacco, vegetables, wheat and greases used for foliage or silage.

Forward Contract - A cash contract in which a seller (producer) agrees to deliver a specific commodity to a buyer sometime in the future. The amount paid for the commodity may or may not have been previously agreed upon.

Livestock - Includes but is not limited to, beef, cattle, dairy cattle, poultry, sheep or swine.

Person - An individual or entity, including but not limited to, a sole proprietorship, a partnership, a corporation, a cooperative, an association, a limited liability company, an estate or trust.

Produce - Means to provide feed or services relating to the care and feeding of livestock. If the livestock are dairy cattle, produce includes milking the dairy cattle and storing raw milk. Provide for planting, raising, harvesting, identity preserving or storing a crop. Produce also includes preparing the soil for planting and also for nurturing the crop by the application of fertilizers or soil conditioners, including those substances regulated under the Illinois Fertilizer Act of 1961, or pesticides as defined by the Illinois Pesticide Act.

Producer - A person who has been offered or who has entered into a contract to produce a commodity. "Producer" does not include a fertilizer or pesticide applicator, a feed supplier or a veterinarian, when acting in that capacity.

Production Contract - Any written document offered to or executed by a producer, under which the provisions of which (i) the producer would sell to a contractor, or the contractor's designee, an identified commodity or commodities; and (ii) the contractor has, or exercises some control or direction over, the production process; or (iii) any written agreement offered to or executed by a producer under the provisions of which the producer would produce, care for, or raise a commodity or commodities not owned by the producer, using land, equipment or facilities owned or leased by the producer, in exchange for payment. For purposes of this definition, control or direction over the production process includes: (i) the contractor's designation of special commodity characteristics, such as those present in value-enhanced grains or specific genetics in livestock; or (ii) the contractor's designation of a production input, such as seed variety, to be used by the producer to fulfill the production contract.