


MANAGING RISK IN UNCERTAIN TIMES: STRATEGIES FOR HEMP BUSINESSES



**A guidebook for hemp
businesses looking for basic
information about what types
of insurance are available**

MANAGING RISK IN UNCERTAIN TIMES



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If 2020 has taught us anything, it is that no amount of planning can remove risk from our lives and business plans.

The best-crafted business strategy can crumble because of unexpected events, and the deepest wells of capital might run dry in the face of a global market collapse.

But can an entrepreneur take steps to help ensure those risks are less costly to a hemp business in the long run? Absolutely.

Welcome to the first risk-mitigation report from *Hemp Industry Daily*, which provides a comprehensive look at the tools available to allay the severity of unknown dangers that hemp businesses might face in the future.

Consider this a basic handbook of strategies and products to protect your hemp investment from unforeseen risks, whether you are growing hemp, processing it into finished goods or bringing those products to the public.

You'll find comprehensive information and insights on risk-mitigation products and strategies—and how much they'll cost, including guidance on:

- Crop insurance.
- Business property insurance.
- Business interruption insurance.
- Workers' compensation insurance.
- Legal strategies to make contracts less risky.

Hemp entrepreneurs have a wealth of options that are available only at incredible cost to the still federally illegal marijuana industry. But hemp's legality doesn't mean insurance is inexpensive. Savvy business owners in any field must weigh the risks before deciding which tools they truly need.

Those tactics will change through the lifespan of any business. This report should not be considered the final word of lessening all risk. Instead, consider this your starting point for evaluating potential hazards in your current business plan.

If you have questions about mitigating risk in the hemp industry or want to provide feedback, please contact me at kristen.nichols@hempindustrydaily.com.

A handwritten signature in black ink that reads "Kristen Nichols".

Kristen Nichols
Editor

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HOW CROP INSURANCE HELPS HEMP FARMERS PROTECT PROPERTY, INTERESTS

When hemp became a federally legal crop in the United States under the 2018 Farm Bill, the possibilities opened for cultivators to access federal programs afforded to traditional crop farmers, including the opportunity to purchase federal insurance through the U.S. Department of Agriculture.

Booming interest in growing hemp also increased the number of private companies that offered policies for crop insurance.

Crop-insurance programs offer a safety net for farmers' investments, providing a way to recoup costs if inclement weather, pests/diseases or a natural disaster destroys a hemp crop.

Seen as a risky crop because of the higher cost of production compared to traditional agriculture, including expensive seed and clones, unstable genetics and a high learning curve for growing a new and labor-intensive crop, hemp farmers have chanced producing it because of the promise of a high payoff at harvest.

But mismanagement of crops at harvest and a nationwide overproduction of hemp has caused crashing market prices, and the potential for mature hemp to test above the federal legal limit of 0.3% has made for a volatile market. Further, severe weather is causing farmers to look for help securing their crops to protect investments.

Hemp growers can apply for both federal and private crop insurance, though the processes are vastly different and offer different types of protection.

FEDERAL CROP INSURANCE

The USDA's introduction of the interim final rule for federal crop protection at the end of October 2019 came along with announcements of new crop-insurance programs for hemp farmers, administered through the USDA's Risk Management Agency. Hemp farmers are now eligible for federal crop-insurance policies, including:

- Whole-Farm Revenue Protection (WFRP).
- Multi-Peril Crop Insurance (MPCI) hemp pilot program.
- Nursery Crop Insurance.
- Nursery Value Select (NVS) pilot crop insurance.
- Noninsured Crop Disaster Assistance Program (NAP).

WFRP covers industrial hemp farmers producing hemp for **fiber, flower or seeds** if they are in areas covered by USDA-approved hemp plans or are part of approved state or university research pilot programs.

The WFRP program provides a risk-management safety net for all commodities on the farm under one insurance policy and is available in all counties nationwide, according to the USDA.

The plan provides coverage for agricultural commodities up to a total insured revenue of \$8.5 million and is common for specialty crops, organic commodities and nontraditional crops.

To be eligible for the **WFRP program**, farmers must be compliant with state or tribal plans, and their hemp crops must not test over the 0.3% THC limit. Hemp will not qualify for replant payments under the policy.

Farmers looking to buy WFRP insurance policies must meet one of the following criteria:

- A five-year history of farm income.
- A three-year history of farm income if they are beginning farmers or military veterans.
- A **contract for the purchase** of their insured industrial hemp crop.

The MPCl hemp pilot program provides coverage against loss of yield because of insurable causes of loss for hemp grown for fiber, grain or CBD.

The MPCl program is limited to producers in **select counties** of 21 states in 2020, including:

- Alabama.
- California.
- Colorado.
- Illinois.
- Indiana.
- Kansas.
- Kentucky.
- Maine.
- Michigan.
- Minnesota.
- Montana.
- New Mexico.
- New York.
- North Carolina.
- North Dakota.
- Oklahoma.
- Oregon.
- Pennsylvania.
- Tennessee.
- Virginia.
- Wisconsin.

Under the MPCl pilot, hemp does not qualify for replant payments, which assist farmers in replanting an insured crop that has been damaged by an insurable cause of loss.

