National Grain and Feed Association

Arbitration Decision

1250 Eye St., N.W., Suite 1003, Washington, D.C. 20005-3922
Phone: (202) 289-0873, FAX: (202) 289-5388, E-Mail: ngfa@ngfa.org, Web Site: www.ngfa.org

June 17, 2010

Arbitration Case Number 2287

Plaintiff: **Cargill Inc., Minneapolis, Minn.**

Defendant: **Matt Ward and Charlie Ward, d/b/a Premier Grain, Walker, Iowa**

Statement of the Case

In 2005, after storing corn on the ground, Matt and Charlie Ward d/b/a/ Premier Grain [Premier] heard that Cargill had a program through which it supplied grain bins to substantial producers who entered multi-year contracts to sell grain to Cargill. The Wards approached a Cargill merchandiser and asked about the program.

Premier explained that it had discovered that if it employed forward contracts, it typically received more for corn than if it sold on the spot market at the time of harvest. Premier aimed for $2.50 per bushel. Its expectation was to sell grain by way of forward contracts during the year and to buy out the contracts at lower prices near harvest.

Premier characterized the agreement as requiring Cargill to provide the steel for bins that would hold 305,000 bushels of corn and giving Cargill the right to call for 305,000 bushels of corn in March 2007, 2008 and 2009 at $2.40[1] per bushel. If the price did not reach $2.40, Premier explained, it would owe Cargill nothing. If the price reached or exceeded $2.40, Premier could buy back the contracts at the then-current price. On the day the parties signed the documents, the nearby futures price was $1.90 per bushel and the March 2007 contract closed at $2.46 per bushel. Premier testified that its examination of corn prices showed that a price spike might cause it to lose as much as 30 cents per bushel in one year out of three. It decided it could afford to risk $90,000 ($0.30/bu. x 300,000 bushels) on the transaction to get $191,474.78 worth of steel, with the seeming likelihood that if corn prices fell, it would get the grain bins without charge.

Cargill understood the agreement somewhat differently. Its understanding was that Cargill was to provide steel for bins that would hold 305,000 bushels of corn. Premier was to sell 305,000 bushels of corn to Cargill in March 2007, 2008 and 2009. If, on the first day of the trading year, the Chicago Board of Trade price for the March futures was at or above $2.40 per bushel, the price would be $2.40. If, on that day, the futures price did not exceed $2.40 per bushel, the price would be established "using one of the marketing alternatives" offered by Cargill at the destination elevator on a day selected by Premier during January or February.

The parties executed a set of contracts that conformed to Cargill's understanding of the agreement.

Premier produced its 2006 corn and sold it to other buyers for considerably more than $2.40 per bushel. In November 2006, Premier approached Cargill and asked to buy-out the contract at the then-current price of $3.90 per bushel. Cargill indicated that it did not wish to sell the contract and that it expected Premier to deliver the grain. Instead, the parties agreed to extend the time of performance of the obligation to deliver crop-year 2006 grain, to adjust the price to be paid for the crop-year 2006 grain, and to add the commitment to sell an additional 305,000 bushels of corn to Cargill if, on Oct. 21, 2009, the price of the December 2009 corn futures contract on the Chicago Board of Trade exceeded $3 per bushel. The Wards met the March 2007 commitment – which by now had become the August 2007 commitment – both by buying corn from other sources and using some of their 2007 crop.

During 2007, the Wards again sold their corn crop to buyers other than Cargill and engaged in a hedge and options program that caused it to lose nearly a million dollars. In December the parties agreed to roll the delivery obligation forward several months to July 2008 in return for a strike price increase from $2.40 to $2.6125 per

[1] To simplify the discussion, from this point forward, all references to price will be net of any basis adjustment.

bushel, a pricing date of Jan. 3, 2008 and the use of the July 2008 futures contract. The agreement is evidenced by signed confirmations dated in January 2008.

On Feb. 21, 2008, Premier wrote Cargill to say that its "participation in the Cargill Bin Program is ended effective immediately." It delivered a list of costs and expected losses showing that the $191,474.78 worth of steel in the Cargill program bins was going to cost Premier $4,231,326 in expenses, costs and lost opportunities. Premier concluded that it was "easy to see the impossibility of our continued participation." The parties met on Feb. 27, 2008, at which time the Wards complimented Cargill's representative on the contract negotiations and formation, but said that they needed to get out of the contracts because corn prices had increased to the point that they could not purchase replacement bushels and input prices had increased to the point where a business selling corn at $2.40 per bushel could not survive. Cargill left the meeting with "significant doubts" as to whether Premier would honor its delivery obligations.

