



News & Views

A Monthly Publication Dedicated to the Feed, Seed, Grain and Farm Supply Industries of Wisconsin

Black Swans ■

A special tip of the hat and thank you to the speakers at the WASA Spring Seminar held earlier this month on the very topics addressed here; David Crass and Porter Martin of Michael Best & Friedrich LLC law firm and Sam Miller of M & I Bank.

We are currently reading a book that we would recommend wholeheartedly to all members in a management position. The book is titled "The Black Swan" and authored by a former Wall Street quantitative analyst. The title of the book is based on an historical fact. As the author writes:

Before the discovery of Australia, people in the Old World were convinced that *all* swans were white, an unassailable belief as it seemed completely confirmed by empirical evidence. The sighting of the first black swan might have been an interesting surprise...,but that is not where the significance of the story lies. It illustrates a severe limitation to our learning from observations or experience and the fragility of our knowledge. One single observation can invalidate a general statement derived from millennia of confirmatory sightings of millions of white swans. All you need is one single black bird.

As the excerpt above points out, we possess an all too human weakness of making assumptions about the future based on our past experiences and especially those in our very immediate past. This tends to focus our attention on assuming a repeat of what we just experienced. In the grain trade, we dangerously assume this year will be just like last year. We didn't have problems last year, so how could anything not like last year's experiences occur. We tend not to even consider the possibility of a "black swan" and its consequences.

At this point, let's define a "black swan." This is not an ordinary occurrence. Instead, it is an event that is

unpredictable and carries a massive impact, and after occurring we develop rational explanations to explain that their occurrence was easily predicted. They, by definition, reside outside your model of risk management of your operation.

So why are we discussing this point at length? Because we may be in midst of one right now and you need to adjust your thinking to consider the ramifications of its happening.

We have already seen all-time record high prices in several commodities. These price levels have impacted feed and grain businesses in ways never considered possible even two years ago. Some businesses are having difficulties adjusting to the new world of margin calls in the amount of what the full cash price of the commodity was a couple years ago. The lack of futures and cash market convergence has rendered traditional hedging a marginal practice at the very least. Sources of credit for agronomy, feed and grain operations are looking at or already have imposed caps on the amount of credit that will be available both to individual businesses or the sector as a whole. Some terminal markets have either gone to basis only bids, pulled deferred month or new crop bids, or imposed fees on some types of contracts to cover interest expenses. Producers are asking what they can do to market a crop in which the furthest deferred bid they are finding is six weeks out. We mention these things to point out how the grain buying market has changed dramatically in the past few months and to suggest that the possibility exists for the situation to worsen. That is; there may be permanent changes occurring that could transform the feed and grain industries in ways that may not be too kind or generous to those who do not prepare for those changes.

So what is the most likely negative things that might impact your operation, and coincidentally the same items we're getting the most phones calls regarding? Producer defaults on contracts, followed by concerns

regarding obtaining adequate operational credit lines.

Regarding the first item, what can you do to protect yourself from a non-delivery situation?

- First, know your customer. It sounds trite and simple, but it's true. Is it a guarantee that someone with whom you have dealt and trusted for years won't "turn on" you? Absolutely not, but past behavior is still a pretty good indicator. And we're not simply talking about how many acres they farm, but what's their financial situation? Desperate people do desperate things. Sometimes the simplest way to stay out of trouble is to be able to avoid it in the first place.
- A quick lesson on Wisconsin contracts. Wisconsin is not what is known as a "merchant" state. That is, farmers are not afforded "merchant status" (as some neighboring states do), which means that verbal contracts are not necessarily enforceable. That's not to say that unsigned farmer contracts aren't binding and/or enforceable, but the grain buyer has to show a history of prior dealings in which the producer did deliver on unsigned or verbal contracts. It can get messy, complicated and cost you a lot of money, so the best advice is; **ALWAYS GET YOUR CONTRACTS SIGNED.**
- *"I've had farmers call me on the phone, tell me they want to sell x bushels at today's price, I send out a contract and never get a signed copy back. What do you expect me to do under those circumstances?"* One solution is to get on the phone and call the farmer, and send a follow up letter, requesting that the signed document be returned. This requires you to stay on top of which farmer is returning signed contracts and which isn't; but a little work on the front end can save you a lot of work and money on the back end. We've also heard what's called the negative confirmation. This is another statement sent to the producer, from whom you have not yet received a signed contract back, which states that if you don't hear back within 10 days, or if the farmer starts delivering grain without returning the signed contract, then the unsigned contract

you sent to that farmer is confirmed and accepted. However, this solution is not without risks and is no substitute for getting a signed contract back. Additionally, if you're going to have any "leg to stand on" in a dispute, attorneys will tell you it will be your documentation. If you don't have the documentation, you're chances of prevailing drop significantly.

