

## Producer Contract Review

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Mercantile Consulting Venture Inc.

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Winnipeg, February 28, 2022

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## Executive Summary

With the help of the Sask. Grower Commissions and APAS, the purpose of this report is to review options to bring more 'balance' into grain contracts from a producer's point of view. More specifically, the objective is to generate actionable items for producer organisations to undertake to improve contracts for farmers.

The report is structured in the following way:

The **Introduction** to the report outlines the context that led the Grower Commissions and APAS to initiate the study and the basic approach and methodology adopted by *Mercantile*.

**Section 1** presents an overview of producer contracts and why they are important tools for both producers and buyers.

**Section 2** presents, in summary fashion, issues identified by producers and provides specific examples from 21 contracts. The issues highlighted by producers in relation to contracts in no particular order are:

- contract balance (lack of even-handedness between producer and buyer)
- Terms and Conditions are too complex and hard to understand
- inability to amend Terms and Conditions
- handling of Overages and Underages
- penalty calculations
- failure of buyer to mitigate damages and
- supply chain issues that should not be passed back to producers, but should be dealt with at a different level

Other than being concerned about gaining possession of existing production, buyers did not raise concerns about special contract terms.

**Section 3** introduces the concepts of fairness, clarity, and overreach/ spheres of control as applied to producer contracts. It organizes the contract issues identified into these premises, again using examples from producer complaints.

Mercantile notes that this study is not a legal opinion, but rather seeks to determine, if there are indeed issues regarding contract fairness, clarity and overreach. The concept of contract balance, or even handedness within marketing contracts is not a new one, but it is one that has been highlighted on a wide scale by the events of the 2021 season. These are discussed in some detail.

**Section 4** discusses potential solutions and gives recommendations. Cooperation between producers and buyers to improve contracts with the goal to reduce contract disputes while improving product flow coordination is highlighted. The key will be to focus on the fundamentals of the contract, to avoid complicating the basic intent of the contracts, and to keep fairness, clarity (transparency) and avoidance of overreach in mind. Indeed, special emphasis is put on simplification and increased clarity of terms. Further, it is recommended that the CGC take on a

role in producer contract training, standard contract administration and in accommodating contract arbitrations between producers and buyers.

## Introduction

A significant portion of crops grown in Western Canada are being produced under production contracts or sold under deferred delivery contracts. Simply put, a contract creates expectations and obligations between the producer (farmer, grower) and the buyer (contractor). The producer expects to be paid for what they deliver and envisage the contract will be executed in the agreed upon time. The buyer anticipates that producers will meet the terms of the contract in the manner described in the agreement - specifically, that the correct quantity and quality of grain gets delivered per contract terms signed. This understanding of contracts presents both opportunities and challenges, especially since there is a growing impression that the terms of the contracts have become too complex and onerous for the producers and are skewed towards advantaging the buyer.

The severe production shortfalls of 2021 heightened long simmering concerns by producers about transparency and intelligibility with contract 'terms and conditions'. A perceived lack of fairness on contract execution, along with a lack of negotiation power regarding contract terms has also been a long-standing sore point with producers. On the other side, buyer companies were equally concerned with contract compliance and with gaining possession of commodities they thought they had purchased. A lot of money and 'good faith' was at risk for both sides of the many ensuing disputes.

Initial producer issues:

Numerous complaints by producers about contract execution in the summer of 2021 led the Agricultural Producers Association of Saskatchewan (APAS) to conduct a survey of 200 producers in the summer/fall of 2021, which highlighted the following issues:

- lack of transparency in calculating buyout and administrative fees
- huge differences in settlement costs amongst different companies, and
- difficulties with the timing of a buyout: some companies did not allow an early buyout of the contract, causing the penalties to rise as commodity prices increased during the summer.

One of the key complaints of producers was that, amongst grain companies, the handling of contract shortfalls was inconsistent. In addition, while many producers showed an interest in standard grain contracts and standard contract resolution procedures, many stated they will not use any forward contracts in the future because of the lack of protection in contract arrangements.<sup>1</sup> However, contracts are an important risk management and cash flow tool for producers, and similarly, a widespread move away from production or forward contracts would make forward trading for grain companies much more difficult.

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<sup>1</sup> The Western Producer, Robert Arnason, Poll: 75 percent of producers couldn't deliver on contracts, December 10, 2021. *Mercantile* notes that 2021 was an unusual year. In any given year, only a small number of producers cannot deliver on contracts. Though no data exists, *Mercantile* expects that defaulted contracts are in the less than 5% range.

The wave of discontent about contract execution in the 2021 crop year led to five Saskatchewan producer commissions<sup>2</sup> adopting a similar resolution pertaining to contracts:

***WHEREAS** the production year of 2021-2022 was one of widespread drought in the Canadian prairies of an unprecedented nature and in the last year Saskatchewan producers have seen grain companies move to recover unfillable forward contracts by unevenly applying service fees and penalties that are both punitive and unfair.*

***AND WHEREAS** in many cases, these fees are not specific or spelled out in the contracts producers have signed.*

***AND WHEREAS** the variance in how these punitive measures have been applied has given the appearance of favoritism or bullying in many cases.*

***THEREFORE BE IT RESOLVED THAT** the Saskatchewan Wheat Development Commission lobby the government to protect producers with fair contract terms and require grain contracts to:*

- Remove administration fees from contract buyouts when a producer provides evidence of crop failures.*
- Require all contracts to include a buyout option clause with a pricing formula at time of signing that is triggered when producers provide notice of a crop failure.*
- Require these changes to be applied evenly to all grain contracts signed in the province of Saskatchewan or Canada as the case may be within the jurisdiction of the legislating government.*

The Western Canadian Wheat Growers Association (WCWGA) likewise expressed concern about the enforcement of commodity contracts relevant to their membership and requested a legal opinion on the issues at hand this past summer. The opinion was based on 14 sample contracts and concluded that the “sample contracts all appear to be drafted by buyers and are heavily tilted in their favour.”<sup>3</sup> The report described several examples that support this opinion and recommended that “Members of the Association should review their contracts carefully and see their local lawyer.”<sup>4</sup>

The various activities in 2021 by Saskatchewan Growers Commissions, APAS, and the Western Canadian Wheat Growers Association point towards the fact that contractual issues are not isolated problems, but symptoms of a larger issue that needs to be addressed. Accordingly, and with the help of the Saskatchewan Commissions and APAS, the purpose of this paper is to review existing producer contracts to determine if grain contracts reflect the rights and obligations of both buyer and producer in a balanced fashion. If such balance is shown to be lacking, then the next objective is to develop options that bring more ‘balance’ to grain contracts from a producer’s point of view. The primary focus will be on grain company commodity purchase contracts and more specifically on the major contract terms as well as the ‘Terms & Conditions’ spelled out on the back of the contracts.

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<sup>2</sup> Saskatchewan Wheat Development Commission, Saskatchewan Canola Development Commission, Saskatchewan Barley Development Commission, Saskatchewan Flax Development Commission, Saskatchewan Pulse Growers.

<sup>3</sup> Thomas S. Kent, General Opinion on Enforceability of Grain Contracts, August 12, 2021, p. 2.

<sup>4</sup> Thomas S. Kent, General Opinion on Enforceability of Grain Contracts, August 12, 2021, p. 5.

Table 1: Basic Contract Obligations and Rights

| Contract Obligations and Rights |                                                                        |                                                  |
|---------------------------------|------------------------------------------------------------------------|--------------------------------------------------|
|                                 | Obligations                                                            | Rights                                           |
| Producers                       | Deliver quality & type grain per sale                                  | Payment per contracted price & per payment terms |
|                                 | Deliver full tonnage sold                                              | Ability to deliver in sales period               |
|                                 | Delivery period per contract                                           |                                                  |
|                                 | Fill other terms per special terms on contract (ex. special qualities) |                                                  |
| Buyers                          | Take delivery per contracted delivery period                           | Reject grain if not per specifications purchased |
|                                 | Pay per contract price & payment terms                                 | Buyout if not delivered per contract terms       |

METHODOLOGY

To do this, *Mercantile* focused on grain commodity purchase contracts and, more specifically, on major (front page) contract terms and Sub Clauses/Terms and Conditions. From the *Mercantile* resources and/ or with the assistance of various commissions, *Mercantile* secured a total of 21 producer’s production contracts and deferred delivery contracts. These contract samples covered all grain companies acting in Western Canada and all grain commodities (grains, oilseeds and special crops).

The 21 contracts were first tabled by terms such as acceptance, delivery aspects and pricing aspects. The initial sort by terms quickly showed that it is easy to get lost in the ‘legalese’ and penalties and default clauses. So, *Mercantile* went back to the resolutions that showed producers’ concerns and the APAS survey answers to key questions. Then, *Mercantile* developed a comprehensive list of issues and contract terms that related to each issue. An example of this is the issue of overreach/ sphere of control. *Mercantile* identified the contract terms that touched on the producers’ concerns about these. Then *Mercantile* looked at the broader issues and developed some common-sense solutions to address them.

To be clear, this report does not set out to give a legal opinion on grain contracts or to discuss all clauses contained in the 21 contracts at hand. Rather it seeks to

- discern generally if there are indeed valid issues from a producer point of view with grain contracts as currently presented/ written; if yes, what are the main issues
- ascertain if the main clauses are ‘fair’ to both parties (fairness),
- assess how the Terms and Conditions compare amongst the 21 contracts reviewed (clarity),
- identify if the Terms and Conditions stated are within the ‘sphere of influence’ of the affected party or are ‘overreaching’ (sphere of influence).

And then, on the basis of the review:

- if valid issues were identified, find neutral, common ground for buyers and producers of grain/ oilseeds/ pulses/ special crops in Western Canada, and
- develop suggestions for a contract template that is fair and reasonable in apportioning risk to both producers and buyers

For the analysis and reporting, *Mercantile* distilled the underlying issues into the three basic premises:

- Fairness/ Level Playing Field
- Clarity (and Transparency)
- Overreach

And then, *Mercantile* searched for common ground for improving contracts for producers and buyers and thus, improving contract compliance and understanding. Recommendations conclude the report.

*Mercantile* notes that we have hands-on experience being on either side of the producer and buyer contracts. The authors appreciate the inherent difficulties and challenges for both producers and buyers and understand why certain terms were initiated. Rather than finding fault or assessing blame, this paper seeks to identify imbalances and appeals to both parties' sense of fairness and equality with the end goal to improve coordination and product flow while decreasing irritants.

