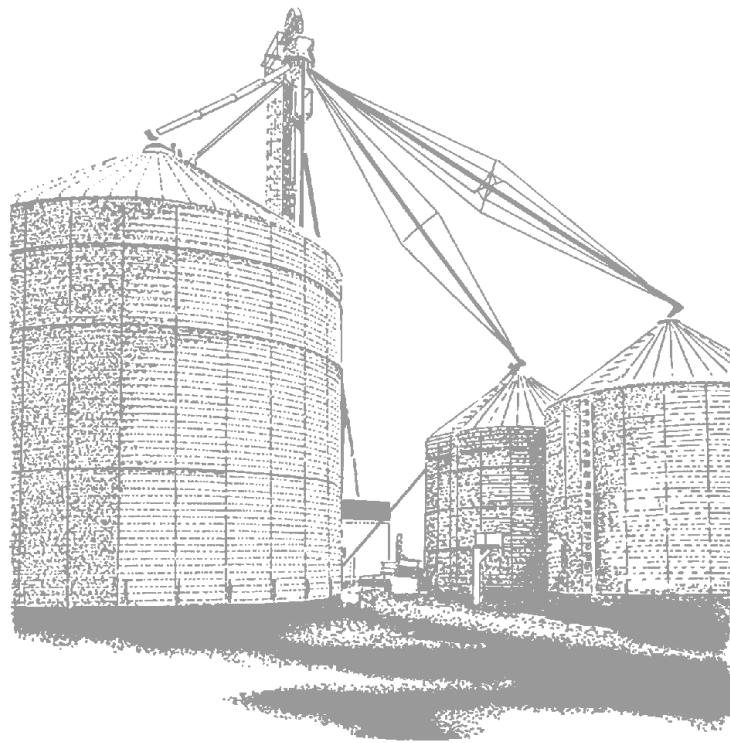




Checklist for Grain Production Contracts

**Prepared by the Missouri Farm Bureau
Task Force on Production Contracts**

**In cooperation with the
Missouri Attorney General's Office**



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Introduction

The following guide is intended to familiarize you as a producer with various questions and concerns regarding contract production of agricultural commodities. Before entering into such a contract, it is advisable for the producer to have any and all documents reviewed by an attorney. Nothing herein is intended to constitute legal advice, nor is the purpose of this guide to promote or discourage producers from entering into production contracts. Rather the purpose is to help producers make informed decisions.

The changing structure of agriculture, combined with the necessity for producers to take a greater role in managing their own risks, has encouraged many farmers to examine their options, opportunities, risks, and responsibilities with production contracts. Production contracts are agreements to produce crops and livestock, which are signed before seed is planted or before animals are produced. The exponential growth in production contracts, as a means of added revenue, has subsequently exposed many producers to risks they have not consciously identified and developed plans to manage. While production contracts offer a wide range of advantages for both the buyers and sellers of specialty crops and livestock, there are downside risks as well. It is the intent of this document to help producers identify risks in contracts and become aware of the need to manage those risks.

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Remember...

- Generally speaking, a contract is written by the contractor to protect the corporate entity. In a broad sense, contracts are set up to minimize the contractor's risk and maximize their profits.
- Always calculate the cash flow to your operation created by the contract. Will it cover debt retirement and still provide additional funds for family living expenses?
- Your questions may be satisfactorily answered before you sign a contract but not afterward. Understand all aspects of the contract before signing.
- Don't sign a contract you do not like hoping to negotiate better terms later.
- Document everything you do.

Grain Production Contracts

Producers of grain under contract may be at risk of losing farm program benefits if they fail the beneficial interest tests applied by the Farm Service Agency (FSA). That regulation requires producers to have a “beneficial interest” in the grain that is stored under Commodity Credit Corporation (CCC) regulations while the producer applies for a loan, loan deficiency payment or plans to use the grain to settle a CCC non-recourse loan. In other words, a producer must have title to the grain, but he may not actually have that title under terms of many production contracts and consequently may lose eligibility for farm program benefits. FSA has not ruled that production contracts make producers ineligible for farm program payments; however, USDA requirements for ownership certainly appear to conflict with the title provisions of many production contracts. Producers should also check with FSA to see if the contract crop they will be growing is classified as a fruit or vegetable and if it will affect their eligibility for farm program payments.

