

ECONOMIC & POLICY UPDATE

VOLUME 21, ISSUE 3

Editors: Will Snell & Nicole Atherton



Hemp Contract Considerations

Author(s): Jonathan Shepherd, Paul Goeringer, and Tyler Mark

Published: March 30th, 2021

Engaging in production agriculture is a risky profession, even for mature markets, such as corn and poultry, much less one that lacks the market transparency of hemp. One way producers mitigate risk in mature markets is through the utilization of production and marketing contracts. A production or marketing contract is a legal agreement between a producer and buyer that, at the most basic level, stipulates a given quantity of product, at a given quality level (or interval) and price at a given time to be exchanged between a given producer and given buyer. For example, a corn contract would specify the quantity of corn to be delivered at a given price, at a given time, assuming quality and moisture meets industry standards. A hemp contract will include at least this level of basic stipulations. However, a detraction for hemp is there are no uniformly accepted industry standards regarding moisture, maturity, storage, and handling practices, etc. This can lead to many variances in contracts between potential hemp buyers. Further, depending on the end-use of the hemp crop, standard contracting language will vary. Below are common items that may be present in a typical hemp contract:

- Moisture at delivery (discount schedule for moisture above expected delivery moisture level)
- Which party is responsible for drying the crop and which party is financially responsible for the drying costs
- Planting date (or interval)
- Harvest date (or interval)
- THC testing
- CBD testing (for floral material destined to essential oil production)
- Production Practices

THC testing is a major risk factor for hemp producers regardless of the end-use of the hemp product. Federal law dictates that a *Cannabis Sativa* crop is hemp if THC tests at or below 0.3% total THC (given a certain confidence interval). Any crop that tests above this THC level is no longer

considered hemp but is considered marijuana and is viewed as an illegal crop that must be destroyed. The current genetics in the hemp seed market, while evolving quickly, do not guarantee that a given cultivar will consistently test below advertised THC levels. A further complication with hemp is that harvest date relative to maturity date as well as genetics can push THC levels above legal limits. Therefore, it is recommended that a hemp contract, regardless as to whether it is intended for the floral, grain, or fiber markets, clearly specify the following items:

- The manner in which THC testing takes place, typically at harvest. However, if harvest is not feasible within the allowable period after testing (usually specified by state law), the contract needs to determine further actions.
- The contract also needs to specify if THC testing will occur during the growing season to monitor THC content, which lab the THC testing will take place, and who is responsible for the cost of THC testing.
- THC testing methodology has garnered a lot of attention. Specifically, the difference between total THC testing and delta 9 THC-A testing. The contract should specify which methodology will be used (typically, this will be based on state regulations until USDA Interim Final rules dictating total THC testing is required nationwide)
- Within THC testing considerations, the contract should specify which party is responsible if the hemp crop tests above legal THC limits (tests “hot”) or THC limits specified in the contract. This may depend on who owns the crop (discussed below). However, both parties need to know who is financially responsible for not only destroying a crop that tests above legal THC limits (as required by current law) but also who is financially responsible for the production costs up to the point of destruction. In some cases, total input costs up to the point of destruction can be essentially all of the costs associated with producing the crop, plus the additional costs of destroying.

Crops testing above legal THC limits are not the only concern. Hemp is just as susceptible to other crop failure factors as any other agricultural crop. In the event of crop failure (e.g. drought, hail, insect), the contract should specify who is responsible for crop production costs up to the point of failure. Crop insurance may be a risk mitigation tool for some producers. However, ownership of the crop will determine who should be the policyholder and ultimately determines who gets the payout. Both parties need to make sure that this is specified in the contract, the correct party has the correct insurance policy, and language should exist to specify how the other party will be compensated if the policy holding party is not the party that has suffered production costs up to the point of the loss. For example, if the processor/buyer actually owns the crop they will be the one who purchases the crop insurance policy. If a crop failure occurs and a crop insurance event is triggered, the contract should specify that the producer receives an agreed-upon amount (or formula for determining that amount) based on production costs incurred up to the point of failure.