There are examples in other geographies where improved cooperation and coordination within the agriculture supply chain has helped smooth the of product flow while reducing disputes between producers and buyers. For example, the Grain Trade Australia (GTA)<sup>5</sup> 'code of practise' along with the development and implementation of a specific grower contract have been helpful to achieve just that. We will refer back to this idea in sections 2 and 4.

To help navigate the document, the paper is divided into four sections. The first section is the overview of the producer contracts. Section 2 presents, in summary fashion, issues identified by producers and provides specific examples from the 21 contracts. Section 3 presents the producers' contract issues as organized into three basic premises: fairness, clarity and overreach. Section 4 discusses ideas for solutions and gives recommendations.

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<sup>5</sup> Grain Trade Australia (GTA) was formed in 1991 to standardise grain trading standards, trade rules and grain contracts across the Australian grain industry to enable the efficient facilitation of trade across the grain supply chain.



## 1 Theory and Purpose of Producer Contracts

### 1.1 Underlying Reasons for Contracting

USDA reports that between 33 and 40 percent of U.S. agricultural production has been produced under contract since the mid-1990's.<sup>6</sup> In a 2013 survey of Canadian Prairie producers, Frasa et al. (2015), found that 28% of respondents had regularly signed contracts for more than 10 years. Sixteen percent of producers had regularly signed contracts in the past 10 years and 31% had regularly signed contracted in the past 5 years.<sup>7</sup>

Beyond production contracts, virtually all commodity sales feature some kind of contractual agreement between the producer and the buyer, where the buyer commits to make payments at a specified time in exchange for delivery of a commodity with specified attributes. These contracts allow buyers (grain elevators or processors) to efficiently manage the timing of product flows to their facilities, ensure that products meet specified quality attributes, and manage price risks.

#### 1.1.1 Producers

For grain farmers, contracts with grain companies are one of the primary ways to manage market and price risk, to manage cash flow throughout the marketing year, and to obtain debt financing. Additionally, when there are capacity constraints at the elevator, a producer might not be able to receive space allocations without a forward sale. Thus, contracts are important tools that allow producers to reduce price risk and to determine a marketing plan that best works for their farm with respect to cash flow considerations, and the management of storage space.

However, while reducing exposure to lower prices when pricing a crop before harvest, producers simultaneously face increased exposure to production risk. This is a risk that needs careful consideration relative to normally occurring production fluctuations. If the production risk is large enough to cause serious financial concerns, farmers using pre-harvest grain contracts can consider revenue protection crop insurance to help manage such risks. However, while helping with the financial fallout of reduced production relative to production costs, this strategy does not necessarily address contractual consequences of such a shortfall.<sup>8</sup> Given that not all risks can be controlled by farmers, at the very least, the consequences for the inability to deliver must be spelled out clearly in the contracts and should reflect fair treatment by the grain company of its contractual partners.

Grain companies offer a several different contracts: each provide a different benefit to producers and have varying degrees of risk protection, pricing, and cash flow options. The most common contracts are production contracts and deferred delivery contracts.

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<sup>6</sup> USDA, ERS, Farm Use of Futures, Options, and Marketing Contracts, Oct. 2020

<sup>7</sup> Frasa, Stefanie & Carlberg, Jared & Hogan, Robert, 2015. "[Use of Contracts by Prairie Agricultural Producers](#)," [Working Papers](#) 232328, Structure and Performance of Agriculture and Agri-products Industry (SPAA).

<sup>8</sup> For example, Global Ag Risk insurance can cover this to some degree. – See Appendix B.

**Production contract (PC):** In a production contract, the producer agrees to deliver some, or all, of the production from a specified number of acres or tonnes. The buyer agrees to call for delivery during a specific delivery window at an agreed upon price. Production contracts eliminate the price risk for the tonnage sold and the risk of restricted delivery opportunities for some, or all of the crop. The contract does limit 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.

**Deferred delivery contract (DD):** In a deferred delivery contract, the producer agrees to deliver a specified volume of grain at an agreed upon price and quality to a grain company by a certain date. The buyer agrees to accept delivery and pay as per the payment terms specified. If the delivered product is lower quality than specified, the final price is usually discounted. Ideally, the discount should be specified in the contract. DD's eliminate the risk of price declines and the risk of restricted delivery opportunities, while not requiring margins to lock in a price for future delivery. The contracts do not allow producers to take advantage of later price rises.

**Futures contracts:** Selling futures contracts used to be a common way to secure a price and to protect price risks for commodities. However, increased volatility in futures have made this tool less user-friendly to many producers. These contracts are highly regulated and not relevant to the purpose of this report.

### *1.1.2 Buyers (Commercials/ Companies)*

Marketing contracts allow the buyers (grain elevators or processors) to manage both price risk and timing of product flows to their facilities and to ensure that products meet specified quality attributes. As such, they facilitate forward selling and are an essential tool in both price risk management and asset management. Most contracts, allow grain companies to delay the flow of grain into their facilities for an array of reasons without penalties for up to 90 days (180 days with penalties to the buyer), while the deferral of grain deliveries by producers is generally met with penalties. With that, it can be observed that contract terms have become more complex over the past ten years, or so, allowing grain companies to control the flow of grain into their facilities beyond what is agreed upon on the 'face' of the contract.

## **2 Common Issues Identified by Producers**

The crop year 2021/22 will be remembered as a year fraught with problems, ranging from Covid-19 complications to extreme weather events in Western Canada. The severe circumstances have emphasised several lingering issues in the agriculture industry that need to be dealt with, especially when climate change impacts are expected to increase in frequency in the foreseeable future.

One of the concerns ‘brought to a head’ by the severe circumstances is the design of grain purchase contracts, and the underlying question of whether they still are ‘fair’ to both producer and buyer and if they apportion various risks embodied in these contracts reasonably to both sides.

While producers came forward with complaints, buyers/ companies did not voice complaints at that point. Part of the reason may be that it is the buyers who draft the contracts, not the sellers. Given that, section 2 may read as producer oriented. However, the overall goal is that producers and buyers agree on solid contract practises.

*Mercantile* listed the issues highlighted by producers in relation to contracts. In no particular order, they are:

- 2.1 contract balance (lack of even-handedness between producer and buyer)
- 2.2 Terms and Conditions are too complex and hard to understand
- 2.3 inability to amend Terms and Conditions
- 2.4 handling of Overages and Underages
- 2.5 penalty calculations
- 2.6 failure of buyer to mitigate<sup>9</sup> damages
- 2.7 supply chain issues that should not be passed back to producers, but should be dealt with at a different level

The following is a discussion of the common issues identified by producers with examples relating to each of the issues:

### 2.1 Contract balance (lack of even-handedness)

Pertaining to even-handedness in contracts (fairness to both contractual partners), it is important to clearly acknowledge that contracts—even one-sided contracts—should be enforced if they are freely made. However, it is equally important to recognize that there are limits to this principle, and that balanced contracts are more easily resolved and tend to result in fewer execution problems. In fact, there “is a recognition in law that unfair contract terms can cause significant harm. They may result in sizeable economic losses for a contracting party. They cause increases in litigation. Finally, they engage the moral sense of the courts and the legislature, which speak of them in the lexicon of moral disapproval, using words such as unconscionable, unconscientious, and abuse of power.”<sup>10</sup>

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<sup>9</sup> **Mitigation** in law is the principle that a party who has suffered loss has to take reasonable action to minimize the amount of the loss suffered. As stated by the Canadian Federal Court of Appeal in *Redpath Industries Ltd. v. Cisco (The)*, “It is well established that a party who suffers damages as a result of a breach of contract has a duty to mitigate those damages, that is to say that the wrongdoer cannot be called upon to pay for avoidable losses which would result in an increase in the quantum of damages payable to the injured party.”

<sup>10</sup> British Columbia Law Institute, *Unfair Contract Terms: An Interim Report*, BCLI Report No. 35, February 2005, p. 1

Regarding grain contracts, especially the application of Terms and Conditions dealing with *commodity delivery terms* for producers (failure to deliver grain in a timely manner) as compared to the failure by grain companies to take delivery of grain in a timely manner fall into this category. As summarised [see Table 2], the failure by producers to deliver tends to be governed by a litany of conditions outlining damages and fees, while the infringements by buyers to take delivery are generally dealt with by automatically extended delivery periods ranging from 60-180 days, while occasional small storage fees apply. In most cases, storage fees apply only after the extended delivery period ends.

Simply put, the bulk of the 21 grain contracts reviewed show that there is ample protection for delays by the grain companies in accepting grain, but the failure of producers to deliver grain in a timely manner is met by fees, penalties, buyouts, or outright contract cancellations. As one producer said, grain companies are not liable for weather events (one of the justifications for delaying grain deliveries), but producers are (by companies not accepting the weather excuse for delays or cancellations).

Grain companies also tend to have much more success at adding in special conditions to contracts compared to producers who want to amend or add terms they disagree with/ wish to add. [See also 2.3]. Below are 2 examples of buyer advantage in contract and 1 example of a producer's lack of success in quering the Terms and Conditions of a contract.

- a) *Example expansion of delivery window:* Under the contract terms reviewed, companies are able to expand/ delay delivery windows amongst other things due to “strikes, lockouts, or labour disputes; wars, riots, acts of terrorism, sabotage, embargoes, actions by foreign, federal, state or local governments; *transportation shortages or delays; shortage of supply or unavailability of railcars or storage space, or delays or defaults caused by common carriers “or any other reason”*” and so on. (Italics Mercantile).
- b) *Example of a Force Majeure clause:* “Force Majeure. Buyer is not responsible for performance under this Contract in the event of conditions beyond Buyer's reasonable control such as but not limited to, labour disputes and disturbances, embargo delays, accidents, fire, delay or non-performance of carriers, acts of God, war, terrorism or other criminal acts or threats thereof, weather, earthquakes or other disaster, governmental action, *unavailability of or delays in obtaining supplies, materials, machinery, utilities or services or other resources, or other events whether similar or not.* In such event, at Buyer's option and upon notice to Producer, *Buyer shall be relieved of further performance under this Contract, in whole or in part,* or Buyer may suspend its performance, in whole or in part, for a period of time equal to the time period of the event and a reasonable period thereafter.” (Italics Mercantile).

