Agricultural
Marketing Guide >>

Crop Contracts

Introduction

Contracting is one way farmers can manage market and price risk. A variety of before- delivery, after-delivery, and before or after-delivery contracts can be used to reduce or eliminate market and price risk.

For an introduction to the topic see “What about Contracts” on our YouTube channel.

Before-Delivery Contracts

These are contracts that are entered into before the crop has been delivered to the buyer.

Production Contracts

The producer agrees to deliver some, or all, of the production from a specified number of acres. The purchaser guarantees to accept delivery. Most do not specify the price or the total volume of grain to be delivered.

Advantages of production contracts:

- Eliminates the risk of restricted delivery opportunities for some or all of the crop.
- No minimum delivery may be required in cases of crop failure.

Limitations of production contracts:

- Does not always deal with price risk or, on crops where it applies, basis risk.
- Limits the choice of companies to which the grain may be delivered.
- A first-right-of-refusal price may mean selling to the contracting company when a higher price is available from another buyer. This is particularly applicable when a lower than base grade is produced and your product becomes subject to a price discount that was not specified in the contract.

Deferred Delivery Contracts (DDC)

The producer agrees to deliver a specified amount of grain, oilseed or special crop to a grain company by a certain date. The purchaser agrees to accept delivery of the specified amount and pay a specified price on the day of delivery. Usually the contract specifies a certain quality or grade that is eligible for the guaranteed price. If the delivered product is lower quality than specified, the final price is usually discounted. The amount of discount should be specified in the contract but some DDCs specify that the discount applied will be the one in effect on delivery.

Some companies will allow pre-pricing of only part of the expected tonnage of crop with a DDC prior to harvest. After harvest, however, a producer may contract or 'price' his entire crop.

Advantages of DDCs:

- Eliminates the risk of price declines on the quantity contracted.
- Establishes delivery period.
- Does not require margins to lock in a price for future delivery.
- Are widely available from local elevators, grain dealers, special crops buyers and some feedlots and feedmills.

Limitations of DDCs:

- The amount of product specified in the contract must be delivered or penalties may apply.
- Limits the choice of company to which the grain may be delivered.
- The contracts do not allow producers to take advantage of subsequent price rises.

Pre-priced Dealer Car Contracts

This contract is similar to a DDC except that it is for forward pricing of grain to be shipped by a producer-loaded dealer car rather than delivered to the elevator, crusher, grain dealer or special crop buyer.

Advantages of dealer car contracts:

- Eliminates the risk of future price declines.
- Establishes delivery period.
- Does not require margins for futures contract accounts.
- Are available from local elevator managers, grain dealers and some special crops buyers.
- Dealer cars usually have a better basis level than for elevator delivery and, therefore, offer a larger net return to producers.

Limitations of dealer car contracts:

- The amount of product specified in the contract must be delivered.
- Limits the choice of company to which the grain may be delivered.
- Dealer cars usually have a weaker basis level than producer cars for the same product.
- The contracts do not allow producers to take advantage of price increases.
- Producers must have enough product available to fill a car.
- Dealer cars, like producer cars, must be loaded by the producer.
- Spotting of cars may be delayed by railway train scheduling.
- Payment is not received immediately. Payment is made after a car is unloaded at the final destination.

Farm Gate Purchase Contracts

This contract is like a DDC used by farmers to price grain for sale from the farm at a later, specified date. The grain company finds a buyer and arranges for farm pick-up of the grain. The producer is paid by the grain company based on the unload weight, grade and dockage. Producers are advised to keep a random sample of grain from each truckload shipped in this manner.

Advantages of farm gate purchase contracts:

- Eliminates price risk.
- No grain hauling by the producer.
- Price may be higher than the elevator price due to elimination of elevation charges.

Limitations of farm gate purchase contracts:

- Load size is unknown until truck unload.
- Payment is not received until after truck unload.

Supply Contracts

A supply contract is an unpriced contract. A producer agrees to deliver a certain tonnage of grain or oilseed during a certain delivery month. The buyer guarantees to accept delivery during the specified month. The buyer may sometimes agree to pay the producer to store the grain on the farm but storage is only paid on product actually in the farm bin, not in the field. Usually, no storage is paid after the product is priced.

Supply contracts may be priced out (i.e., the price is locked in) at the time of delivery at the spot or street price for that day. They may also be priced out prior to delivery using a DDC. Supply contracts are offered mostly by canola crushers and buyers of special crops.

Advantages of supply contracts:

- Part of the cost of on-farm storage may be paid.
- Establishes delivery opportunities.