Seed technology agreements are common in most areas of modern agriculture. Hemp is no different. A contract needs to specify who actually owns the genetics, assuming the contracted buyer is supplying the genetics. If the contractee is providing genetics outside of the contract with the buyer, the contractee still needs to be aware of any potential patents associated with the seed they are purchasing and limitations on saving seed, etc.

The hemp industry is still in its infancy and is largely being funded by venture capital as opposed to traditional financing means. This means that funding volatility is more prevalent in the hemp industry than in other traditional agricultural sectors. Many 2019 hemp producers have found themselves with a hemp crop that does not have a buyer because the company in which they contracted no longer has investors, or has gone bankrupt. It is strongly encouraged that the hemp contract specifies when the producer will receive money for the crop and consequences for late payment. There are many ways for this to be structured. In more traditional contracts, monies are typically dispersed once harvest is complete and the product is delivered. Given funding volatility in the hemp industry, it may

be less risky for both parties to specify payments along the production path based on certain production milestones. Within this, both parties need to establish whether interest and penalties apply for failure to pay. Further, the contract should specify when ownership of the crop switches parties if payments are not received. Another consideration for hemp producers and buyers to consider is setting up an escrow account to secure the periodic payments in advance of incurring costs. Another approach would be for producers to consider requiring a certain percentage of the crop be paid upfront.

Management practices for specifically floral material will typically be specified within the contract. Grain and fiber may also have various production requirements or restrictions. Oftentimes, these contractual management procedures are very detailed and prescribe planting and harvesting dates, drying methodology, cultivation expectations, storage and handling specifications, as well as any chemical use (assuming chemicals are labeled), heavy metals, and residues. These specifications are typically based on best management practices as understood by the processor/buyer. However, best management practices as determined through empirical research are still being developed. As a result, these management specifications typically vary significantly between contracts. The contract needs to clearly stipulate not only the expected management practices to be executed but the timing of each practice. Further, specifications on how the producer/grower adequately records/proves that these management actions have been executed as required by the contract. Yet another consideration is what if environmental factors prevent the producer/grower from executing prescribed management practices within specified time intervals. Is there language that provides that these actions should occur in a specified time interval assuming the actions are feasible?

Anecdotally speaking, hemp production contracts have historically contained vague language, couched in “legalese,” that provide the contracting company with ways out of the contract on for basically any reason they can cite which may be hard to verify or refute from the producer/grower perspective. An example of this language is “Company XYZ can refuse to purchase producers hemp crop if Company XYZ determines that the crop would be financially infeasible to sell..... “ The number one rule in contracts is the person who drafted the contract took care of the contracting company. The hemp production contract the hemp grower is presented with was drafted by a skilled attorney looking to create outs for the company, in some cases. Hemp growers should read a contract with a critical eye towards how the contracting company could provide an out. This may not always be easy for a grower and growers should consider working with an attorney who can review the contract and suggest changes to better protect the grower’s interests.

The purpose of this article is to inform potential hemp producers and processors of the common areas that need to be considered in a hemp contract. Because this is a developing market, close attention needs to be paid to the hemp production contract. The production contract can be a valuable risk management tool by shifting risk to the appropriate party in the transaction. This article is not to replace legal counsel and it is recommended that both parties seek qualified legal counsel to fully understand any contract before they sign.

Recommended Citation Format:

Shepherd, J., P. Goering, and T. Mark. "[Hemp Contract Considerations](#)." *Economic and Policy Update* (21):3, Department of Agricultural Economics, University of Kentucky, March 30, 2021.

Author(s) Contact Information:

[Jonathan Shepherd](#) | Extension Specialist | jdshepherd@uky.edu

[Paul Goering](#) | Extension Specialist | University of Maryland | lgoering@umd.edu

[Tyler Mark](#) | Associate Professor | tyler.mark@uky.edu