

## **NACMA – the benefits of a commercial framework for the grain industry**

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#### **BACKGROUND**

In 1980's the amount of first hand grain traded in Australia outside the control of statutory organisations is estimated at 1.0 million tonnes. By 1990 this had increased to an estimated 3.0 million tonnes. All of this trading activity occurred outside of any form of specialist regulatory framework, apart from common law.

It was quite apparent that the size of domestic trading was increasing at a gathering pace and further planned deregulation of statutory controls was setting the scene for an even greater expansion of the domestic grain trading sector.

The commercial setting for grain trading in 1990 was quite different to today's trading environment. In 1990 there was;

1. multiple grain standards across Australia for the same commodity. This was somewhat confusing - which grain standard was aligned to the contract?
2. multiple contract terms and conditions –participants had to be across all the terms of trade for all the various organisations in the market; and
3. if there was a commercial dispute the only recourse was via commercial litigation, a somewhat costly and time inefficient method to settle disputes.

The commercial aspects associated with trading grain were quite complex as there was no standardisation within the trading sector. A precursor to market development is standardisation on contractual issues. For instance, the US grain industry in 1842 standardised their forward contracts leading to the formation of the Chicago Board of Trade, now the pre-eminent grain futures exchange in the world..

The market needed to develop with the ever increasing deregulation taking place, hence there were many market participants asking the questions such as " Would a commercial framework that gave some commonality to various commercial process aid the development of the grain trade?"

To sum up – the grain trading environment was changing rapidly.

At the same time there was the realisation that the best interests of the participants in the grain industry were best served when they cooperated with other market participants for the common good.

The various state merchant associations addressed these issues in 1991 when they formed the National Agricultural Commodities Marketing Association Limited, commonly referred to as NACMA. The state merchant associations initially tasked NACMA with, amongst other things, of standardising grains standards across Australia.

There are international precedents for the formation of such an organisation. These include the Grain & Feed Trade Association in London (GAFTA), formed in 1880 which is recognised as the international arbitrator on export contract disputes and the National Grain & Feed Association in the US, formed in 1896. Both these organisations are voluntary, self

regulating organisations whose objective is to provide processes to enable their members to trade grain in the most efficient manner possible.

These organisations obviously have the benefit of time to get their processes in place, something not available to NACMA. In many cases, NACMA has been in "catch up" mode since 1991.

From 1991 onwards, NACMA has been developing grain standards to the stage where there is one standard Australia wide for most of the grades within a commodity. In 1998, NACMA introduced the Terms of Trade which standardised the issues to be addressed in a contract and their definition. Also at this time, the Dispute Resolution Rules were introduced. 2001 saw NACMA Track & FOB contracts introduced.

So, 13 years after NACMA's formation you have the situation where the bulk of grain contracts transacted today refer to the NACMA grain standards, Terms of Trade and Dispute Resolution Service.

## **NACMA ENDORSEMENT**

Why have these core NACMA processes been so well received by the grain trade? In some respects we need to look to the issues if contractual management is not successful. Grain contracts have to be delivered against, and payment effected. If this occurs, according to the contracts terms and conditions, i.e. without disputation, then the process has been successful.

Success breeds success. When the NACMA process occurs with minimal disputes then the confidence of participants increases, thereby encouraging further trading leading to further increases in liquidity.

However, should a dispute arise, the NACMA dispute resolution service is able to respond. A general trend across various industry sectors is for commercial disputes to be subject to arbitration in preference to commercial litigation. The advantage that arbitration has over commercial litigation is that disputes are generally settled in a more timely and cost effective manner.

## **NACMA CORE ACTIVITIES**

NACMA core functions have been refined over the years, however there is still plenty of items to be addressed. All of the core functions are dynamic functions, i.e. they need to be constantly reviewed by members to ensure they are aligned to member's needs.

### **1 Grain Standards**

Grain standards endorsed by the industry through the NACMA process ensure that the objective and subjective parameters of the grains are described ensuring both the buyer and seller appreciate the exact type of commodity to be sold and subsequently delivered.

### **2 Terms of Trade**

The Terms of Trade set the base for the contractual obligations to be conferred on both buyer and seller. They must be quite specific and clearly set out the obligations of both parties. Point to note is that ignorance is not a defense for nonperformance against the contract – an obvious point but one which tends to be tendered in arbitrations.

Issues that are often referred to as “custom of the trade” must be written into the contract either as standing terms of trade or as a special condition. If there is an issue with the contract, the law will only be interested in what is written in the contract.

Contract writing can be seen as a tedious chore, however, care at this stage is repaid many times over as ambiguity is removed and both buyers and sellers fully understand their obligations.

### **3 Contract development**

NACMA has developed three contracts, the grower contract in 1998 which is endorsed by the Grains Council of Australia, followed by the FOB and Track Contracts in 2001. The Terms and Conditions for the NACMA Grower Contract can be found on most grower contracts nation wide, perhaps with slight modification whilst the Track Contract is used extensively by accumulators for both export shipments and the local consumptive market.