This compares to terms pertaining to producers, such as: “The Producer shall be fully liable for any failure to deliver the Grain or any other default or failure to perform its

obligations under a Contract due to any cause whatsoever, *whether beyond the Producer's control or not.*"

Presumably, should Force Majeure or the various exemptions stated, not apply equally to both sides of the contract?

- c) One producer queried the following items in Terms and Conditions of one contract:
- i) no tolerance stated; producer would like to establish a tonnage tolerance (quantity on Face page given as an exact MT).
  - ii) the settlement by "unload weights, grade and dockage *less any elevation or handling fee as stipulated in the corresponding grain receipt*"; producer would like the elevation fee defined (grain receipt not available until delivery and the agent could not specify what this charge was).
  - iii) "if the seller is unable or otherwise fails to deliver (buyer) at its option may take delivery on the Seller's land, in which case, the Seller grants the rights of ingress, access and egress, and cost of such delivery shall be based on hauling rates deemed reasonable by (buyer) and will be charged to the Seller"; producer wanted this clause removed (property rights, access without injunction, buyer-only not buyer/producer agreement on cost and hauling rates).
  - iv) the addition of an Elevation fee; producer wants this removed as sold fob farm. The agent said he'd ask Head Office (buyer) and later returned with "that's Head Office (buyer)" on all queries except for the scrapping of the elevation fee.

The lack of even-handedness in the above examples is evident, with the contract cost/benefit advantaging the buyer rather than shared in a reasonable way by both buyer and producer.

## 2.2 Complexity of Terms and Conditions

All contracts reviewed feature a distinct set of Terms and Conditions. These cover one to three full pages of densely scripted Terms and Conditions outlining anything from contract acceptance, delivery terms, extension periods, notice periods, contract cancellations, defaults, Force Majeure, liability, grade determination, underlying law, to Grain Act declarations and more.

The main problems with this approach are:

- Contract terms and wording can vary from company to company, though they are very similar on all key aspects.
- There are too many Terms & Conditions, and many terms are difficult to understand without legal training.
- Terms can change from one season to the next without being highlighted.
- Producers are frustrated by the fact that attempted amendments are extremely unlikely to be accepted by the company. They also have to fight for change separately with each company.

- Many contracts have “catch-all phrases” in their force majeure clauses.

It has also been repeatedly stated that company buying agents are not able to fully explain or clarify terms when asked to do so by producers. If the agents do not understand the terms they are asking producers to sign, then neither party is exercising due diligence.

Adding to the complexity and potential confusion is the fact that all the contracts reviewed are distinct from the others, and terms, definitions and wording vary between contracts. It seems that companies have more leeway to move target dates for various hard to dispute reasons, while producers generally face penalties for such moves. Generally, companies also have a lot more contract enforcement tools at their disposal than do producers.

The devil is in the detail: In addition to the difficulty of understanding the phrasing of many terms, below is the ‘range’ or ‘variety’ of conditions commonly used in the 21 contracts reviewed (number of contracts in brackets).

**Table 2: Range of Terms**

| Range of conditions commonly used (no. of contracts out of 21 in brackets)                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Call period</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
| <ul style="list-style-type: none"> <li>- <b>Range of Call Periods by buyer</b> <ul style="list-style-type: none"> <li>o “Immediately” (x1)</li> <li>o 24 hours (x3)</li> <li>o 7 days (x1)</li> <li>o Not specified (x16)</li> </ul> </li> </ul>                                                                                                                                                                                                                                                                                               |
| <b>Extended delivery period</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
| <ul style="list-style-type: none"> <li>- <b>Range of Extended Delivery Windows available to buyer</b> <ul style="list-style-type: none"> <li>o No “Extended Delivery Window” provision (x1)</li> <li>o 1 Month (x1)</li> <li>o 60 days (x4)</li> <li>o 90 days (x7)</li> <li>o A period not to exceed 180 days (x1)</li> <li>o For a period of time equal to the time of the event that prevented the buyer’s performance and a reasonable amount of time after the end of the event (x1)</li> <li>o Not specified (x6)</li> </ul> </li> </ul> |
| <b>Storage Fee, Penalty, or Storage Penalty</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
| <ul style="list-style-type: none"> <li>- <b>Range of Storage Fee rates payable for undelivered grain to producer</b> <ul style="list-style-type: none"> <li>o No more than 0.5% of the purchase price per month (x1)</li> <li>o \$0.05/mt per day (x1)</li> <li>o \$0.10/mt per day (x1)</li> <li>o \$1.00/mt per month (x1)</li> <li>o \$1.95/mt per month (x1)</li> <li>o \$2.00/mt (x1)</li> <li>o \$2.00/mt per month (x5)</li> </ul> </li> </ul>                                                                                          |

- A one-time lump sum of \$10.00 and Liquidated Damages as defined by the handling tariff posted by the CGC<sup>11</sup> plus 1% interest on all outstanding Liquidated Damages (x1)
- According to the CGC Licensed Primary Elevator tariffs for the buyer company (x1)
- Storage rates according to the CGC Licensed Primary Elevator tariffs for the buyer company and interest by calculating the interest rate on the price of the grain. (x1)
- Not specified (x7)

#### Administrative Fees

- **Range of Administration Fees charged by buyer**
  - \$5.00/mt of undelivered grain (x1)
  - \$15.00/mt of undelivered grain (x2)
  - \$20.00/mt of undelivered grain (x1)
  - The buyer's Tariff Rate (posted with the CGC) x mt of undelivered grain (x1)
  - All costs and expenses including legal fees (x2)
  - Not defined (x12)
- **Range of interest charges on Administration Fees by buyer**
  - 1% per month compounded monthly (12.68% annually) to the date of payment
  - Simple interest of 3% from the date of default to the date of the payment. (x1)
  - 1.75% per month compounded monthly (29.15% annually) to the date of payment (x3)
  - Simple interest rate of 3% (x1)
  - None mentioned (x16)

#### Non-Delivery Penalty

- **Range of Non-Delivery Fees/ penalty charged to producer for late delivery or default**
  - \$0.05/mt per day until grain is delivered (x1)
  - \$0.10/mt per day until grain is delivered (x2)
  - The price difference between the contracted grain and current higher market price plus \$15.00/mt of undelivered grain. (x1)
  - The price difference between the contracted grain and current higher market price plus \$20.00/mt of undelivered grain (x1)
  - None mentioned (x16)

#### Current Market Price

- **Range of buyout calculations charged to producer**
  - Replacement cost and any competitive premium. (x2)
  - All costs of buying out of the hedge, or replacing the grain, or all other losses, damages and expenses. (X2)
  - Amount of undelivered crop multiplied by the price on the last day of the delivery period multiplied by the handling tariff with the CGC. (x1)
  - The difference between the contract price and the replacement cost (x4)
  - Include, but not limited to the replacement cost. (x1)
  - Replacement cost or any other reasonable amount. (x1)

<sup>11</sup> The current list of elevator charges registered at the CGC can be found here:  
<https://www.grainscanada.gc.ca/en/grain-research/statistics/elevator-charge-summaries/>

- o Not mentioned or defined (x10)
- **Range of definitions of "Replacement Cost"**
  - o Not specified (x8)
  - o The difference in price between the contracted price and the price of recent purchases made by the buyer on or around the day of cancelation (x2)
  - o The difference between the contract price and the price at the close of the next day when trades can be made. (x1)
  - o The difference between the contracted price and the price that must be paid to replace the commodity at the delivery point. (x1)
  - o None mentioned (x9)

**Alternative Delivery Location**

- **Range of Transportation Cost compensation to producer if delivery location was changed**
  - o No compensation is mentioned. (x3)
  - o Buyer will pay for the increase in transportation cost. (x5)
  - o Buyer will pay standard Freight Rates of a maximum of \$15/mt. (x1)
  - o No alternate delivery location mentioned (x12)

**Monies Deductible or Set-Off**

- **Monies deductible from producer's compensation for grain include**
  - o Amounts owing to the buyer including monies owed from
    - Producer's failure to deliver
    - Liquidated Damages
    - Carrying Charges
    - Feed sales
    - Fertilizer sales
    - Chemical sales
    - Interest charges
    - *Any and all applicable railway freight tariff increases or increase in freight rates*
    - Any reason
  - o Amounts owed in cash advances

**Ability to Demand Assurance**

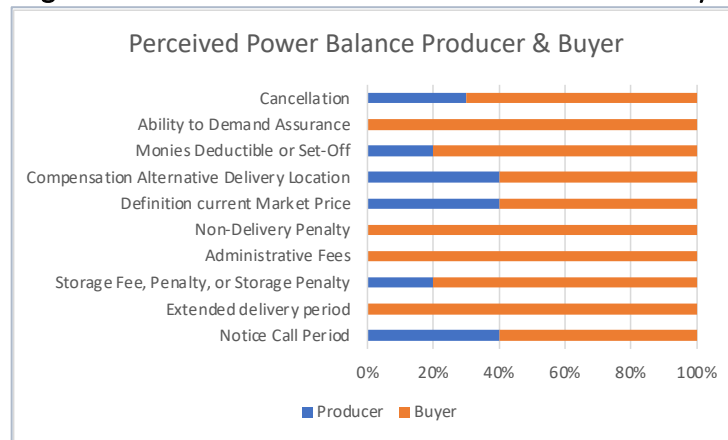
- **Range of Assurances available to buyer**
  - o Securities Deposit
  - o Securities interest in the Grain or any proceeds from the Grain including production contracts, grain settlements, cash purchase tickets, cash advances, revenue/ crop, insurance proceeds, government payment, or other sources associated with the Grain.
  - o Irrevocably appointing the buyer as the producer's attorney to settle any insurance claims and receive the proceeds thereof.
  - o Inspect grain
  - o Inspect crop
  - o Audit producer's records and facilities and those of the producer's agents
- **Range of timeframes**
  - o 48 hours available to deliver



| Cancellation |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
|--------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| -            | <p><b>Range of reasons for cancelation by producer</b></p> <ul style="list-style-type: none"> <li>o “Exceptional cases” such as crop failure, only if agreed upon by the buyer (x1)</li> <li>o Default of contract by buyer (x3)</li> <li>o Agreement between buyer and seller (x2)</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| -            | <p><b>Range of reasons for cancelation by buyer</b></p> <ul style="list-style-type: none"> <li>o Any default of contract by seller (x12)</li> <li>o Late/delayed signing of contract by seller (x1)</li> <li>o If the buyer is unable to receive the grain within the extended delivery window (x1)</li> <li>o “Any Reason” or “No Reason” (x2)</li> <li>o Insolvency (x1)</li> <li>o Bankruptcy (x1)</li> <li>o Receivership (x1)</li> <li>o If a case is brought against the seller (x1)</li> <li>o If a trustee or custodian for the seller is appointed in a case. (x1)</li> <li>o Agreement between buyer and seller (x2)</li> <li>o The cancellation of a different contract between the buyer and seller. (x1)</li> <li>o Not mentioned (x10)</li> </ul> |
| -            | <p><b>Cancelation Liability</b></p> <ul style="list-style-type: none"> <li>o Equally distributed</li> <li>o Buyer is not liable to the producer for any amount while the producer is liable to the buyer for all costs associated with the contract cancelation.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
| -            |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |

