

# ***GRAIN CONTRACTING: KNOW THE FINE PRINT***

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Why do farmers and grain buyers  
contract?

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# Why Study Contract Provisions?

- Contract provisions vary considerably across different commodities.
  - Contract provisions vary considerably across companies within the same industry.
  - Contract provisions change every year.
  - There is a concern that some farmers focus on contract price and don't study the other contract terms.
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# Key Functions of a Contract

- Divide Value
    - Price is only one element of value.
  - Divide Control Rights
    - Who has authority to make decisions concerning actions which influence value?
  - Divide Risk and Uncertainty
    - Who is exposed to the outcome(s) of various adverse events?
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# *Economic* Considerations

- Any transaction must be a (potential) “win-win” proposition.
  - Considerations which are of greatest importance when the contract terms or transaction provisions are designed, agreed upon and executed.
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# *Legal* Considerations

- Considerations which are of greatest importance when the contract terms or transaction provisions must be verified by an independent third party and/or disputes must be resolved.

# Dividing Value from Exchange

- Assigns a price or pricing formula.
  - Fixed Prices
  - Price relative to specified futures market
- Specifies time and location for exchange.
- Specifies timing of payments.
  - Lump sum
  - Sequential over time

# Dividing Control or Decision Rights

- Who is responsible for making decisions which impact value?
- Crop Contract Examples:
  - Choice of seed varieties
  - Choice of herbicides or production practices
  - Choice of deliver locations and timing



# Dividing Risk & Uncertainty

- All contracts are *incomplete*.
  - Contracting parties cannot anticipate all possible events.
  - What does the contract specify?
  - What do we do if something happens which is not included in the contract?
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# Dividing Risk & Uncertainty

- The longer the contract duration, the greater the uncertainty.
  - Measurement of key quantity and quality characteristics can create challenges.
    - Objective Measurement vs. Subjective Measurement
    - Can measurement be verified by an independent third party?
  - Price variability
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# Options for Unexpected Conditions

- Execute the contract.
  - Renegotiate or amend the contract.
  - Utilize arbitration or mediation.
    - May be included in the contract.
  - Bring into the court system.
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# General Classes of Crop Contracts

- Marketing Contract
- Production Contract
- Definitions are very broad and there is not a clean division between the two.

# General Classes of Crop Contracts

- Marketing Contract (purchase agreement)
  - Focus is on establishing price, quantity, and quality for a specified commodity to be delivered in the future.
  - Producer (seller) has wide discretion concerning production practices.
  - Typically used for crops already produced.

# General Classes of Crop Contracts

- Production Contract
  - Establishes price for a specified commodity which is to be produced and delivered in the future.
  - *Buyer* includes provisions concerning appropriate production practices.

# Contracting Systems

- Processor  $\rightarrow$  Grower:
  - Grower delivery directly to processor
- Processor  $\rightarrow$  Grower (local delivery):
  - Grower delivery to local elevator, with re-delivery to processor
- Processor  $\rightarrow$  Elevator  $\rightarrow$  Grower:
  - Grower contracts/delivers to local elevator, with re-contract/re-delivery to processor

# Key Contract Considerations

- Quantity:
  - All production on specified acres.
    - Full Production Contract
  - Fixed production on specified acres.
    - Partial Production Contract
    - Example: Max. of 1,000 lbs./a. (first units)
  - Specified number of bushels, pounds or tons of production.
    - Example: 12,000 bu. of malt barley



# Key Contract Considerations

- Quantity:
  - If fixed quantity, how will production short-fall be covered?
  - Can production from another field be delivered?
  - Can seller deliver another individual's (ex. neighbor's) production?
  - Are service fees charged if buyer must fill contract shortfall?

# Key Contract Considerations

- Quantity:
  - If fixed quantity, how will contract **over-run** be handled?
  - Is there a “right of first refusal”?
    - Usually requires written authorization.
  - How will contract over-run be priced?
  - Are there fees for re-delivery?

# Key Contract Considerations

- Act-of-God Clause (*Force Majeure*):
  - Provides seller and buyer an exit provision due to drought, flood, fire, pests, strikes, etc.
  - Does not excuse poor management.
  - Seller usually required to deliver available production.
  - Seller must give notice to buyer in writing, usually within 10 days of event.

# Key Contract Considerations

- Act-of-God Clause (*Force Majeure*):
  - How is prevented plant handled?
  - Is replant of another crop allowed?
  - Are multiple fields (land tracts) treated individually or jointly?

# Key Contract Considerations

- Quality Specifications:
  - Min. standards should be detailed.
    - USDA (FGIS) Standards
    - Buyer Specific Standards
    - MRL – this is an emerging issue!
  - Objective measurement criteria recommended.
  - Be cautious of “visual inspections”.
  - Act of God clause usually does not apply to quality issues.

# Key Contract Considerations

- Quality Specifications:
    - Quality specifications for rejection or price adjustments.
    - Price adjustments (premiums and discounts) usually determined at time of delivery.
    - What happens if delivery is delayed?
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# Key Contract Considerations

- Quality Specifications:
  - Is quality averaged across all deliveries or applied to each load?
  - How long does buyer save samples after delivery for re-testing?
  - Should seller save samples?
  - Can seller deliver production from another individual (ex. neighbor)?

# Key Contract Considerations

- Quality Specifications:
  - Buyer's options for dealing with quality variability:
    - Blend
    - Clean or Sort
    - Segregate
    - Reject



# Key Contract Considerations

- Time of Delivery
  - “At Harvest” – When does harvest begin and end?
  - General period – “First half October”
  - “Buyer Call” – at buyer’s discretion; seller usually provided with delivery window.
    - Are storage payments made?

# Key Contract Considerations

- Delivery Location (FOB)
    - The local elevator.
    - The processor's facility.
    - Designated receiving site.
  - Will this impact harvesting efficiency or conflict with other farm operations?
  - Will this impact on-farm storage capacity?
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# Key Contract Considerations

- Time of Payment
  - After contract is fulfilled and all deliveries have been made.
  - Can be different from delivery dates.
  - May be split or sequential payments.
  - *By accepting payment, seller is agreeing that contract is fulfilled.*

# Key Contract Considerations

- Dispute Settlement:
    - Mediation – A neutral third party reviews dispute and renders opinion, but is not binding.
    - Arbitration – A neutral third party reviews dispute and renders binding resolution.
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# Key Contract Considerations

- Dispute Settlement:
  - Use the court system.
  - Who pays dispute settlement fees?
  - What damages can be included?
    - Difference in price, plus fees
    - Lost business activity
    - Punitive damages

# Key Contract Considerations

- Counter Party Risk
  - What happens if one of the parties does not fulfill their contractual obligation?
- It depends upon the cause – Examples:
  - Large scale quantity or quality shortfall
  - Changing market conditions
  - Insolvency and/or Bankruptcy
  - Breakdown in sequential sales
  - Purchased by another company

# Key Contract Considerations

- Reputation is important!
  - Are you easy to do business with? (timely and flexible)
  - Are you firm, but fair?
  - Some buyers include contract provisions that may not be enforced, but are included to add “teeth” to the contract.
  - All buyers interviewed had a list of farmers they would not do business with again.

# ***QUESTIONS & COMMENTS?***

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