

01 September 2014

Mr Brett Hosking
 Chairman
 VFF Grains Commodity Group
 Farrer House
 24 – 28 Collins St
 Melbourne VIC 3000

Dear Brett

Re: Insolvencies in the grain industry

Grain Trade Australia (GTA) welcomes the VFF initiative in confronting the issue of insolvency in the grain industry and is pleased to be able to provide the following commentary in response to the VFF Draft Industry Discussion Paper.

The issue of insolvency within the Australian grain industry has attracted substantial commentary recently and is an issue that Grain Trade Australia has been looking closely at for a number of years. Our efforts to reduce the impact of insolvencies results from our mandate to facilitate trade, by working with our membership to build confidence in the integrity of grain trading systems operating across the Australian grain industry.

Frequency and quantum

A breakdown of the financial effect of recent insolvencies across Australia is provided in the following table.

Based on the creditor lists, GTA has allocated creditors to particular sectors. It is an imperfect science analysing creditor lists so the table is a guide only. However, it does give a feel for the size and sectors affected.

The insolvencies most quoted are those listed below.

	GTA member	Secured creditors (banks) \$ mil	Growers\$ mil	Traders & others \$ mil	Total \$ mil
One World Grain	Yes	\$2.00	\$1.30	\$1.40	\$4.70
Convectore	No	\$1.90	\$7.20	\$6.20	\$15.30
Sapphire (SA) Pty Ltd	Yes	\$5.30	\$5.00	\$4.00	\$14.30
Meeniyah Stockfeeds	No	No access to creditors lists			\$1.37
	Totals	\$9.20	\$13.50	\$11.60	\$35.67
Mid West Milling	No	Unknown amounts			

Note:

- The total amount is \$36 million spread between secured creditors (\$9.2m), growers (\$13.5m) and trade/post farm gate (\$11.6m).
- Two of the insolvencies are processors.
- Three out of the five are not GTA members.

GTA involvement

While we support your initiative and welcome this dialogue, we fundamentally disagree with the following statement;

*Such market failures demonstrate a very real need to increase the level of professionalism and accountability in the grain trade, which can **only** (emphasis added) be achieved through the assistance of government to implement a form of industry self-funded self-regulation such as a licensing scheme.¹*

¹ VFF Draft Industry Discussion paper, page 3.

Government intervention can only be justified where market failure is evident.

As serious as recent insolvencies may be, they do not evidence market failure. They are in fact a fundamental if regrettable part of any market.

An insolvency event affects all sectors of the supply chain and it is for this reason that GTA has taken several initiatives in recent years. Whilst it is not possible to detail the exact effect that any of these actions has had, we believe it is likely that these actions have reduced the number and impact of insolvencies within the Australian grain sector.

This document will detail the actions that GTA has undertaken and new initiatives that could be considered.

GTA actions to date could be grouped into the following broad categories:

1. Education/raising awareness
2. Legal/statutory intervention
3. Governance of GTA

Education / raising awareness – production sector

We must both concede that there is sometimes a lack of professionalism by producers, as well as the Trade and we each have a responsibility to raise standards in the industry.

The best way to mitigate the effects of insolvencies is to limit the number of growers trading with “risky” operators. It is a sad fact of commercial life in any industry that some operators are higher risk than others. Sometimes there are warning signs, but sometimes there are not. Knowing what to look for can help.

- **A Guide to Taking Out Grain Contracts**

This publication was developed by Grain Trade Australia for grain growers with the aim of assisting them to understand their rights and responsibilities in relation to their contracts and as an aide memoire to taking out a contract to supply grain. The booklet was distributed to over 36,000 growers and other industry personnel and distributed nationally via the GRDC Ground Cover publication in 2008/2009/2010/2011. It is also available on the GTA website.

Proposal

GTA would be pleased to discuss with VFF the publication and distribution of this publication to their members.

- **Understanding Grain Markets (grower module)**

This course details the basics of grain marketing with particular emphasis on grain contracting and managing counter-party risk. This course has had very limited uptake by the production sector yet is ideally suited as the basis for an education program. GTA offered to conduct this course during the federal government wheat deregulation process. The GTA offer was not accepted.