Looking at all the variations in terms one might ask: Who benefits, and who does not, and which terms benefit whom? The following graph shows the power (im)balance for various terms between producer and buyer as perceived by Mercantile:

Graph 1: Perceived Negotiation Power Balance between Producer and Buyer



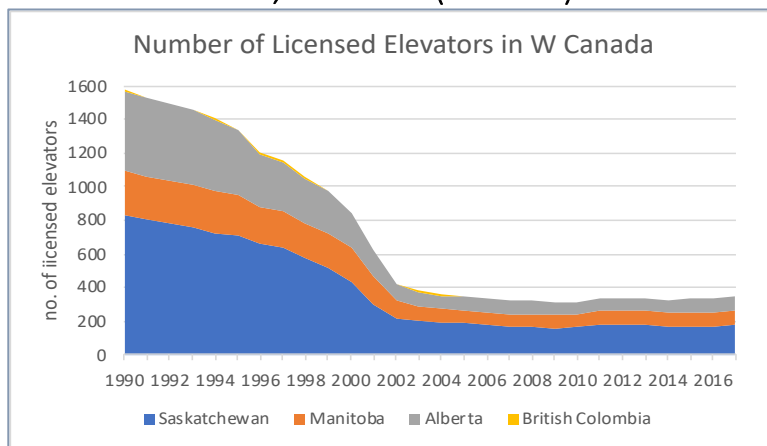
### 2.3 Ability to amend terms– Lack of bargaining power

Mercantile can attest to numerous cases where producers tried to amend some contract clauses (for example, buyer’s excessive delivery window extensions) but were turned back with a “take it

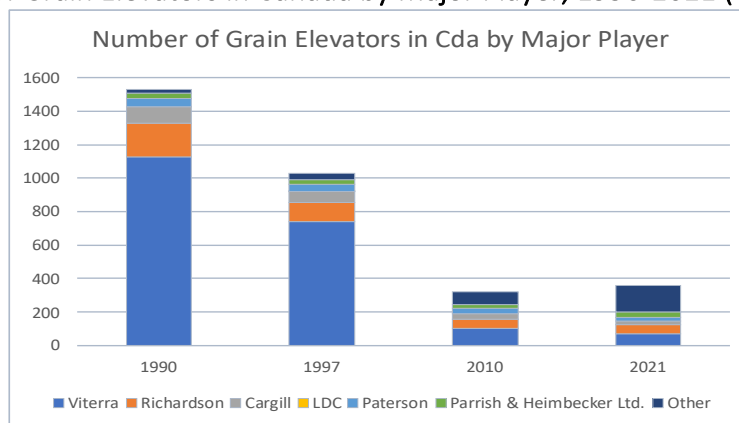
or leave it” comment. Many company purchase contracts cannot be amended either due to an “entire agreement” clause, or because company policy discourages amendments. “Entire agreement” clauses contain language that the contract cannot be changed or amended in any way and that the contract supersedes any and all conversations, promises, agreements and understandings (verbal or written) between the elevator agent and the buyer prior to the contract. A commonly heard phrase is: “Head-office does not allow amendments.” It is frustrating to producers that most requests for amendments are rejected outright. One outcome is that the practise discourages producers from doing a thorough reading/review of all Terms and Conditions.

The ability to amend contracts may be related to the number of alternative facilities/ companies accepting/ receiving grain at any point in time within reach of producers. When enquiring about contract processes in other geographies, contacts in Australia stated: “If traders use contractual terms that farmers do not like well, they will just stop selling to them and move on to the next alternative.” - Depending on the commodity and area under discussion, there seem to be fewer company options available in Canada, so that sales to alternative companies are not always a viable option [see graphs 2 and 3].

Graph 2: Number of Licensed Elevators, 1990-2021 (CGC data)



Graph 3: Number of Grain Elevators in Canada by Major Player, 1990-2021 (CGC data)



\*For 1990 and 1997 "Vitera" is a combination of all the Pool and UGG elevators.

## 2.4 Handling of Overages and Underages

Many purchase contracts show no tolerances to the tonnage purchased when deliveries cannot be accurate due to the nature of the deliveries. Tolerances are a standard feature in contracts between companies. Contracts between commercial entities carry a 5% more or less tolerance to the tonnage at seller's option at the stated contract price. This accommodates tonnage differences due to bin estimates or transportation and helps avoid disputes about the value of the overage/ underage.

In comparison, Grain Trade Australia (GTA) specifically developed a producer purchase contract (Contract #6)<sup>12</sup>, which states the following to accommodate delivery tolerances: "QUANTITY TOLERANCE: The Seller shall have the option of delivering five percent [5%] or twelve [12.00] mt, whichever is the lesser quantity, more or less than the contractual quantity at the Contract price. This variation of five percent [5%] or twelve [12.00] mt is hereinafter referred to as the "Tolerance"." As it currently stands in Canada, the tonnage discrepancies in the purchase contracts lead to unnecessary disputes about the tonnage owed and/or disputes about the pricing of the overage.

## 2.5 Buy-Out and Penalty calculations

Buy-out calculations: There needs to be more transparency/ precision about how replacement values are handled. Specifically, the calculation of 'liquidated damages' needs to be clearly and transparently defined and what triggers the buyout/ effective date triggering the calculation.

If the buyer intends to collect penalties beyond the liquidated damages, this should be clearly stated, highlighted, and defined in the contract. It is the lack of clarity around the buy-out and calculations that triggered the 2021 resolutions by five grower organisations cited above.

Administration fees: Not all contracts specify that 'administration fees' will apply in case of contract cancellation, and it is debatable if this is a necessary charge when contracts are cancelled due to environmental reasons. *Mercantile* also notes that producers do not tend to charge 'admin fees' when changes are made at the company end. Thus, administration fees are seen as one-way fees for buyers but not the producers in the case of contract cancellation. The Administration Fees discovered in the 21 purchase contracts reviewed ranged from 'undefined' to '\$20.00/mt of undelivered grain' [see also Table 3].

---

<sup>12</sup> GTA Contract No.6 – Grower Contract,  
<https://www.graintrade.org.au/sites/default/files/TRC/Contract%20No%206%20Growers%20Contract.pdf>

**Table 3: Range of Administration Fees**

| Range of Administration Fees Commonly Used (no. of contracts out of 21 in brackets) |                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
|-------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| -                                                                                   | <b>Range of Administration Fees charged by buyer</b> <ul style="list-style-type: none"> <li>o \$5.00/mt of undelivered grain (x1)</li> <li>o \$15.00/mt of undelivered grain (x2)</li> <li>o \$20.00/mt of undelivered grain (x1)</li> <li>o The buyer’s Tariff Rate (posted with the CGC) x mt of undelivered grain<sup>13</sup> (x1)</li> <li>o All costs and expenses including legal fees (x2)</li> <li>o Not defined (x12)</li> </ul>                      |
| -                                                                                   | <b>Range of interest charges on Administration Fees by buyer</b> <ul style="list-style-type: none"> <li>o 1% per month compounded monthly (12.68% annually) to the date of payment</li> <li>o Simple interest of 3% from the date of default to the date of the payment. (x1)</li> <li>o 1.75% per month compounded monthly (29.15% annually) to the date of payment (x3)</li> <li>o Simple interest rate of 3% (x1)</li> <li>o None mentioned (x16)</li> </ul> |

Replacement fees: In addition to administration fees, some companies also charged ‘Replacement fees’ (ranging from \$30-\$60/mt) on top of the administration fee and buyout calculations this past fall, without giving a justification or rationalization for such fees.

Liquidated damages or buyouts: ‘Liquidated Damages’ is the cost of buying the undelivered grain at today’s price. According to the APAS survey, there were several cases where no justification or objective standard was given on how the ‘current market price’ was determined. While some companies used their spot price on the day of cancellation, others were charging replacement fees upwards of \$4.00 per bushel over their current posted bid. Table 4 is a list of the various ways that ‘current market price’ is defined in the 21 studied contracts.

**Table 4: Range Buyout calculations and Definitions of Current Market Price**

| Range Buyout Calculations and Definitions of the ‘Current Market Price’<br>(no. of contracts out of 21 in brackets) |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
|---------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| -                                                                                                                   | <b>Range of buyout calculations charged to producer</b> <ul style="list-style-type: none"> <li>o Replacement cost and any competitive premium. (x2)</li> <li>o All costs of buying out of the hedge, or replacing the grain, or all other losses, damages and expenses. (X2)</li> <li>o Amount of undelivered crop multiplied by the price on the last day of the delivery period multiplied by the handling tariff with the CGC. (x1)</li> <li>o The difference between the contract price and the replacement cost (x4)</li> <li>o Include, but not limited to the replacement cost. (x1)</li> </ul> |

<sup>13</sup> The current list of elevator charges registered at the CGC can be found here: <https://www.grainscanada.gc.ca/en/grain-research/statistics/elevator-charge-summaries/>

- Replacement cost or any other reasonable amount. (x1)
- Not mentioned or defined (x10)
- **Range of definitions of “Replacement Cost”**
  - Not specified (x8)
  - The difference in price between the contracted price and the price of recent purchases made by the buyer on or around the day of cancelation (x2)
  - The difference between the contract price and the price at the close of the next day when trades can be made. (x1)
  - The difference between the contracted price and the price that must be paid to replace the commodity at the delivery point. (x1)
  - None mentioned (x9)

In addition to administration fees and replacement costs, we found contracts with provisions for late delivery fees,<sup>14</sup> [Table 5] interest charges [Table 5], or a combination of any and all of the fees mentioned above: Administration Fee + Replacement Cost + Delivery Penalty x Interest Rate.

