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JB BANKING LAW TODAY

A NEW DEAL

The Problem of Agricultural Suppliers and Purchasers Failing to Honor Pricing Agreements

The current economy is hurting everyone in the agricultural sector – not just the farmers. Agricultural suppliers and commodities buyers alike are feeling the bite as past due receivables and customer defaults have exploded. This strain causes problems that farmers and their lenders often never see coming.

Supplier Side Problem 1:

The first problem arises when suppliers raise prices on agricultural inputs after the farmer has prepaid for the product at a lower price. Sometimes the price increase is due to a price increase further up the supply chain and sometimes it is purely due to the supplier struggling financially. In either case, the price increase comes as an unpleasant surprise for farmers who thought they mitigated their risk by locking in inputs at a given price.

In the face of such an abrupt and unwelcome price increase, farmers and their bankers often ask – how can the suppliers do this and what can we do in response? The answer is less comforting than many would hope.

The legal answer is that the supplier has probably breached their contract with the farmer, provided the farmer can prove what the deal was and provided there was not a provision in the applicable contract which gave the supplier the right to pass along cost increases (even something as simple as a force majeure clause can give the supplier an argument in this regard).

That said, the practical answer, unfortunately, is that the farmer and their lender probably do not have any good recourse against the supplier.

In order for a breach of contract to translate into any tangible relief, the farmer would be forced to bring a lawsuit and attempt to get a judgment against the supplier. Even if the farmer did this, all they could really get is their money back; they could not force the supplier to provide any product. Alternatively, the farmer could pay the increased price and then sue for the difference, but the supplier would probably stop working with them after that. There just is no good answer for the farmer other than possibly for them to work with a different supplier in the future.

The bank could attempt to bring claim a directly against the supplier, but the bank would probably lack standing to do so and may even be risking a lender liability claim for going this route. As such, direct action by the bank is ill advised.

Supplier Side Problem 2:

A second, more troubling, problem arises when the supplier fails entirely after the prepayment was made but before the product is delivered. If this were to happen, the farmer would be nothing more than an unsecured creditor in a bankruptcy or receivership proceeding who would likely receive only ten cents on the dollar or less on what they are owed.

Grain Buyer Problem 1:

Problems can also arise for farmers when grain buyers refuse to honor futures contracts that involve pricing that is too favorable for the farmer.

When this happens, the futures contract has been breached by the buyer, but getting meaningful relief for the farmer might be challenging. The farmer would have to sell the grain to another buyer (at a lower price) and then sue the original buyer for the difference. In such a lawsuit, the farmer would bear their own attorneys' fees, which would reduce net recovery, and would still have to collect on the ultimate judgment. Recovery may be quite difficult if the buyer breached the purchase contract due to financial difficulties.

It is notable that the bank might also have a direct right of action against the grain buyer, given that the bank may have a security interest in the futures contract. However, like the farmer, the bank would still incur attorneys' fees that it would not be able to recover from the grain buyer and would still have to collect on any judgment it obtains.

Grain Buyer Problem 2:

A second, more troubling, problem arises when the farmer delivers grain to the buyer, elects deferred payment, and then the buyer's business fails before payment is made. In such case, the farmer again would be left as an unsecured creditor in a bankruptcy or receivership who would likely receive only ten cents on the dollar or less on what they are owed.

So, what can a bank do in the face of the above described scenarios? The only real answer is understand that risks such as these are a reality in today's economic environment and assess which borrowers they will continue finance. Strong borrowers can weather breached supplier and purchaser contracts – weak borrowers may not and may destabilize in their wake, causing pronounced losses to bank and borrower alike.

-Matthew Bialick, Esq.

Outside Insights

A Forum for Thoughts and Articles from Sources Outside of the Johnson | Bialick Law Firm

The Potential Economic Effect of Unhedged Storage of Soybeans Until June of 2019

An Article by Thomas Walker, Jr. of Praexis Business Labs

We have been hearing, through observers of the agricultural scene, of bullish sentiments on the 2018 soybean crops now chilling in bins around Minnesota. It is inevitable that the tariff spat will resolve, and that we see a more-than-typical increase in prices in 2019, so goes the logic.

The logic is unassailable based on the facts cited. But whatever the current smart play is supposed to be, farmers have historically favored storing their crops unpriced in expectation of price increases into the following summer.

We shouldn't rush to bet against people with the most skin in the game. A survey of soybean prices received by farmers, adjusted for cost of carry (full market interest rate was used as a proxy for real-world subsidized loan rates plus cost of on-farm storage), shows price movements from Fall to the following June play as indicated in the chart below.

Net of cost of carry, soybean sold in June beat harvest prices by $.19 from 1977-2017. Additionally, it is hard to miss the apparent trend toward much greater price advantage from June sales.