- Monitor your existing to-arrive book to see if any customers are getting behind in their delivery schedules. And don't think because you're not talking to the customer the problem will solve itself. Communicate and follow up. Everyone with whom we have spoken that found themselves in a tough business situation has said in retrospect they wished they had spoken up earlier because a little communication could have solved a lot of pain.

Regarding how your lines of credit are administered, you should be aware banks are not isolated in their knowledge regarding these markets and potential consequences. They are very well aware of the situation and are scrutinizing their clients' operations accordingly. Perhaps, number one on their list is to assure themselves of what their clients' procedures are regarding contract compliance. Instituting the procedures listed above will go a long way to making your lender more confident that your operation will have the collateral in place on which they have extended credit going into harvest. The next point is to communicate with your lender. Talk to them about potential scenarios in which prices go higher and what your needs might be. It is better to know now and plan accordingly, rather than try sort out a situation when credit is even tighter.

We are not even into any type of a weather market yet and we could see prices go even higher. How high? Now one knows, but as prices climb higher from these levels, problems will compound. Please take the time to do some planning and reassessing your policies to avoid finding your options limited and being only presented with unpleasant choices if we either continue at current or even higher price levels.

Somebody Asked■

We would like to introduce (hopefully, space permitting) a new, regular feature in *News & Views*. We often get questions from members on topics that we, the staff, perhaps take for granted. The subject matter is not in the knowledge base of the general membership simply because they aren't dealing with the subject everyday. We would like to address that situation and each month cover a question that is both interesting and useful regarding the industry. As our intended focus is not in addressing or providing answers to either legal, marketing or business specific questions, we will not be discussing those items. Our goal is to bring up a general interest topic and provide a concise and clear response.

We generally get enough questions on a variety of topics that we'll be able to come up with a topic each month, but we welcome questions or topics from the membership. So let's get started with the program.

Q.: Let's assume that a producer has a relatively high priced new crop contract compared to current prices with a grain buyer. If that grain buyer defaults prior to the producer delivering on that contract, is the producer eligible to make a claim for the lost value in the grain contract against the Wisconsin producer security fund?

A.: No. The Wisconsin producer security program, "The Fund," only covers actual losses on grain in which title has passed to the buyer under the grain dealer portion of the program. These claims are limited by both the available funds in the program and to individual payout percentages. Losses resulting from price movement on undelivered contracts are not covered by the program.

Incidentally, the warehouse portion of the program covers stored, depositor-owned inventory under the control of the state licensed warehouseman, again subject to available funds and individual payment limitations.

Eldon Roesler Scholarships■

The criteria for consideration for the scholarships will remain the same and are as follows:

- be a Wisconsin resident,
- have completed one year of study at a Wisconsin university, college or vocational/technical college in an agricultural discipline or in another discipline with the stated intent of pursuing a career in an agriculture-related field,
- have a minimum of a 2.75 cumulative grade point average on a scale of 4.0, and
- can demonstrate in written form qualities of leadership, academic ability and financial need.

What do you need to do? Just copy both sides of the enclosed form and leave it on your counter and/or mention it to any employees or customers who may have an eligible child. If an applicant is awarded a scholarship that received their application from you, the resulting good will and potential positive publicity can't do you any harm. And all you have to do is have the applications on your counter or mention it to your employees. Not a bad deal.

Deadline for applications to be received in the WASA office is April 30th, so get 'em in.

Looking Down the Road■

June 11 - 12 4 State Dairy Nutrition & Management Conference
Grand River Center, Dubuque

WASA Directory Update■

The following updates should be made to your WASA Directory.

New:

Olsen's Mill, Inc.
N5355 Junction Rd.
Jefferson, WI 53549
Phone: (920) 674-8513

As additions or changes are made throughout the year, we will notify you here in *WASA N & V*.