**Table 5: Range of Additional Fees**

| <b>Range of Additional Fees and Penalties</b> (no. of contracts out of 21 in brackets) |                                                                                                                              |
|----------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------|
| <b>Non-Delivery Penalty</b>                                                            |                                                                                                                              |
| -                                                                                      | <b>Range of Non-Delivery Fees/ penalty charged to producer for late delivery or default</b>                                  |
| ○                                                                                      | \$0.05/mt per day until grain is delivered (x1)                                                                              |
| ○                                                                                      | \$0.10/mt per day until grain is delivered (x2)                                                                              |
| ○                                                                                      | The price difference between the contracted grain and current higher market price plus \$15.00/mt of undelivered grain. (x1) |
| ○                                                                                      | The price difference between the contracted grain and current higher market price plus \$20.00/mt of undelivered grain (x1)  |
| ○                                                                                      | None mentioned (x16)                                                                                                         |
| <b>Interest Rate</b>                                                                   |                                                                                                                              |
| -                                                                                      | <b>Range of interest rates</b>                                                                                               |
| ○                                                                                      | 1% per month compounded monthly (12.68% annually) to the date of payment                                                     |
| ○                                                                                      | Simple interest of 3% from the date of default to the date of the payment. (x1)                                              |
| ○                                                                                      | 1.75% per month compounded monthly (29.15% annually) to the date of payment (x3)                                             |
| ○                                                                                      | Simple interest rate of 3% (x1)                                                                                              |
| ○                                                                                      | None mentioned (x16)                                                                                                         |

2.6 Failure of buyer to mitigate damages

<sup>14</sup> Late delivery fees charged to the producer begin on the first day after the end of the delivery window in contrast to storage fees charged to the elevator that begin on the first day after the 30-90 day extended delivery period.

There are complaints by producers about the timing of buyouts. In volatile markets, especially those driven by environmental calamities, the timing of the buyout can result in important differences to the magnitude of the buyout invoice. Both parties need to be conscious of and responsible for the consequences of not reacting to the notice of threatening default (non-performance). Again, there should be a clearly outlined process as to how these are handled. Early warnings by producers that their ability to perform may be in jeopardy need to be taken seriously. The damage should be confirmed/ corroborated by the buyer/ buyer's agent. Early notice dates need to be marked and should initiate the process of damage mitigation. Non-action by the buyer should not necessarily become the burden of the producer.

Example of buyer delay in buyout action: the buyer was officially notified by the producer on July 12<sup>th</sup> that the damage to their fields due to lack of moisture was such that the producer could no longer expect to generate enough volume to cover their contract. The producer asked to settle a buyout at that time. After the buyer failed to react with the buyout calculation, the producer repeatedly asked the buyer about the status of the buyout on a weekly basis but was only presented with a buyout value on Sept. 9<sup>th</sup> (59 days after the initial notice) based on Sept. 9 values. Buyer delays in acting on buyout requests like these present legitimate questions about *damage mitigation* by the buyer. Given that climate variation threatens to cause increased variability in production outcomes, a consistent set of rules about how to handle buyouts caused by unusual (confirmed) circumstances will doubtlessly prevent many disputes about buyout values.

## 2.7 Supply chain issues

This issue turns back to the ability of companies to expand/ delay delivery windows amongst other things due to “strikes, lockouts, or labour disputes; wars, riots, acts of terrorism, sabotage, embargoes, actions by foreign, federal, state or local governments; *transportation shortages or delays; shortage of supply or unavailability of railcars or storage space, or delays or defaults caused by common carriers*”, and so on.

As discussed in Section 3, occurrences completely out of the control of producers, but within the purview of companies, should not be a valid excuse to expand contract terms. Companies should not be able to delay delivery periods without consequence and need to take responsibility for all terms under the contract. They should find ways to execute accordingly.

### 3 The concepts of fairness, clarity and overreach/ spheres of control with respect to producer contracts

#### 3.1 Fairness/ level playing field<sup>15</sup>

Fairness can be defined as the “the quality or state of being fair, *especially* fair or impartial treatment, and lack of favoritism toward one side or another.”<sup>16</sup> Fair-mindedness is marked by impartiality and honesty.<sup>17</sup> A ‘level playing field’ is defined as a state in which conditions in a competition or situation are fair for everyone.<sup>18</sup>

When applied to contract design, this concept would imply that contract terms should assign bonuses and penalties evenly to both parties, relinquish the attempt to create one-sided advantages, and apportion risk reasonably between the two parties. For example, penalties may apply evenly for delays in delivery and delays in accepting delivery. Similarly, tonnage tolerances exist in contracts between buyers, and should also apply to producers to accommodate shipments. And there should be a process where producers and elevators can discuss contract terms and adjust them should they find this mutually beneficial.

In reality, the GTA tries to achieve this in their design of a grower contract, discussions about mutual contractual obligations<sup>19</sup>, and training workshops.

Frasa et al. (2015) found that 46% of Prairie agricultural producers feel that they are being treated fairly by contracts compared to 24% who indicated that they do not feel that contracts treat them fairly.<sup>20</sup> In contrast, when producers were asked whether their rights were protected by the contract, just 24% of producers said they somewhat agreed to strongly agreed versus 41% who said they somewhat disagreed to strongly disagreed. Meanwhile, 80% of producers indicated they felt that the companies' (buyers') rights were being protected by the contract.<sup>21</sup>

<sup>15</sup> The concept of Fairness/ Level Playing Field is also variously referred to as code of practise (p.7), even-handedness (p. 10) and fair-mindedness (p. 21).

<sup>16</sup> “Fairness.” *Merriam-Webster.com Dictionary*, Merriam-Webster, <https://www.merriam-webster.com/dictionary/fairness>. Accessed 16 Feb. 2022.

<sup>17</sup> “Fair-minded.” *Merriam-Webster.com Dictionary*, Merriam-Webster, <https://www.merriam-webster.com/dictionary/fair-minded>. Accessed 16 Feb. 2022.

<sup>18</sup> “Level playing field.” *Merriam-Webster.com Dictionary*, Merriam-Webster, <https://www.merriam-webster.com/dictionary/level%20playing%20field>. Accessed 22 Feb. 2022.

<sup>19</sup> GTA – Guide to a Contract Washout;

<https://www.graintrade.org.au/sites/default/files/Publications/014%20Grain%20Contracts%20-%20Contract%20%27Washout%27%2019July2021b.pdf><https://www.graintrade.org.au/sites/default/files/Publications/014%20Grain%20Contracts%20-%20Contract%20%27Washout%27%2019July2021b.pdf>

<sup>20</sup> Given the responses to the APAS survey and the interviews that Mercantile has done with farmers over the years, we expect that this sentiment of fairness has diminished since this survey took place in 2013.

<sup>21</sup> Frasa, Stefanie & Carlberg, Jared & Hogan, Robert, 2015. "[Use of Contracts by Prairie Agricultural Producers](#)," [Working Papers](#) 232328, Structure and Performance of Agriculture and Agri-products Industry (SPAA).

Reviewing the current apportioning of risk between producers and buyers, a larger burden falls on the side of producers, while leaving buyers with enhanced coverage. It is no surprise that a legal opinion based on the earlier 14 sample contracts concluded that the “sample contracts all appear to be drafted by buyers and are heavily tilted in their favour.”<sup>22</sup>

For example, under the current contract design, growers carry most of the production risk, quality risk, storage risk (up to delivery), and cash-flow risk. Meanwhile buyers are able to cover the bulk of the sourcing risk, purchase price risk, quality risk, asset utilization, and currently are able to pass down some of their rail logistic risks back to producers.

**Table 6: Various risk covered by contracts for both producer and buyer**

| Risks Covered by Contract |                            |                                                                                  |
|---------------------------|----------------------------|----------------------------------------------------------------------------------|
| Contractual Partner       | Existing Risks             | Are Risks Covered by Contract?                                                   |
| Producer Risks            | Production risk            | No                                                                               |
|                           | Quality risk               | No                                                                               |
|                           | Price risk                 | Yes                                                                              |
|                           | Storage risk               | Partially; elevator has the ability to extend the delivery window up to 180 days |
|                           | Cash Flow                  | Yes, only if delivery period is not changed significantly.                       |
| Buyer Risks               | Grain sourcing             | Yes                                                                              |
|                           | Price risk                 | Yes                                                                              |
|                           | Grain quality              | Yes                                                                              |
|                           | Elevator/ asset management | Yes                                                                              |
|                           | Logistics/ rail            | Partially, w.r.t grain supply                                                    |

*Mercantile* also notes that - while this is not evident in the current producer contract design, through the 20th century both the judiciary and legislature have increasingly moved to strike out surprising and unfair terms, particularly in favour of consumers, employees, or tenants with weaker bargaining power.<sup>23</sup>

As more contracts are being challenged this year, the act of adjusting the Terms and Conditions of the producer contracts towards a more cooperative, balanced, and fair-minded design, might prevent intervention by the regulatory environment and will enhance contract compliance. In this context, the idea of a ‘code of practice’ surrounding producer contracts was floated by a member of the faculty of Agricultural Economics of the University of Saskatchewan.<sup>24</sup> To this

<sup>22</sup> Thomas S. Kent, General Opinion on Enforceability of Grain Contracts, August 12, 2021, p. 2.

<sup>23</sup> “English Contract Law”. [https://en.wikipedia.org/wiki/English\\_contract\\_law#Unfair\\_terms](https://en.wikipedia.org/wiki/English_contract_law#Unfair_terms). Accessed 16 Feb. 2022.

<sup>24</sup> Richard Gray, Professor and Grain Policy Chair, Department of Agricultural and Resource Economics, University of Saskatchewan, conversation Feb. 17, 2022



end, the Australian GTA has a Code of Practice that could be instructive for both producers and buyers in improving the grain contracts here in Canada.

### 3.2 The need for Clarity (and Transparency)

Unless it is clearly defined what the contract terms mean to the contracting company, there is room for contract disputes and costly trips to the law courts. Indeed, the general legal advice on contracts is: use plain language; use defined terms, make sure both parties understand all terms.

Revisiting the contract issues highlighted by producers (e.g., inability to understand terms, inability of buyer's agents to explain terms, lack of definition of buy-out calculations and penalty calculations, handling of overages/ underages), it is evident that some contracts have not been well understood, and that clarity has not been achieved.