Loss of farm program benefits because of production contract provisions must be calculated into the payment provisions of the contract or the producer is ignoring the loss of significant income on program crops. In the same manner, producers may not retain “insurable interest” required by the Federal Crop Insurance Corporation if the crop is being produced under terms of many current contracts.

Producers of grain sold on contract need to be aware of the protections afforded them by the Missouri Grain Dealer and Missouri Grain Warehouse Laws. To determine if these protections are applicable, you will need to determine if the person with whom the contract is being written is a licensed grain dealer or licensed grain warehouseman and if the transaction is a sale of grain or a contract for services rendered.

An increasing amount of grain produced under contract has special traits that have been genetically developed to provide an added value to the grain. This is considered to be intellectual property and is subject to patent protection which seed companies strongly guard. Seed companies wanting to expand their supply of seed stock will contract with producers for “grow out.” However, if producers save some of the seed and plant it, the company is losing the benefit of its patented genetics. To protect their investment, seed companies will claim rights under terms of the U.S. Plant Variety Protection Act or the Plant Patent Act.

Dozens of alliances between seed and food processing companies have resulted in specialty grains being available for producers to grow with the opportunity for additional profits. Such production contracts may involve high oil corn, white corn, food grade soybeans, popcorn, or certain kinds of wheat with special milling and baking qualities.

Grain production contracts might include:

1. **Identity-preserved**—usually grains, such as organically produced grains or those with special traits needed in livestock feeds.
2. **Specialty crops**—production of untraditional crops, such as food grade soybeans, white corn, popcorn, and other crops with niche markets.
3. **End-use tailored varieties**—usually grains genetically designed to provide special traits, such as low saturated fat soybeans for

the consumer market, high oil corn for poultry feed markets, and others with a genetic value added.

4. **Value-added production**—any commodity that sells for a premium price based on a physical change in the commodity made by the producer.
5. **Composition-based grain marketing**—usually a grain which is sold on the basis of its nutritional components, such as evaluating soybeans for oil and protein content, the starch content in corn, or the protein content in wheat.

Grain Contract Checklist

A. Consult Experts. Before committing yourself to this contractual obligation, be absolutely sure you understand the entire document.

1. Other Producers
 - Talk to other producers who have had experience with contracts. They may be the best source of advice.
2. Attorneys
 - If you do not fully and completely understand the legal terms in the contract or the legal consequences of the contract, then you should consult an attorney.
3. Financial and Technical Experts
 - If you do not fully understand the financial or tax consequences of the contract, then you should consult your lender, a tax professional, the Extension Service, agricultural consultant or others.
4. Farm Service Agency
 - If you do not fully and completely understand the Farm Program consequences as a result of the contract, then you should consult your local Farm Service Agency office.
5. Crop Insurance Professionals
 - If you do not fully understand the responsibilities and consequences of crop insurance as a result of the contract, then you should contact a crop insurance professional.

B. Production Issues

1. Facilities and Equipment
 - a) Does the contract require you to make investments in equipment or facilities?
 - b) Will the cash flow of the contract cover debt retirement and provide additional funds for family living expenses?
 - c) Is the duration of the contract adequate to recover your investment?
 - d) Is special drying, storage, irrigation, or other handling equipment needed? Does this equipment require extra management, fuel, utilities, or repair?
 - e) Can the contract be terminated before your investment is fully recovered?
 - f) Does the contract require your facilities or equipment to be approved or certified? Is special calibration needed?

- g) If identity-preserved grains are involved, then will you need special storage and handling facilities?
- h) Will required segregation of each grain variety create storage problems?

2. Production Costs

- a) Do you know your costs of production for the crop involved? If not, then you should consult the Extension Service or others for estimated costs of production.
- b) Do the requirements of the contract increase the production costs above those normally expected?
- c) Are you required to buy inputs from a certain source?

3. Yield/Production Penalty

- a) What is the expected yield of the crop involved?
- b) If specialty grains are involved, then is the projected yield less than one would normally expect?
- c) Will the contract premium you receive for the crop make up for any reduction in yield?