Hemp also does not qualify for prevented-plant payments, which offer farmers coverage when they fail to plant an insured crop with the proper equipment by the final planting date designated in the insurance policy's special provisions, or during the late-planting period, if applicable. Final planting dates and late-planting periods vary by crop and by area. Eligibility requirements stipulate that growers:

- Have a history of at least one year producing hemp.
- Have a contract for purchase of their hemp crops.
- Have a license to produce hemp.
- Comply with the appropriate state, tribal or federal regulations or operate under a state or university research pilot authorized by the 2014 Farm Bill.
- Produce at least 5 acres of hemp for CBD or 20 acres for grain or fiber.

Hemp producers that cannot access federal crop insurance can purchase the USDA Farm Service Agency's NAP, which is available to protect against losses associated with:

- Lower yields.
- Destroyed crops.
- Prevented planting.

Basic coverage is available at 55% of the average market price for crop losses exceeding 50% of expected production, and farmers can increase that coverage in some cases. Premiums and service fees apply on a per-crop or per-producer basis.

To become eligible for NAP coverage, farmers must:

- Have a contract for purchase of their hemp crops.
- Have a license to produce hemp.
- Comply with the appropriate state, tribal or federal regulations or operate under a state or university research pilot authorized by the 2014 Farm Bill.
- Provide a processor contract to the USDA no later than the acreage reporting date.

Beginning in 2021, hemp producers growing the crop in containers will be insurable under the nursery crop-insurance program and the NVS pilot crop-insurance program starting in the 2021 crop year. Producers are eligible only if they are compliant with state, tribal and federal regulations.

NVS is a pilot program that allows nursery producers to select the dollar amount of coverage that best fits their risk-management needs. Coverage levels for both programs range from 50% to 75%.

NVS is available in select counties in Alabama, Colorado, Florida, Michigan, New Jersey, Oregon, Tennessee, Texas and Washington state.

Nursery growers are eligible for coverage under these programs by plant category if they meet the following criteria:

- Plants are grown in a nursery that receives at least 40% of its gross income from the wholesale marketing of nursery plants.
- They meet all the requirements for insurability.
- Plants are grown in an appropriate medium.
- They are grown and sold with the root system attached.
- Hemp nursery plants might not be insurable if they are:
 - Grown in containers containing two or more different genera, species, subspecies, varieties or cultivars.
 - Classified by a state or county as illegal to grow or sell in the county in which the nursery is located.
 - Grown as stock plants.
 - Grown solely for harvest of buds, flowers or greenery.

The nursery must be inspected and approved as acceptable before insurance coverage can begin.

As an asset-based form of insurance, the hemp nursery programs cover similar causes of loss as the existing nursery program including:

- Adverse weather conditions such as wind, hurricane and freeze. If cold protection is required for the plant category, adequate and operational cold-protection measures must be in place.
- Failure of irrigation water supply, if it stems from an insurable cause of loss, such as drought.
- Fire, provided weeds and undergrowth are controlled.
- Wildlife.

Under the additional level of coverage, nursery growers may purchase the Occurrence Loss Option (OLO) in conjunction with the NVS policy in exchange for an additional premium. The OLO allows indemnities to be paid on smaller losses if a minimum dollar value of loss is exceeded.

FEDERAL INSURANCE RULES

For all federal crop insurance programs, producers must report their acreage to county farm regulators as soon as possible after planting, said Richard Fordyce, an administrator in the USDA's Farm Services Agency (FSA). The final acreage reporting date for both programs in 2020 is Aug. 15.

Acreage reporting is required to comply with federal and state law enforcement. Hemp farmers must also provide their THC testing results when production is reported.

"Hemp (that tests) above the federal legal level (0.3% total THC) is an ineligible cause of loss," Fordyce said.

Hot hemp—or crops that test above the federal legal limit of 0.3% THC—will be ineligible for production-history purposes, and the USDA will not pay an indemnity on it, according to Fordyce.

All multi-peril federal programs are available through private crop-insurance agents. Farmers can find a list of crop-insurance agents at USDA service centers and the RMA website.

More details about the USDA-RMA programs are [available here](#).

PRIVATE POLICY COVERAGE

To cover the limitations of the federal crop-insurance programs, private insurance companies suggest farmers consider adding more coverage.

They say federal crop insurance is designed to work in specific states with specific qualifying criteria, and because of the high costs of crop inputs such as seed and clones, as well as labor for planting and harvesting, the federal coverage limits won't even cover the costs.

"When you are dealing with more than you can afford to lose, you need to insure your investments," said Lynn Nicholson, vice president of sales at Full-Spectrum Insurance in Fort Wayne, Indiana.

"Federal crop insurance alone is very inadequate coverage for a legitimate hemp operation."

Private market insurance offers access to crop insurance as well as other insurance such as workers' compensation, general liability, finished stock and inventory, building, transportation and business interruption that farmers can bundle with their policies, Nicholson said.

"Sometimes we're just trying to fill in the gaps if a hemp operation is already insured through a federal program—and it's really specific to the grower's needs—but a lot more coverage components are available," Nicholson said.

John Schreiter, specialty crop lead for Crop Insurance Solution in Nebraska City, Nebraska, said he hasn't seen much interest in the federal programs yet and that growers are opting for private policies.

