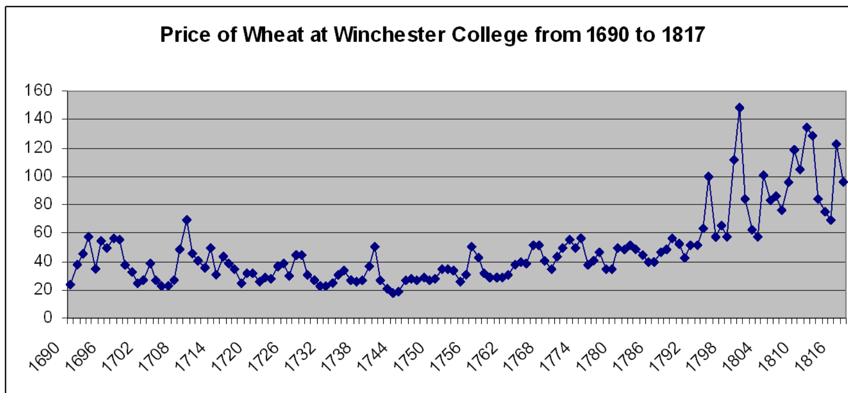
SUBMISSION TO THE PARLIAMENTARY SELECT COMMITTEE

Introduction:

Wheat, barley and other grains have a very long and illustrious history and have been cultivated by human beings for approximately 10,000 years. They have formed a crucial foundation to the evolution of civilisation. Despite our incredible technological sophistication, today these grains are no less indispensable to us than in the past and the farmer who produces and markets them is no less essential than he or she ever was.

It would appear that since time immemorial wheat prices in particular and grain prices generally have been highly volatile. Set out below are two graphs setting out the movement in prices in England over 128 year period from 1690 to 1817 and another chart, as a modern example, setting out the price movement on the CBOT of July 2006 wheat.



The CBOT prices are pre the price bubble of 2007/08. In the 103 year period from 1691 to 1793, before the onset of the Revolutionary and Napoleonic wars, prices changed from year to year on average by 18.4%. The maximum percentage change was 80% and in 47% of those years the change was greater than 50%.

Price volatility is a function of what economists call the inelasticity of supply and demand. Translated into plain English this says that a farmer has usually only a limited ability to store wheat after harvest and finance a deferred cash flow from that wheat, in which case he or she is usually under a lot of pressure to accept the current market price, irrespective of how low it might be. Likewise the flour miller is also under a lot of pressure to pay the current price, however high, because wheat is essential to his or her business. That puts the man in the middle, the grain trader, in a very powerful position. This is so not only because the price is so volatile, but also, in an unregulated market, there are various ways in which the man in the middle can manipulate the market to his or her advantage. Historically, the competition to occupy a dominant position in the middle, has been fierce and hence has favoured participants who are ruthless and unprincipled.

Consequently, there has been, over a considerable period of time, the existence of strong political pressure to regulate this market. Countries like Australia, particularly in North America, have adopted one of two regulatory models. Given its historical derivation, the first can best be described as the Canadian model, namely the single desk, which was also the model Australia adopted in the period from 1939 to 1999, and which it subsequently progressively deregulated, culminating in the complete abolition of the single desk in 2008. The other model can best be described as the US model, which is a competitive model, but which confines competition to a regulated futures market, such as the CBOT. When it was first introduced the scheme was confined to the grain market, however in 1936 it was extended to encompass all commodities. From its inception in 1922 there was always one significant exception, known as the forward exclusion, which permitted the grain farmer to forward sell outside a regulated futures market, so long as it was a genuine forward sale and not a speculative exercise in a derivative.

The advocates of deregulation look to the US, and such exceptions as the forward exclusion, as the model which Australia has now, in effect, adopted. In these submissions we say nothing could be further from the truth, under the forward exclusion in the US there is genuine competition, whereas in Australia, and putting to one side the position in Western Australia, because bulk handling is virtually a monopoly on the Eastern Seaboard and is a monopoly in