Limitations of supply contracts:

- The amount of product specified in the contract must be delivered.
- Limits the choice of company to which the grain must be delivered.
- Does not eliminate price risk.

Open-basis or "To-Arrive" Contracts

An unpriced marketing contract that is only available for crops where there is a futures contract for pricing. The producer guarantees to deliver a certain tonnage of crop at a specific time period for a guaranteed futures price for a specified futures month. The basis, however, has not been finalized when the contract is signed.

The final price is determined when the seller chooses, or locks in, a basis. The final price, then, is the initial guaranteed futures price for that commodity plus or minus the basis that was locked in at the later date. An open-basis contract can be used for standing crop or for farm-stored grain. The basis can be locked in at any time up to the day of delivery, hence the name "to-arrive". See Basis – How Cash Grain Prices are Established for more information.

Advantages of an open-basis contract:

- Locks in the futures but allows the producer to take advantage of possible improved basis levels at a later date.
- Eliminates the risk of restricted delivery opportunities since used prior to delivery.
- Locks in a high futures price without using a commodity futures broker.
- Allows a producer to speculate on strengthening or improved basis levels.

Limitations of basis contracts:

- Requires a good understanding of basis and the factors that influence it.
- Used alone, it does not totally eliminate cash price risk.
- Limits the choice of company to which the grain may be delivered.

- Open-basis contracts are only available for commodities for which there are futures contracts.

After-Delivery Contracts

These contracts are used only after product has been delivered to a buyer.

Deferred Pricing Contracts

Deferred Pricing Contracts (DPCs) are sometimes, but incorrectly, called “storage tickets”. DPCs allow a producer to deliver grain or oilseeds and accept a very small partial payment immediately. The producer agrees to a final price on or before a deadline date specified in the contract.

Advantages of DPCs:

- Eliminates on-farm spoilage risk.
- Reduces on-farm storage requirements.
- Eliminates the risk of restricted delivery opportunities at a later date.
- Allows pricing with just a phone call.
- Allows producers to take advantage of price improvements within a certain time after delivery.

Limitations of DPCs:

- Exposes a producer to price risk.
- Stronger (narrower) basis levels may not apply to grain already delivered via the DPC.
- The product must be priced-out and payment received within 30 days after delivery to be covered by Canadian Grain Commission bonding protection.
- A large number of DPCs expiring in a short time may pressure futures prices.

Cash-for-Futures Contracts

A cash-for-futures (CFF) contract is an unpriced marketing alternative that applies to crops with a futures contract. To use a CFF contract, the producer first delivers grain or oilseed and locks in the price for it either immediately or within a certain number of days of delivery. The producer receives payment for at least 50 per cent of the product value the day it is priced. The remaining funds are used by the grain buyer to buy an equivalent tonnage of futures contracts on behalf of the producer. If futures prices rise, the producer profits from the increase in value of the futures contract. If futures prices fall, the losses are covered by the funds held by the purchasing grain company. The producer must choose a point to close out the futures position to lock in the futures gain or loss.

Producers should be sure that the buyer is a company has a Registered Futures Commodity Merchant (RFCM) arm. If the company does not have an RFCM arm, they may be in violation of security regulations. See Choosing a Commodity Broker for more information on RFCMs.

Advantages of cash for futures contracts:

- The producer receives partial payment for his crop while waiting for price improvement.
- Allows producers to speculate on the futures market without using an RFCM directly.
- Allows a producer to lock in a favorable basis, if available, at time of delivery.

Limitations of cash for futures contracts:

- The producer is not protected against futures price risk.
- There is significant risk of losing money on any futures trade.
- CFF contracts only apply to crops with a futures contract.
- The amount per tonne withheld by the grain company is usually higher than the margin deposit required on futures contracts required by RFCMs.
- There is usually no interest paid on the money withheld by the grain company.
- There may be a small administration fee charged by the grain company for each futures contract purchased and sold.
- CFF contracts not priced and paid in full by 30 days are not protected by Canadian Grain Commission bonding protection.

Minimum- or Floor-Price Contracts

A minimum-price contract is a priced contract that allows a producer to contract delivery of a crop to a buyer, but be able to take advantage of any future price upswings. A producer delivers the product to a buyer, prices it and is paid about 90 to 95 per cent of the value of the product. The five to ten per cent of the product value not received by the producer is used to buy an option on the canola futures market. An option is like price insurance in that the producer has a minimum price locked in , but can take advantage of higher prices should they develop. Like options, floor- or minimum-price contracts are only in effect for a certain time period. If a futures rally takes place, the producer must choose a point to lock-in the new higher price since the option doesn't automatically lock in the highest price available.