Research into contractual obligations has shown that the main factor that inhibits the understanding of contract documents is the complexity of document itself. There is a need for the contract document to be written in plain language. Research also shows that there are "various factors that could support the process of improving the understanding of contract document. The highest ranked factor is sincerity in contracting. This issue is related to the complexity of the contract documentation itself. The contract document must be written with the intention of a 'win-win' attitude in mind. The contract document must be clear and precise. On top of everything, the contract document must be fully understood by the stakeholders."<sup>25</sup>

Related to the topic of clarity is the notion of obfuscation, the action of intentionally making something obscure, unclear, or unintelligible. Obfuscation in contract law is defined as the concealment of intended meaning in communication, making communication confusing, intentionally ambiguous, and difficult to interpret. It can be deliberately confusing in order to conceal the truth. An example of obfuscation may be the following:

The inclusion of grading factors (beyond the official grade factors) in contracts, when prior discussion between producer and buyer/ agent was based on 'official' grade standards/ grade names. (e.g., inclusion of HFN in #2 CWRS purchases (specifying a specific falling number); # 3 CWAD 'Milling' (listing specifications almost identical to #1 CWAD specifications).

Because of several inherent uncontrollable risks, the smooth workings of the agriculture supply chain depend on trust and cooperation between partners along the value chain. In this environment, increasing contract clarity and decreasing obfuscation will without doubt increase efficiencies.

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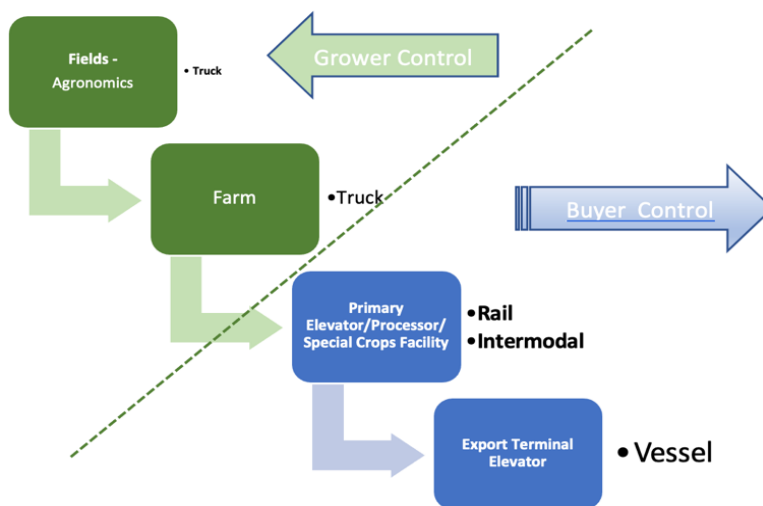
<sup>25</sup> Rosli Mohamad, Clarity and improving level of understanding of contract documentation, January 2008, [https://www.researchgate.net/publication/49910807\\_Clarify\\_and\\_improving\\_level\\_of\\_understanding\\_of\\_contract\\_documentation](https://www.researchgate.net/publication/49910807_Clarify_and_improving_level_of_understanding_of_contract_documentation), accessed Feb. 16, 2022.

### 3.3 Overreach/ Spheres of Influence

The definition of overreach includes the “the gaining of an unconscionable advantage over another especially by unfair or deceptive means”.<sup>26</sup> This is very strong wording, and we would like to add to this the concept of “Sphere of Control”, not in the political sense, but in terms of the ability to control events or actions relevant to contract execution.

Perhaps the most blatant example of overreach touches on delivery issues. Producer contracts generally specify “Fob farm” or “Delivered elevator” as delivery end point and have zero influence or concern in what the grain company plans to do with the grain, or how it plans to move the grain. The company, in turn, coordinates their sales programs independently and is the entity negotiating with railroads and transportation companies. The risk of non-delivery of railcars or delays for the conveyance they contract, should rest with the company controlling the grain to be loaded. To pass back the negative effects of delays to the producers simply is not a reasonable apportioning of that risk. Basically, grain companies need to take full responsibility for their purchases and the timing inherent in their purchases.

Graph 4: Grain Logistic Areas of Control



(Mercantile, 2022)

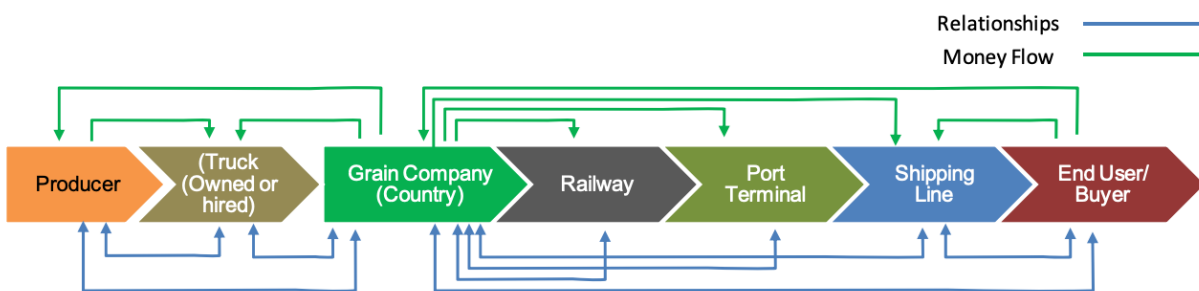
To elaborate on this point: In their Supply Chain study<sup>27</sup>, Quorum corporation states the following: “The Canadian grain supply chain has one fundamentally unique attribute in that the production of the product is one step removed from the rest of the supply chain (as portrayed in

<sup>26</sup> “Overreaching.” *Merriam-Webster.com Legal Dictionary*, Merriam-Webster, <https://www.merriam-webster.com/legal/overreaching>. Accessed 10 Feb. 2022.

<sup>27</sup> Quorum Corporation, *Supply Chain Study-Final Report*, Sept. 2014, p. 30.

the Graph 5 below). Producers’ (farmers) relationship with the supply chain will generally be at a single point– through the grain company - who buys their grain and then market and manage all subsequent logistics for the movement to the end buyer. The relationships and attendant supply chain costs associated with all aspects of the sale and movement are factored into the price obtained by the farmer at the country elevator when grain is delivered. Consequently, the producers of Canadian grain do not have direct participation or formal commercial relationships with the other participants in the supply chain except for the grain company they are selling to, however, they must accept the costs that flow back through the supply chain and are reflected in the price paid for their grain.”

**Graph 5: Quorum -The Canadian Grain Supply Chain Model (Bulk product through the country elevator system)**



Again, producers have no authority over the furtherance of their grain beyond delivery, and therefore the execution of their contract should not effectively be dependent on conditions the grain companies face with contractual partners down the supply chain.

Additional examples of overreach/ spheres of influence concerns:

“Entire Agreement” clauses: These clauses state that amendments can only be done in writing, and matters discussed before signing the contract may not be used as evidence compared to the written report. Grain brokers in Saskatchewan took particular offence to the practice that “several major companies do not honour what their representatives/ agents have discussed and agreed upon with growers (or the broker representing the grower)”. They highlighted this modus operandi as the “single biggest problem” with current grain contracts, when, in practise, the agent is the only available contact to discuss the agreement to be entered.

Unrevealed changes in grades: In an example recorded in February 2022, a grain company advertised a certain price for a “#3 CWAD” purchase. The producer and elevator agent agreed on the grade price, but when the contract was sent to the producer, it read “# 3 CWAD Milling” under grade, but the specifications listed below the grade designation were almost entirely equivalent to a #1 CWAD. When questioned about the specifications, the agent responded that these are “their own # 3 CWAD

Milling specifications". However, in this case, the contract should read grade per listed specifications, but NOT # 3 CWAD.

The ability to access land: Several of the contracts studied had the provision that the elevator company could send representatives onto the producer's land for the purposes of sampling the crop, inspecting the grain, picking up the grain, or auditing and inspecting the producer's records and facilities.

The ability to obtain financing on behalf of the farmer: Some elevator companies have clauses in their contract granting them permission to access financing on behalf of the producer in order to obtain payment for outstanding amounts of grain.

Confidentiality clauses: Many contracts have confidentiality clauses where the producer is expected to keep confidential the terms and conditions of the contract.

Appointment of the elevator company as producer's attorney: There was one clause that irrevocably appoints the elevator company to be the producer's attorney to settle all claims and to receive any and all proceeds from insurance.

The notion of 'spheres of influence' might be helpful to design more balanced contracts by clearly delineating where responsibility is assigned and accepted [see Graph 6].

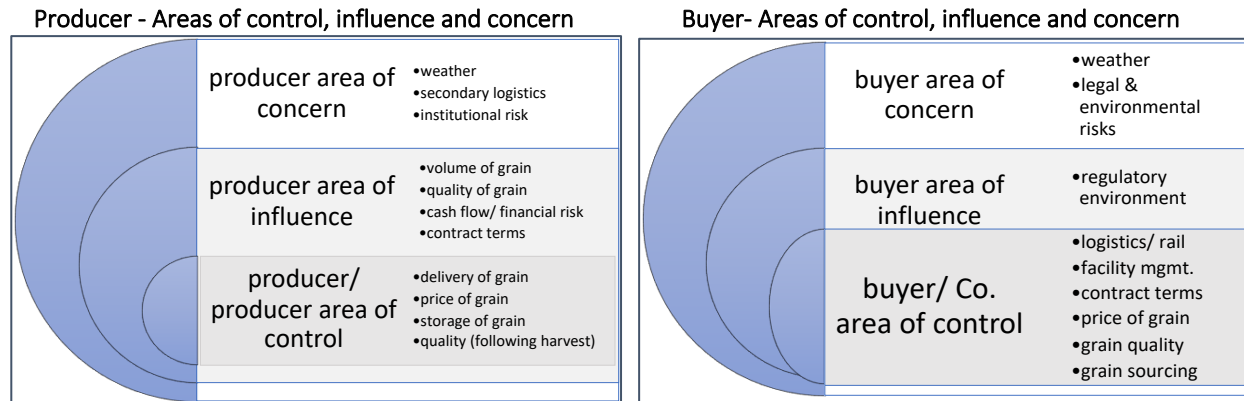
These graphs are designed to:

- a) outline areas of control, influence and concern for both producer and buyer, and
- b) depict the various risk covered by contracts for both producer and buyer.

The fundamental, key terms covered on the face of the contract include Commodity, Grade, Quantity, Price, Shipment period, Payment terms and potentially, a Governing Contract. These are the fundamentals of the agreement and both parties should be very clear about the responsibilities taken. Any changes to the fundamental terms, like quantity delivered and shipment period, should require a formal agreement between both parties based on clearly outlined procedures. To have risks that are clearly not under the control of one party flow back to producers through Terms and Conditions on the back of the contract is akin to shirking responsibility for the contract as written.