SA, there is an enormous potential for one grain trader (the Bulk Handler) to greatly manipulate the market. Before we develop this proposition let us first note the contrast between the position in this country and that of the United States. For example, in 11 US States, namely Illinois, Indiana, Iowa, Kentucky, Michigan, Minnesota, Mississippi, Nebraska, Ohio, Tennessee and Wisconsin there are a total of 45 different grain elevators, of which at least 6 are farmers' co-operatives. Whereas in Australia, according to ABARE figures, as at February 2011, 80% of Australia's wheat harvest was in the control of only three bulk handlers, namely Graincorp, Grain Flow and Viterra in Queensland, New South Wales, Victoria and South Australia. Viterra has a monopoly in South Australia and Graincorp controls 80% to 90% of the trade in Queensland, New South Wales and Victoria. Not only are these bulk handlers also grain traders, but in addition there are only another 5 or so others who operate in that market. In the US there is healthy competition. In Australia, there is an oligopolistic market, 80% of which is dominated by two bulk handlers.

So far as we are aware the model which Australia has now adopted, after 2008, is one for which there is no precedent.

Testing and Blending:

Where there exists one bulk handler who has a monopoly, there is obviously enormous scope to exploit opportunities to artificially down grade grain by distorting the testing process. Nevertheless one would have thought that it cannot be beyond human wit to devise a regulatory regime to assure that grains are accurately and scientifically graded. If government cannot achieve that much, then, it is respectfully submitted, that it is simply not doing the job which the community is entitled to expect. However, assuming, through an appropriate regulatory regime, farmers can be assured that there is in place a procedure that will guarantee that their grain is accurately and reliably graded, other problems will arise where there exists a privately owned bulk handler who is also a grain trader and has a bulk handling monopoly. That bulk handler can quite legitimately fully exploit the profits which can be made through what is sometimes called shandies, commingling or blending. In these submissions we will adopt the word blending.

If I have 100 tonnes of wheat which is classified as APW1 and which has a protein level of say 11.5%, and if I also have another 100 tonnes of wheat which is classified as ASW1 and which would otherwise have been classified as APW1 but for the fact that the protein level is 10%, and not the required 10.5%, then I can make a profit by simply blending portions of

those two quantities. If I combine 35 tonnes of APW1 with 65 tonnes of ASW1 then I will have 100 tonnes which will have an average protein level of a fraction over 10.5%. I will have bought 65 tonnes of ASW1 at say one price and sold that wheat as APW1 at a significantly higher price. This is a form of arbitrage. Furthermore because the protein level of the blended wheat is a fraction over 10.5% I have now fully exhausted the blending profits which were available in 35 tonnes of the original 100 tonnes of APW1 wheat. If I can now acquire another 95 tonnes of ASW1 wheat at 10% protein I can now fully exploit the remaining blending profits which are inherent in the 65 tonnes of APW1 wheat which is left over. In this way I can now ensure that when I sell APW1 wheat there are no residual blending profits available to the next guy. I can also use those blending profits as a means to subsidize a predatory pricing strategy which will enable me to acquire an increased market share over that of all my grain trading competitors, thereby placing me in the position of market leader.

A monopolistic bulk handler who is also a grain trader enjoys by way of blending profits an enormous advantage. Be that as it may, the fact that this advantage exists in theory does not mean that it is in fact being exploited. Is there any evidence that this advantage is being applied to benefit of the monopolistic bulk handler? The profit potential of this advantage lies in the spread between APW1 and ASW1. If the blending profit potential is being exploited we should observe a significant increase in that spread. The Table below sets out the spread at random dates in 2009 in respect to the Adelaide zone and the Port Lincoln zone:

	Adelaide			Port Lincoln		
Date	APW1	ASW1	Spread	APW1	ASW1	Spread
31-Jul-09	272	267	5	273	268	5
4-Aug-09	272	267	5	273	268	5
5-Aug-09	272	267	5	273	268	5
7-Aug-09	239	234	5	241	236	5
10-Aug-09	239	234	5	241	236	5
13-Aug-09	244	239	5	246	241	5
4-Sep-09	225	220	5	226	221	5
7-Sep-09	218	213	5	219	214	5
15-Oct-09	203	185	18	204	186	18
19-Oct-09	200	182	18	201	183	18
20-Oct-09	202	184	18	203	185	18
13-Nov-09	207	191	16	209	193	16

This shows a spread which never got above $18. In the period from 8 April 2011 to and inclusive of 14 April 2011, the spreads were respectively $60, $57, $55, $63 and $66. What we find most disturbing about this dramatic growth in the spread is that it apparently excites absolutely no interest in either the ACCC or ASIC. We readily acknowledge that there may well be another explanation for this growth in the spread, however, we think that the relevant authorities would have demanded that there exist sufficient transparency so that no one is left to wonder which explanation is correct.