He said because the federal program isn't available everywhere, offers coverage only up to a certain dollar amount and requires growers to jump through too many hoops to acquire it, growers are subject to losing money and insurance coverage. Conversely, the county plan and specific hail-coverage plan doesn't require any extra "hoops" and growers can buy coverage for the dollar amount they need covered.

Further, the time limits placed on farmers to apply and qualify for federal insurance were restrictive. The timing of the USDA's announcement of the 2020 programs afforded a short, six-week window for farmers to apply for and secure insurance.

A requirement that farmers needed to have contracts before they were able to qualify for federal insurance was challenging, considering that even in 2019, when the demand for hemp was higher and market prices weren't as volatile as they are in 2020, there were few buyers in the commercial marketplace for hemp—especially those with the cash flow available to pay farmers for their crops.

Further, the federal crop-insurance programs did not make it clear whether a memorandum of understanding or a letter of intent, which are not legally binding documents, were sufficient for coverage, according to Julie Lerner, CEO and founder of Denver-based commodity exchange marketplace PanXchange.

"There are no major commodity trade houses in this market that come in and take counterparty risk and transportation risk and storage risk and have the working capital to make these types of forward contracts," Lerner said.

AVAILABLE POLICIES

Many insurance agents sell both federal and private insurance policies, so they have the tools to help hemp farmers create custom programs.

Insurance solutions are often based on gathering direct feedback from cultivators, combined with aggregate data, according to Jeff Kleid, owner of Elite Risk Insurance Solutions in Newport Beach, California. This process allows insurance companies to create and implement custom solutions that best serve farmers and their specific needs.

The types of insurance include:

- Area or county coverage. These policies are based on average crop prices for the county or area, not individual prices or yield. Insurance policies for weather events can also be created based on the geographical region, down to the county, using a 10-year average of the weather in the county, and farmers get paid if weather deviates from the average, according to Schreiter. Many crop-insurance companies monitor weather conditions and regional perils such as hail and other adverse events to help farmers know which coverage plans suit them best.
- Multi-peril. This is basic coverage that protects against crop yield losses by insuring a percentage of historical crop production. It protects crops against all natural perils, including adverse weather, fire, insects, disease, irrigation failure and natural disasters. This insurance is delivered by private companies and reinsured by the federal government.
- Indemnity. This insurance policy, also known as professional liability insurance, is designed to protect business owners when they're found to be at fault for a specific event, such as failure to deliver expected products or services, or professional misjudgment, such as making an incorrect estimation of value or assumption of the market.
- Parametric. This insurance does not indemnify pure loss, or the value of losses attributable to events and activities during the current year, but the company agrees to make a payment when a triggering event occurs, such as a natural disaster that could cause a loss or series of losses. It's well-suited for low-frequency, high-intensity losses caused by weather-related issues or catastrophic events.
- Captive. A captive insurer is an insurance company that is wholly owned and controlled by the companies or individuals it insures. Its primary purpose is to insure the risks of the owners.

Most farmers know their land and know what they need, Kleid said.

"The better they know the land and the better they communicate with the insurance agent what their needs are, the better position they'll be in," he said.

For smaller-scale farmers and lower-level coverage, building a custom program based around MPCl offers good coverage. However, larger hemp farms and cultivators that have taken on investors might want to consider high-deductible solutions, Kleid said.

"Probably the best solution for the larger farmer is a hybrid between traditional indemnity or parametric insurance cover and surrounding that with a dollar-one captive insurance solution," he said.

Private policies can include:

- Living plant coverage.
- Product liability.
- Goods in progress.
- Business interruption coverage.
- Equipment coverage.
- Inventory.
- Finished stock.

Farmers can also add crop coverages for different types of weather events, or lack thereof, including damage from:

- Hail.
- Frost.
- Flood.
- Drought.
- Lack of precipitation.
- Excessive wind.
- Excessive heat.
- Excessive rain.
- Storm surges.
- Tornado (regional).
- Wildfire (regional).
- Earthquake (regional).

While the federal government and many private insurance companies will not specifically cover hemp that tests over the legal THC limit of 0.3%, there are other aspects of coverage that could help farmers recover investments if weather, heat or drought were found to have contributed to the loss of the crop.

“Sometimes, certain perils can be excluded, whether hemp-specific or not for example, a crop currently can’t be covered for going ‘hot’ pretty much no matter what,” Nicholson said.

“But sometimes other causes of loss are excluded in a policy, so that’s where we come in to find the best deal specific to each operation and risk appetite.”

INSURANCE COSTS

The cost of crop insurance is sometimes where farms of different sizes draw a line in the sand, according to Kleid.

Many of his clients are seeking out policies covering \$500,000 or more, which includes a \$50,000 deductible.

Even smaller farmers are investing anywhere from \$150,000 to \$1 million in their farms to grow 20 to 100 acres, but they often are looking for lower-cost insurance, Kleid said.

“We’ve got it down to the point where at \$350,000 in coverage can be cost-effective and give someone some sense of comfort, but if they try to get lower than that, we’re not the right fit,” Kleid said.

“And I don’t think there’s anyone out there that is the fit. The federal crop program would have been the right fit,” but because of deadlines, hemp growers can’t always access it.