Proposal

GTA would be pleased to discuss with VFF the roll out across Victoria of this course.

- **Offer to conduct training sessions on trade rules/contracts (no charge)**

From time to time, GTA has offered to conduct training sessions to the Secretariats and their respective Grain Councils of grower representative organisations.

Proposal

GTA would be pleased to conduct this session at no charge for the VFF Grains Committee and staff members.

Education / raising awareness – post farm gate sector

- **GTA Trade Rules & Contracts**

This course has run since 2005 with attendance by over 750 industry personnel. Managing counter-party risk is featured at the commencement of this course.

- **Grain Accounting**

This course was added to the suite offered by GTA in 2011 and is designed for industry personnel who are responsible for:

- compliance with their organisation’s credit/contracting policy(s);
- accounting practices to ensure trading positions are reflected accurately on a timely basis.

This course has been run in-house for a number of trading organisations.

- **GTA Advisory & Compliance Workshop**

The issue of counter-party risk and insolvency has been the subject of a number of sessions in recent years, in particular:

25 July 11	<p>REGULATORY ISSUES & COMPLIANCE – you need to be across these</p> <p>Personal Property Securities Act 2009 will affect you. What is it? Geoff Farnsworth, Principal, Macpherson + Kelley Lawyers Sydney</p> <p>Insolvency:</p> <ul style="list-style-type: none"> • managing the risk, i.e. your counterparties - your due diligence • managing the fallout, i.e. post the insolvency event, particularly of a counter party <p>You need to ensure your action to manage affected contracts limits your financial exposure. This needs to be done in sync with the requirements of the GTA Trade Rules. Malcolm Finlayson, Director of Finesse Solutions</p>
30 July 12	<p>REGULATORY ISSUES & COMPLIANCE – you need to be across these</p> <p>Developing your Personal Property Securities Register Fleur Gibson, Senior Associate, Macpherson + Kelley Lawyers</p> <p>Grain Pools – Self Regulation or Legislation? Andrew Young, Managing Director, Plum Grove</p>
29 July 13	<p>REGULATORY ISSUES & COMPLIANCE – you need to be across these</p> <p>Personal Property Securities Register – a practitioners perspective Chris Heinjus, Principal, Rural Directions</p> <p>Grower Broker / Grower Agent –follow up Jeremy Rosenthal, Principal, SBA Law</p> <p>It’s all about the contract Stephen Thompson, Principal, Holman Fenwick Willan</p> <p>Pool Providers – Australian Grain Industry Code of Practice Stuart Clarke, Pools Manager, GrainCorp</p>
28 July 14	<p>MANAGING COUNTERPARTY CREDIT RISK ACROSS THE GRAIN INDUSTRY Irrespective of where you are in the supply chain, it is your right to expect contractual performance, in particular as a seller to get paid. This session will cover roles and responsibility across the supply chain.</p> <p>A producer’s perspective What are the issues a producer needs to consider to market their product and, to the best of their endeavors, ensure their contractual arrangements are upheld i.e. give delivery, receive payment. Leo Delahunty, Producer, Murtoa Victoria</p> <p>Grain marketing advisors & producers – defining the relationship There has been an increased uptake of adviser services by producers in recent years. What are the issues that define the relationship? Does one or both have a duty of care to the other? Brett Stevenson, Director, AgRisk Management Pty Ltd, Sydney NSW</p> <p>Industry Policy & Development Southern Australia has seen numerous trader insolvencies over the past 2 years leaving counterparties out of pocket and under financial pressure. What are grower organisations seeking to address the issue? Brett Hosking, President Victorian Farmers Federation (VFF) Grains Group</p> <p>Business Finance Management One bad debt is one too many! How do you cover yourself irrespective of where you are in the supply chain albeit producer, country merchant or international trading house? Malcolm Finlayson, Finesse Solutions & GTA Director</p>

Industry briefing papers

- GTA has published the following Industry briefing Papers as a service to industry:
 1. Brokers and Agents in the Australian Grain Industry - the Difference and the Implications (July 2013)
 2. Managing Insolvency (November 2011)
 3. Personal Property Securities Question & Answer Sheet (August 2011)
 4. What is the Personal Property Securities Act? (August 2011)
 5. Australian Personal Property Securities Reform (June 2009)

Legal remedies - GTA Contracts and Trade Rules

- **NSW Sale of Goods Act**

In 2007 GTA advocated to all state governments that their respective Sale of Goods legislation needed to be changed to reflect that an organisation can retain title to their goods where the goods have been commingled. This came as result storage providers (Shepherds Producers, Creasy Grain) becoming insolvent and the receivers relying on a 1932 High Court ruling that allowed receivers/liquidators to claim title in the commingled goods.