Two questions arise from the above. One, what is the extent of that blending profit, and two, who is entitled to it? The first question is impossible to answer because of the lack of transparency which pervades this industry. We have data on quality which is provided through Viterra's Ezigrain site, and that shows that, amongst all receival sites which Viterra controls, the protein levels, as at early April 2011, in APW1 averaged 11.12% and ASW1 averaged 9.36%. We do not know what quantities are at various receival sites. This is information which apparently Viterra will not release. From ABARE data we know that in

February 2011 bulk handlers in South Australia carried a total 5.4 million tonnes of wheat. If one assumes that say 50% of that was APW1 and say 10% to 20% was ASW1, or more accurately that the ratio of APW1 to ASW1 is 2:1 or higher, then all or at least most of the ASW1 wheat could be upgraded to APW1 at no cost to Viterra other than the cost of blending. That would generate a blending profit of at least $20m to $30m, and that is only the blending profits associated with upgrading ASW1 to APW1. That would not include other blending profits which might be extracted from upgrading AGP1 to APW1 or say Feed1 barley to malt barley. Potentially blending profits could be enormous, however, given the total lack of transparency one is in no position to know whether blending profits are being generated or, if they are, how large those profits are.

Furthermore, one should not overlook the fact that not only are these profits derived at the expense of South Australian farmers and to the potential detriment of competition amongst grain traders in South Australia, through arming Viterra with the ability to engage in predatory pricing, but also these are profits which will go offshore to the overall detriment of both South Australia and Australia. In terms of predatory pricing, a monopolistic bulk handler, can offer above market prices for APW1 wheat and thereby attract sales in the spot market and at the same time acquire those loads which are graded as ASW1. It can then more than subsidise the above market APW1 prices by upgrading the ASW1 wheat that it incidentally acquires.

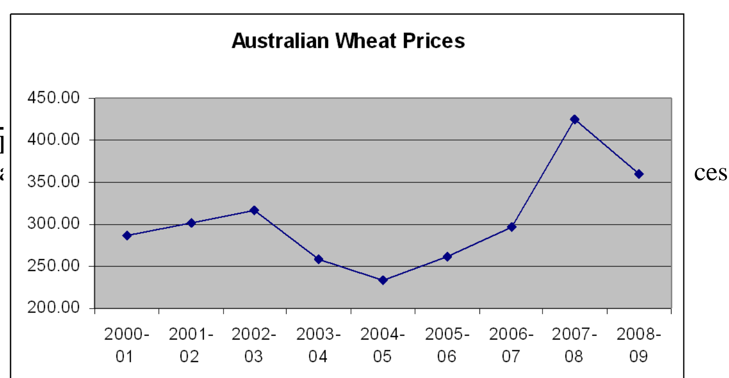
We are also of the view that these blending profits, less blending costs and a reasonable rate of return on that expenditure, are profits which belong to the farmer. It may be the case that their legal entitlement to those profits may be difficult to establish outside a class action, it is submitted, however, that on any view they are morally entitled to them. There is nevertheless a difficult question as to how those profits can be distributed to farmers or otherwise applied for their benefit. We will, in the course of these submissions, make some suggestions how a portion of those profits could be applied for the benefit of farmers. Before dealing with that we would like to put some submissions as to how this market is currently regulated and as to why the regulatory model is so unsatisfactory from a farmers point of view. Not only does this regulatory model establish an oligopsony of buyers in which one, the bulk handler, dominates, but it is so lacking in transparency as to justify the description of being a mushroom regulatory model. Namely ,one in which the farmers are treated like mushrooms, kept in the dark and fed bullshit.

<u>The Mushroom Model:</u>

The grain market consists of a large number of sellers who generally speaking operate small businesses selling to a small number of buyers who operate large businesses and who have a very sophisticated understanding of the domestic and global grain markets. In terms of knowledge there is, as between buyer and seller, a very pronounced asymmetry. The position is further aggravated by the fact that most of the grain farmers who operate today come from a period in which, for two generations, their marketing was done for them by statutory bodies in the exercise of a statutory monopoly. In the last few years, these farmers have been dropped into the deep end and what they desperately need is access to reliable information, particularly in relation to a market which is subject to substantial price volatility and which is principally determined in a futures market on the other side of the Earth, namely the CBOT, in which the overwhelming majority of participants are speculators.

