THE GIVE AND TAKE OF SHARE AND CONTRACT MILKING

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Outline

This paper examines how a well-planned and managed Sharemilking or Contract Milking Agreement (SM/CM) will generate a win-win result for both the Farm Owner and the SM/CM. The agreements covered in this paper include the Herd Owning Sharemilker, the Variable Order Sharemilker, and the Contract Milker. These agreements are all Contractors positions with the overall farm business being managed by someone who is remunerated by way of a Contract Agreement rather than an Employment Agreement.

The paper will also outline how a good Agreement should give better results than an employment agreement. The points covered are as follows:

- The Farmers objectives, policies and expectations – and how these can be met.
- The SM/CM's objectives of career growth, greater independence and the opportunity to be in business – and how these are met.
- The essential details of the main contracts in use.
- An example of a successful agreement.

This paper focuses more on why various options are likely to work, rather than a focus on a great deal of the working detail.

Background

Farm Consultants are often required to help with Contract disputes and the resultant disappointed Farmers and SM/CM's. When dealing with this, an important point to remember for all SM/CM agreements is this: "the farm owner or the farm owner's agent must retain the

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management and control of the farm, all of the farms operations, and of the management of the herd". So what then are the indicators of good and bad relationships?

Indicators of a poorly designed agreement

Typical danger signs from a farm consultancy point of view include:

- The first question often asked around a new position tends to focus on the contract rate not the details. Both parties are usually equally guilty of this. This indicates a general ignorance from both parties of how the relationship needs to work.
- Expressions like "we farm like this" from the SM/CM's are of a concern. The SM/CM is actually required to follow the Farmers policies, not the other way round.
- New SM/CM's with a recently purchased expensive vehicle and the associated sudden personal weight gain are a concern. An attitude can appear soon after appointment to that 1st Contract position, where the SM/CM believes that managing the farm from the seat of that vehicle or from the home is now the norm. Farmers and farm staff are very unimpressed by this.

Indicators of a healthy agreement

- Sound financial and personal growth of all involved.
- Improved KPI's for animal health, repro and milk production with more pasture harvested.
- The farm is kept tidy and well maintained. Staff retention and the overall feel of the workplace makes it a great place to work and to visit. The Farmers and SM/CM's are farm-proud, and are pleased to bring their friends and family onto the farm. Regular and accurate reporting and information about the farm are made available to all.

Farmers Objectives

Everyone is different. The desire of farmers as they grow older to have the time and head space to devote to a diverse range of activities (some family, some leisure and some business) is typical of all people. It is not particularly important what the desired outcome, what is important for the farm business is that it needs steady focused management. The new management structure will need to generate the following:

- Greater farming profit than it has in the past to pay for the additional costs of the smarter more focused SM/CM at least. And also to pay for any desired Farmer spending that they may wish for personal activities.
- Less hassle in the Farmers head, and at home.

The Farmer requires that the farm business must maintain a robust steadiness about it, with only occasional changes of people, rather than regular changes. Also, the farm system and policies that they have in place should not have to be changed much from what they have been. This means a minimum of new capital spending and trying out the new ideas of the SM/CM. The number of SM/CM's who simply do not get this is very surprising.

The sharemilker/contract milkers' objectives

As with Farmers, everyone has their own objectives. Typically for a SM/CM, there is a desire for the growth of net worth in both money terms and future employment value. The sense of self-worth and pride from being in charge of the management of a farm business and being responsible for generating its production and profit is huge. The opportunity for high levels of remuneration and increased equity, growth in farm management skills, and a growing reputation for making a farm produce well and look great summarises the general needs.

The opportunity to learn employment and business skills (buying and selling – employing, training and disciplining) is paramount. It is important that people are empowered to be able to make mistakes (only once), to make good profits and small losses, and learn how to cope with the repercussions.

The farmer and sharemilker/contract milker objectives – which contract?

The ideal situation for both parties allows both sets of objectives to be met. When one party is significantly advantaged over the other the relationship doesn't go well for long. It is therefore important to choose the best agreement for each situation, and know that in a few years as circumstances change the best agreement is likely to be something else.