Advantages of minimum-price contracts:

- Allows a crop grower to take advantage of possible futures price increases.
- The producer is protected against price declines.
- Can be used to deliver during times of strong basis levels even if price increases are expected.
- The greatest amount a producer can lose is the premium cost for the contract.

- Allows a grower to generate cash flow by pricing and being paid for the crop without holding it in the bin.

Limitations of minimum-price contracts:

- A minimum-price contract does not guarantee the highest futures value for the time it is in effect.
- The producer must be disciplined enough to choose a futures value to price out the contract.
- Many of the contracts expire worthless because producers do not lock in a profit when it's available. Instead, they often wait for a higher price and miss the pricing opportunity.
- The call option premium can be quite expensive if crop futures values are volatile.
- The call option premium is higher, the longer the minimum-price contract is to be in effect.

Before-or After-Delivery Contracts

These contracts can be used before or after product has been delivered to a buyer.

Basis contracts

A basis contract is an unpriced marketing contract only available for crops where there is a futures contract for pricing. The producer guarantees to deliver, or has already delivered, a certain tonnage of crop at a guaranteed basis above or below a certain futures price. The producer is able to lock in the futures price of the grain or oilseed at any time before some specified later date.

The final price is determined when the seller locks in a futures price. The final price is the chosen futures price for that commodity plus or minus the basis specified in the contract. A basis contract can be used for standing crop, before delivery of farm-stored grain or for grain at time of delivery. See Basis – How Cash Grain Prices are Established for more information.

Advantages of basis contracts:

- Locks in the basis but allows the producer to take advantage of later futures price increases.
- Establishes delivery opportunity when used prior to actual delivery.
- Can be used in conjunction with the futures market to create a perfect hedge, in other words, a hedge with no basis risk.

Limitations of basis contracts:

- Requires a good understanding of basis and the factors that influence it.
- Used alone, it does not eliminate price risk.
- Limits the choice of company to which the grain may be delivered.
- Basis contracts are only available for commodities for which there are futures contracts.
- Basis contracts on delivered grain, not priced and paid in full by 30 days, are not protected by Canadian Grain Commission bonding protection.

Target-Pricing Contracts

A target-pricing contract, sometimes called a grain pricing order, is also an unpriced alternative. In the contract, the producer states the price he would like to receive for a specified amount of product. If the grain or oilseed reaches that price, it is priced out automatically. This kind of contract can be used for unpriced grain already delivered or for farm-stored grain.

Advantages of target pricing contracts:

- The producer specifies the desired price in advance.
- The product is priced without constantly watching the market.
- Allows producers to “speculate in the bin".

Limitations of target pricing contracts:

- Marketing decisions are isolated from the producer.
- The market price could miss the producer-selected price by only a few cents, and a good marketing opportunity could be missed.
- Prices could rise above the target price but the producer would only receive the target price.
- Target-pricing contracts are often only in effect for a specified time period, usually 90 days, although some companies will renew them if the producer wishes.
- Target-pricing contracts on delivered grain, not priced and paid in full by 90 days, are not protected by Canadian Grain Commission bonding protection.

General Comments

Producers should carefully read and understand every contract before signing it. Here are some questions that should be considered before agreeing to a contract.

- Is the purchaser licensed and bonded and, just as importantly, financially stable?
- Does the quoted price include any or all freight or trucking charges?
- Does the quoted price include any deduction for dockage or shrinkage? Does the contract specify a minimum delivery grade?
- Does the contract specify any grades that are undeliverable?
- Does the contract indicate discounts for lower grades and, if so, are the exact discounts specified?
- If no exact discounts for lower grades are specified, how is the discount for lower grades determined?
- Is grading to be done by the company or the Canadian Grain Commission?
- How are grading disputes to be settled?
- Does the contract specify discounts for special foreign matter?
- Does the contract specify a guaranteed delivery period or date?
- Does the contract include payment provisions?
- Does the contract include a seed-supply provision? If so, what is the quality, who pays for it and when is it to be paid for?

Important Note: Under the Canada Grain Act, there is currently no maximum time that grain delivered to a licensed company can remain unpriced. However, at the time of writing, unpriced product must be priced and full payment received by the producer within 90 days of delivery to be protected by Canadian Grain Commission grain- company licensing and bonding protection regulations. Once a producer receives a cash purchase ticket or cheque from a licensed company, that producer is covered by the licensee's security only for 30 days after the payment is issued.

For further details contact the Canadian Grain Commission.
Phone: 1-800-853-6705

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