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## Industrial Hemp Production Contracts: Managing Expectations and Mitigating Loss

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As states increasingly afford farmers opportunities to grow hemp and produce hemp products, legal disputes between buyers and sellers are bound to arise. Both buyers and sellers can look to mitigate their risks by ensuring that they plan for them in their production contracts. Contract law varies from state to state, but there are general principles that apply everywhere. Contracts for hemp production are no different. Hemp contracts are still relatively new so good contracts are hard to find; however after collecting available examples from around the country we have broken them down by common clauses to discuss differences and similarities in this new industry.

### Licensing and Costs

Hemp cultivation and production is heavily regulated by both the state and federal governments. Accordingly, growers and processors often need to be licensed before beginning operation. Failure to secure the proper licensing before beginning an operation will invariably lead to delay or termination of production, and possibly civil or criminal penalties.

To address this issue, many hemp production contracts explicitly require parties to secure and prove that they have the proper licenses before beginning any production. This burden almost exclusively falls on the grower, not the buyer of the final product; however most states also require that the processor of the raw hemp crop also have a license which they would be responsible to obtain. One area where licenses and fees are more likely to be shared are for testing, delivery, or other post-cultivation activities which may not fall squarely into either grower or processor responsibilities.

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## Confidentiality

Ensuring confidentiality is a common practice in business contracts, but it is particularly common with hemp production. Because hemp cultivation is relatively new industry, there are continuing innovations among growers and producers to set their products apart from the competition. Consequently, intellectual property, such as the innovation of proprietary technology and genetic modification, is often the focus of these confidentiality provisions. Another common subject of a confidentiality clause is the pricing mechanism that the processor uses to compensate the grower. Some contracts go as far as prohibiting parties from even disclosing the existence of the contract.

Prohibitions on disclosure of various facts of production or the agreement are not categorical. Absent express exceptions in the contract, various state and federal statutes require disclosure of certain things despite a contract's confidentiality requirements. For example, parties may disclose what they are required to by applicable law without being considered in breach of the contract. However, most contracts require that the other party receive notice before this information is disclosed. Furthermore, confidentiality clauses typically do not bar the disclosure of information that has become readily publicly available through no fault of the grower or information that was independently developed by employees or consultants of the buyer without reliance on such confidential information.

Another objective of the confidentiality clause is security. Hemp production contracts often address preservation of the secrecy of the location of the greenhouses or fields where the hemp is grown. Though hemp is legally different from marijuana, that distinction is not common knowledge. Consequently, hemp production sites face enhanced security threats as individuals may think the crop is marijuana or there have been instances where people knowingly stole industrial hemp plants. One of the most efficient ways that parties can protect against this risk is to include in their contract a confidentiality provision protecting against disclosure of the site where the crop is grown along with the quantity grown.

## Cultivation

The grower is typically required to use its best efforts in cultivating the agreed upon product. This standard is often defined as producing and cultivating hemp in accordance with industry standard. The grower agrees perform its services diligently to meet those standards. For example, a grower's typical obligations are to:

- Cultivate and care for the product and take precautions to keep it free from disease and comply with the terms set by the buyer.
- Apply only the chemicals and treatments pre-approved by the buyer and legal under state or federal regulation.
- Provide access to the crop for the buyer from time to time to ensure that the growing conditions conform to the agreement.
- To limit access to the product and knowledge of the operation to only those parties involved in the contract or state or federal agencies with enforcement authority.

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Certain contracts explicitly prohibit the growth of marijuana on any land that will be used to grow industrial hemp. In the event that this type of cross-contamination occurs, the agreements provide that the grower will have waived its right to any compensation for the product grown and will be declared in breach of the contract. This is for both ensuring quality and avoiding any criminal liability for the grower or buyer. Many contracts acknowledge that the grower may not be successful in producing the estimated quantity or quality expected by the buyer. Accordingly, the agreements typically provide that a grower is not obligated to do so if he is legitimately unable to; however, if it is unable to grow the expected quantity or quality, the grower is prohibited from transferring that product to any other party.

As the industry matures we expect contracts to further tailor the cultivation and harvesting requirements to meet the individual needs of the processors taking into account factors such as the equipment that they use and the final products that they market.

