



# Farmer Contracting Basics

What's Been Learned from  
Recent Market Volatility

# BASICS



- The **CONTRACT** is what has been offered and accepted
- Trade Rules require that these terms be put into a written confirmation
- Focus is on negotiated terms (price, quantity, delivery, grades)
- But ... other contract terms are written, implied or assumed

# WRITTEN TERMS



- Often in the “fine print” of the confirmation
- An “additional” term is one that is present in one confirmation but not in the other’s
- A “different” term is one that addresses a common subject but in a way that is different as between the parties’ confirmations

# IMPLIED TERMS



- Created by the mere act of contracting
- Both parties have the intention and capacity to perform
- Covenant to act in good faith
- Course of dealing between the parties
- Custom of the trade

# ASSUMED ELEMENTS



- Parties to the contract bring many assumptions to the transaction
- A premise for the contract (selling production not bushels)
- An application of contract terms (discounts to be applied)
- Flexibility in performance (automatic extensions; non-GMO)

# NOT JUST A “CONTRACT”



- The contract is only a part of the transaction – important but not isolated
- Think of transaction risk, not contract risk
- Transaction Phases
  - Contract Formation
  - Gestation
  - Execution
  - Settlement

# RISK ASSESSMENT



- Different risks in different phases of the transaction!
- What are the risks?
- When are they the greatest?
- Which ones can be addressed in your contract?
- Which ones can only be managed outside the contract?

# VOLATILITY AS RISK



- Market Volatility obeys no laws
  - Unpredictable direction
  - Unpredictable magnitude
  - Unpredictable duration
  - Unpredictable correlations
  
- Does it change the odds, increase the stakes, or both?

# MARKET VOLATILITY



- In a spot purchase, is market volatility a significant risk factor?
- When and how does market volatility affect your contract? Your transaction?
- Consider the *whole* transaction in the light of volatile markets

# THE CHALLENGE



- The challenge is
  - To manage your risk
  - In the context of unpredictable factors
  - Over the life of the whole transaction
- The tools you have to use are
  - Your contract (confirmation) ***and***
  - Your behavior

# IN YOUR CONTRACT



- Require margins or other security
- Right of offset
- One default = Cancel all
- Right to first bushels delivered
- No obligation to roll; charges to roll
- Additional charges if cancellation
- Right to recover atty fees, arbitration costs

# OUTSIDE YOUR CONTRACT



- Behavior
  - What are others doing?
  - How does it affect your risk?
  - Can you react or modify the behavior?
- Environment
  - What is changing?
  - How does it change contract expectations?
  - Can you take new steps to mitigate risk?

# SCORING RISK



- Risk changes – so keep a running “score card” of risk
  - By Contract
  - By Price
  - By Producer
  - By Month
  - In total
- Then, create a plan to manage the highest risks and act on the plan ... everyday

# KNOW YOUR CUSTOMER



- What does he expect out of the performance of his contracts?
- What does he need out of the performance of his contracts?
- What is his ability to buy out of contracts if needed?
- Who else is at risk for his performance?

# KNOW YOURSELF



- What is your overall business objective?
- What is your objective for this customer?
- Are you giving advice or predictions?
- Does the opportunity justify the risk with this customer?
- Can you afford to lose contract equity?
- How much?

# KNOW YOUR COMPETITION



- Is it seeking market share?
- What is its risk appetite compared to yours?
- Does it adhere to market discipline?
- How do its deliverables differ from yours?
- Are there effective communication channels?
- Can this be a win-win?

# TACTICS



- 80/20 rule: deal with the 20%
- Confront the reality; denial won't help
- Communicating in difficult situations is difficult, but the alternative is worse
  - Talking and listening
  - Be clear and final
- Document more than you think you should
- Be consistent in good times and bad

# WHAT DID WE LEARN?



- Everything and Nothing
- We're in the "risk" business; volatility increases risk and opportunity
- Sound business practices, adherence to trade rules and practice, consistency, honesty and integrity *matter*
- And they matter *more* in volatile markets



Questions and Comments?

Thank you!