4. Growing Obligations

- a) Are you able to comply with the growing obligations in the contract? Are you willing to comply with these obligations and give up certain decision-making freedom on how, when, and where to grow crops?
- b) Is a specific pest control program required?
- c) Is the hybrid involved herbicide susceptible or resistant? Is the hybrid involved insect susceptible or resistant?
- d) Is a particular fertility program required?
- e) Do you need to maintain a distance from other crops to prevent cross-pollination or other adverse effects?
- f) How much crop residue is left from this crop and how does that impact your conservation compliance plan?
- g) What authority does the contractor have to enforce growing obligations?
- h) Can the contractors enter your land and do work on the crops? If so, who is responsible for any damage to crops or property? Who is responsible for personal injury and liability of contractor employees who come on your property?

C. Payment and Delivery Issues

1. Payment Terms

- a) How are you being paid? Are the terms of payment clear?
- b) If you are being paid on the price of the grain, then how is that price established? Is the established basis the Chicago Board of Trade or is there a different pricing method?
- c) When is the grain priced? Can the grain be forward priced?
- d) Who, in fact, markets the grain?
- e) Are corn or soybean check-off funds collected on the grain?
- f) Is the schedule of payments firmly set? Does this schedule satisfy your cash flow?

2. Premiums\Bonuses\ Condition of Crop

- a) If there are premiums or bonuses involved, how are they calculated and when are they paid?
- b) Can you examine the calculations used to determine these premiums or bonuses?
- c) What does the contract require as to the condition of the grain such as moisture, foreign material, test weight, oil content, protein content, etc.?
- d) Has the Federal Grain Inspection Service established quality standards for this grain and these factors? If not, what standards are used? Can you achieve those standards?
- e) What about aflatoxin and other mycotoxins? Is this grain mycotoxin resistant or susceptible? What are the mycotoxin limits under the contract?
- f) Who conducts the quality tests and when?
- g) If you disagree with the test results, can you get a third-party, independent test? How are conflicting test result disputes resolved?
- h) What are the penalties for quality non-compliance? How is the amount of the penalty determined? Is it set in the contract language itself or is it determined at the time of harvest?
- i) Are you penalized if the quality non-compliance was caused by adverse weather conditions or other factors out of your control?
- j) Who bears extra costs incurred to achieve quality compliance (such as extra drying to achieve test weight)?
- k) Does quality non-compliance on a portion of the crop result in penalties on the entire crop involved in the contract?
- l) If the grain is rejected as a specialty grain, can it be sold in the open market as regular grain?

3. Amount of Production

- a) Are you required to deliver a set amount of grain under the contract?
- b) What is the penalty for failing to deliver this amount?
- c) Do you have to find substitute supplies to fulfill the contract if you have a shortfall?
- d) Are you responsible if the shortfall is due to an "Act of God," such as weather, insects or plant disease?
- e) If the weather prevents planting, can you make adjustments in the number or location of acres? Are there trigger dates for these adjustments?
- f) Are you responsible if the shortfall is due to production decisions you did not make (such as fertility or pest programs)?
- g) Under Missouri law, you may be able to be excused for a breach of contract because of local crop failure if the contract specifies the output of particular tracts of land. Does this contract list and specifically describe the fields on which the crops are to be grown? Does this contract require you to deliver the output of those particular tracts of land or does it measure your performance by some other standard?

4. Delivery Site/Delivery Date

- a) Where is the crop to be delivered?
- b) If the delivery location changes, who is responsible for the additional transportation costs?

- c) Are there any special handling procedures?
- d) Who pays for the delivery to the site?
- e) Is the date of delivery specified in the contract? If not, who sets the date?
- f) Is the contract a “buyer’s call”? If so, how much notice is the contractor required to give?
- g) What is the penalty for late delivery? Early delivery?
- h) What if late delivery is due to circumstances beyond your control?

5. Payment Date

- a) Will you receive payment upon delivery of the grain or in a specified number of working days after delivery?
- b) If payment may be made after delivery, what guarantee of payment do you have?

