DAIRY **WOMEN'S** NETWORK

success through inspiration

Eyes Wide Open

"Negotiating a Fair Contract"

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Date **NOVEMBER 2014**

No.8 HR

OBJECTIVES

The purpose of today's workshop is to:

- Help you to decide if you are ready to consider working within a business to business rather than employed business model, and
- Show you how to negotiate good outcomes under these circumstances

You will leave the programme with:

- Increased knowledge of the different business models you could use / be involved in
- An understanding of what model is most appropriate to your circumstances now and in the future
- Identification of your objectives within their chosen business model
- Knowledge of the contract negotiation process
- The confidence to enter into discussions with potential business partners

SESSION ONE

Are you ready to take the next step...

- As a farm worker - to taking more responsibility and risk?
- As an owner – to moving away from dayv to day management?

Session Objectives

By the end of this session you will be able to:

1. Understand key terminology of a Contract from a legal and contractual perspective
2. Clearly distinguish the difference between a Contract Milker and Sharemilker and understand the advantages and disadvantages of each
3. Identify the legal requirements from a farm owner perspective (including OSH requirements for both owners and sharemilkers/CM)
4. Understand how to use budgets and accounts to determine whether the proposed Contract or Sharemilking position is viable for both parties

So what does being in a business to business model mean?

Customary Dairy Farming Business to Business Models

Sharemiling or contract milking are the names given to business to business relationships, as opposed to employed relationships that we traditionally use in New Zealand. A sharemilker carries out dairy farming work as an independent contractor in return for a share of the income from selling milk and other produce.

Business to business agreements on dairy farms are traditionally divided into three classes:

Contract Milking Agreements

The farm owner provides the herd and the contract milker is paid on the basis of an agreed $ per kilogram of milk solids produced. Because the contract milker does not receive a share of returns or profits contract milkers and contract milking agreements are not covered by the Sharemilking Agreements Act 1937 or Sharemilking Orders made under that Act.

It is important that the business to business relationship meets IRD criteria for contract milking:

- Intention of the arrangement
- The degree of control / independence (the Contract milker must have management control and flexibility, otherwise can be deemed to be an employee and the farm owner becomes liable for associated costs, PAYE, holiday pay etc)
- Ideally the contractor is a business rather than a person on their own account
- Integration test - is the contract milker integrated or an accessory to the business. The main requirement is that the contract milker is an independent contractor, provides labour, some machinery/tools.
- In a smaller herd situation, it is suggested that Contract milkers should receive at least $1.25 / kg MS otherwise they would be better off on wages.

http://www.ird.govt.nz/resources/2/5/257b390049bfafdabd73bd37e0942771/ig1101.pdf

Herd Owning Sharemilkers Agreement

Under these arrangements the sharemilker supplies the herd and the arrangements between the businesses are governed by the Sharemilking Agreements Act 1937 or Sharemilking Orders made under that Act.

Under a sharemilking agreement the sharemilker is entitled to receive a share of the returns or profits derived from the dairy farm operation. In many instances this agreement is refered to as a **50/50 Sharemilking Agreement.**

A herd owning agreement typically agrees:

- There is a contract between 2 parties and the details can be altered by mutual consent
- The farm owner provides land, infrastructure, fertilizer
- Sharemilker provides cows, labour, machinery, fuel, power
- Shared costs include: grazing, nitrogen, supplements, feed, water

Variable Order Sharemilkers Agreement

Variable order sharemilking agreements are essentially hybrid agreements where the farm owner supplies the herd and the sharemilker contributes to some costs.

These arrangements are also governed by the Sharemilking Agreements Act 1937 or Sharemilking Orders made under that Act and under the sharemilking agreement the sharemilker is entitled to receive a share of the returns or profits derived from the dairy farm operation.

A variable order sharemilking agreement typically agrees:

- The sharemilker provides labour, some machinery, sometimes a share of nitrogen and feed
- By statute, for herds of 300 cows or less the sharemilker must have a net income of at least 21% of milk payments (22 % if Fonterra dividend payments are not included)

Typical Requirements (Including Legal Requirements)		
Requirement	**Farm Owner**	**Contract Milker/Sharemilker**
Employment		
Workplace Safety		
Plant & Equipment		
Replacements		
Maintaing cow numbers		
Pasture cover at commencement		
Business Insurances (incl contamination)		
Resource Management Act Requirements		
Electricity		
Damage to Plant & Equipment		
Stock care / costs		

Two useful workplace safety websites:

http://www.dairynz.co.nz/people/legal/health-and-safety/
http://www.business.govt.nz/worksafe

What's going to Work Best for Me? Making the Numbers Work

The challenges around both contract milking and VOSM agreements are making sure that an adequate level of profit is achieved for both parties to fund growth and some lifestyle. If you are growing equity in the early stages of your career, then your plans look different to someone looking to free up retirement income or reduce their commitment to the business.

Contact Milking Rough Example

Contract milker, 200 cows @ $1.10 per milksolid (21% of $5.25k MS payout)

Income	
*200 cows * 330kg MS/cow = 66,000kg MS*	
*66,000kg MS * $1.25*	**$82,500**
Expenses	
Dairy power	*$8000*
Relief staff	*$2940 @ 21 days at $70/milking*
Rubberware	*$1200*
Bike/fuel	*$5000*
Accountant/ACC/ insurance	*$1500*
Drawings	*$40,000*
	$58,640
Surplus for tax and growth	*$23,860*

A great website to help you work through the numbers is at DairyNZ
www.dairynz.co.nz/farm/financial/budgets/opportunity-calculators-sharemilking

Share and Dividend Issues to take into Consideration

DRPA (dividend related payment adjustments)

As time moves on, the number of Fonterra shareholders paying dividend related payment adjustments (DRPA) to sharemilkers is decreasing. The reasons for this are many and varied. The key message is that this is a consideration that a sharemilker with no DRPA should fully understand and may want to negotiate different terms on costs in consideration of this. Some sharemilkers have successfully included a sliding scale, where, as the milk price increases, DRPA decreases. This ensures sharemilker income is protected, to a degree anyway, at the lower payout range.

