



Arbitration Decision

National Grain and Feed Association

July 15, 1999

Arbitration Case Number 1821[®]

Plaintiff: Champaign Landmark Inc., Urbana, Ohio

Defendant: Michael Terry, Urbana, Ohio

Statement of the Case

This case involved claims and counterclaims arising from the sale of cash wheat and corn by the defendant, Michael Terry (Terry), an Ohio grain producer, to the plaintiff, Champaign Landmark Inc. (Landmark), an Ohio agricultural cooperative association. The case was arbitrated pursuant to a court order¹ issued by the Court of Common Pleas of Champaign County, Ohio.

Landmark claimed that Terry failed to deliver 7,379.80 bushels of wheat covered under Landmark purchase contract number 5345 and 68,000.00 bushels of corn covered under Landmark purchase contract number 5344. Both of these purchase contracts were hedge-to-arrive (HTA) transactions, in which the Chicago Board of Trade (CBOT) futures reference prices were established at the time the contracts were initiated. The final cash basis was not established at the inception of the HTAs, and each contract had terms defining the final basis pricing date. The contracts also had a specified shipment period for the grain covered by each agreement. Landmark claimed it was owed a total of \$127,542.32 (the total of the two contract cancellations, as discussed below), plus interest at a rate of 24 percent annually from July 1, 1998, as well as attorney fees and other costs.

Terry countered that Landmark breached the contracts when the company unexpectedly in May 1996 changed the way its HTA program was offered to grain producers. Terry claimed that Landmark left him with the impression that there always would be trading features available to the farmer to use, and alleged that the inability to use these features caused Terry to lose control over his commodities and suffer losses that otherwise could have been averted. Terry also claimed that Landmark acted in bad faith, unfair dealing, and engaged in fraudulent and deceptive conduct. Further, he maintained that

the HTA contracts that Landmark entered into may not have qualified as cash forward contracts as defined by the Commodity Futures Trading Commission (CFTC).

Terry also contested the validity of the arbitration before the NGFA. He claimed, among other things, that the provisions on the reverse side of the Landmark contract confirmations referencing the NGFA Trade Rules and Arbitration Rules were not provided to him when he entered into the contracts.

The following is a description of the facts pertaining to each of the contracts:

HTA Contract Number 5345:

Landmark contract number 5345 was entered into with Terry on May 25, 1995. Terms of the contract were 5,000 bushels of wheat delivered to Urbana, Ohio, during July 1995. The contract was a HTA with a futures reference price of \$3.75 per bushel and a futures reference month of July 1995. Terms also required that the basis be set prior to delivery, and that the contract be priced or rolled by June 30, 1995. Additional remarks indicated "5/25 sold 1 Sept. 3.90 call @ .13 - .02 fees = .11 premium, option expires 8/18/95" and "if options are exercised, an HTA at the strike price is contracted for delivery." The original contract was signed and dated by Terry on June 2, 1995.

The contract was rolled forward on June 29, 1995. The delivery period was amended to "Fall '95" and the futures reference price and month were amended to "\$3.78 Sept '95."

On July 21, 1995, the call options referenced on the original contract number 5345 were exercised and a new HTA (number 5982) was written for 5,000 bushels of wheat with a

¹ Champaign Landmark Inc. was and is a NGFA Active member. Michael Terry was not a member. The court's order was based on an arbitration provision included in the parties' contracts. The trial court's order was affirmed by an Ohio appellate court in *Champaign Landmark, Inc. v. Michael Terry*, Case No. 97 CA 29 (Ohio 2d App. Dist. 1998).

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futures reference price and month of \$4.01 September 1995. The delivery period was stated as Fall '95.

On July 26, 1995, the contract was rolled forward again. The delivery period was amended to "December 1995" and the futures reference price and month were amended to "\$4.3477 December 1995." The confirmation stated that the contract was to be priced or rolled by Nov. 30, 1995. There appeared to be a delivery applied against the contract in June 1995, and then an additional 3,213 bushels were sold and added back to make the quantity on this contract 5,000 bushels.

Also on July 26, 1995, HTA contract number 5982 was rolled forward. The futures reference price and month were amended to "\$4.07 December 1995" and the delivery period was left unchanged (Fall '95).

HTA contract numbers 5345 and 5982 were combined and rolled forward on Nov. 30, 1995. A total of 10,000 bushels were averaged and rolled forward. The amended delivery period was March 1996. The amended futures reference price and month were \$4.1389 March 1996. The contract also required that the contract be priced or rolled by Feb. 29, 1996.

HTA contract number 5345 was rolled forward on Feb. 26, 1996. The futures reference price and month were amended to \$3.9739 May 1996 futures. The delivery period was amended to read "July 1996 & July 1997." The contract was to be priced or rolled by April 30, 1996.