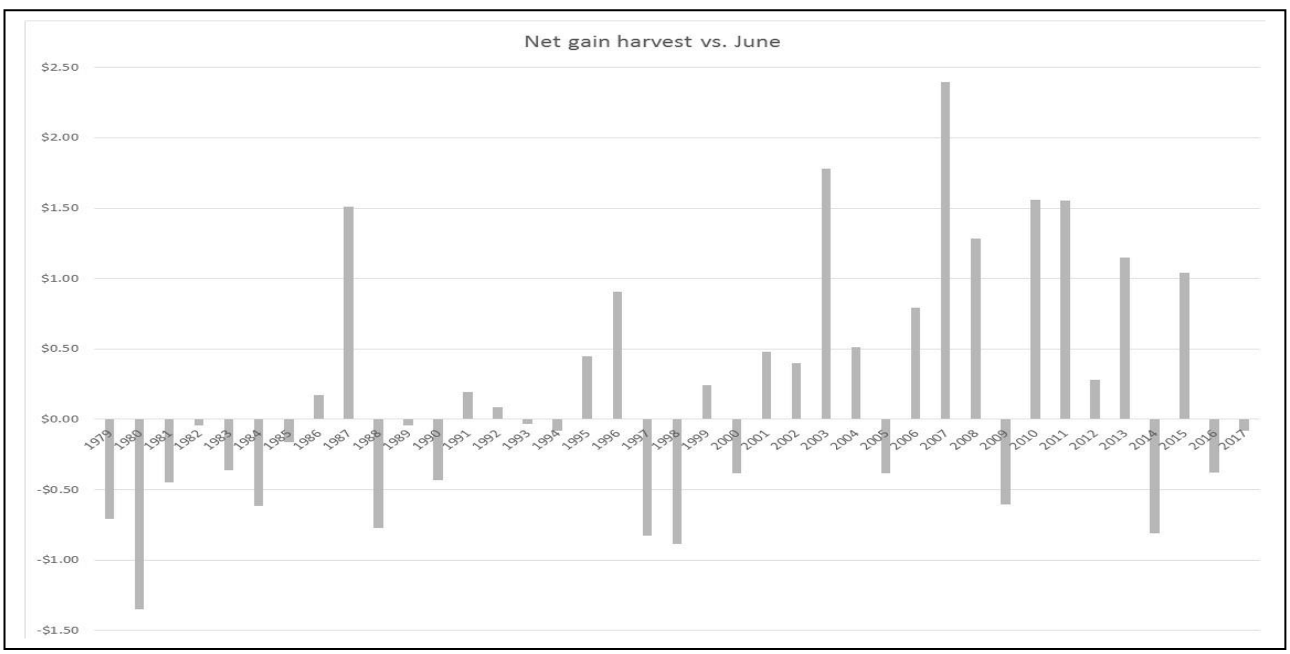
The problem with averages is they are realized sequentially. In real life, any untimely encounter with a tail-end event can be a game ender, making your personal average rather worse than the market at large. You might gain $2+/bushel holding to June (2007/8); you might lose $1.35 (1979/80). You might say that the trend is toward greater compensation for unhedged storage, but is the trend permanent or a mere cycle?

With crisis looming the question is, what is the cost of being wrong, rather than what is the advantage of being right. You abandon the possibility of a $.88 gain (average of all winners) from unhedged storage to avoid a $.47 loss (average of all losers on years where a loss occurs) from the same.

For a farm of commercial scale in Minnesota (3,000 acres), the average downside exposure is $30,550 (assuming s 47-cent price drop, 50 bushels per acre yield and 1,300 acres devoted to soybeans), with a historical maximum of $87,750 (assuming a $1.35 price drop, 50 bushels per acre yield and 1,300 acres devoted to soybeans), on soybeans alone. If defensible, based on historical average, practice is applied to corn as well, 2018 stored crop is subject to a potential ***$286,650+*** devaluation (assuming the same $1.35 price drop for soybeans and a 60-cent price drop for corn, with 195 bushels per acre and 1700 acres) due to adverse market moves that could occur between January and June. Given the tight margins over the last few years, such a loss could exhaust working capital and cause failure in weaker performing operations.

Prospects in agribusiness going into 2019 are at least volatile, and uncertain; we arguably have downside exposures across many, or most, asset classes. Average working capital on Minnesota farms is 1/2 to 1/3 its peak in 2012, and one disappointing year from turning negative. The verdict is not yet in on whether 2018 is that year. Economic adjustment is a question of when rather than if. This is a strong signal to create certainty wherever possible: don't leave 2018 crop exposed to market forces.

-Thomas Walker, Jr., Agricultural Economist with Praexis Business Labs, 651-999-9970



THE ENLIGHTENING ROUND

Q: Are there potential legal ramifications if banks provide emails for their customers to give to co-ops, indicating that there will be sufficient space available in lines of credit to cover new purchases?

A: Yes, by providing such an email, the bank would essentially make itself a guarantor on any new debts or, at the very least, may be opening itself up to a promissory estoppel claim by the co-op. Promissory estoppel is a claim that exists when one party made a promise or representation that turns out to be false and the other party relied on that representation to their detriment. As such, if the bank represented that there would be financing to pay off the co-op and the co-op offered supplies based on this representation, which later turns out to be false, the bank could be held liable under a promissory estoppel theory. So, bottom line, the bank must realize that by providing the borrower with this type of email, it is essentially guaranteeing the debt.

Q: Is there a simple way for me to check if there is any pending litigation against my borrower?

A: Yes, you can go to http://pa.courts.state.mn.us/default.aspx, select civil case search and then enter the name of your borrower. Any litigation should show up, regardless of whether it resulted in a judgment.

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