6. Ownership of Crop/Risk of Loss

- a) Who owns the crop?
- b) Usually the party with title of ownership bears the risk of loss. Does the contract modify this rule?
- c) Who bears the risk of loss of the crop in the field, in storage, or in transport?

7. Grain Dealer License Status/Grain Dealer Bond

Generally, a person who buys grain from producers in Missouri must be licensed as a grain dealer under Missouri law. Every person licensed as a grain dealer shall have filed a surety bond for the benefit of all persons selling grain to the grain dealer. For a further explanation of Missouri Grain Dealer Law contact: Missouri Department of Agriculture, Grain Regulatory Services, P.O. Box 630, Jefferson City 65102-0630, Phone 573-751-4112.

- a) Is the contractor a licensed grain dealer?
- b) Is this contract a sale of grain? Or is the contract to pay you for services rendered? (Payment for services rendered may be tied to bushels produced, without the transaction being a sale of grain.)
- c) Is the price established at or before the time of delivery? If not, does the contract provide that the transaction becomes a credit sale of grain at that point? (Not all credit sales contracts are covered by the surety bond.)

8. Liens

A producer may be able to place a lien on crops grown under a contract but no Missouri statutes specifically authorize such a lien.

- a) Does the contract prohibit you from granting liens or security interests on the crop to a third party such as a landlord, lender, or supplier?
- b) Will you as a producer be able to obtain a lien on the crop that is superior to all other liens? What are the legal requirements for preserving the lien?
- c) Does the contract prohibit you from discussing your contract with others?
- d) Does the contract request or require you to “waive” statutory provisions in order to be accepted by the contractor?

9. Contractor Credentials

- a) If you have concerns about getting paid under the contract, will the contractor provide you with a

financial statement or a list of producers the contractor has contracted with in the past?

- b) Is the contractor bonded for this type of obligation?
- c) Does it appear that the contractor is committed to contracting in the region? Has the contractor made investments in fixed assets or relocated management to the region? Is contracting the contractor’s core business?

10. Your Credentials

If the contractor has questions about your ability to perform the contract, are you willing and able to give the contractor a financial statement and names of individuals who will verify your financial stability and management abilities?

11. Parent Company Responsibility

If the contractor is a subsidiary company, then does the contract make the parent company responsible for payment if the contractor defaults?

12. Genetically Modified Organisms (GMOs)

- a) Does the contract require you to plant GMO seed?
- b) Has the GMO seed identified in the contract been approved for use in foreign markets, including the European Union (EU)?
- c) What is your delivery point’s (local elevator or co-op) position with regard to taking fall delivery of GMO products? On what terms will your delivery point take delivery of GMO products? Will your local delivery point commit in writing to terms under which it will take delivery of GMO products?
- d) If the contract requires you to plant non-approved GMO products, what ability do you have to look to the contracting company for any kind of compensation should you incur economic losses as a result of planting that seed?
- e) Who pays the testing cost? If there is a dispute, can the grain be tested by a neutral party? Who pays the additional testing costs?
- f) What are the terms for certifying the product you deliver to be either non-GMO or approved GMO?
- g) Does the certification include language that places responsibility on the farmer for any potential liability resulting from the detection of non-approved GMO products later down the line? Does the producer’s liability for purity continue after the grain is delivered?
- h) Is there potential for development of a two-tiered market or price structure?
- i) What is the possibility that foreign countries other than the EU may address the GMO issues in the future?
- j) What is the possibility that users other than the grain processing industry may take a position in the future concerning the use of GMO grain?

D. Other Legal Issues

1. Dispute Resolution

- a) Does the contract require alternative dispute resolution such as mediation or arbitration before the parties can go to court? Mediation is negotiation

between you and the contractor facilitated by a neutral third party. Arbitration is a process wherein a third party arbitrator hears the dispute like a judge and renders a decision that is usually binding on the parties without the opportunity for appeal. Both mediation and arbitration are generally less costly than litigation, but arbitration is generally more expensive than mediation.

- b) Does the contract specify how the mediator or arbitrator is selected? Who pays for their services?
- c) Does the contract identify special rules under which the mediation or arbitration shall occur? For example, will the arbitration be conducted according to the National Feed and Grain Association's rules? How will any special rules affect you?