Farmers who are looking for smaller policies have the option of working with other farmers in their area to get a larger policy so the premium makes sense, Kleid said.

For instance, for a hemp cultivator who wants to obtain \$100,000 in insurance, the premium could cost \$30,000, but if they go in with other farmers on a \$350,000 policy, it’s more affordable.

“This is a different time where I absolutely want to ensure somebody at \$100,000 or \$200,000,” Kleid said. “But the problem is it just doesn’t make sense because the fixed costs that go into it are so high that it makes the weight not make sense for the premium.”

Area crop insurance at the county level might cost a premium of 12% per \$100, according to Schreiter; however, the coverage doesn’t include adverse weather events or natural disasters.

Ultimately, the cost of the insurance varies depending on how much coverage the farmer wants. The question is how much risk farmers are comfortable taking.

HOW TO APPLY

Compared to federal insurance programs, private policies have limited eligibility restrictions.

“You have to grow hemp for the policy to attach,” Schreiter said. “There are no other qualifications.”

Farmers can work with their agents to file the proper paperwork in multiple markets and get a policy in place within days.

“We streamline the process and translate all the industry jargon to make it as painless of an experience as possible,” Nicholson said.

Hemp farmers must be candid with their agents about what kind of coverage they need, ask what coverages are in the policy that’s being offered and then read the policy to ensure that what they’re buying is what they want, Kleid said. Many farmers lose out on making claims against policies that don’t offer the right coverage because they didn’t read the policy.

“The hard part right now is more and more people have access to offer the coverage in the space, but there’s more and more people that don’t know what they’re selling—and it’s actually worse for the industry,” Kleid said.

“What’s concerning is if we screwed this up and we have people thinking they have coverage for something they don’t and then claims aren’t paid, it shoots the industry for next year.”

PROPERTY INSURANCE

COMMERCIAL PROPERTY INSURANCE

Commercial property insurance is designed to protect the building(s) in which your hemp business is located. For example, if a fire or tornado demolishes your business, commercial property insurance could cover any damage that is outside your control. The key is that you have enough coverage to rebuild. And if you have more than one building, you will pay a much higher premium.

BUSINESS PERSONAL PROPERTY INSURANCE

If commercial property insurance covers the building itself, business personal property insurance covers everything inside—your furniture, computers, office equipment, supplies, etc.

“If you could actually pick your building up and turn it upside down, everything that drops out, that’s business personal property,” said Rhett Braniff, owner of the Texas-based Sunstone Insurance Agency.

Here again, you’re going to want enough coverage to cover your losses, so make sure you keep a meticulous inventory of your belongings.

HOW DO YOU GET INSURANCE FOR YOUR BUILDING AND PROPERTY?

Marijuana and hemp business are in a challenging position when it comes to insurance. Marijuana is still federally illegal and hemp is a new legal industry, so both are considered high risk for different reasons. That means standard insurance carriers typically don’t do business with hemp or marijuana companies. Instead, hemp and marijuana businesses rely on what are called “Excess and Surplus” lines of insurance. Sometimes these are offshore companies.

There are plenty of good “Excess and Surplus” insurance underwriters, but there are drawbacks. They can charge high prices and their policy forms are not standard across the board because they were not reviewed by state insurance regulators. The forms are therefore inconsistent from one to another and filled with exclusions for extraordinary circumstances.

As a result, business owners must pay close attention to their policies to make sure what’s covered and what’s not. It’s also recommended that businesses get an insurance broker who can provide different options and a lawyer who can make sense of what’s covered. Some of these “Excess and Surplus” carriers deal only with brokers.

INSURANCE COSTS

It’s difficult to come up with an average price range because so many factors go into determining the final cost of a policy. Location is one of those elements. Some places are more expensive than others if they’re located where hurricanes are common, for example. It also depends on how many buildings and how much equipment you have.

That said, a small business in Austin, Texas, pays about \$7,000 annually for \$1 million in coverage for commercial property, \$500,000 for business personal property and \$500,000 for business income insurance, Braniff pointed out, using an example for a standard insurance without disclosing the insurer’s name.

An “Excess and Surplus” insurance would be more expensive, although it’s difficult to estimate by how much. Policy provisions vary between one account and another, including limits, exclusions and amount of insured value. The hemp and marijuana industries are considered higher risk, leading to the higher cost.

WHAT TO LOOK FOR IN TURBULENT TIMES

Safeguarding your property and office equipment is all well and good, but what protects you when there are other types of interruptions to your business, as some hemp companies are experiencing during the COVID-19 crisis?

In cases such as these, you need business income interruption insurance—whether it's the coronavirus pandemic or the next unforeseen calamity that forces you to close. This type of insurance covers you when you lose income because you were forced to shut down, and it covers a variety of reasons.

Business interruption insurance is usually just thrown in as part of a policy package or as additional coverage at no extra cost, Braniff said. Businesses also can purchase such coverage separately.

The challenge for some marijuana and hemp businesses is they haven't been around long enough to demonstrate a history of revenue to calculate how they were impacted by a work stoppage, said Lisa Pittman, a cannabis attorney with a background in insurance law. Many financial losses do not fall within "physical damage" to property, she said.