While the owner has the right to pay/not pay DRPA, the business relationship does need to be a positive one with mutual benefits. Talk to local sharemilkers and owners who think outside the square regarding extra work carried out, growing young stock and use of management abilities across other enterprises.

TAF hooks

Now that Trading Amongst Farmers (TAF) is live there are potential areas where conflict may arise between shareholders and sharemilkers. If a Fonterra shareholder intends trading shares for units, the discussion on sharemilker payments around unshared supply has to be had up front and early on. If not, there is a risk of lower income to the sharemilker, or on the other side of the ledger, a shareholder having to pay DRPA to a sharemilker off a milk price-only payout. The smart thing to do in this area is to have had the discussion, agreed on a solution, and noted it in the contract.

This is an area that can be complex to work your way through. Speak to your accountant or someone with expeience who can help guide you through these matters if you are unsure.

The Other (Most Important) Stuff

Remember, when you are looking at a Business to Business relationship it is very different to an employed relationship and getting it right first time will ensure the relationship thrives.

Contract or sharemilking arrangements are a great way of keeping entrepreneurial blood thriving in our industry. We will face labour challenges in the next 10 years with competition from town jobs where the pathways to business ownership can look more attractive.
Many people enter the dairy farming industry with the dream of building wealth for their family and a business to business relationship is one way of doing this.

Benefits for farm owner

- Free up time and money
- Lifestyle change – less hands-on
- Succession planning

Benefits for contract / sharemilker

- Opportunity to run own business
- Responsibility of management and decision making
- Lifestyle and wealth creation

So who can help?

- Federated Farmers (0800 327 646)
  Membership $598 per year
  Members get a discount on contracts ($69.00 each). Non-member price $414.00 each.
  www.fedfarm.org.nz
- Rural Professionals who specialise in this area
- Lawyers
- Accountants

SESSION TWO

Negotiating a Good Contract for Everyone

- As a Contract / Sharemilker – what's my bottom line and what's going to work for me?
- As an owner – how do I make sure I get everything I need and make it work for everyone?

Session Objectives

By the end of this session you will be able to:

1. Identify the PROCESS required for fair contract outcomes which deliver a win/win situation for both parties
2. Clearly identify the financial implications of different contract options(for both owners and sharemilkers/ CM) including employment obligations and costs (for CM/SM if employing own staff)
3. Understand and identify where tools/resources are available to ensure a fair contract
4. Identify how it can go wrong (using relevant case studies) and what to do when it does go wrong

Any successful agreement is based on honesty and integrity. With clear goals and plans, and good communication a business to business agreement will allow both parties to grow personally and financially. Sharemilking gives a good lifestyle and it is a way to create wealth for the next generation of dairy farmers.

A Good Negotiation Process		
Stage	**What**	**Skills Required**
1. Planning	Working out the numbers Working out the implications What's the cost of this opportunity? What's my bottom line?	
2. Positioning		
3. Re-thinking		
4. Re-framing		
5. Making everyone successful		

Keys for Successful Contracts

(includes reference notes from seminar delivered by Ciaran Tully – Federated Farmers)

Communication

You need to feel confident that you can communicate with each other. All contracts are based on outcomes and assume trust and skill. The best relationships are those that include high levels of discussion, planning, trust, are based on the longer term and where each party has a mindset that the sum of the two businesses is better than the individual businesses on their own.

The Contract

- Take time to read and go through contracts in full (typically this should take several hours).
- Seek independent advice
- Discuss and note individual clauses
- Sign it

Make sure everything is clearly defined

- Expectations
- Production targets, maintenance/capital works, fertiliser, supplements policies
- Time frame
- Make sure the contract is drafted by a reputable business that knows what it is doing in this area
- Ensure there is a good disputes resolution process within the contract

Before signing

- Check infrastructure, houses, shed and stock on farm
- Do reference checks
- Remember ‘leopards don’t change their spots’

If you get into dispute

- Keep calm, use common sense
- Have a third party listen and facilitate (they don’t have to give a solution)
- Keep the issue in its simplest form
- Remember, arbitration and mediation are EXPENSIVE (90% of cases are sorted before this stage)

What can go wrong?

Case Study One

J & B Bloggs Ltd had a contract milker (Jim and Jo) on their 240 cow. Jim was the one who effectively made all the decisions and Jo was his helper – her involvement on farm was limited; she reared the calves and did the records.
Towards the end of calving Jim and Jo's relationship split up and Jim left leaving Jo to run things. Jo engaged a 17 year old to assist her. He had limited dairy farming experience and was left to milk unaided – as a result the SCC went up, production was down and the infrastructure on farm became run down…

Case Study Two

Mickey & Minnie McDonald were two years into their 50/50 sharemilking agreement on Adams Family Farm, with 230 cows. The Adams Family purchase a neighbouring block of land, and the farm could then carry 345 cows. The McDonalds were excited to be able to grow their numbers without having to move, and agreed to sign a new 50/50 contract.

When they were presented with the new contract to sign, they expected the feed requirements to have increased by 50% (the same as the cow numbers increased), however, the feed input requirements had increased by around 500% - the Adams Family had decided to also change their farming system from a low input to a very high input system. The McDonalds were faced with two options, sign the contract, or move on at the end of the season…

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