To get some idea of how extensive speculation is on the CBOT, we note the following. In the period from and including 13 September 2010 to 1 Oct 2010, which covers 15 business days, there were altogether 1,087,869 futures contracts entered into on the CBOT. This involved the sale and purchase of a little over 5.4 billion bushels of wheat, being the equivalent of over 148 million metric tonnes. To get some idea of how large that is. In the US in the 2008/09 season that trade was more than twice what the US produced in wheat of every description, and it was more than all of the physical trades in wheat across the Globe for the period from July 2008 to June 2009.[1]

This enormous body of speculators can profoundly affect the global wheat price. In 2007, following the collapse of the US housing bubble, there developed a price bubble in commodities which saw the price on the CBOT go from an average of under US500 cents per bushel in the period from September 2006 to June 2007 to a peak in April 2008 of US1250 cents. That saw a commensurate increase in Australian Wheat which went from $295.95 in 2006/07 to $425.02 in 2007/08.[2] Price movements for the period 2000/01 to 2008/09 are set out in the graph below:



1 See USI

2 This data ... ces.

As this price bubble was unfolding two other events were also unfolding, namely Australian wheat marketing was fully deregulated and a back to back drought was also sneaking up on farmers. The initial slow rise in wheat prices lured a large number of farmers with no prior experience into forward selling the 2007/08 harvest, which, owing to the drought, collapsed. In the period from 1995/96 to 2005/06 wheat production in South Australia averaged 3.189 million tonnes. In 2006/07 it fell to 1.446 million tonnes and in 2007/08 it was at 2.296 mt. Not only did the farmer lose a substantial proportion of his or her production, but also those who forward sold were facing, in aggregate hundreds of millions of dollars in washout costs, thanks to the spectacular rise in wheat prices. By early 2007, if one was properly informed, one would be able to anticipate a significant price increase, given the movements which were then taking place with the global and US stock to use ratio. We strongly suspect that the only people who were taken completely by surprise with this price increase were Australian grain farmers.

In theory at least farmers can access information from the following sources:

1. Rural consultants who have an expertise in grain markets.

2. Grain traders.

3. Carry out their own research.

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For many farmers, who do not have a strong academic bent and a good understanding of economics, the third option would not provide them with a practical means of getting reliable information. In respect of the second option, it may seem a little paradoxical that grain farmers would be able to obtain information from grain traders, however, in certain circumstances that is the case. This has been the subject of what has now become protracted litigation between us and a number of grain traders in the Federal Court. Annexed to these

submissions is a detailed summary of the nature of that litigation. For the purpose of these submissions we do need to go into the nature of the precise legal issues which that dispute gives rise to.

For the purposes of these submissions we will try to put that dispute into a larger context. Broadly speaking, a grain farmer can dispose of his or her produce in one of four ways. The farmer can forward sell, or dispose of it after harvest, by either selling it on the spot market, selling into a pool or warehousing it and selling it at some later time. If he or she sells after harvest, unless he or she can afford to warehouse either with a bulk handler or on his or her farm for any length of time, then that farmer will be required to sell at the prices which prevail at or around the time of harvest. On some occasions, as is the case at the time of writing, those prices may be very good. However at other times they can be particularly poor.

There is therefore, at times, a real advantage in being able to forward sell and capture a price rise which occurs pre-harvest and which may not endure up to harvest. However forward selling also poses considerable risks as the harvests of 2006/07 and 2007/08 demonstrated. It is obviously necessary, before a farmer forward sells to get the best information which is available as to what are the risks of a production failure and, what is much more important, what is the risk that the price will increase significantly between the time the forward sale occurs and harvest. If the farmer forward sells under a basis contract, an agricultural swap or an option then he or she will be entitled to a product disclosure statement ("PDS") under chapter 7 of the *Corporations Act 2001* (C'th) and that PDS will have to inform the farmer of all significant risks associated with forward selling and the issuer will also have to provide ongoing disclosure if there are significant changes in the risk profile.