To achieve improved even-handedness and a better apportioning of risks in the contracts, secondary logistic problems (i.e., the buyer's logistic challenges) should not be allowed to be passed back to the producer and both parties need to be regarded as equal negotiation partners.

Graph 6: Areas of Control, Influence and Concern



(Mercantile, 2022)

## 4 Potential Solutions

### 4.1 Cooperation between producer and buyer

There is a clear need for contract revision, certainly from the producers’ perspective. The issues raised in this report also show that buyers may be at risk of offering contracts that their agents are unable to explain or meaningfully negotiate with the producers. This suggests, quite strongly, that it is mutually beneficial to producers and buyers to improve the producer contracts used in the Grain Trade.

If there was agreement within the industry that producer contracts can be improved upon for the benefit of both producer and buyer, this already would be the first step to enhancing existing contracts. The principles of *improved fairness (level playing field), clarity, and better balance of contract terms and conditions* might be the basic guideposts for a contract re-design.

However, an overall producer contract review will require cooperation and good will between producers and buyers (companies). Based on the recent initiatives on resolutions, growers may well represent themselves in this exercise by a committee of their grower commissions. On the buyer side, it will require the willingness of buyers to cooperate both with each other and with producers. If successful, mutual cooperation and good will towards the process will enhance contract compliance and might prevent intervention by the regulatory environment. The know-how and experiences of companies can be incorporated in the standard terms and conditions.

Important:

Before turning to the potential benefits of a standardized contract, *Mercantile* considers there must be a discussion about the essential elements of the contracts and about the responsibilities taken in a contract (by both parties) to achieve significant streamlining of the document.

For example:

- a) Delivery delays: Typically, for producer contracts, there are two delivery bases: fob farm and delivered elevator. For fob farm and delivered elevator, we propose a one week extension allowed for the buyer (or as specified and vetted by both parties on the face of the contract).
  - o If the buyer fails to take the product within the terms purchased, the default clause comes into play.
  - o Similarly, if the seller/ producer fails to deliver per contract, then this represents a default, and the buyer can buy in at market price (based on the price at day of default). If the market price is better than the contract price, the buyer can walk away from the contract.
- This simply means that both buyers and sellers/ producers must take full responsibility for the contract. Being this clear, a whole range of terms and conditions can be struck.
- b) Specific terms: There needs to be a category for additional terms on the face of the contract. These terms need to be discussed by both parties and agreed upon in writing (by both parties) at time of purchase.
- c) Each contract must be negotiated and signed by both sides.

Having very clear consequences for both contractees for missing to fulfill all terms of the contract will increase clarity and transparency of the contracts, will simplify the list of terms, and will remind both sides of the responsibilities taken with each contract.

## 4.2 Standardized Contracts

Other than setting strict general guidelines for producer contracts, one option for contract enhancement involves the development of a simple and clear standardized contract.

The advantages of standard form contracts include:

- reduced cost
- better familiarity with and understanding of consistent contract terms
- higher confidence in contract terms
- an established body of case laws for future reference.

Standard contracts also highlight the essential elements of the contract, as these are the fundamental terms left to be defined on the face of the contract. Specifically, these include type of grain; quality; quantity; delivery period; delivery point; price; other special terms & conditions.

A simultaneous incorporation of specific Trade & Dispute Resolution Rules also helps to outline and define how any disputes or controversies relating to the contract are going to be handled. Underlying trade rules generally give clear definitions of all terms used, thus standardizing the

terms, and making them more transparent. Over time, a library of arbitrated disputes can/ will serve as a body of cases for future reference.

The development of standard grain contracts is not a new idea. In fact, 80% of the world's trade in grain is shipped based on standard contract forms developed by GAFTA<sup>28</sup>, and as such grain companies are already well acquainted with standardized contracts and contract arbitration as defined by these contracts. GAFTA contracts are geared towards trade between grain companies and across international borders. Similarly, the Global Pulse Confederation (GPC)<sup>29</sup> developed a standardized contract for the international trade of pulses, which pulse exporters are familiar with. There are also examples of standard contracts specifically developed for trade between producers and grain companies. Grain Trade Australia (GTA)<sup>30</sup> developed 'Contract No. 6' specifically for the use of producers and grain merchants. The contract is widely used in that country between producers and buyers.

Regarding contract No. 6, the GTA states that "The intention of Standards is to create a "level playing field" with regard to the quality of grain being traded which facilitates transparency in pricing and the quality of the Australian crop, benefiting producers and traders alike. .... It is critical that anyone who becomes a party to a contract that refers to GTA Standards has a clear understanding of what the Standards mean in practical and theoretical terms and how to apply those Standards."<sup>31</sup>

The GTA also conducts an Arbitration service to deal with contract disputes. To quote: "GTA's Dispute Resolution and Arbitration Service instills commercial confidence in the industry by underpinning and providing sanctity of grain contracts in Australia. This increases market efficiency and reduces risk across industry. Awards issued by GTA Arbitrations are as enforceable as a ruling by a Court. The service is open to all participants of the grain trade, not just GTA members." The Australian approach of industry cooperation and coordination might serve as a template towards a fresh and considered approach towards Canadian producer-buyer contracts.

In this context *Mercantile* would like to highlight that we are not talking about diluting producer responsibilities. Rather, we consider a neutral, fair, clear, and balanced approach desirable and beneficial for the whole industry.

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<sup>28</sup> The Grain and Feed Trade Association (Gafta) is an international trade association with over 1900 members in 100 countries. The aim of the association is to promote international trade in agricultural commodities, spices and general produce, and to protect the members' interests worldwide.

<sup>29</sup> The Global Pulse Confederation (GPC, formerly known as CICILS IPTIC) represents all segments of the pulse industry value chain from growers, researchers, logistics suppliers, traders, exporters and importers to government bodies, multilateral organizations, processors, canners and consumers. Its membership includes 24 national associations and over 600 private sector members.

<sup>30</sup> Grain Trade Australia (GTA) was formed in 1991 to standardise grain trading standards, trade rules and grain contracts across the Australian grain industry to enable the efficient facilitation of trade across the grain supply chain.

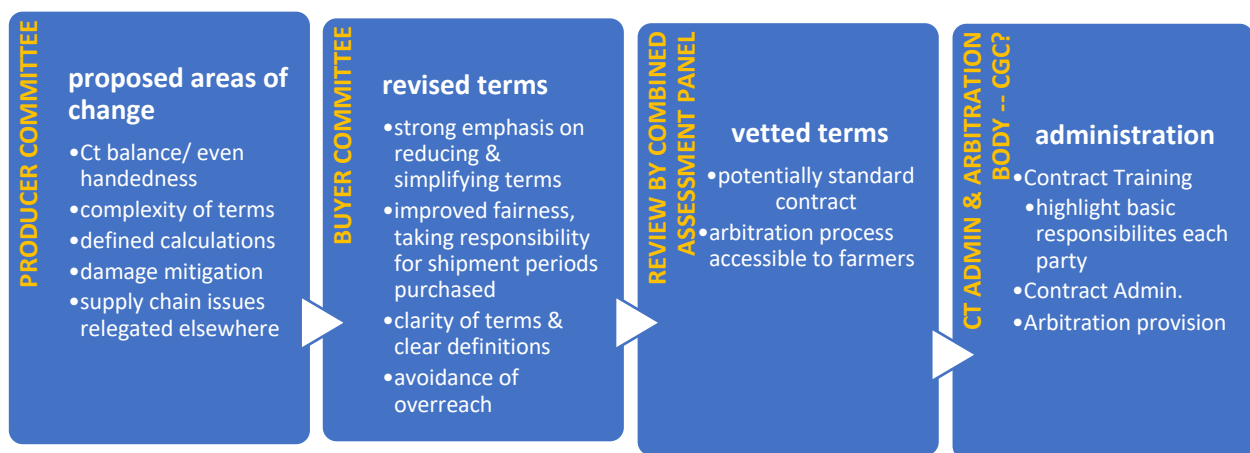
<sup>31</sup> GTA, Guide to the GTA Grain Trading Standards 2021/22 Season, 24<sup>th</sup> edition, p. 3

For example, referring to producers, the GTA code of practice includes the following statement: “Producers should clearly understand at the time of contracting what the risk and its implications are in the event of production difficulties and the inability to fulfil contract obligations due to reduced or failed production; Where variations to the contract are agreed, these should be confirmed in writing between the parties in a clear and transparent manner.”

Referring to buyers, the GTA code of practice includes this statement: “Buyers and other industry participants will implement the following protocols: Publish all fees and charges associated with any products or services in a transparent and clear manner. This will be achieved by buyers posting all fees and charges on their respective websites and/ or making such information freely available upon application.”<sup>32</sup>

A streamlined process to a revised contract is shown below (Graph 7). The key will be to focus on the fundamentals of the contract, to avoid complicating the basic intent of the contracts, and to keep fairness, clarity (transparency) and avoidance of overreach in mind.

Graph 7: Proposed Process to Revised Contract



(Mercantile, 2022)

#### 4.3.1 Development and Administration of Standardized Contracts

As suggested above, changes to the way contracts are approached can come from the grain company level, the producer level, the federal government level, or a combination of these.

At the grain company level, elevator associations such as the Western Grain Elevator Association (WGEA) could be a leader in recognizing the current imbalance of overreach in the contracts

<sup>32</sup> GTA Code of Practice, <https://www.graintrade.org.au/grain-industry-codes>, accessed Feb. 15, 2022.



issued by their members. In an act of self-governance, the WGEA could require its members to adopt contracts that are revised or standardized and could set up systems to ensure compliance through regular (annual) checks or third-party audits.

Options are more limited at the producer level given the current structure of the market. However, the recent resolutions that were coordinated between the major Saskatchewan producer associations show a willingness to work together to achieve change. Producers may well represent themselves by a committee of their producer commissions. If this effort fails, producers may favour intervention by the regulatory environment.