On April 29, 2008, Cargill made a demand for adequate assurances of performance by noon on Thursday, May 1, 2008. Premier did not respond to the demand and, on Monday, May 5, 2008, Cargill notified Premier that it was cancelling the outstanding contracts as of the close of the grain trading market on May 5. Cargill calculated that the difference between the contract price ($2.67) and the market price as of cancellation ($6.06, both numbers apparently including a basis value) was $3.39 per bushel. Multiplying the figure by 915,000 bushels, Cargill demanded payment of $3,101,850.

Cargill asked the NGFA to arbitrate the dispute. The Wards responded, denying the validity of the contracts, challenging Cargill's computation of damages and counterclaiming for $1,598,444, plus interest. Both parties asked for an oral hearing.

The NGFA arbitration panel conducted an oral hearing in the Council Bluffs Room of the Omaha (Neb.) Embassy Suites Hotel on March 23, 2010. Both parties were present and represented by counsel.

The Decision

VALIDITY OF CONTRACTS

Premier Grain argues that the document the two parties signed should not be enforced because neither party sent a written confirmation, as provided for under NGFA Grain Trade Rule 3. A "confirmation" – as understood both in the grain trade and the Uniform Commercial Code – is a written document that confirms an oral contract. Where, as here, the two parties execute the same written document, there is nothing to confirm and, therefore, no need for a written confirmation. Therefore, the arbitrators determined that Premier could not use Grain Trade Rule 3 to avoid the contract.

Premier Grain next contends that the Cargill bin contracts constituted illegal credit-sale contracts under Iowa law. A credit-sale contract is a contract in which a farmer delivers grain to a licensed grain dealer but, for any of a variety of reasons, is not paid within 30 days and – by virtue of that delayed payment – is not covered under the state grain indemnity fund. Nothing in the contract documents suggested that Premier would be extending credit to Cargill. Thus, the arbitrators determined the contract was not a credit-sale contract.[2]

Finally, Premier argues that the parties' radically dissimilar understanding of the terms of the agreement indicated that the parties had never reached an agreement and, consequently, there was no contract to enforce. If there was a misunderstanding between the parties, it should, could and – if both parties had read the documents at the time of execution (the Wards testified that they did not) – would have been identified and remedied before markets moved and one or the other parties wished it had not entered the agreement.

Having concluded that there were valid contracts between the parties, the next task was to determine who performed and who breached.

CARGILL CLAIM FOR DAMAGES

Cargill delivered the steel it contracted to deliver.

In November 2006, Premier indicated that it could not meet its obligation to deliver the 2006 crop-year grain in March 2007. Although Premier could have forced Cargill to elect to buy-in grain (Grain Trade Rule 28(a)(2)) or to determine a cash-out price

[2] If the contracts could be understood to be credit-sale contracts, Iowa law permits the Iowa Department of Agriculture and Land Stewardship to suspend the offending grain dealer's license. The statute does not, however, say that the parties to such a contract may avoid performing their obligations under the agreement. Premier notes that Iowa judges sometimes void contracts as being made contrary to the public policy of the state of Iowa. Because the arbitrators did not think themselves equipped to determine that the policies of the state of Iowa would be better served by enforcing or voiding a series of grain contracts, they declined to engage in such speculation.

based upon the market price at the close of business the next day (Grain Trade Rule 28(a)(3)), either of which would have established a buy-out price, this is not what happened. Instead, the parties negotiated and executed an agreement to extend the time for performance (Grain Trade Rule 28(a)(1)) that involved both increasing the contract price for the grain and adding the provision that if, on Oct. 21, 2009, the price of the December 2009 corn futures contract exceeded $3 per bushel, Premier would deliver and Cargill would buy an additional 305,000 bushels of corn in October/November 2009 at $3 per bushel.

2007 Corn and 2008 Corn

At some point, Premier and Cargill each reached the conclusion that Premier was not going to meet the grain delivery obligations of March 2008 and March 2009. In trying to determine when those events occurred, the arbitrators considered:

- Nov. 30, 2006: The date Premier said it told Cargill that it wanted to buy back its March 2007 obligation;
- Feb. 21, 2008: The date of the letter Premier sent to Cargill saying that its participation in the program "is ended effective immediately";
- Feb. ??, 2008: The unknown date upon which Cargill received Premier's notice;
- Feb. 27, 2008: The date the two parties met and Cargill said it formed "significant doubts" as to whether Premier would perform;
- March 31, 2008: The date by which Cargill knew that Premier had not delivered 305,000 bushels of corn during March 2008; and
- May 1, 2008: The date upon which Premier failed to respond to Cargill's demand for adequate assurances of performance.

The importance of the dates was that pursuant to Grain Trade Rule 28(a), Premier was responsible for price changes until such time as it notified Cargill that it would not perform or until Cargill could, by the exercise of due diligence, determined that Premier would not perform. At that time, under the Grain Trade Rules, the following should have occurred: The parties either agree to extend the time for performance, Cargill buys-in grain for the account of Premier, or Cargill cancels the defaulted portion of the contract at fair market value based on the close of the market the next business day.