2. Termination of Contract

- a) Under what conditions can the contractor terminate the contract?
- b) Who determines whether those conditions are met? Are there objective standards or is it at the discretion of the contractor? For example, can the contractor terminate the contract if the contractor determines you have not complied with quality provisions? Or does the contractor have to verify the quality problems with independent testing?
- c) Can the contractor terminate the contract for minor breaches of the contract?
- d) How much notice does the contractor have to give prior to termination?
- e) Are you given an opportunity to cure a problem before termination? How much time are you given for this?
- f) What are your rights after termination by a contractor?
- g) Can you sell or use the crop not purchased under the contract?
- h) Under what conditions may you terminate the contract?
- i) What if you get sick, disabled, or die? What if you go bankrupt?

3. Approvals and Renewal of Contract

- a) Do other parties have to approve the contract, such as your landlord, lender, or spouse?
- b) Under what conditions can the contract be renewed?
- c) Are there any conditions under which you are guaranteed an opportunity to renew the contract or is it up to the contractor?

4. Legal Relationship of Parties

- a) What legal relationship does the contract create between you and the contractor? Is it a landlord/tenant relationship, employer/employee relationship, independent contractor, partnership, joint venture or agency? (The legal relationship involved will determine your rights and duties under the contract and will have important tax consequences.)
- b) Does the contract refer to a bailment?

5. Assignment of Contract

Can the contract be assigned or transferred by you or by the contractor to other parties? This may have important tax consequences.

6. Farm Program

To be eligible for USDA programs, you must have a "beneficial interest" in the commodity. This is determined by looking at the contractual terms regarding title, risk of loss, and payment.

- a) Will the contract affect your eligibility for farm program payments? (For example commodity loans, market loss payments, loss deficiency payments, etc.)
- b) Is the crop considered a program crop for purposes of payment or base retention? How will this affect your established farm program yield?
- c) Is the contract crop considered a fruit or vegetable by FSA? How will it affect your eligibility for farm program payments?

7. Insurance

- a) Are you required to buy multi-peril, hail, or other crop insurance? Liability insurance (for risks such as pesticide drift)?
- b) Can you get Federal Crop Insurance for the crops involved? If so, can you use your actual production history or will other yield determinations be used?

8. Protection of Intellectual Property

"Intellectual property" is legal jargon connoting a legally protected property interest in a valuable product or process. The secret formula for a popular soft drink or a GMO are examples of intellectual property.

- a) Does the contract require you to take certain steps to protect the contractor's property interest in the grain's germ plasm (genetic material)?
- b) Are you responsible for preventing the unauthorized use or acquisition of the germ plasm?
- c) Who owns the germ plasm? Does the contract limit your ability to save seed to plant on your own farm in future years? What about seed that is rejected by the contractor?

9. Choice of Law/Venue/Change of Law

- a) Does Missouri law apply for the enforcement of the contract or does another state's law apply? Is this choice of law fair?
- b) Does the contract set a venue location for any lawsuit that might be filed? Is this location fair?
- c) Does the contract permit renegotiation or nullification of the contract if the laws governing production contracts are changed?

10. Duration of Offer

How long do you have to accept the contract? Is there an expiration date for signing?

11. Put It in Writing

You should not rely on oral agreements or interpretations of the contract. Reduce all understandings or modifications to writing.