### 1. Regulate

At the Federal government level, the Canadian Grain Commission (CGC) is the federal body responsible for administering and enforcing the Canada Grain Act and the Canada Grain regulations. In doing so, they “regulate the grain industry to protect producer’s rights and to ensure the integrity of grain transactions.”<sup>33</sup> The CGC already has systems in place for monitoring compliance regarding disputes in grain grading. Further, on August 1, 2018, the CGC announced its surplus investment framework. The framework outlined ways the CGC was planning to invest its \$130 million accumulated surplus. One of the three “strategic investment” pillars is to “strengthening safeguards for producers” by making “enhancements to producer protections and grain quality assurance.”<sup>34</sup> While the CGC is likely expecting to make their enhancements to producer protections regarding payment and grain quality, enhanced protections and fairness in contract terms could be included in this framework. A possible structure for a ‘grain contract oversight and compliance committee would include one member from the CGC, and two members elected by the grain elevator associations and two members elected by producer groups. - *A role for the CGC in enhancing grower knowledge about contracts (training) and in the administration and potentially arbitration of standard contracts would provide a role for the CGC in line with the Grain Act and the function to “protect producer’s rights and ensure the integrity of grain transactions.*

### 2. Collaborate

Alternatively, producers and elevators could develop a collaborative approach that could be facilitated by organizations such as the Canada Grains Council. The Canada Grains Council is a national organization composed of several producer groups and grain elevator companies with a mission to “lead, facilitate and support policy development and implementation on cross commodity issues and opportunities.”<sup>35</sup> An organization like the Canada Grains Council seems to be aptly situated to facilitate collaboration between producers and elevators to design/adopt a more balanced contract. Similar to above, the committees would include an equal number of

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<sup>33</sup> <https://www.grainscanada.gc.ca/en/about-us/org/initiatives/2021/updating-grain-grading-dispute-resolution.html> Accessed: Feb 17, 2022.

<sup>34</sup> <https://www.grainscanada.gc.ca/en/about-us/org/initiatives/2018/surplus-investment.html#:~:text=The%20Canadian%20Grain%20Commission%20will,the%20entire%20Canadian%20grain%20sector.> Accessed Feb 17, 2022

<sup>35</sup> <https://canadagrainscouncil.ca>. Accessed Feb 17, 2022

members elected by the grain elevators and producer groups with a neutral third party that is mutually agreed upon by producers and elevators.

In each of the structures, the committees would be in charge of designing and/or adopting the terms of the contracts and would have the responsibility of reviewing the contracts on an annual basis.

## 5 Recommendations

Considering the number of disputes and general discontent this past fall and winter, *Mercantile* sees little downside to a thoughtful contract review and potentially contract standardization if the primary goal is to reduce such disputes while improving product flow.

There are several approaches that could be taken to improve the lack of fairness, clarity and balance of contract terms and conditions, but the most effective one will be a collaborative approach between grain buyers, producers and regulators.

1. Collaboration
  - Mercantile's strong recommendation is to undertake a serious attempt at collaboration between producers and buyers (each represented by an appointed committee) to:
    - simplify contract terms by concentrating on contract fundamentals and specific terms on the face of the contract and reduce the number of Terms & Conditions
    - define and tighten up all remedial actions and fees to achieve more clarity and transparency
    - clearly define both parties' responsibilities to achieve better balance.

[See also Graph 7].

A collaborative approach to this issue will be the best way to move forward and ensure that the rights of all parties are protected in grain contracts. Mercantile recommends that leadership on this issue come from the producer, buyer and government levels in the forming of a committee in charge of designing or adopting the fair, clear and reasonable terms of a standardized contract. This standardized contract would then be used across the industry. This committee would also be tasked with reviewing the terms of the contracts on a regular basis (annually), monitoring compliance and resolving any disputes that may arise.

2. Standard Contracts
  - Mercantile recommends the adoption of a standardized contract that is fair and balanced to both the buyer and the producer. Grain contracts issued by GAFTA, GPC and the GTA are examples of standardized contracts that are being successfully used. A well-designed standardized contract will protect the rights of both sides of the contract, increase

confidence in the industry and would thus limit litigation, increase efficiency and decrease risk across the industry.

3. Contract Administration and Arbitrations

- Further, the Canadian Grain Commission seems ideally suited and financially able to take on a role in producer contract training, standard contract administration (if a standard contract is the choice) and accommodating contract arbitrations between producers and buyers.

Appendix A: List of figures was obtained from Frasa et al. (2015) study: "Use of Contracts by Prairie Agricultural Producers"<sup>36</sup>

Figure 2. Online respondents' historical usage of marketing, production, and TUA contracts

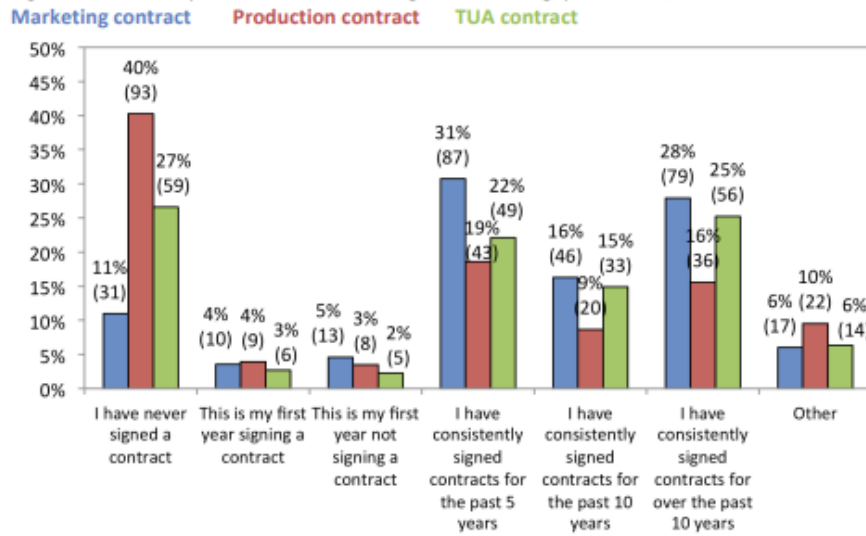
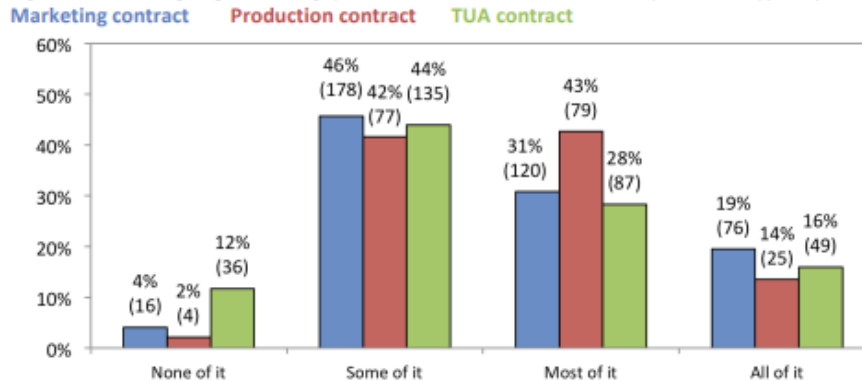


Figure 5. Before signing marketing, production, and TUA contracts, respondents' typically read



<sup>36</sup> Frasa, Stefanie & Carlberg, Jared & Hogan, Robert, 2015. "Use of Contracts by Prairie Agricultural Producers." Working Papers 232328, Structure and Performance of Agriculture and Agri-products Industry (SPAA).

Figure 12. Respondents' perspective of "When using the contract, my rights are protected"  
Marketing contract

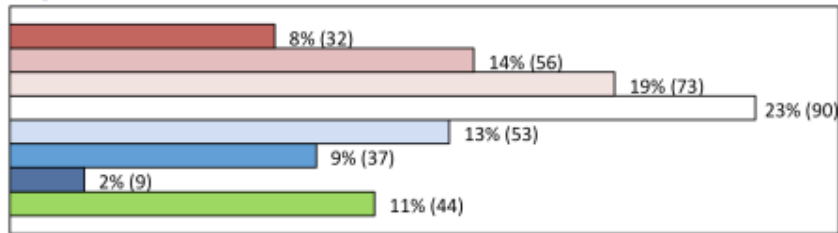


Figure 13. Respondents' perspective of "The company's rights are protected by the contract"  
Marketing contract

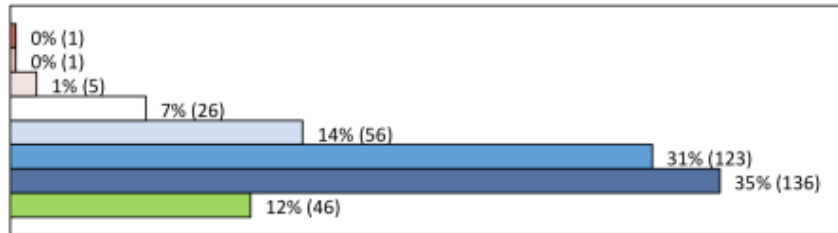


Figure 14. Respondents' perspective of "When I read the contract, it is easy to understand"  
Marketing contract

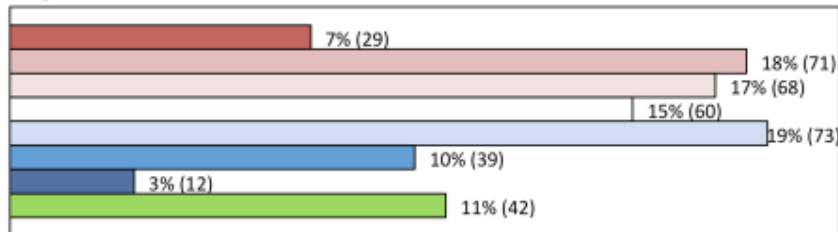
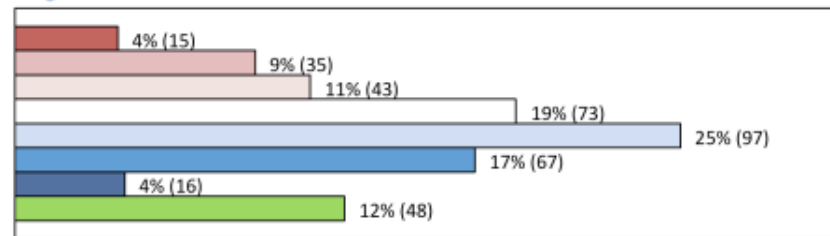


Figure 15. Respondents' perspective of "I am treated fairly by contracts"  
Marketing contract



- Strongly disagree
- Disagree
- Somewhat disagree
- Neither agree nor disagree
- Somewhat agree
- Agree
- Strongly agree
- No response