GTA was successful, with NSW changing its legislation. GTA contracts and Trade Rules now reference the NSW Sale of Goods Act giving those growers who use this contract much greater legal certainty should their warehouse operator become insolvent.

- **GTA Storage & Handling Agreement**

As a result of storage operators becoming insolvent, GTA launched this contract in 2008 to protect growers who wished to store their grain in a warehouse which did not have a storage & handling agreement. Importantly this agreement references the NSW Sale of Goods Act which confers title in commingled commodities.

- **GTA No 3 Contract Confirmation**

This contract was originally developed in conjunction with the Grains Council of Australia. In 2008 a Retention of Title clause was included in the Confirmation specifically to protect growers' interests.

Governance within GTA

- **GTA Constitution**

In 2010, the Constitution was changed to permit the Board to expel a member who became insolvent as defined by the GTA Trade Rules. The Constitution also allows for the expulsion of a member who acts in a manner that is prejudicial to the best interests of the grain industry or brings GTA into disrepute.

These powers have been exercised with the recent expulsion of two GTA members and the removal of a GTA Arbitrator, following an insolvency event.

- **GTA Membership**

Potential GTA members are screened prior to a recommendation to the Board for the granting or otherwise of membership.

Included in the application process is the requirement of the applicant to make disclosures relating to prior and/or previous Directorships and or Company Officers positions as defined in the Corporations Act. There have been applications for GTA membership that have not been approved as a result of the application of these tests / requirements.

- **Code of Practice for the Australian Grain Industry**

This Code was released in July 2013 following two years of industry consultation. It is mandatory for GTA members to adhere to the requirements of the Code. The Code requirements for Financial Management are detailed in Section 2.7.6.

GTA Member organisations that do not adhere to the provisions of the Code can be expelled.

- **Technical Guideline Document (TGD) - Pool Providers**

Title to grain consigned to a pool provider changes from the grower to the pool operator on delivery, hence growers are exposed to the insolvency of the pool operator. To alleviate these concerns, GTA developed this TGD which contains a number of initiatives to protect growers funds held in a pool.

Refer Attachment - Technical Guideline Document No 4 - Operating Standards for Grain Pool Providers

Comments in relation to the VFF Discussion Paper

VFF is advocating the introduction of a:

1. Grain Trade Licence; and
2. Grain Trade Guarantee Fund.

At this stage GTA cannot provide anything other than “high level” observations in the absence of a fully developed and costed proposal.

As a statement of principal, we would oppose any proposals which might have the effect of penalising prudent operators; reducing competition; stifling innovation, and adding prohibitive costs which would reduce returns to all participants in the grain value chain.

These are the comments we can make at present.

1. The Australian grain industry in recent years has demonstrated remarkable adaption to the changing marketing environment and GTA has a concern that to introduce new legislative / regulatory controls could stifle market based innovation. A good example of this is the increasing number of companies that are offering shorter payment terms to the traditional 30 days End Of Week of Delivery (EOWD).
2. GTA has only recently released its Code of Conduct as a major aspect of industry self-regulation. We expect that this Code of Conduct will encourage higher standards of conduct with the trade by GTA members. We would hope that eventually growers will prefer to deal with GTA members who are bound by the Code (which includes a Complaints Handling procedure).
3. We would expect to see some compelling evidence that a **Grain Trade Licence** system would reduce the likelihood of insolvencies, particularly given that any licencing system would definitely increase costs.

The major projected benefit of licencing is that it would require a certain level of commercial discipline and acumen. GTA believes that a similar outcome could be attained by growers requesting evidence of compliance with the Code of Conduct including information on the professional training of their counterparties.