"And in some cases it's going to be indirect because it is a shutdown up the supply chain by your manufacturer or your supplier or down the chain as the retailer," Pittman said.

It's important to consult with your attorney about whether to make a claim—and develop strategies about how aggressive you want to be. If, after consulting with your attorney, you decide the likelihood of coverage is low, Pittman suggests you might want to forgo the claim so you don't "go down as causing a fuss with your insurance company and causing your premiums" to spike.

"You want to make sure that it's a solid claim before you make it," she said.

Even having a solid claim such as being affected by the coronavirus-spurred economic downturn, there's no guarantee you'll succeed because insurance companies will try to find a way out of coverage. In fact, Braniff said, it's already happening.

"A lot of the carriers are denying them. In fact, every single one that I've seen so far has been to deny it," he said. "Because the argument on this by the insurance company is: 'There's been no actual loss to your building, right?'"

WHAT HEMP BUSINESSES NEED TO KNOW ABOUT WORKERS' COMPENSATION INSURANCE

Workers' compensation insurance helps employees mitigate financial difficulties in case of injuries or health issues that occur in the workplace—that is, on the business premises and during working hours.

The following definition is from the Insurance Information Institute:

“Workers' compensation insurance serves two purposes: It assures that injured workers get medical care and compensation for a portion of the income they lose while they are unable to return to work, and it usually protects employers from lawsuits by workers injured while working.”

The benefits of workers' compensation insurance vary depending on the state, but they usually help cover:

- Medical expenses such as hospital visits, medications and emergency surgeries.
- Lost wages if your employee takes time away from work to recover.
- Ergonomic accommodations when your employee returns to work.
- Disability benefits if a work-related injury causes a partial or permanent disability.
- Ongoing care costs such as physical therapy.

Without workers' compensation insurance, your injured or sick employees might become financially strained, and they could sue for their work-related injury or illness if you don't have coverage.

IS WORKERS' COMPENSATION MANDATORY?

Whether workers' compensation is mandated by law depends on your business structure. According to the Insurance Information Institute, sole proprietors and partnerships in most states are not required to purchase workers' compensation unless they have employees who aren't owners. Employees are generally defined as people performing services at the direction of the employer, for hire, including minors and workers who are not citizens.

Most states will allow sole proprietors and partners to cover themselves for workers' compensation if they choose to.

Many states exempt employers with only a few employees from mandatory coverage laws. The threshold number of employees that triggers mandatory insurance is either three, four or five, depending on the state. Texas is the only state in which workers' compensation insurance is optional.

HOW MUCH DOES IT COST?

According to The Hartford, how much coverage you'll need and how much your policy may cost depends on:

- Number of employees.
- Types of employees.
- The kind of work your employees do.
- How large your payroll is.

The costs for workers' compensation include premiums, payments made under deductibles and the administrative costs of handling claims and making reports.

According to the Insurance Information Institute, premiums are based on the employer's industry classification code and payroll. Premiums for more hazardous jobs or businesses—logging or offshore drilling, for example—might be much higher than premiums for administrative or office jobs.

Some employers are eligible for a so-called experience rating, which adjusts the premium up or down depending on the claims history of the company relative to its industry peers. Businesses with higher-than-average claims will pay higher premiums, and those with lower claims will generally pay less.

"Businesses have an incentive to make their workplaces safe," said Jeff Eddinger, a senior executive at the National Council on Compensation Insurance. "They pay upfront a premium for their workers' compensation, and their premium is adjusted depending on their experience."

The number of workers' compensation claims is more important for the experience rating than the monetary value of claims: The higher the frequency of claims, the greater the probability of big losses.

HOW DO YOU GET IT?

According to The Hartford, there are different ways to buy a workers' compensation insurance policy, depending on the state in which your business is located:

Private workers' compensation insurance companies offer coverage regulated by each state, but they can set their own prices and choose to accept or reject customers.

State-funded workers' compensation insurance could be the answer for those companies that can't get coverage from a private carrier. State-funded programs are set up to help ensure your employees are covered, regardless of your type of business.

Some states offer coverage from a private carrier or a state program. These state-funded workers' comp programs compete with private insurance companies for customers.

Laws in North Dakota, Ohio, Washington and Wyoming, require businesses to get coverage through state-funded program. Each state uses taxpayer dollars to help pay claims if the state doesn't put enough money into the workers' comp pool.

HOW SMART CONTRACT WRITING CAN REDUCE BUSINESS RISKS

With federal and state regulations on industrial hemp and cannabidiol changing on a monthly or even weekly basis, a thorough, well-worded contract can have major repercussions for cultivators, brokers, processors and entrepreneurs.

Risk exposure varies across the hemp industry supply chain, and the right contract helps all parties understand those risks, who bears them and what the consequences will be if those risks come to fruition.

TYPES OF CONTRACTS

Seed contracts

Hemp farmers generally have a supply agreement with nurseries or seed providers to obtain clones or seeds on a season-by-season or multiseason basis. The complexity of these seed contracts, however, can vary widely, according to Ed Culhane, a Minneapolis-based hemp and CBD business attorney at Culhane Law.