As at the time of writing, and despite the fact that there are three judgments on this matter in our litigation, it is unclear whether grain traders, who forward buy under a forward contract, are required to provide a PDS. Because of the burdens which chapter 7 impose on grain traders they therefore, almost overwhelmingly, forward buy only under forward contracts, and that is because they take view, be it correct or not, that chapter 7 does not apply to forward contracts. In that way they can keep the farmers in the dark. The almost exclusive use of forward contracts, as opposed to basis contracts, swaps and options, constitutes what is known as regulatory arbitrage and is seriously distorting the flow of reliable information to farmers and aggravating the adverse effects of this oligopsony market.

It may be thought that the obvious solution to this problem is to employ a rural consultant.

There are however two major difficulties with that option. One, is the need to install a system in place which ensures that these grain marketing consultants are properly qualified, and two, ensuring that they act only in the interests of their farmer clients. Where there exists an industry which is dominated by a small number of large grain traders, with one who is a monopolistic bulk handler, their interests will be preeminent and will strongly influence all who derive benefits from them, which will include rural consultants. A part of the business, and no doubt a necessary part of the business, of a rural consultant is to provide consultancy services to grain traders usually in the form of agronomic advice. That, in our submission, will create a very real potential for a conflict of interest between the interests of the dominant grain trader and the humble farmer, with a real risk that the interests of the farmer will come off second best.

At the time when the industry regularly invited farmers to enter into either basis contracts, swaps or options a person who conducted a business as a grain marketing consultant had to have an Australian Financial Services ("AFS") Licence, which was a requirement under chapter 7. As a result those consultants were regulated by ASIC, which was therefore in a position to ensure that such consultants were appropriately qualified and acted ethically. However if forward contracts are not caught by chapter 7 and the industry either exclusively or predominantly forward buys through forward contracts then the whole industry, including its consultants, will fall outside the jurisdiction of the *Corporations Act* and ASIC, and will fall into a regulatory void. The mushroom regulatory model will then have been perfected and as little reliable information as possible will make its way to farmers.

Before moving on we would also like to make one other important observation. The disaster of 2007/08 was made possible by the occurrence of three things. One, farmers did not know what they were doing, partly because of the paucity of reliable information. Two, there were back to back droughts, and three, there was a commodity price bubble which extended to wheat prices. The simultaneous occurrence of drought in Australia and a price bubble on the CBOT in Chicago are obviously independent events and will only rarely occur at the same time. However, in 2007/08, that disaster was only made possible because of the concurrence of those two unrelated events. In other words there was a perfect storm.

Owing to climate change, the frequency and intensity of El Ninos is likely to increase bringing with them more frequent and more savage droughts in Australia. Similarly, in our view, commodity price bubbles will also become more frequent, thus increasing the likelihood of a perfect storm. Nonetheless, perfect storms will still be rare, and what is more

insidious they will be sufficiently rare that farmers are at a great risk of having forgotten the last one as the next one is about to happen, and, so on each occasion, they will be burnt again. Once again these calamities will be the product of the mushroom regulatory model which is currently in place.

Conclusion and Recommendations:

The abolition of the single desk was always going to be difficult to avoid where competition policy enjoyed by bipartisan support at both the State and Federal levels. However the passage of South Australia's bulk handling infrastructure from a farmers' co-operative into the hands of a foreign owned private corporation, through Ausbulk and then ABB, reflects a malaise in the political consciousness and organisation of grain farmers. The general political apathy and indifference amongst farmers, and their general lack of organisation, is now becoming extremely costly. This is a problem, which in our submission, must be addressed.

We would recommend the following:

1. Blending profits, particularly monopolistic blending profits, ought to be heavily taxed by way of the imposition of a blending fee.

2. The revenue from that blending fee ought to be used to fund a fair, reliable and independently operated system under which grain is graded in this state.

3. There be complete transparency in respect of the grain held by bulk handlers, and, in particular, information as to the quantities, location, type, grade and significant characteristics (such as protein levels for example) of all grain stored at receiveal sites in South Australia be made publicly available.

4. There should also be established a statutory body called, let us say GrainSA, whose board of management would be elected by South Australian grain farmers. GrainSA would be a grain trader but with a mandate to offer basis contracts, swaps and/or options. It would need to be registered with ASIC and hold an AFS licence. One of its more important tasks would be the formulation of a PDS which would properly inform grain farmers of the risks and benefits of forward selling. It would, in compliance with chapter 7, also provide continuous disclosure. In short it should establish itself as a model grain trader.