GTA is currently seeking authorisation to conduct and award a Diploma in Grain Management. This type of qualification is ideally suited to train industry personnel with the potential to include ongoing professional training similar to that required by other professions.

GTA believes this type of approach will not only be less cumbersome and bureaucratic, but it will also deliver an appropriate market based approach.

Careful thought will need to be given to unintended consequences of any licencing scheme. Who will need to be licensed, for example? There appears to be an assumption that all producers only sell to merchants but that is not the case. Producers sell grain directly to multi-national traders; end consumers; banks and derivative providers; government aid agencies; charities, export customers and even other producers.

4. The creation of **Grain Trade Guarantee Fund** is in essence a credit insurance program. Credit insurance is already offered by a number of insurance companies and is a product widely used by post farm-gate organisations. VFF to their credit attempted to introduce a similar scheme for grain growers, however the uptake by growers has been limited and a compulsory socialised model is now being proposed.

A key issue will be developing a strategy to promote the concept to growers across Australia. Evidence needs to be tabled that the concept has widespread grower support as they will be the funding source.

5. While you are no doubt responding to your members who have been affected by insolvencies, many of your members will not have been so affected. . By introducing yet another levy on producers, this time to insure against the effect of trading with higher-risk counterparties, you are potentially penalising your members who have deliberately chosen to avoid higher-risk counterparties.

6. The creation of a Grain Trade Guarantee Fund could give rise to a number of other issues that include:
 - 6.1. Do the State Governments have the appetite to introduce new legislative controls on the grains industry? If implemented only in Victoria could this action be seen as anti-competitive or discriminatory to the Victorian economy?
 - 6.2. What would be the size of the fund? Insolvencies have ranged from very small amounts up to \$160 million in the case of the NSW Grains Board. The model noted in the Discussion Paper cites the Ohio State Fund which has a minimum of \$10 million and a maximum of \$15 million.
 - 6.3. The, as yet, unknown costs to administer such a scheme, given this concern is addressed in the amendments to the Canada Grain Act as noted in the Discussion Paper.
 - 6.4. Most importantly, a proposed Fund may appear to be a panacea which may encourage growers to exercise less due diligence on counterparties if they felt they would be covered in the event of a default on payment.

Conclusion

GTA is as concerned about insolvencies in the grain trade as grain producers are.

GTA is however inclined to favour a self-regulation model given that it is unlikely that any regulatory system could be guaranteed to prevent insolvencies and would increase costs for both producers and the Trade.

The better outcome, from our perspective, is that GTA and its members work closely with VFF members and the production sector generally and nationally to increase professional standards right along the grain value chain.

We look forward to reviewing the costed proposal and working with VFF to identify additional strategies that could be implemented.

Yours sincerely



Peter Reading
Chairman

Australian Grain Industry

Code of Practice

Technical Guideline Document

No. 4

**Operating Standard for Grain
Pool Providers**

First Edition Published July 2013

Compiled on behalf of the Australian Grain Industry by:

Grain Trade Australia



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Operating Standard for Grain Pool Providers

1. Preamble

1.1 Pool Providers

GTA requires that its members adhere to this standard when offering grain commodity pools to their clients. GTA encourages all potential clients of any GTA members' pools to conduct an initial assessment of the capabilities of the Pool Provider. Before committing to enter into a contract as a Pool Participant, a potential customer should satisfy themselves that a Pool Provider has in place:

- the appropriate skills,
- payment systems,
- risk systems and procedures,
- governance and compliance protocols,
- policies and resources

to manage the Pools that they offer and that they are regularly reviewed to evaluate the currency of their application. Potential Pool Participants should seek information relating to each of the above components before entering into a contract.

1.2 Potential Pool Participants

Potential Pool Participants should also be fully aware of the terms of the contract and understand the aims of the Pool Provider for each pool product on offer. Ensuring that a Pool Provider's marketing and pricing strategy for a particular Pool and the associated policies accord with the expectations of a potential Pool Participant is an important assessment that should occur before a contract is entered into.