The Contract Milking Agreement

This agreement has matured quickly in recent years. In 2011 Federated Farmers produced an Agreement that was sufficiently robust enough to determine the role of a Contractor so as to be deemed suitable for general use. Before this time many Farmers were using agreements that may have not passed the contractor test. Some of these Agreements were simply (and sometimes cynically) being used to replace employers' responsibilities for holidays, PAYE and possibly Health and Safety.

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The Inland Revenue Department describes the conditions that need to be met for an agreement to be classified as a Contractor position on its web site. These conditions are vested at the front of the Federated Farmers Contract Milking Agreement. These conditions are quite different to those of an Employment Agreement. Basically, a contractor can choose:

- How they carry out their work, but are responsible to get work done.
- They will face consequences if that work is not done, and many bring their own tools.
- They will provide for their own training and will have some risk in a business sense.

Best practice must include a carefully constructed estimate of income and expenses for the Contract Milker. A carefully prepared Farm Policy document, along with the other details of the expectations of both parties is very helpful at avoiding surprises and in particular helping control both parties costs. Anyone can draw up a contract agreement but the work done by Federated Farmers has produced a template that encourages a through relationship establishment process.

Typically, Contract Milking Agreements have the Contract Milker paying all wages, farm dairy running costs, supply and running of motor bikes, supply of reels and standards, calf rearing equipment and all loose tools and animal health gear necessary for the particular business. The addition of a tractor, feed-out gear and mowers tends to be the next addition to these Contracts. However, requiring these additional resources can reduce the pool of applicants that are able to take up the position.

Contract Milking agreements do not usually include a share in feed costs. This means that Farmers must have good monitoring systems to ensure supplementary feed and nitrogen are used in an agreed and profitable manner. Feed can be included in an agreement but it must be ALL the purchased feed and nitrogen. Anything less typically has the Contract Milker avoiding the feed they are paying a share of, and overusing the alternatives – thus potentially spoiling an otherwise good relationship and performance. The avoidance of buying feed for a new Contract Milker (and subsequently reducing milk production) can occur especially with cash strapped Contract Milker beginning their 1st season. The efficient use of feed is best managed by monitoring and planning.

Ways to make it work more easily

The first winter for a beginning Contract Milking Agreement can be difficult from a cashflow point of view. It is September before any money arrives in the bank account and even then it is not much. Some Farmers do offer to soften the start-up process by paying a set amount per month (often about 85%), of likely costs for a number of months (up to 12 months in some cases); with a balance up at the end of the season when final production is known.

How long should an agreement be set?

One year with a three year intention is popular because it generates the opportunity for a detailed review of expectations and outcomes at all levels including the Contract Milkers costs. The review and re-signing needs to be done in December to enable both parties to find a suitable alternative if that is the best thing to do.

What should it cost/pay?

The income left (Contract Milkers profit, including drawings) after all expenses including an allowance for depreciation and the cost of the Contract Milkers capital involved in the business. This pre-tax income should be significantly more than a Manager's salary in the same job because the Contract Milker is taking risks. How much risk will vary with the complexity and size of the farm. This premium for payment to the Contract Milker above a Managers salary should be in the range of $10,000 - $40,000.

The Variable Order Sharemilking Agreement

(Previously known as Lower Order Sharemilking Agreement.)

This agreement is an Order in Council and was last made in 2011. This is a Statute of New Zealand law and must be treated as such. Users of the Order may not claim it for themselves but can repackage it and distribute it how they like but not change it. The originals can be purchased from Bennetts Books, online, or easily downloaded from the Parliamentary Council Office. This agreement was prepared by Farmers and Sharemilkers with the help of Federated Farmers. If carefully and thoroughly prepared and monitored it works very well.

As it is an Order in Council it may not be changed in the way that it is used. It uses a percentage of the milk income to generate the Sharemilkers income. It is illegal to change the remuneration from paying a percentage of the milk income to paying $'s per kg milksolid. A general rule of use is that any changes must benefit the sharemilker. Attempting to change the method of remuneration to a flat rate will not benefit the sharemilker in a higher milk payout year.