Contract Production Glossary

- Act of God**—A fact situation unforeseeable by the parties due to circumstance out of the control of the parties, such as the circumstance of nature (flood, drought, tornadoes, storms, etc.) or of man (labor strife, wars, lack of supply, government restriction) which interferes with the party's intentions to perform a contract.
- Agent**—A representative of a contractor who looks after the interests of the company and can make oral or written changes in a contract.
- Anticipatory breach**—The indication by one party in a contract that he will not be able to carry out his obligation. This indication, whether written, oral, or an act, can be treated by the other party in the contract as confirmation that the agreement has been broken.
- Arbitration**—A non-court way of settling disputes in a contract. An arbitrator who is a neutral, disinterested person is chosen to hear both sides of the matter, formulate an appropriate settlement, and impose that decision on both sides.
- Bailment**—An arrangement between two parties in which one takes care of the property belonging to the other, usually in exchange for a fee. The ownership of the property does not change, but the property manager is expected to take reasonable care of the other party's property.
- Breach**—The breaking of a contract in which one side does not perform his obligations. The other party in the contract has the right to, and frequently will, sue for damages.
- Consideration**—The payment to be received by someone providing a product or service in the performance of a contract.
- Contract**—An agreement between two or more legally competent parties to engage in an activity or conveyance of a product or service in which one party pays the other in return for the product or service.
- Damages**—A monetary payment awarded by a court or arbitrator as a result of a broken contract. The amount is determined by the loss suffered by the other party to the contract. Consequential damages are directly related to the loss sustained. Punitive damages are awarded to serve as a punishment for fraud.
- Default**—Non-performance of one's contractual obligations.
- Disclaimer**—Language used to protect a person or company from any liability should a problem develop with a product being sold. A disclaimer is usually in the form of a warranty indicating what the buyer should or should not expect the product or service to accomplish.
- Encumber**—To place a lien or other restriction on property in order to secure or protect a debt or an obligation.
- Force majeure**—A provision in a contract to protect the parties from being unable to perform their obligations as a result of unforeseen circumstances, such as an Act of God.
- Goods**—All things that are movable at the time of identification to the contract for sale, including the unborn young of livestock and growing crops.
- Identity preserved**—Action taken to keep separate one commodity from another because of its unique characteristics. The effort is usually made to separate grains which have traits that cannot be visibly detected and appear to resemble other grains of that commodity. The effort at preservation is made from planting to processing to insure the special traits are not adulterated.
- Independent contractor**—A party who agrees to perform certain duties specified in a contract but who is not an employee of the contractor.
- Intellectual property rights**—Rights maintained by the developer of a valuable product or process that can be confidentially protected by a patent or contract.
- Joint venture**—A partnership arrangement developed to conduct business while sharing risks and profits.
- Mediation**—A non-court dispute resolution process that involves a neutral, disinterested third party. However, the neutral party serves as a fact finder and assists the disputing parties come to an agreement without a binding settlement.
- Merchant**—Someone who sells goods or services and has knowledge of the expected success or failure of the performance of those goods or services.
- Passed-acres clause**—A contract provision that allows a contractor to not take (pass) on acres of production that are not needed by the contract. The contract provision usually establishes a payment procedure for the producer.
- Release**—A statement from one party in a contract that allows the other party to not have to perform certain obligations.
- Rebuttable presumption**—A presumption is a rule of law that requires the assumption of a fact from another fact and has the effect of shifting the burden of proof to the other party. A rebuttable presumption may be overcome through the introduction of contrary evidence.
- Specific performance**—A court order for a contract provision to be performed by the first party when the second party has been damaged but when a monetary damage would be insufficient to cure the problem.
- Termination**—Concluding a contract before the time initially agreed upon. Termination can occur when both parties agree or when one party defaults.
- Title**—The actual ownership of property. Title can be conveyed from one person to another.
- Uniform Commercial Code (UCC)**—A state law that defines and governs commercial transactions.
- Vertical integration**—The organization of production, processing and distribution systems all controlled by a single company in an effort to capitalize on certain economic efficiencies and working arrangements.
- Waiver**—The action of yielding a right or privilege established in a contractual relationship.
- Warranty**—A statement given by a seller to a buyer that the product or service will produce certain expected results. An express warranty is a written promise. However, an implied warranty is a perceived promise of expected satisfactory performance.



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Other Sources of Information

Hamilton, Neil D., A Farmers' Legal Guide to Production Contracts, Farm Journal, Inc., Philadelphia, Penn., 1995.

The World of Corn, National Corn Growers Association and National Corn Development Foundation, St. Louis, Mo., 1995.

Web Sites of Interest

Agricultural Contracts

[http://agebb.missouri.edu/
mgt/agcontract/index.htm](http://agebb.missouri.edu/mgt/agcontract/index.htm)

Legality and Contract Issues

[http://www.agrisk.umn.edu/
results1.asp?Keywords=Contract%20Arrangements](http://www.agrisk.umn.edu/results1.asp?Keywords=Contract%20Arrangements)