On April 29, 1996, the contract was rolled forward again and the futures reference price and month amended to \$2.9939 July 1996 futures. The delivery period was clarified to read, "July/Aug 1996 intended delivery - estimated 4,000-5,000 BU., Balance July '97 Delivery." The contract also stated that it must be priced or rolled by June 28, 1996.

At some point between April 29 and July 31, 1996, Terry delivered at least 2,620.20 bushels of wheat.

HTA contract number 5345 was amended on July 31, 1996. The quantity was changed to 7,379.80 bushels to reflect the delivery made. The futures reference price and month were changed to \$3.0239 September 1996 futures. The delivery period was amended to July/August 1997 and under remarks the statement, "Must be delivered by 8/97" and "[t]his updates undelivered balance" were printed on the amendment. The contract amendment also stated that the contract must be priced or rolled by Aug. 29, 1996.

On Aug. 28, 1996, HTA contract number 5345 was rolled forward. The futures reference price and month were amended to \$3.0689 December 1996 futures. The delivery period was left unchanged; that is, delivery was required by August 1997. The contract also stated that it was to be priced or rolled by Nov. 18, 1996.

On Nov. 29, 1996, the contract was rolled forward again. The futures reference price and month were amended to \$2.8489 March 1997 futures. The contract delivery period was not changed (must be delivered by August 1997). The contract amendment also stated that it must be priced or rolled by Feb. 27, 1997.

On Feb. 28, 1997 Landmark sent a letter to Terry stating that, "As of the close of business on Thursday, Feb. 27, 1997, we have cashed out the following contract for your account. -- Wheat contract number 5345." The letter also stated that Landmark was charging Terry \$6,502.32 to cancel the contract. Landmark indicated that it arrived at the amount due as follows: Contract Price = \$2.8489 versus Current Market Price (Feb. 27, 1997) of \$3.68 equaled a difference of \$0.8311. Less 5-cent contract cancellation fee equals a total of \$0.8811 per bushel due. 7,379.80 bushels at \$0.8311 = \$6,502.32 due Landmark. This amount is a portion of Landmark's claim against Terry.

HTA Contract Number 5344:

Landmark contract number 5344 was written on May 25, 1995 for 30,000 bushels of corn to be delivered to Urbana, Ohio, during December 1995. This was a HTA contract with a futures reference price of \$2.76 per bushel and a futures reference month of December 1995. Terms also required that the basis be set prior to delivery, and that the contract be priced or rolled by Nov. 30, 1995. Additional remarks indicated "5/25/95 sold 6 Dec 2.80 calls @ .17 - .02 fees = .15 premium, options expire 11/17/95" and "if options are exercised, an HTA at the strike price is contracted for delivery." The original contract was signed and dated by Terry on June 2, 1995.

On Oct. 20, 1995, the call options referenced in the original contract number 5344 were exercised and a new HTA contract (number 6713) was written for 30,000 bushels of corn, specifying a futures reference price and month of \$2.95 per bushel December 1995. Delivery was stated as December 1995.

During the fall of 1995, Terry apparently delivered 19,602.71 bushels to Landmark. This was determined by an adjustment to the bushels on HTA contract number 5344 and by indications from the parties to that fact.

On Nov. 30, 1995, Landmark and Terry amended contract number 5344. They combined bushels from HTA contract numbers 5344 (10,397.29 bushels.), 6713 (30,000 bushels) and 6459 (40,000 bushels) into one agreement (#5344) that consisted of a total of 80,397.29 bushels. They also rolled the futures reference price and month to \$3.07 March 1996 futures. The amended contract also stated that the contract was to be priced or rolled by Feb. 29, 1996. The delivery period was amended to March 1996.

Between Dec. 1, 1995 and Feb. 28, 1996, Terry delivered and applied another 4,000 bushels of corn to HTA contract number 5344.

The contract was amended and rolled forward on Feb. 28, 1996. The balance of the contract was now 76,397.29 bushels. The futures reference price and month were changed to \$3.05 May 1996 futures. The delivery period was changed to "Fall '96 & Fall '97." The amendment also stated that the contract was to be priced or rolled by April 30, 1996.

Terry delivered and applied another 8,397.29 bushels of corn to HTA contract number 5344 between March 1 and April 26, 1996.

On April 26, 1996, the contract was amended and rolled forward. The balance of the contract was now 68,000 bushels. The futures reference price and month were changed to \$2.84 July 1996 futures. The delivery period was not changed (Fall 1996 and Fall 1997) and in the remarks section of the contract, a note was added that said, "Fall 1996 intended delivery of 38,000 Bu./Balance Fall 1997." The amendment also stated that the contract was to be priced or rolled by June 28, 1996.

