

The combination of a promising start to the grain growing season, a number of subsequent months of below average rainfall at the same time as unprecedentedly high grain prices has meant that a large number of grain growers are unable to meet forward and physical contractual obligations. This impost is exacerbated by high debt to equity ratios given the series of drought affected below average harvest years experienced in recent years.

This briefing note aims to provide growers with information regarding contracts in general and the potential options if growers are unable to meet their contractual obligations. It will also detail what your Association is doing to assist affected growers.

A contract is an oral or written agreement between two or more parties which is enforceable by law. Grain contracts are important tools for managing price and income risk in the volatile price environment that exists today. However, using them successfully requires a complete understanding of how various contracts work, the kinds of risk they are designed to control, and the areas of risk that remain after the contract is signed.

## What should you know about grain contracts?

Important business principles apply to contracts, regardless of their type:

**1. Before you agree to a contract, know and understand all of its features and how they will affect your business.** Understand how it reduces market risk, where it exposes you to risk, and your obligations. And the best way to do that is to put it in writing. Growers need to be aware that agreeing to a contract in any manner, such as verbally over the phone, face-to-face or electronically, is binding. The fact that a written copy of confirmation may only appear in the mail some time later is irrelevant. The contract is made once the parties agree.

The following should be recorded about telephone conversations:

- Who the telephone call was with;
- When the telephone call was made, including the time, date and who called who;
- What was discussed in the telephone call;
- When this note of the telephone call was recorded.

**2. If in doubt, don't sign.** Get assistance if you do not understand any aspect of the contract. Ask the buyer and, if necessary, get legal advice.

**3. Know the other party to the contract.** If possible, have information on the party's financial condition and ability to perform obligations. Get a credit check if necessary. Be sure the other party can explain to your satisfaction how the contract works under all possible market conditions.

**4. Know how your net grain price will be determined under all conditions.** If a formula is involved, be sure you understand how it works. Use it to determine what your price would be with extreme market conditions.

**5. Understand the implications of your contract under different scenarios.** For instance if your production falls short of the quantity you have contracted to deliver. A production shortfall can have implications for your net income and financial risk exposure, as well as for meeting contract obligations. The contracting firm establishes a position in the futures or options market to support your contract, and hence has financial obligations that depend on timely fulfillment of your contractual obligations. Remember that if your crop suffers losses through adverse seasonal conditions such as frost and drought, these are considered production risks and are not covered by 'Act of God' or 'Force Majeure' clauses.

As soon as you suspect that you might have issues fulfilling any condition within the contract, it is recommended that you discuss the issue with the buyer prior to delivery or as soon as you are aware of the possible issue. Buyers may be more amenable if they are warned as soon as you suspect an issue.

**6. Maintain good communication with the other party to the contract** before signing and throughout the life of the contract.

## **What are the options available for growers unable to meet contractual obligations?**

The following should be considered by growers who are unable to provide the grain required under their contract:

- Contact your buyer to determine what options are available;
- Contact your financial lender as soon as you are aware that you may be unable to meet your contractual obligations;
- Acquire grain elsewhere to fulfil your contract obligations;
- 'Wash out' your contract. This involves a cash settlement on the difference between the contract price and the current market price multiplied by the contract tonnage. Additional fees may also apply to contract washouts.
- 'Roll' your contract over to the following season. This involves delivering next years harvest against this year's contract. The advantage of this option is that the liability is deferred until the following year when seasonal conditions may improve. However, the disadvantages of this option are that price and interest penalties are imposed and that there is a risk that you will similarly be unable to meet this obligation the following year if poor seasonal conditions persist.
- If you believe grain prices will fall before your contracts end delivery date, consider deferring settlement (washing out or rolling over).
- If you believe grain prices will rise before your contracts end delivery date, consider immediate settlement (washout or rollover).
- If you have any disputes regarding the contract, it is recommended that you:
  - a. Check internal and external dispute resolution terms specified in your contract.
  - b. Seek resolution from the person you originally negotiated with. Failing that;
  - c. Seek a resolution with their superiors. Failing that;
  - d. Use the structured mediation/arbitration process within the National Agricultural Commodities Marketing Association and seek resolution. For more information please see [http://www.nacma.com.au/\\_data/page/129/Dispute\\_Resolution.pdf](http://www.nacma.com.au/_data/page/129/Dispute_Resolution.pdf). Failing that;
  - e. Seek legal advice and resolution through the court system.

## **What is the Association doing?**

- Met with the elected representatives from other State Farming Organisations to determine whether a collective solution can be brokered with the Australian Bankers Association
- Discussing with the major grain traders the extent of the problem and the potential options available to growers
- Discussing options with the National Agricultural Commodities Marketing Association (NACMA).
- Considering whether Queens Counsel advice (which suggests that drought can be encompassed within the definition of a force majeure event) should be pursued in the court system utilising the Australian Farmers Fighting fund.
- Provided information to grower members about contracts, potential risks and options if growers are unable to meet their contractual obligations.