“At its simplest form, a buyer is merely agreeing to purchase seeds from the seller,” Culhane said. “With a sophisticated seed seller, the contract may also assert controls over the buyer’s use of the seeds and prevent any use other than planting for a single harvest. This is to protect the seller’s intellectual-property rights surrounding the development of proprietary seed varieties.”

Because the hemp market is in its infancy, Culhane said, most hempseed contracts are not as detailed about cultivation practices as those covering corn, soybeans or other agricultural commodities. Hempseed contracts typically focus on quantity, price, delivery dates, quality (CBD and THC levels) and whether the buyer is permitted to use the seeds to propagate more than one generation of crop.

Under the 2018 Farm Bill, U.S. hemp farmers can purchase seeds internationally, with the primary regulatory issue involving phytosanitary and pest-free certifications upon arrival in the United States. In practice, international hempseed imports can be a high-risk venture if and when they are inspected by U.S. Customs and Border Protection agents.

“Lawful seed imports are still being interceded and held at the border, and it can be a crapshoot getting your shipment in,” Culhane said. “A well-drafted contract to purchase seeds from a foreign source will address quality issues, including CBD and THC levels, but enforcing that contract with an international counterparty can be difficult, if not impossible. Diligence on your seller’s products, reputation and financial strength becomes critical.”

Hemp farmers or other parties drawing up seed contracts should also know what the state-level requirements and restrictions are for hempseeds, Culhane said, as some states have strict requirements as to what seeds may be used lawfully under their hemp rules.

Agricultural contracts

Large-scale hemp buyers, including brokers, processors or brands that are well capitalized, will draft contracts with farmers to obtain long-term supply or mass supply of product. These agricultural-production contracts, or APCs, help manage risk and control expenditures by detailing the production practices, who is responsible for supplying the production equipment and manpower, the quantity and quality of the product and the method of payment, according to Portland, Oregon-based Harris Bricken attorney Jesse Mondry. Payment is typically predetermined and outlined in the contract.

Other types of agricultural contracts include:

- Forward contracts for the sale of a fixed amount of a commodity at a set price for future delivery.
- Marketing agreements, in which a member of a cooperative agrees to sell some or all of a commodity produced through the organization.
- Futures contracts, in which the sale and purchase of a standardized quantity of a commodity is negotiated for future delivery on a regulated commodity exchange.

“Technically, a forward contract is a standard contract between two private parties to sell/buy a commodity in the future,” Culhane said. “It ‘settles’ on the date of delivery. A true futures contract is a much more complex contract traded on established markets, none of which have been established yet in the hemp industry.

“When someone uses the term ‘futures’ contract in the hemp industry, assume they mean a forward contract. The primary similarity is that they allocate the risk of market-price changes to one of the parties.”

Processing contracts

In the middle of the supply chain, processing contracts break down into two common types: toll processing and split arrangements.

In a toll agreement, the owner of the biomass pays the processor to process it for a fee. The owner of the biomass retains ownership, and the processor returns the finished product to the owner.

In a split arrangement, the owner of the biomass—typically the farmer or someone the farmer sold the biomass to, such as a broker—asks a processor to process the biomass, and in exchange, the processor receives a split of either the input or output. The split is negotiable and generally depends on what the processor is seeking. He or she might want to keep a percentage of the biomass itself, or keep a percentage of the output, be it crude, distillate or isolate. In the latter case, the split for the processor would be based on the additional work and expenses incurred.

“Depending on the market, the split can be 50-50, it can be 70-30, 60-40, it just depends,” Culhane said.

Bulk purchase/white label contracts

Swimming downstream in the chain of commerce, brands and brokers might want to draft a contract to buy bulk oil and supply it to white label processors who make tinctures, rubs or other consumer products. A broker or brand might also draft a contract to buy the bulk for their own needs.

“Depending on the sophistication of the party, that could be at market price, or it could be multiyear supply agreements that have allocated risk for market changes,” Culhane said.

CONTRACT STRUCTURE

The clauses and provisions included in a hemp industry contract will largely depend on the kind of agreement negotiated. The following are some common concepts that most contracts should touch on:

Representations and warranties

This section of a contract outlines facts and securities against loss if the statements made in the contract are not true. A representation is an assertion that is true on the date made and given to induce another party to enter a contract or take some other action. A warranty is a promise of indemnity if the assertion is false. A representation is called “inaccurate” if it is not true, while a warranty is considered “breached” if it is not true.

In reviewing a contract, it’s important to verify that the parties’ representations and warranties are in compliance with applicable laws.

“In hemp, that means the federal farm bill and the state hemp program and the states of operation,” said Shawn Hauser, partner and chair of the hemp and cannabinoids division at Denver-based Vicente Sederberg, a cannabis-focused law firm. “It also means federal and state food or drug laws, which is a bit of a sticky contractual point.”

The challenge with legal compliance in the hemp industry arises from the fact that the U.S. Food and Drug Administration is in the process of determining its regulatory approach to CBD-containing food and dietary supplements and other cannabinoid products.

“Some businesses can represent and warrant that they are fully compliant with the Federal Food, Drug and Cosmetic Act, but it’s not possible for many businesses to say that,” Hauser said. In such cases, she noted, hemp contracts have included qualifications or language that pledges “reasonable best efforts to comply.”

