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PRINCIPLES OF THE CONTRACT OPTION AGREEMENT

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Aims

A Contract Option Agreement (COA) is similar to a Contract Farming Agreement, except for the fact that it allows the Contractor to purchase the growing crops immediately prior to or after harvest by means of an option. A COA simplifies contract farming with an annual agreement and requires no number two account to be set up. The Contractor can control input purchasing, harvest operations and crop marketing.

Method

- The Farmer continues to be a trading entity and commits to the agreement for the cropped area of the farm
- Buildings are rented separately to the Contractor if required and permitted under any tenancies
- Hedges, ditches and grassland would normally be excluded, and separate contract rates would be payable for specific work carried out and invoiced separately
- The Sustainable Farming Incentive (SFI) can be incorporated into the agreement (by amendment of the premium) or if preferred can be excluded and retained by the Farmer
- The Farmer retains the delinked Basic Payment Scheme income
- The Contractor purchases all inputs and provides the contract services for the crops for all operations up to point of harvest. The agreed expenditure will be recharged to the Farmer in three simple invoices. The timing of these invoices is normally 31st December, 31st March and 30th June. The invoices will accurately reflect crop input costs and contract costs occurring up to the date of the invoice
- Shortly after the agreement commences, the Contractor should exercise their option to purchase the growing crops. The option fee will be made up of three components:

1. Cost of all inputs and contracting costs
2. An agreed premium payable per acre
3. A variable premium payable / receivable only if crop prices on set days are above or below a predetermined range. This can influence the premium

Risk

As with similar Contract Farming Agreements, both parties must be aware of the risks associated with entering into such agreements, such as particularly in respect of HMRC, any tenancies and the RPA and Defra. Both parties must seek independent professional advice to satisfy themselves that the agreement is suitable and appropriate to their personal situation to proceed with a Contract Option Agreement.

To help ensure the commerciality of this arrangement is maintained, there is risk to the Farmer to two ways:

1. At the 30th June in each crop year - the Farmer owns all of the crops. There is only an option to harvest and buy, offered to the Contractor.
2. Assuming the option is exercised, the ultimate return from the crops is subject to the level of the bonus payment / reduction set by the commodity values. Thus the return per acre is not guaranteed.

Other Contract Work

As detailed above, the Contract Option Agreement would cover all aspects of the crop production area. Other farm contract work such general farm maintenance and all other non arable crop activities could be supplied by the Contractor or a third party but would be dealt with as separate items to the cropped area and invoiced separately.

Advantages to the Farmer:

- Simple agreement (3 invoices from Contractor)
- Low administrative cost
- Retention of delinked BPS
- Retention of SFI and opportunity to incorporate into crop rotation
- Flexible cashflow
- Lower contract charges if Contractor has opportunity to benefit from uplift in sale price of crop
- Reduced marketing complexity
- Market linked final returns – dependant on predetermined option price plus bonus / reduction due to market prices

Advantages to the Contractor:

- Simple agreement
- Efforts and costs are concentrated on crop growing
- Opportunity to benefit from input purchasing and crop marketing
- Flexibility in storage options
- Less risk of confrontation on harvesting / storage / marketing operations
- Potential additional work relating to environmental schemes

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