2. Duties of a Pool Provider

When operating a Pool, a Pool Provider must:

- act with honesty and integrity;
- exercise reasonable care and diligence;
- act in the best interests of the Pool Participants and, if there is a conflict between the Pool Participants' interests and the Pool Provider's interests, give priority to the Pool Participants' interest;
- ensure that any costs or fees resulting in the Pool Provider receiving a financial benefit from the Pool are disclosed;
- not make use of information acquired through being the Pool Provider to gain an improper advantage for itself or another person or cause detriment to the Pool Participants;
- ensure the clear identification of grain belonging to a Pool and the separation of Pool assets and liabilities from other Pools and that of the Pool Provider; and
- ensure that any related party dealing resulting in the Pool Provider receiving a financial benefit from the Pool is reasonable in the circumstances and at arm's length.

3. Terms and conditions of a Pool

A Pool Provider will publish and make available to all prospective Pool Participants terms and conditions of the Pool which address matters including (but not limited to):

- the risk to Pool Participants of delivering grain into a Pool;
- the strategy and management plan to be adopted by the Pool Provider of the Pool;
- whether related party transactions may be conducted by the Pool Provider and an acknowledgement that if there are any related party transactions, they are reasonable in the circumstances and at arm's length;
- the risk mitigation tools used by the Pool Provider (such as hedging or derivative products);
- the costs/fees (including management, service and administration fees) chargeable by the Pool Provider and how they are calculated;
- the expected term of the Pool;
- the regions or locations where the Pool will operate;
- how estimated and final returns of the Pool are calculated (both on an aggregated Pool and individual Pool Participant level) and notified to Pool Participants;
- the freight rates or GTA Location Differentials used to determine EPRs to a 'delivered receival site' basis;
- pool payments such early contracting bonuses and quality payments made to select Pool Participants and the impact such payments may have on other Pool Participants' returns; and
- the timing and methods of payment available under the Pool and the costs or interest associated each different payment method.

4. Estimated Pool Return

- Where a Pool Provider posts an Estimated Pool Return (or similar terminology) for a Pool, that EPR will be a fair and reasoned estimate that the Pool Provider will be able to justify to Pool Participants at the time it is posted.
- The EPR must explicitly define what costs, fees and charges are included and excluded in the published figure.
- The EPR will be regularly updated via a posting on the Pool Providers website at least monthly. Where there is a Material Adverse Change to the EPR, the Pool Provider will update the EPR as soon as practicable.
- The EPR will be published for each grade, payment method and port terminal on a Net EPR basis.

5. Reporting and Audit of Pool

- During the term of the Pool, the Pool Provider will publish and deliver to Pool Participants, at least quarterly, reports concerning the performance and operation of the Pool. Where there is a Material Adverse Change to the EPR of a Pool, the Pool Provider will report on the reasons for the change.
- The Pool Provider will ensure adequate records of the Pool's operations are kept and prepare separate accounting records for each Pool adhering to requirements of an

accredited external auditor. In relation to related party transactions, the Pool Provider will maintain accounting records detailing the value and time of such transactions.

- Before or following closure of a Pool, and no later than six months of the final payment of a Pool, the Pool Provider will:
 - engage an independent auditor to audit:
 - the accounting records of the Pool;
 - the Pool Provider's compliance with its duties under this Code (to the extent it is practically possible);
 - the Pool Provider's compliance with the terms and conditions of the Pool; and
 - publish and deliver the findings of the auditor to Pool Participants.

6. Definitions

Estimated Pool Return or EPR

Is the financial return that Pool Participants can expect net of all Pool Provider charges at a designated price basing point, i.e. country silo, port or free on board.

Net EPR

The value of the EPR once costs for fobbing, associated export shipping charges (including shipping slot costs), financing and other pool costs have been deducted.

Material Adverse Change

In relation to an EPR means a reduction of the original published EPR of more than 5%.

Pool

Refers to a grouping of grain treated by a Pool Provider as a Pool for the purposes of buying grain, grouped according to time of delivery, location, quality, grade or variety of grain or such other matters as determined by the Pool Provider. Sales are made from the grain Pool and profits (losses) are shared between the Pool Participants.

Pool Provider

Means a commercial organisation that derives a financial advantage from conducting a Pool for the benefit of Pool Participants.

Pool Participant(s)

Is a person or organisation that provides grain