5. GrainSA would also provide rural consultancy services. It would also formulate and run an educational programme for farmers. It would where necessary offer its services on a fee for service basis and would compete in respect of its various entrepreneurial activities with the private sector. To the extent that it required funding it should also be funded out of the blending fee, however, in respect of its commercial activities it should be required to compete on a level playing field with the private sector. Finally, it goes without saying, that it would be a not for profit organisation.

We believe that the recommendations set out above would address the problems which we have identified above.

These submissions have been prepared on behalf of Timothy and Elizabeth Keynes by B. O' Brien of counsel.

Dated ?? April 2011

ANNEXURE

A SUMMARY OF THE LITIGATION BETWEEN KEYNES AND RURAL DIRECTIONS, ABB AND GLENCORE

On 1 April 2011 His Honour Besanko J handed down a judgment in *Keynes & Ors v Rural Directions & Ors*. In order appreciate the significance of that judgment I will need to relate the background which led to it.

Facts and Issues:

On 4 August 2008 the plaintiffs issued proceedings in the Federal Court against five defendants. The plaintiffs consist of four individuals all of whom are wheat farmers in the Eastern Eyre Peninsula in and around the town of Kimba. The first two plaintiffs, Timothy and Elizabeth Keynes, operate a farming partnership and the other two are sole traders, however all market their grain collectively. In the case of two of the five defendants proceedings have been discontinued against them by the plaintiffs. Therefore there are now only three defendants, who are Rural Directions Pty Ltd (a rural consulting firm), ABB Grain Ltd ("ABB"), as it was then known, and Glencore Grain Pty Ltd ("Glencore").

In 2006 and 2007, on the advice of Rural Directions, the plaintiffs entered into a number of basis contracts and forward contracts in respect to the sale of the 2007/8 wheat and barley crop. In 2006 and 2007 there were back to back droughts and, as a result, the plaintiffs suffered a very substantial production failure and were largely unable to deliver those forward sales. They now owe, according to the grain companies, washout costs that amount to $463,968, however this amount is disputed by the plaintiffs. The only relevant issue which arises in this context concerns the forward contracts which were entered into in April and June of 2007 in respect of the wheat and barley crop of 2007/8. The plaintiffs undertook to deliver 2,300 tonnes of barley and 600 tonnes of wheat. Prior to that they had entered into basis contracts in respect of 1,496 tonnes of wheat.

In the period up to and including May 2007 rainfall had been unusually high. The rainfall up to that time was 131ml, whereas the average is 103ml. Thereafter the rainfall dropped dramatically. On average, in the period between June and October the rainfall in Kimba is 198ml, whereas in that same period in 2007 it was only 90ml. The plaintiffs had sown to wheat and barley a total of 4,997 hectares, which required a yield per hectare of 0.88 tonnes,

in order to meet all of their forward commitments. On average, in the Eastern Eyre Peninsula, they obtain yields per hectare of 1.38 tonnes. In 2007, they in fact achieved a yield of 0.5 tonnes to the hectare. The lowest ever recorded.

When they entered the basis contracts wheat was selling on the Chicago Board of Trade ("CBOT") at around US430 cents per bushel. When some of those forward contracts were washed out wheat was then selling at US1,200 cents per bushel. The totally unexpected collapse in the rainfall coincided with an equally unexpected bubble in wheat prices, which was part of a much larger bubble in commodity prices generally. This occurred at a time when grain farmers in this country had just been shifted from a highly regulated market, which had been regulated for two generations, to one which was largely deregulated.

Whilst the price bubble in commodity prices was not something that could have been readily foreseen, there were definite signs, which an astute and sophisticated observer would have noted, which would have indicated that the wheat price was going to be under considerable upward pressure. In the 10 years from 1998/99 to 2006/07 the US stocks-to-use ratio had come down from 39% to a projected 20.3% by April 2007, which indicated that there was a strong trend, extending over the previous 5 years, that global demand was exceeding the global supply of wheat and that wheat prices would rise accordingly. However, to the recently deregulated Australian wheat farmer, this observation would no doubt have escaped him or her, unless it was drawn to his or her attention.