On June 27, 1996, the contract again was amended and rolled forward. The contract quantity was not changed (68,000 bushels). The futures reference price and month were changed to \$0.9150 December 1997 futures. The delivery period remained split with 38,000 bushels for Fall 1996 delivery and the balance (30,000 bushels) for Fall 1997 delivery. The contract also stated that the contract must be priced or rolled by Nov. 27, 1997.

There were no further deliveries evident on the contract.

Landmark's attorney on July 29, 1997 sent a letter to Terry's attorney indicating that HTA contract number 5344 was in default of delivery pursuant to the agreement between the parties. The letter also stated that Landmark would "cash out" these contracts on Friday, Aug. 15, 1997 unless the parties reached some agreement relative to the failure to deliver by Terry.

On Aug. 15, 1997, Landmark sent a letter to Terry informing him that it had "cashed out" HTA contract number 5344 at the close of business on Friday, Aug. 15, 1997. Landmark charged Terry's account for \$121,040 on the cancellation, explaining the charge as follows: "Contract Price = \$0.9150 vs. Current Market Price (8/15/97, 12:00 Noon) of \$2.6450 equaled \$1.73 difference. Less 5¢ contract cancellation fee equals a total of \$1.78 per bushel due. 68,000 bushels at \$1.78 = \$121,040 due Landmark." This amount is a portion of Landmark's claim against Terry.

Landmark claimed that it entered into these HTA contracts with Terry based upon the fact that the trade was made subject to NGFA Trade Rules in effect at the time of the trade. Landmark's confirmations also stated "Seller and Buyer agree that all disputes and controversies of any nature whatsoever between them with respect to this contract shall be arbitrated according to the Arbitration Rules of the National Grain and Feed Association, and that the decision and award determined thereunder shall be final and binding on Seller and Buyer." Landmark stated that it followed the provisions of NGFA Grain Trade Rules 6(a), 6(c) and 10. Landmark also contended that Terry did not deliver as contracted, was in default and, therefore, was liable for damages.

The Decision

The arbitration committee found that both parties entered into the contracts willingly and agreed to the original terms and conditions.

As to whether arbitration – and more specifically NGFA arbitration – applied, the arbitrators concluded that the terms of the contracts were very clear. Each of Landmark's contracts provided on the front page that: "THE TERMS AND CONDITIONS CONTAINED ON THE REVERSE SIDE HEREOF ARE AN INTEGRAL PART OF THIS CONTRACT". Moreover, paragraph 3 on the reverse side provided as follows:

"Seller and Buyer agree that all disputes and controversies of any nature whatsoever between them with respect to this contract shall be arbitrated according to the Arbitration Rules of the National Grain and Feed Association, and that the decision and award determined thereunder shall be final and binding on Seller and Buyer."

These contract terms and the court order² to arbitrate provided the arbitrators with the jurisdiction and authority to decide the issues raised by both parties in this case.

This case involved two separate contracts between the parties. The arbitrators concluded that NGFA Trade Rule 43 applied, which provides that:

"Failure to perform in keeping with the terms and conditions of a contract shall be grounds for the refusal only of such shipment or shipments, and not for the rescission of the entire contract or any other contract between Buyer and Seller." [Emphasis added.]

Consequently, the arbitrators addressed the issue of contract performance separately for each contract in question.

HTA Contract Number 5345:

The final confirmation amendment on this contract issued by Landmark was dated Nov. 29, 1996, which called for delivery of the grain "[b]y August 1997." Landmark canceled this contract on Feb. 27, 1997, well before the stated delivery period. There was no evidence presented by either party to show that there was a reason to cancel the contract before the required delivery period. Landmark claimed it cancelled this contract under the provisions of NGFA Grain Trade Rule 10. But the arbitrators concluded that the NGFA Trade Rules do not permit the buyer to cancel a contract or buy-in bushels to fill a contract until there is a default or a statement by the seller that he/she is unable to deliver the grain covered by the contract. Landmark stated that Terry did not deliver and did not advise Landmark of his inability to deliver. The HTA contract did have a pricing or roll date of Feb. 27, 1997. In other words, the contract should have had the basis established, or been rolled forward, before that date. But this pricing deadline did not give the buyer reason to "buy in" the contract for failure to deliver. Nor were the arbitrators provided with any written communication between the parties to show any other reason for contract cancellation or default by the seller. Thus, the arbitrators were not provided with evidence that justified Landmark's unilateral cancellation of this contract in advance of the stated delivery period.

² The three-judge appellate court panel examined this question in detail and said that, "[t]he policy under both Ohio law and federal law is to encourage resolution of claims through arbitration." The court found that all of the claims asserted by Terry against Landmark also were arbitrable.

Consequently, based upon the facts presented, the arbitrators concluded that Landmark prematurely canceled this contract without providing proper notice to Terry under NGFA Grain Trade Rule 10. Therefore, the arbitrators denied Landmark's claim for damages of \$6,502.34 asserted against Terry on HTA contract number 5345.