“You want to ensure that the person you’re engaged in business with is a compliant operator and is willing to make that representation but (also) that you’re asking them to do something reasonable and practical,” Hauser said. Because in some cases, “certifying compliance can be tricky,” she added.

Term of contract

The duration of a contract is an important factor to consider given the dynamic nature of the hemp industry and its markets, and some experts caution hemp cultivators and businesses against pursuing longer-term contracts.

“You need to be careful about locking in for a long time when you’re in an industry that reinvents itself every six months,” said Culhane, the Minneapolis hemp and CBD business attorney .

According to Los Angeles-based Harris Bricken attorney Griffen Thorne, one remedy for a longer-term contract is the inclusion of language that allows one or both parties to renegotiate or terminate the contract if there is a drastic change in law.

“If we’re talking about some kind of joint venture that’s expected to last two or three years, it’s almost guaranteed that the law is going to change significantly in that jurisdiction in that time,” Thorne said.

Parties to the contract

When drafting a contract, a key consideration is not only what performance is expected from the other party but also whether the other party can deliver on those expectations, Hauser said.

“If you’re expecting a certain amount of production of a certain quality,” Hauser noted, “do they have the facility that’s of the quality and capacity to produce that?”

“Do they have the capital to service you for the term you anticipate? Are they going to warrant minimum production levels? Are they going to warrant a minimum CBD percentage? And, if so, is that included in your contract?”

The identity of the other party—particularly his or her criminal record—can play an important role in the future validity of a hemp industry contract. Under the 2018 Farm Bill, anyone convicted of a felony related to a controlled substance under state or federal law is barred from producing hemp for 10 years after the date of conviction.

An exception applies to people who were lawfully growing hemp under the 2014 Farm Bill before Dec. 20, 2018, and whose conviction occurred before that date. They are exempt from the 10-year ban.

Hemp companies should vet other parties consulted in the contract-writing process for their understanding and experience in the hemp industry, said Jonathan Robbins, who chairs the cannabis practice at Akerman law firm in Florida.

“The importance of professionals is paramount here—and I’m not just talking about attorneys,” Robbins said. “I’m talking about your accountant, your insurance professional. Even with general liability-type insurance, it’s easy to procure a policy, but without an understanding of how this industry works, you may inadvertently be excluding coverage on a lot of types of claims.”

Important Provisions

Insurance and other provisions are critical contract terms in risk mitigation for the hemp industry.

Depending on the type of business and the type of contract, companies should consider the inclusion of the following:

- Crop insurance.
- General liability insurance.
- Product liability insurance.
- Equipment breakdown.
- Workers’ compensation insurance.
- Listing the counterparty as additional insured, where appropriate.
- Attorneys’ fees.

“An important one is attorneys’ fees provisions,” Hauser said. This provision sets out that, in the event of a dispute between the parties, the prevailing party gets attorneys’ fees reimbursed by the other party. “That’s something that sometimes gets ditched when people are trying to get a contract shorter, but it makes a difference as to whether its viable to pursue a claim or not,” she added.

Indemnification

One of the most important risk-allocation provisions in a contract is the indemnification clause. The basic idea behind indemnification is that, if one party does something that causes loss or damage to the other party, that first party will pay to fix it.

“Indemnification encourages each party to concentrate on the risks it controls rather than worrying about problems only the other party can avoid,” Jonathan Ezor, associate general counsel at Verizon Consumer Group in New Jersey, wrote in a legal post for Bloomberg. “While either could sue the other to force payback in the event of a problem, putting an indemnification provision in the contract minimizes the time, expense and uncertainty of the process by at least hopefully avoiding the need for a lawsuit.”

What is covered in the indemnification provision is just as important as what is not.

Some scenarios that might be included in an indemnification clause include:

- Breach of agreement.
- Product liability claims.
- Negligence or noncompliance with the law.
- Title and risk-of-loss provisions.

Risk-of-loss provisions can be especially important in the hemp space. Due to the plant's near-indistinguishability from federally illegal marijuana, hempseeds and biomass continue to face the risk of becoming impounded by state or federal authorities during import or interstate commerce.

With a risk of loss provision in hemp, "you're contemplating what happens if the hemp gets seized, what happens if there's loss or damage to hemp in transit and limitations of liability and disclaimers of warranty around that," Hauser said.

Jurisdiction

Most legal experts advise hemp industry professionals to include clear language about jurisdiction and their choice of law provisions in their contracts.

"You want to make sure that you choose a law and venue for dispute that will actually enforce a contract," said Robbins, the Florida hemp attorney. "Certain states still don't have their hemp laws on the books, and ... you don't want to have a client operating in violation of state or federal law."

"Hemp laws are frequently changing," Harris Bricken's Thorne said. "At our firm, we evaluate the (cannabis) clients on a monthly basis for what the laws are in all 50 states. Oftentimes in the span of a month, there will be significant changes within each state, so you have to be hypersensitive to the laws wherever you're operating."

