## Forage Contracts Help Ensure Payment

*by J.W. Schroeder, North Dakota State University*

Forage is the cornerstone of every lactating dairy diet. High feed prices and a late spring have delayed and diminished the availability of forage in our area. Weather losses to crops in states along the Mississippi river will only exacerbate the situation. Now is the time to plan for 2009 forage needs. Whether buying or selling, here are some key points to keep in mind as successful contracts are written.

Commercial hay producers may want to consider a contract with dairy producers. The two common questions with forage contracts are:

- How can a producer ensure payment for forages sold?
- What if the quality or quantity of the forage is significantly different than predicted?

A milk assignment or letter of credit is often recommended and is a written authorization from the dairy producer that directs the buyer to pay the forage provider from the proceeds of the milk sale. The assignment specifies the payment sum and duration of payments. A milk assignment is simple, inexpensive, and offers low risk to the provider.

A milk assignment is a voluntary service and not all milk buyers offer them. Dairy producers can terminate a milk assignment by providing written notice to the buyer. For this reason, the forage provider should consider contract provisions that require the dairy farm to provide notice if terminating the milk assignment, and additionally should require a security agreement.
A letter of credit comes from the dairy producer's financial institution. It allows the forage provider to demand payment directly from the financial institution should the dairy producer fail to pay for forage. It is a simple, low-cost mechanism for ensuring payment.

A forage provider could also take a lien on the forage or against livestock, equipment or other assets of the dairy farm to ensure payment, but it is more costly and risky for the forage provider because an attorney must prepare lien documents and enforce the lien. Some courts will not honor a lien on forage after the livestock consume the forage. In addition, other creditors of the dairy likely already will have a security interest in the dairy's assets that would take priority over the forage provider's security interest.

Installment payments are another option for forage providers. Many forage contracts align forage payments with milk sales, which allows the dairy farm to budget payments. Typical arrangements include monthly or quarterly payments, with or without an initial payment upon delivery. Even with an installment payment arrangement, the forage provider should require a security agreement or letter of credit in the event payment is not made.

Dealing with the uncertainty of forage quantity and quality creates a risk for both the forage provider and the dairy farm. Utilize forage pricing models to identify acceptable quantity and quality ranges, then adjust prices for values that are above or below the identified range. Many parties are combining price adjustment provisions with longer-term contracts to further minimize risks.