The plaintiffs' case, as against the grain companies, rests on the assertion that when a grain company enters into a forward contract with a wheat farmer they are governed by Chapter 7 of the *Corporations Act 2001* (C'th) and are therefore required to provide a Product Disclosure Statement ("PDS") to the farmer which must state, amongst other things, all significant benefits and risks[3] associated with taking out the forward contract, as well as "any other information that might reasonably be expected to have a material influence on the decision" to enter into a forward contract.[4] Furthermore, under s.1017B(1A) of the Act, the grain companies would also be required to make continuous disclosure of changes, which, for example, might give rise to a significant risk. However, the requirement to provide a PDS which would then inform farmers of all the significant risks will only apply in respect of forward grain contracts if those contracts are financial products, as defined in the Act.

In the Federal Court proceedings, on 21 November 2008 Glencore brought an application that

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3 See s.1013D(1)(b) and (c) of the Act.
4 See s.1013E.

the case brought by the plaintiffs against it be dismissed. Subsequently ABB brought a similar application. The basis of those applications was that the forward grain contracts ("FGC") in question were not, as a matter of law, financial products. Those applications were finally dealt with, at first instance, by His Honour Besanko J on 3 June 2009 in a judgment in which His Honour agreed with ABB and Glencore that FGCs were not financial products. The plaintiffs appealed that decision to the Full Court of the Federal Court. The appeal was heard on 13 November 2009 and the decision was handed down on 13 August 2010. In that decision they dismissed the appeal but handed down a judgment which has still left open the possibility that FGCs are financial products within the meaning of the Act. It is not the intention of the plaintiffs to take an appeal to the High Court, however, they do intend to re-agitate, at first instance, the question of whether a FGC is a financial product. In order to understand why there remains one outstanding issue which has yet to be resolved, one needs to understand how the complex definition of financial product would apply, if at all, to FGCs.

In order to establish that a FGC is a financial product it is necessary to show that it meets one of two positive criteria and that it does not come within both of two negative criteria. To come within the positive criteria, it is necessary to show that it either comes within s.763C, in that it manages financial risk, or that it comes within s.761D(1), in that its value varies by reference to something else, in this case its value varies by reference to the price of the grain which is sold under that contract. So far as the Full Court was concerned they were satisfied that, on the evidence before them, it was, at least, arguable that an FGC would satisfy both of those criteria. However the problem was whether an FGC did not also come within each of the two negative criteria. Those two negative criteria are formulated as follows:

1. "The arrangement does not permit the seller's obligations to be wholly settled by cash…";[5] or

2. "usual market practice" does not "permit the seller's obligations to be closed out…".[6]

The second criterion employs terminology which is derived from terms employed originally in futures markets and which has a somewhat esoteric meaning. For present purposes, since the Full Court found against us in respect of that criterion, and since we do not intend to challenge that decision there is no point in explaining the issues which arise out of the application of that criterion to the facts of this case. Therefore, moving onto the first criterion two issues arise.

5 Section 761D(3)(a)(ii)
6 Section 761D(3)(a)(iii)

One, if one defines the arrangement as being the FGC on its own then does it permit the seller's obligations to be wholly settled by cash? The Full Court's answer to that question was no, the FGC does not permit the seller's obligations to be wholly settled by cash because the contract gives the option to wholly settle by cash to the buyer but not to the seller. Since we do not intend to appeal that decision then we are must therefore accept it. However, we also argued that the arrangement is not simply the FGC but also the collateral understanding and practice, which is universally applied in the industry, namely, that in the event of a production failure, the seller is always at liberty to wash out, that is the seller is always at liberty to wholly settle by cash. We put to the Full Court that the Act clearly contemplated that an arrangement was more than just a simple contract, it would also include understandings and practices and other arrangements which operated in tandem with a simple contract and which were part of an overall scheme. This can be seen from the definition of arrangement in s.761B of the Act, which says:

"If:
(a) an arrangement, when considered by itself, does not constitute a derivative, or some other kind of financial product; and
(b) that arrangement, and one or more other arrangements, if they had instead been a single arrangement, would have constituted a derivative or other financial product; and
(c) it is reasonable to assume that the parties to the arrangements regard them as constituting a single scheme;
the arrangements are, for the purposes of this Part, to be treated as if they together constituted a single arrangement."