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With high and low milk solid payout fluctuations, the impact on both parties can be difficult to manage. Where the remuneration range is potentially too great, a Contract Milking agreement may be the best option for a Sharemilker. However a number of agreements exist where the Sharemilker invoices the majority of the annual expenses (split monthly and paid monthly by the Farmer). With this type of VOS, the Sharemilker receives a relatively low percentage of the milk cheque for the remainder of the agreed share of income. This type of agreement can work well to include the Sharemilker in the ups and downs of dairying with minimal risk.

The advantages of the Variable Order Sharemilking Agreement

The details in the Agreement regarding dispute resolution are very helpful. Farmers find the complexity and wording of the Agreement frustrating. Particularly when determining if a Sharemilkers performance failures warrant early contract termination, and what the consequences of that will be. This situation is best avoided by careful selection by both parties and careful management of the Agreement. Accurate and comprehensive farm reporting and record keeping (along with adequate conversation about the things that have no plan or adequate policy) will mean a relationship can withstand most challenges.

Farm development and other work that might be described as the "owners" tasks

From time to time external contractors are asked to do work (capital work) that has not been planned. Whether this work will add cost to the Sharemilker by way of wages or other running costs needs to be checked by both parties before this work is undertaken. Conversely, a Sharemilker can operate as the complete manager of a farm, carrying out development tasks and monitoring expenses and managing the farm expenses budget. There is no problem with this arrangement under any of the Agreements so long as the costs associated with this work are covered, and the details of expectation covered by KPI's and farming plans.

Herd Owning Sharemilking agreements

Traditionally these were all 50/50 agreements, and have been a very important driver of the growth and development of our industry for more than 75 years. The Sharemilking Agreements Act was passed in 1937. This Act has enabled dedicated and skilled families to become farm owners in a way unique to New Zealand. In the last decade as farm sizes and capital structures have changed the number of pure 50/50 agreements has declined sharply. There is plenty of comment about this in the public domain and not part of the brief for this paper.

The agreements available for purchase from FarmWise and Federated Farmers are very robust and are not the problem. They work well, and allow for the % to be different to the standard 50/50 if appropriate. An agreement can be very flexible and include or exclude many aspects of who does what. But normally the Sharemilker provides the herd and all the plant and machinery to run the farm. This frees up the Farmers capital, and gives then time to perhaps go and live elsewhere and/or participate in whatever off farm activities suits their needs.

Making agreements work

All SM/CM Agreements are better prepared if a third party such as an experienced Farm Consultant is used to help draw up the detail of the agreement. It is important that the Farm Consultant is called in from time to time to check in with the parties to ensure that what was intended is actually still occurring. Relationships at this level will have tension at times. Both parties are learning how to run the Agreement and there are situations that occur that make life awkward (drought, flood, sickness, finances, death and divorce to name the more dramatic things).

At times, things occur that are outside the scope of the Agreement. As a rule, any expectations are simply emotions until they are written down. Changes to policy or deviation from any points in the Agreement can be worked through if they are advantageous to both parties. In all things, decisions are brought back to normal farming practice, and fairness. Each party is prepared to give and take.

As in all relationships, sometimes things go wrong. It is important to remember to act fairly, and to also act like a grownup. People do make mistakes on both sides, and there are times when it is necessary to forgive a transgression so that both parties can move on together.

So why do some agreements fail?

There are two separate roles in all Agreements and business – Governance and Management.

1. Governance – this is the Farmers role. They set the farm policy to provide the guidelines for the SM/CM to manage the farm business.

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2. Management – this is the SM/CM's role. They manage the farm business under the policies and guidelines outlined by the Farmer.

In most agreements where there is good communication, the Farmer will seek the opinions of the SM/CM when policies need to be reviewed. Typically, agreements fail due to a lack of communication, or miscommunication. More often than not, the policies of the Farmer are not communicated effectively to the SM/CM at the start of the agreement.

