The Minimum Price Contract

The minimum price contract allows the producer to lock in a minimum price and still have the opportunity to take advantage of higher prices that may occur later. Its effect for the farmer is much like purchasing a put option or selling the cash crop and buying a call option. Like the forward contract, it can be used before planting, during the growing season, at harvest or after harvest.

How does the Minimum Price Contract Work?

A specific quantity is sold. The established price is specified as the *minimum* the seller has to accept. It is the seller's responsibility to determine whether the minimum being offered is acceptable.

The seller chooses a strike price, from which the grain dealer subtracts a fee (the option premium), and adds or subtracts the basis for the delivery month in question to determine the minimum sales price (MSP) offered. The grain dealer is basing this cash contract offer on the purchase of a call option. When using the minimum price contract offered in the cash market, the futures price must rise above the strike price by more than the premium cost for the seller to achieve a selling price that is greater than the MSP.

Advantages to the Minimum Price Contract

- It reduces downside risk by setting the minimum the seller must accept.
- The seller has the flexibility to set a higher price later, if the opportunity arises.
- Upon delivery, grain condition and storage risk pass to the grain dealer and the producer receives at least the MSP.
- Generally, you can contract for any quantity of grain. I some cases, minimum bushel amounts may be required.

Disadvantages to the Minimum Price Contract

- It is generally the seller's responsibility whether the basis and premium adjustments made to the futures price are acceptable.
- In the event the futures market moves above the initial agreed upon strike price it is generally the seller's responsibility to notify the grain dealer to lock in a price above the MSP.
- Seller forfeits any future basis gain.
- Seller incurs cost of the price insurance (fee or option premium).

Best time to Use the Minimum Price Contract

- When a price decline is expected and there is a potential for higher prices to occur later.
- When the MSP is greater than USDA's loan rate or Revenue Assurance/Crop revenue coverage guarantee.
- When the basis offer and fee associated with the contract are appropriate.

	Cash price is 6.00 Fee: Minimum price minus transaction fee		
1.	A minimum price contract is offered for wheat with an at-the-money strike price of $6.25/bu. The option premium is .20c/bu. The basis is even. What is the minimum selling price that the seller can achieve?	$/BU 5.80	
2.	What is the futures price at time of offer?	$/BU 6.25	
3.	What price does the futures price have to rise to before the seller can realize any additional gain from the minimum price contract?	$/BU 6.26	
4.	Scenario #1 – futures price goes up. So you reprice the option at .40c/bu	$/BU 6.20	
5.	Scenario #2 – futures price goes down. So you reprice option at .0c/bu	$/BU 5.80	