Analyzing the Risk in Grain Marketing and Production Contracts
By Danny Klinefelter

Until recently, the use of marketing and production contracts for grain has been primarily limited to seed production. But genetic breakthroughs are causing that to change rapidly. In many areas of the U.S., producers and lenders are going to have to consider the associated risks as a major part of their business and credit analysis. The following questions draw on the work of Neil Hamilton and two surveys of contract growers as a means of summarizing some of the major issues involved.

1. How much will production costs increase? This could be in the form of higher priced inputs, more intense production practices, increased handling or storage costs, and investment in specialized equipment or facilities.

2. What is the potential for lower yields or greater yield variability?

3. If an investment in specialized equipment or facilities is required, does the length of the contract or the assurance of the relationship continuing match the repayment period required to finance these assets?

4. How financially sound and ethical is the contracting entity? A bankrupt contractor or a product for which there are a limited number of alternative markets could result in significant losses.

5. Is the contract for a specific quantity or for the production on a specified number of acres? What is the penalty if the grower does not produce a sufficient quantity to fulfill the terms of the contract? Does the contract include an Act of God clause excusing weather or disease problems?

6. How much will the grower be paid under the contract? Is it a fixed amount or is the amount based on a premium relative to some base price? If there are quality discounts or bonuses, how are they determined and who determines them? Some contractors have increased or decreased scrutiny depending on supply and demand conditions.

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7. What is the nature of the legal relationship being created? Is the grower an independent contractor, an employee or a joint venturer? What is the potential liability? What legal recourse does the grower have in the event of nonperformance on the part of the contracting entity?

8. When does the title to the crop pass? Is it at the time of planting, at harvest, at delivery or upon payment? Does the grower ever have legal title? This issue can affect the grower’s rights in event of contractor default, as well as the rights of landlords and lenders financing the crop.

9. When will the grower be paid? Is there a fixed date or point in the process? Are there potential payment delays and for how long?

10. What contract terms must the grower satisfy before performance is complete? What are the breach of contract clauses? What records must be maintained in order to prove compliance?

11. How will any disputes be resolved? Does the contract require mediation or arbitration? Which state’s laws apply?

12. Does anything in the contract allow the contracting entity to alter the contract terms after the agreement has been entered into?

13. What is the basis for termination or renewal of the contract?

14. Can the contract be assigned and who has to approve?

15. Are the points of delivery, such as an elevator, conveniently located and can the grower be assured of reliable testing and segregation of the product to assure he is fairly treated based on the quality of the product delivered?

16. Where inputs, such as seed and chemicals, are bundled by the contracting entity, can the grower be assured of timely delivery and is he protected against a cost squeeze?

17. Are there any assurances that the price premium will not be reduced in subsequent contracts? This is a particular concern where an investment in specialized capital assets is required?

18. Will landlords increase rental rates if the grower enters into a
contractual arrangement?

19. What restrictions are placed on the sale or use of the crop if it is not purchased under the contract? Can it be sold to someone else? Can it be used for seed? Does the contracting entity have to release its claim before the crop can be used or sold?

20. Are there specific delivery timing windows? What happens if weather delays the grower in harvesting the crop or delivering out of on-farm storage.

21. Does the contracting entity have the right not to purchase the crop even if it meets the contract’s specifications? “Passed acres” clauses are very common in vegetable crop contracts.

22. How will the contracting entity react if the grower joins a grower alliance or collective bargaining group? Many contracting entities have moved out of areas where growers have organized.

23. If new contracts are to be offered for expanded production in a specific geographic areas, will existing growers be given the first opportunity for the new contracts? Once contract production has become accepted in an area, competition among prospective growers has been one way contracting entities have been able to reduce premiums.

24. Once the contracting entity achieves its volume objectives, will it attempt to concentrate production into the hands of a few of its best growers?