To build a productive relationship, it is important that the Farmer has a comprehensive Farm Policy document, and that it is made available to the SM/CM. Included in the Farm Policy document should be Key Performance Indicators such as mating targets, Somatic Cell Count levels, productivity targets etc. Ideally the Farmers policies should be available or discussed at the initial interview stage to gauge compatibility between the parties.

Often, the SM/CM may not actually agree with the policies that the Farmer has in place. It is not the role of the SM/CM to set farm policy. If the farm policy in question was in place when the SM/CM took the role and they were not happy with it, one should question why they took the role. However, if the Farmer wishes to change a Farm Policy, then it is important that this is discussed fully (this would happen in a sound relationship) – particularly if this change in policy will affect the potential remuneration levels or workload of the SM/CM.

If there is debate or confusion about issues of farm policy, it can usually be solved through communication with a suitably qualified and neutral 3rd party. However, if no agreement on issues of farm policy (or any other issues) can be reached, then it is best for the Agreement to terminate at its noted natural conclusion date in the agreement.

Selecting the right sharemilker/contract milker or owner

Always select the person before the reputation or qualifications. In many cases, Agreements fail simply because the two parties don't "get on". There may be a lack of respect, a lack of trust or perceived lack of trust, or it may be that one party always wants to get a small victory, win or "cheat" over the other party.

Both parties must feel comfortable with the other, and have a mutual feeling of trust. Each party must ask the right questions, and also check the references offered. It is good practice to have 3rd party involved in the selection and interview process, so that they can judge whether there is a suitable "fit" of personalities.

Sharemilking agreement case study

Bruce and Jocelyn Palmer (Farm Owners); and Jason Macbeth and Beth Phillips (Variable Order Sharemilkers 2010/11 to present); based in Murchison.

Bruce and Jocelyn moved south to Nelson in 2004 to purchase a sustainable dairy farming business at a reasonable price. Their goal has always been to grow that business by harnessing youthful enthusiasm, and providing opportunities for keen upcoming young farmers to also prosper and grow their own businesses.

Jason and Beth won the 2013 Farm Manager of the Year in 2013. Their goal is to grow equity to become 50/50 sharemilkers, and eventually own their own farms.

Both parties work well together to achieve mutually inclusive goals. It is a symbiotic relationship where one party uses the other in a mutually satisfying way.

Palmer Property – physical description

- 91 ha effective dryland, 150 m asl.
- 290 Crossbred cows
- 24 aside herringbone
- 90 cows wintered on, all young stock grazed off on supporting runoffs
- Silage from supporting runoffs, 8 ha summer turnips/chicory, and 160 t PKE bought in.
- Cows milked 2AD till summer crops, then 3in2 till mid-April; then OAD till end May.

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Table 1. Palmer property production history 2002-15

Season	Total MS	MS/Ha	MS/Cow
2002-3	94,403	1,037	337
2003-4	105,899	1,164	385
2004-5	106,411	1,169	373
2005-6*	109,769	1,206	385
2006-7*	111,528	1,226	391
2007-8*	111,534	1,226	391
2008-9*	120,307	1,322	430
2009-10*	116,169	1,277	415
2010-11*	100,775	1,107	359
2011-12*	121,929	1,340	435
2012-13*	124,409	1,367	437
2013-14*	136,271	1,497	478
2014-15♣	140,000	1,538	483

District Average = 1,060 MS/ha & 360 MS/cow
*Owned by Palmers; ♣Estimated Production 14/15.

The Palmers have owned their Murchison dairy farm since 2004 (10 seasons). With the careful employment of motivated and highly skilled Sharemilkers, the Palmers have steadily increased both per cow and per ha production. During this time, they have also purchased a large runoff and now live off the dairy farm.

The property is summer dry, with daytime temperatures reaching into the mid 30's for extended periods. Summer crops such as turnips and chicory are grown to provide additional feed during this time. At this stage in the lactation (typically late December/early January), the cows are placed on 3 milkings in 2 days (3in2) with no significant production decline.