Premier argues that damages should be calculated as of a date in late November 2006 when the Wards told a Cargill representative that they did not have the corn and would like to buy back their obligation. At that point Cargill was on notice of an anticipatory repudiation as to the March 2007 delivery obligation. The parties resolved the problem by way of an extension of time to meet the delivery obligation, pursuant to Grain Trade Rule 28(a)(1). Because each delivery obligation is to be treated separately (see Grain Trade Rule 28(c)), the arbitrators determined that the events of November 2006 did not affect delivery obligations for March 2008, March 2009 or fall 2009.

With respect to those later delivery obligations, if – pursuant to Rule 28(a) – Premier had telephoned Cargill and followed with the written confirmation, the arbitrators would use the date of the telephone call as the date of the anticipatory repudiation. Because Premier sent a written notice, the date should have been the date that Cargill received the notice.[3] However, the parties presented no information to enable the arbitrators to determine when that occurred. The arbitrators do know, however, that the parties met and discussed the situation on Feb. 27, 2008 and, accordingly, will use that date as the occasion upon which Premier notified Cargill – or that Cargill could have determined – that Premier was not going to deliver corn on its contracts.

At the end of Feb. 28, 2008, the Chicago Board of Trade reported the closing prices of yellow corn to be:

July 2008:	5.6775
March 2009:	5.7300

Assuming – because the parties presented no contrary information – that the basis remained constant, the arbitrators subtracted the maximum contract price ($2.6125 for the 2007 corn and $2.40 for the 2008 corn) from each closing price and calculate damages as follows:

305,000 bushels x ($5.6775 – $2.6125) =	$934,825
305,000 bushels x ($5.7300 – $2.4000) =	1,015,650
	$1,950,475

Premier is responsible for the damages that had accrued as of the time of its default. It is not, however, responsible for changes in market value that occurred between the time of the default and May 5, 2008, the time at which Cargill sought to fix damages.

2009 Corn

Premier sold Cargill the right to call for the delivery of 305,000 bushels of corn in October/November 2009 at $3 per bushel if, on Oct. 21, 2009, the December 2009 corn futures contract exceeded $3. At the time of Premier's repudiation of the contracts, in February 2008, this right had a value. The contract did not explain how to calculate damages in the event of an anticipatory repudiation of an option to call for grain. Under

[3] Just as Grain Trade Rule 3 anticipates an oral contract and a written confirmation, Grain Trade Rule 28 anticipates an oral notice and a written confirmation. When the initial contract or notice is in writing, the Rules do not require subsequent confirmation.

Grain Trade Rule 28, Cargill either was to agree upon an extension to the contract (which did not happen), to buy-in the defaulted portion of the contract for the account of Premier (which did not happen), or to determine the fair market value of the defaulted portion of the contract based upon the close of the market the next business day. The defaulted portion of the contract was not, as Cargill asserts, 305,000 bushels of corn at $3 per bushel. Instead, the defaulted portion of the contract was *the obligation to deliver 305,000 bushels of corn in October/November 2009 at $3 per bushel if, on Oct. 21, 2009, the price of the December 2009 corn futures contract exceeded $3.* Because neither the contract nor the trade rules provide a mechanism for calculating speculative damages, the arbitrators find that Cargill has failed to prove – and for that reason the arbitrators decline to award – damages for Premier's repudiation of the option contract for fall 2009 corn.

PREMIER CLAIM FOR DAMAGES

Premier contends that Cargill owed Premier $1,598,444, plus interest, in damages because Cargill breached its agreement with Premier to allow Premier Grain to buy out the bin program contracts. Although the arbitrators questioned many of the assertions and calculations, they disallow the claims because they cannot find that the parties entered into such an agreement.

The Award

The contract authorized Cargill to recover attorney's fees and costs incurred in litigation or arbitration, but only after Cargill demanded and the Seller failed to offer adequate assurances of performance. Because Premier made an anticipatory repudiation of the contract in February 2008, the demand Cargill made for adequate assurances in April 2008 does not figure into this arbitration. Thus, the arbitrators decline to award Cargill pre-award interest or arbitration costs.

In addition to the $1,950,475 in damages, the arbitrators do, however, award Cargill interest on this award at the rate of 5% per annum pursuant to NGFA Arbitration Rule 8(m), beginning on the date the NGFA delivers this decision to the parties.

Submitted with the unanimous consent of the arbitrators, whose names appear below:

Jerry Cope, Chair
Transportation Manager/Wheat Merchandiser
South Dakota Wheat Growers Association
Aberdeen, S.D.

Simon B. Buckner
Corporate Counsel
Bartlett Grain Company, LP
Kansas City, Mo.

Joe N. Christopher
Senior Grain Merchant
Crossroads Cooperative Association
Sidney, Neb.