Whilst the contracts can be used “as is” which is the case with the Track Contract, other terms and conditions can be added to the contracts to suit the needs of the respective parties. Importantly, if reference is made to a particular NACMA contract then it is this contract without modification that is used.

### **4 Dispute Resolution Service**

The Grain Standards, Terms of Trade and the Contracts are the NACMA carrots, however, in the event of contractual disputation that can't be resolved by the parties NACMA does have a stick that members can use – the NACMA Dispute Resolution Service.

The threat of arbitration ensures that it is in the interests of both parties to ensure the contractual terms are thorough and fully describe the transaction, i.e. both the buyer and seller are of the same understanding of what is required to fully meet their respective contractual obligations. How effective this has been will be examined later.

## **BENEFITS TO THE TRADE**

- 1 Quick and accurate contract execution** NACMA processes allow merchants, end-users, and growers to execute contracts quickly and accurately ensuring all the important aspects of the contract are addressed.
- 2 Managing price risk** Just as the futures market requires speculative activity to remove risk from those involved in the physical activities of the market, so to does the grain trade. Speculators look first and foremost to markets with common and well understood terms of trade and accurate product specification. The NACMA process agreed to by industry imparts confidence, which draws in speculative activity. Increased numbers of speculators leads to increase liquidity which is a boon for those looking to cover physical exposures.
- 3 Industry funding** Financial institutions look for a sound commercial platform for their customers to transact their business. NACMA processes provide this platform to the grain market giving confidence to the banks that contractual issues will be managed according to set industry protocols.

## THE CHALLENGES

### **Challenge 1 Contract types need to keep pace with development of alternatives.**

The grain trade has evolved from the straight forward back to back deal to a market where string and circular trades are now common place. Contracts within the trade and also with growers now utilize the use of derivate products, be they swap products offered by financial organisations or futures contracts on the ASX or overseas exchanges.

To keep pace NACMA must be continually looking to develop contracting types required by market participants. At the present, NACMA is developing a Delivered Container Terminal (DCT) Contract specifically for the container trade. This development came as direct result of member's request.

Whilst looking for new contracting types is important, the major focus must still be on improvement to the current terms of trade to ensure "the custom of the trade" activities actually become gazetted terms.

### **Challenge 2 Standards must reflect consumer's needs**

Many people involved in agriculture tend to focus on the supply side of the equation, i.e. what is "it" we can produce. However, the real issue is what is required by the end user and their requirements are constantly changing. NACMA needs to be receptive to the needs of all end users and ensure the grain standards and contracting types reflect changing processing/end-user needs.

### **Challenge 3 State of flux within the transport & storage and handling sector.**

NACMA approved contracting types make direct reference to transport rates & storage and handling operations. The rapid privatisation within these sectors requires constant consultation to enable NACMA to obtain and disseminate to industry the information required by the trade to conduct trading activities.

For instance NACMA distributes the location differentials that are used to price grain in various contracts. NACMA collates the rates and distributes them to members. Also, bulk handling companies need to apply to become "Approved Bulk Handlers" for NACMA contracts.

### **Challenge 4 Increasing the Membership base**

NACMA derives the bulk of its revenue from membership. NACMA must continually look to add value to members businesses to ensure that grain trade participants see the NACMA membership as a tangible asset to their business. An example of the additional services is the Professional Development Program introduced this year.

## MEETING the CHALLENGE

*"Every person owes a part of their time and money to the business or the industry in which they are engaged. No person has a moral right to withhold their support from an organisation that is striving to improve conditions within its sphere." Theodore Roosevelt.*

NACMA purely manages the processes. NACMA provides the forum for debate and resolution, however the drivers for changes or additions to any of the NACMA process comes from members with proposals going to the appropriate Committee. The Committees are

composed of specialists drawn from all sectors of the trade who along with the Board members are all volunteers giving freely of their time.

NACMA members are able to place submissions before the respective Committee for their consideration. The successful submissions will be placed on the agenda at the Common Interest Forum for ratification by the industry. The Common Interest Forum will be held this year on 9<sup>th</sup> august in Sydney.

Where there is an issue that requires implementation prior to the Common Interest Forum, then the changes will be effective 30 days from the recommendation being ratified.

## **CONCLUSION**

Is there an acid test to demonstrate the effectiveness of NACMA? Over the years there has been an increase in the numbers of cattle on feed, chickens, dairy cows (especially those who have enjoyed supplementary feeding), pigs plus a developing aquaculture industry. The general population has also risen which equals growing demand for bakery products, noodles etc. All of this adds up to a general increase in domestic consumption and of course an increase in traded grain.

In 2002/2003 this first hand traded grain was at least 6 million tonnes with some of this subsequently re-traded possibly another 5 or 6 times. In the same time NACMA conducted 5 arbitrations involving just over 1,000 mt of business. Trade disputation that is not resolved between the parties and requires arbitration is at an absolute minimum which is real testimony that the trading framework established by NACMA is of real benefit to the industry.

In conclusion, the various NACMA core activities of grain standardisation, terms of trade and contract development and arbitration have allowed the grain industry to establish a robust and commercially sound framework to ensure business is transacted efficiently.

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