## Quality and Testing

The quality of the delivered product is typically one of the most focused upon and detailed provisions of hemp production contracts. The buyer typically sets the standards for the quality of hemp it expects. One example of the standards set are as follows:

- Not greater than 1% green seeds after cleaning;
- 0% orange or brown “meats” after hulling;
- Not greater than 2% yellow “meats” after hulling;
- Not greater than 0.1% sclerotinia;
- 0% pesticides, fungicide or herbicide chemical residue, no glyphosates at all.

Often the standards for quality based upon state or federal regulations. This typically requires that the hemp is relatively free of any contaminants such as mold or non-hemp biomass and shall have a moisture content that is consistent with long-term product stability. The buyer often further requests that the product be free of chemical, pesticides or herbicides and that the grower prove such by providing the buyer with a copy of a state license and state-issued fitness certificate or certified third-party laboratory. To ensure that the product is the quality that the buyer expects, agreements generally require that the grower either deliver a sample for testing to the buyer or perform testing on the product itself to determine the quality of the product. For example, one agreement requires that the grower provide a five-pound sample immediately after harvest that is representative of the grower’s production. A separate sample is required for each grade that is grown. Buyers also often require growers to provide access to the crops as often as is deemed necessary to inspect the crops from time to time.

If the buyer is performing the tests in-house then the grower may also want to take samples at the same time and send them off to a certified third-party lab to verify the results that the buyer gets because those results are often going to have a dramatic impact on the price the grower will receive.

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## Delivery

Strict time limits are often imposed regarding the time between harvest and delivery ranging from 48 hours to 5 days. These requirements are generally specifically addressed, but sometimes contracts just note that time is of the essence. Liability for delays in delivery are almost entirely placed on the grower absent gross negligence by the buyer. Upon delivery of the inappropriate quantity or quality, some contracts provide that the grower is responsible for paying the buyer for storage of the product, which typically determined by a set price per pound, per day.

Leftover seed or product grown in excess of the agreement is typically agreed to be the property of the buyer and the grower has no authority to sell excess seed or product to anyone but the buyer that is a party to the contract. Similarly to when a non-compliant crop is cultivated, growers are generally required to destroy excess hemp or leftover seed.

## Liability/Risk of Loss

When disputes arise over the quality of the product, agreements vary as to the remedies available to each party. Typically, the buyer or distributor has great discretion and protection in dealing with these issues, which often means the ability to reject the product at its sole discretion. Nevertheless, the buyer still must normally notify the buyer of its decision to reject the product. When this happens, the grower is often allowed to keep the rejected product unless the contract requires otherwise, which would likely be because of some intellectual property interest that the buyer has in the hemp. However, even when the grower retains the rejected product, contracts will likely require that the buyer destroy it to prevent the grower from profiting from a product not grown in accordance with the contract.

The grower generally assumes the responsibility for any liability arising from the quality of the product grown. On occasion, contracts permit for liability to shift to the buyer upon transfer provided that the grower provided all necessary and accurate information related needed for testing of the product. For example, the grower may be liable, and accordingly suffer a loss, if it fails to take precautions to keep the crops free from disease and comply with any directions given by the buyer. This includes only applying chemicals and treatments to the crops that the buyer has permitted to be used.

In the event that disputes grow into litigation, parties may choose to address this through mandatory arbitration or choice of law and venue provisions. Though growing and production agreements are often between intrastate parties, most contracts contain a choice of law clause. In the instance that the two parties are not within the same state, the agreement typically provides that the applicable law is that of the state where the buyer is located. Choice of venue clauses typically set venue in the jurisdiction—often the county—where the buyer is located.

## Conclusion

Contracts for the cultivation and sale of industrial hemp are still in their infancy. Many contracts across the

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country do not take into account the different challenges facing the industrial hemp industry compared to other commonly grown crops. However, due to the high investment costs associated with growing industrial hemp farmers, and their lenders, like the certainty afforded by these contracts. When this is coupled with the requirement from the USDA Agricultural Marketing Service that hemp growers must have a contract in place to market the crop before they are able to purchase crop insurance has made contracting even more appealing to growers.

Unfortunately, the collapse of the CBD market in 2019 has made many processors unwilling to guarantee a purchase price which puts crop insurance out of reach for many growers and exposes growers to greater risk due to the high cost of producing a hemp crop for CBD or CBG purposes.

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