HTA Contract Number 5344:

The arbitrators found that both parties entered into this HTA agreement willingly and agreed to its original terms and conditions. The defendant delivered a total of 32,000 bushels of corn against this contract at different times. The defendant also signed the original HTA confirmation and all of the subsequent amendments. These facts were a clear indication that the contract terms were known by, and acceptable to, Terry from the outset.

The arbitrators also concluded that the options-related positions within the terms of the original contract were valid and that the subsequent spin-off HTA contract (number 6713) did require physical delivery of the corn to Landmark.

Landmark, through its attorney, provided Terry with notification that he was in default of delivery on July 29, 1997. Then, on Aug. 15, 1997, Landmark canceled and "cashed out" HTA contract number 5344.

The arbitrators broke the default analysis into two parts:

- ◆ First, the contract called for delivery of 38,000 bushels of corn in Fall 1996. This appeared to be the only portion of the contract in default. The other 30,000 bushels were for Fall 1997 delivery. The arbitrators could not find any reason or evidence presented for the cancellation of the entire contract. The only portion that was in default was the 38,000 bushels that were to be delivered in Fall 1996. NGFA Grain Trade Rule 43 provides that: "Failure to perform in keeping with the terms and conditions of a contract shall be grounds for the refusal only of such shipments, and not for the rescission of the entire contract or any other contract between Buyer and Seller." For this reason, the arbitrators determined that only 38,000 bushels were in default and could be properly canceled by Landmark under the procedures set forth in NGFA Grain Trade Rule 10.
- ◆ Second, at issue was whether Landmark followed the proper procedure under the NGFA Trade Rules when it canceled the 38,000 bushels for Fall 1996 delivery. The arbitrators concluded that Landmark waited quite a long period of time to find Terry in default (from December 1996 until July 29, 1997). The evidence provided to the arbitrators seemed to show that the parties to this contract were in the initial stages of litigation during this period. Therefore, Landmark may have held some hope of having the corn delivered to satisfy the requirements of the agreement. By July 1997, the market price also moved back to a price level nearly the same as it would have been in December 1996. Landmark did provide Terry with notice of the default (attorney's letter dated July 29, 1997) and even allowed him an additional two weeks to settle the issue before cancellation or "buy-in" of the quantity in question. Because of these facts, the arbitrators deter-

mined that Landmark did follow proper procedures and thus was entitled to damages on 38,000 bushels of corn in default from the Fall 1996 delivery.

Based upon these facts, the arbitrators found in favor of Landmark and against Terry in the amount of \$67,640 on HTA contract number 5344. This represented the cancellation charges on 38,000 bushels of corn that was defaulted by Terry on the Fall 1996 portion of the contract (38,000 bushels X \$1.78 bushels = \$67,640).

Terry's Claims Against Landmark

Terry claimed that Landmark breached these contracts as a result of changes in policy that limited his (Terry's) ability to roll. The arbitrators determined that Landmark was under no obligation to roll the HTA contracts forward "indefinitely." Any amendments to a contract must be agreed to by **both** Buyer and Seller, as per NGFA Grain Trade Rule 41. Terry also claimed that Landmark acted in bad faith, and engaged in unfair dealing and fraudulent and deceptive conduct.

While the arbitrators found that Landmark did err in canceling contract number 5345 prior to the stated delivery period without agreement from Terry, the evidence did not substantiate the allegations asserted against Landmark by Terry. It should be noted that **both** parties to any grain contract need to communicate, especially if problems develop with the trade. The lack of communication only makes the situation worse.

Finally, Terry questioned the legality of the Landmark HTA contracts. Essentially, Terry argued that the contracts did not meet the self-executing forward contract exception contained in the federal Commodity Exchange Act. The arbitrators disagreed. Each of the contracts in this case contained express delivery requirements. The arbitrators, therefore, concluded that the contracts were legitimate cash grain contracts and enforceable agreements.

The Award

Therefore, it was ordered that:

- ◆ Champaign Landmark Inc. is awarded a judgment against Michael Terry in the amount of \$67,640, plus compound interest at the rate of 7.5 percent per annum from Sept. 15, 1997 until paid in full;
- ◆ Each party is to pay its own attorney fees and costs; and
- ◆ All other claims asserted or assertable by the parties in connection with these contracts are denied.

Submitted with the consent and approval of the arbitrators, whose names are listed below:

William Bluml, Chairman
Assistant Marketing Manager
West Central Cooperative
Ralston, Iowa

Roger Fray
Grain Merchandising Manager
Ray-Carroll County Grain Growers Inc.
Richmond, Mo.

Jeff Edwards
J & J Commodities LLC
Greenville, N.C.