Thomson Reuters Legal, a Toronto-based business information firm, provides the following helpful list of considerations when drafting an indemnification provision:

1. Whether the indemnification provision should be unilateral or apply to both parties.
2. Whether the indemnity also covers people or entities who are not parties to the contract; for example, managers, affiliates or even customers of the indemnified contract party.
3. Whether the provision also covers the obligation to defend, which includes the obligation to reimburse (or advance funds) for covered litigation costs and expenses and which might apply even if indemnification ultimately is not triggered. (For example, because the underlying claim has no merit.)
4. What types of damages or expenses incurred by the indemnified party are recoverable, for example, whether the indemnity extends to attorneys' fees and extracontractual tort damages.
5. The specified events that give rise to the indemnity, for example, whether the indemnity extends to direct claims of the indemnified party in addition to third-party claims.
6. The degree to which the event giving rise to the indemnity and the indemnified party's damages need to be related for the event to qualify for recovery.
7. Whether indemnification is the exclusive remedy for the specified events that give rise to the indemnity.
8. Any exceptions, for example, excluding indemnification for the indemnified party's negligent or grossly negligent acts or omissions.
9. Any deductibles, baskets or thresholds that apply to shift the risk back to the indemnified party until the specified level of damages have accrued.
10. The relationship between the indemnification clause and other provisions in the contract.

TIP

In the case of international contracts, it's especially important to clarify jurisdiction and how disputes will be resolved.

"You generally want to have arbitration of dispute and judgment from an arbitration panel, typically enforceable in foreign jurisdictions under a separate United Nations convention," Culhane said. "A judgment in a court of law may not be enforceable, and it takes a long period to get a judgment from the United States enforced in a foreign country."

Language

In a well-drafted contract, both parties understand the obligations of each party, who is taking on the risks and what the consequences will be if those risks come to fruition.

"It's a new industry, so at first we saw a lot of people doing business without contracts or having very short contracts that didn't really contemplate the obligations of the party or allocate risk appropriately," Hauser said.

Even as hemp farmers and businesses begin to draft more robust contracts that touch on all the important provisions to mitigate risk, sometimes the way those provisions are written can create problems for interpreting them in the event of a legal dispute.

"Contracts are not always drafted as clearly as you would expect or as you would hope," Culhane said. "If you can't pick up a contract and read everything and understand what's going on, it's not properly drafted."

Culhane also warned hemp businesses about finding themselves pressured to include provisions in a contract that they do not understand.

"If somebody's asking you for a provision because it makes them feel good, but it's ambiguous or it's vague or it's weird language, and you're asking, 'What does this mean?'—you shouldn't have it in your contract," he said.

Force majeure

Force majeure, a French term that translates to "superior force," is most commonly known in the legal world as a provision that essentially frees one or both parties from performance obligations in the event that an act of God or an extraordinary event makes the contract impractical or impossible to execute.

The events covered by force majeure must be:

- Unforeseeable and unavoidable.
- Not the result of the defendant's actions.

A rainstorm during an outdoor event, for example, would not be considered grounds for a force majeure provision, given that rain is a normal and common occurrence. A war or riot, on the other hand, might be considered a force majeure.

The force majeure provision should anticipate events that could specifically impact your business, said Vicente Sederberg's Hauser.

"In some states, that's more likely to be a fire or flood or natural disaster," she said. "Does it include a pandemic? Does it include a labor strike? You have to contemplate worst-case scenarios."

Identifying specific events will provide clarity down the road, but how broad or narrow your contract's force majeure provision should be depends on which side of the contract you fall on, according to Culhane.

"If you're the buyer of the product, you've got different risks than if you're the seller," Culhane said. "Generally, the buyer wants to limit the opportunity for the seller to be excused from performance."

In the event the agreement between two or more parties yields an international contract, Culhane said hemp professionals should be clear about which law governs the contract, and how disputes will be resolved.

In signatory nations, the United Nations Convention on Contracts for the International Sale of Goods (CISG) governs contracts for the sale of commercial goods between parties in different countries—unless the parties have expressly waived its applicability.

"Generally, it says if the parties specify a choice of law, we'll respect it," Culhane said. This means that a farmer or processor in Colorado can specify that Colorado law applies in order to have a better sense of if and how the force majeure clause will be enforced.

"If you're silent, then default rules apply, and you could very well be operating under a contract under the laws of a foreign country," Culhane said.

Absence of force majeure

The inclusion of a force majeure provision will likely become a mainstay in the hemp industry even after the COVID-19 crisis passes, but some experts say it's not the end of the world if an existing contract is silent on the issue.

"It really should be in there, but at the end of the day, there are other doctrines that can relieve parties of their responsibility under a contract," Harris Bricken's Thorne said. "They're just much harder to prove, and whether or not they apply is not necessarily an easy issue to resolve."

If a force majeure clause is missing from a contract, the parties might find recourse in the following common law doctrines and conventions:

- Doctrine of frustration of purpose/doctrine of impossibility.
- United Nations Convention on Contracts for the International Sale of Goods (Article 79).
- The Uniform Commercial Code (Article 2).

The International Chamber of Commerce offers boilerplate force majeure and hardship clauses that parties can include in their contracts. The ICC Force Majeure Clause 2003 provides both a general force majeure formula and a list of events that, upon taking place, altered the evidential balance in favor of the party invoking the clause.

U.S. courts will look at several factors in determining whether and when to enforce a force majeure clause, including:

- Whether the clause includes the event in question.
- Whether the event was foreseeable.
- Whether the event was the cause of nonperformance.