Mating management requires the identification of non-cycling cows by the planned start of mating. At this stage, all non-cycling cows (typically 50-60 of 290); are drafted off, milked OAD, and run separately with high BW and DNA tested Jersey bulls. At the end of 4-5 weeks of AI, all cows are put back together on 2AD with the bulls for a total of 8-9 weeks mating. Empty results range from 4-11%, with a 91%; 6 week in calf rate recorded for this year. Last year the mid-point for calving was 8 days. Typically 60 replacements are kept (20.6%). All heifers are mated to Jersey bulls of similar quality to the main herd. By using this mating programme, significant numbers of recorded crossbred heifers are produced.

The relationship

In the period that they have owned the property, the Palmers have employed four sharemilkers, including their 1st Sharemilkers inherited from the previous farm owners. All of these Sharemilking Agreements have been based upon the Variable Order Sharemilking Agreement. These agreements have been negotiated between both parties, with the percentages and/or any stock policies negotiated to suit an agreed methodology of remuneration.

The property typically has 300 in-calf cows wintered, to satisfy Clauses 40 and 41 of the VOS Agreement, where the percentage negotiated can be less than 21% for the Sharemilkers labour. At a $6 payout, and 135,000 MS (and with the expenses as below); this would require a payment of 32% of the milk cheque to the Sharemilker. This level of payout would be outstanding for the Sharemilker, but uneconomic for the Farmer. Instead, an alternative system involving stock payment is used. The Sharemilking Agreement is structured as below:

- The Sharemilker receives 25% of the milk cheque (excluding dividend).
- The Sharemilker can rear extra heifer calf replacements from the heifers, non-cycling cows and late calving cows (up to 100 calves in total) on milk powder. When these calves are weaned at the end of December, they are 100% the responsibility of the sharemilker.
- The Sharemilker can buy 20-30 carryovers to graze rougher areas of the runoffs as further remuneration.
- The Sharemilker is to provide the basic farm Machinery to run the farm (tractor, silage wagon, mower, nitrogen applicator, ute etc)
- The Farm Owner is 100% responsible for payment for new grass and base fertiliser applications, and will pay for Contractors as required.
- Harvesting, forage crops, and purchased feed are all shared at the Agreement percentage of 75% - 25%.
- Nitrogen, cow and heifer replacement grazing are paid 100% by the Farm Owner.

The structure of this agreement works well for both parties. The Sharemilker has the opportunity to build equity significantly faster from stock, than from receiving a greater

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percentage of the milk cheque. By paying a lower percentage and topping up remuneration with the offer of high quality stock, the Farm Owner can afford to hire very skilled Sharemilkers. Together, with give and take, both parties are able to grow their businesses.

Why does this agreement work?

This agreement works due to communication. They have an overarching general policy of "no surprises". They have regular meetings with their FarmWise Consultant to review performance, look at opportunities, and to plan policy and management for the coming weeks. The Owner and the Sharemilker also meet regularly on farm (usually informally) throughout the week as tasks are undertaken. Whenever there is a point of contention, it is openly discussed. Give and take is the goal. If the problem is outside the norm, or they want a second opinion, they contact their FarmWise Consultant for input. All decisions are brought back to the Agreement.

Summary

With all Agreements, it is important that a climate of "no surprises" is maintained between the parties. The Farmer must have a Farm Policy document in place, and make this available. The SM/CM must always be aware that the Farmer sets the policies, and it is the SM/CM's role to carry out those policies. When there is a positive relationship, the Farmer should always include the SM/CM in refining those policies. Otherwise, expectations will become emotions.

Always select the person before the qualification. Having a SM/CM run a farm for a Farmer is like a marriage. They must be compatible or there will be a messy divorce. When selecting people or a position, do your homework. Get a 3rd opinion and professional help such as your Farm Consultant to aid in the selection process. Use these same people to help guide the relationship, to ensure that the rules are followed, and the Contract runs smoothly. If these things are done well, then all parties will achieve their goals and objectives to the highest standard. It's all about give and take.