Despite the fact that we pointed out, and in fact pleaded, that all but a small fraction of one forward contract had been washed out, nonetheless the Full Court found that we had not pleaded that particular issue and therefore they would not consider that question, and then went onto dismiss the appeal. Furthermore in paragraphs 56A and 56B of the proposed pleadings we had stated the following:

56A. The Washout Contracts discharged the Basis Contracts pleaded in paragraphs 10 and 25 hereof, and the First Forward and the Second Forward contracts, and were made either:

56A.1 pursuant to the terms of those contracts;

56A.2 as contemplated under the terms of those contracts; or

56A.3 as contemplated under the arrangements in respect of which those contracts formed an integral part.

56B. The reference to as contemplated under the arrangements in paragraph 56A.3 hereof is

> a reference to the common practice within the grain industry of permitting farmers who forward sell grain to be excused from making delivery so long as they washout the contract by paying the difference between the contract price and the market price in those cases in which the market price is higher than the contract price.

Consequently there is no decision on that particular point, and it is arguably open to us to now seek to amend our pleadings so as to raise that issue in a way which would require the court to either accept or reject it. If it is accepted then it will follow that FGCs are financial products and that when grain companies enter into them they are required to provide a PDS. If, on the other hand, the court refuses to apply the expanded definition of arrangement to the collateral practice or understanding of washing out then we will know that grain farmers have been denied, in respect of FGCs under the Act, a protection which is extended to a wide variety of other financial products, and that, therefore, there is a need to amend the legislation so as to give grain farmers the same protections which are provided to other people in equivalent situations.

Recent Developments:

Recently the Keynes applied to amend their pleadings so as to squarely raise the issue of whether the collateral arrangement in respect of forward contracts which allows for washouts in the case of a production failure costituted an arrangement which permitted cash settlement within the meaning s.761D(3)(a)(ii), which is the sole remaining obstacle to forward grain contracts being treated as a financial product. Because a judgment had been given against us under s.31A of the *Federal Court Act 1976* (C'th) that judgment had to first be set aside. We thus applied to set aside that judgment and amend our pleadings. In his judgment His Honour dismissed our application to set aside the original judgment. Whilst most of the issues are dealt with in one or other of the attachments which includes my written outline of submissions in respect of our application to set aside the judgment and amend our pleadings there is one aspect which is not raised in either my written submissions or in His Honour's judgment but was raised during oral argument by myself which I needs to be explained here.

In the course of His Honour's judgment he made the following observation:

> 55 Even if there was an understanding of the type alleged in paragraphs 50A and 50B that is relevant to only one aspect of the Full Court's reasoning. It would not overcome the aspect of the circumstances identified by the Full Court in the following passage (at 295 [41]):

> Further, even if one assumes that the seller may insist upon washout, that entitlement only arises in the event of production failure. It would not permit the seller to discharge its obligations in cash in any other circumstances.

It is thus suggested that in the passage which His Honour quotes from the Full Court judgment that they have in fact decided that the practice of washing out does not constitute a permission to cash settle. This is despite the fact that at two points in their judgment the Full Court said they were not going to consider that issue. Furthermore it is unlikely that they would have decided that issue in two sentences. In addition it also overlooks another passage from the Full Court judgment, namely:

It may be rare for a court to order specific performance of a contract for the sale of goods, but the theoretical availability of that remedy also says much, in principle, against the applicants' argument.[7]

In the passage which His Honour quotes from the Full Court judgment the Full Court may well be saying that even in circumstances where the contract, as such, could not even in theory be specifically enforceable, where there was a production failure, nonetheless, it is still the case that the written terms of the contract do not permit cash settlement.

Before concluding I will just make one final observation. It may be said that if an appeal is pursued against the recent decision of Besanko J, the only issue which will arise is whether the judgment under s.31A should be set aside and whether we ought to be allowed to amend our pleadings in the manner which we proposed in our application before His Honour. That appeal will not raise the question whether the practice of washing out brings a forward grain contract within the definition of a financial product in that it permits cash settlement. We would, however, argue that before the Full Court can decide to set aside the 31A judgment and allow us to amend our pleadings in the manner proposed they would also have to decide whether it was reasonably arguable that the practice of washing out constituted cash settlement within the meaning of s.761D(3)(a)(ii).

7 This passage is from paragraph 31 at p.293 of the Full Court judgment.