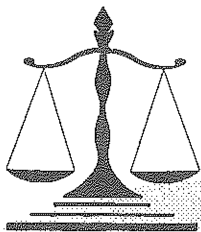

Arbitration Decision

National Grain and Feed Association

October 24, 1997

Arbitration Case Number 1788

Plaintiff: The Andersons Inc., Maumee, Ohio

Defendant: Lowell E. Harter, Fairmount, Ind.

Statement of the Case

This case involved a dispute arising from the non-delivery of corn on five cash forward contracts entered into between Lowell Harter ("Harter"), the producer-seller, and The Andersons Inc., the buyer.

The Andersons contended that Harter breached the contracts by refusing to deliver. The Andersons sought damages in the amount of $52,850, contract cancellation charges in the amount of $3,000, plus interest, costs of collection and attorney fees.

Harter contended, among other things, that The Andersons engaged in "fraudulent and deceptive activities...in the sale of certain hybrid contracts commonly known as hedge-to-arrive ('HTA') contracts to Harter." Further, Harter alleged that the contracts were "illegal, off-exchange contracts in violation of various provisions of the Commodity Exchange Act" and federal regulations. Harter asserted claims against The Andersons for damages amounting to $75,929.19, plus attorney fees, costs and punitive damages.

The contracts entered into between Harter and The Andersons set forth the following terms:

Contract Number	and Date	Quantity (Bushels)	Futures Reference Price	Futures Month-Year	Contract Basis	Original Delivery Period
35576	Nov., 11, 1994	10,000	$2.31	March 1995	Unassigned	JFM 95
35618	Nov, 14, 1994	5,000	$2.50	December 1995	Unassigned	ON 95
35624	Nov. 14, 1994	5,000	NPE*		Unassigned	JFM 95
	Sept. 12, 1995	Set Price	$2.9775	December 1995		
35625	Nov. 14, 1994	5,000	NPE*		Unassigned	JFM 95
35626	Nov. 14, 1994	5,000	NPE*		Unassigned	JFM 95

*No Price Established

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The submitted evidence showed that during the subsequent 18 months covered by the contracts, several amendments were made to extend the delivery periods and roll forward the futures reference price numerous times. At the time the dispute arose, all contracts had been amended to a delivery period of May 1996. The rolling forward of futures reference prices occurred in a market structure where the closest futures were gaining in price relative to the deferred futures prices. This created a situation in which the series of rolls resulted in amended reference futures prices that were less than the original contracted reference price, as reflected in the following table.

Contract Number	Quantity (Bushels)	Amended Reference Price	Amended Futures Month-Year	Contract Basis	Amended Delivery Period
35576	10,000	$2.3275	July 1996	Unassigned	May 1996
35618	5,000	$2.3275	July 1996	Unassigned	May 1996
35624	5,000	$2.8075	July 1996	Unassigned	May 1996
35625	5,000	NPE*		Unassigned	May 1996
35626	5,000	NPE*		Unassigned	May 1996

*No Price Established

On May 1, 1996, Ed Shirey of The Andersons contacted Lowell Harter to confirm the delivery of the corn to satisfy the contracts. He was informed by Harter that no corn was left to be delivered to the Andersons.

A meeting was conducted on May 4, 1996 between The Andersons and Harter to discuss options available to Harter. A letter with a settlement proposal was sent by The Andersons to Harter on May 10, 1996 that offered to settle the account with Harter for $51,787.50 due to The Andersons. On May 16, 1996, Harter asked The Andersons to allow him until May 20, 1996 to consider the proposal. On May 16, 1996, Harter also filed suit on the written contracts against The Andersons and other parties in the U.S. District Court for the Northern District of Illinois[1]. On May 21, 1996, The Andersons received a letter from Lowell Harter's attorney requesting that The Andersons mitigate all damages.

On May 21, 1996, The Andersons canceled the priced contracts using a Chicago July 1996 Corn Futures Price of $5.09. *(Note: the arbitration committee verified that this price was within the range of trading prices for May 21, 1996).* This resulted in a price difference totaling $52,850 on the 20,000 bushels of priced contracts. In addition, The Andersons also claimed contract cancellation charges totaling $2,500 based upon a 10-cent-per-bushel charge for the 20,000 bushels of priced grain and a 5-cent-per-bushel charge on the remaining 10,000 bushels of unpriced contracted grain. The combined total cancellation claim of The Andersons was $55,350. This was consistent with the cancellation methods set forth in The Andersons' contract.

While Harter brought suit in federal court on the contracts, he also argued in defense of non-delivery that the Andersons' contracts were illegal, off-exchange contacts in violation of the Commodity Exchange Act and, therefore, were not binding. He also contended that he was led into a speculative contract and never intended to deliver grain against the contracts.

The Andersons contended that the contracts specifically required delivery. Further, The Andersons maintained that Harter's production capabilities and past contracting and delivery practices with the company demonstrated that The Andersons had every reason to believe that Harter would deliver on the contracts. To substantiate this position, The Andersons submitted evidence demonstrating that Harter had contracted for the sale of grain to The Andersons since 1991, and had previously delivered on contracts.

In response to Harter's court case, The Andersons petitioned the court to stay the judicial proceedings and to compel arbitration before the National Grain and Feed Association in accordance with the express terms of the contracts entered into between Harter and The Andersons. The court on Sept. 25, 1996 granted The Andersons' motion to compel arbitration and stayed the judicial proceedings[2]. The Andersons sought reimbursement for outside counsel fees and court costs totaling approximately $85,000 through November 1996, which were incurred in connection with the federal court litigation.

[1] Lowell E. Harter and Doretta Harter v. Iowa Grain Company, et al., Case No. 96 C 2936 (N.D. Ill., Eastern Div., May 16, 1996).

The Decision

The arbitrators reviewed all submitted materials, which included lengthy court documents. After reviewing the arguments, the arbitrators concluded that the plaintiff and defendant had kept in contact during the 18-month period covered by the life of the contracts and that each amendment to these contracts was agreed to by both parties. This chain of amendments and mutual agreements ended in May 1996 with the letter from Harter's attorney to The Andersons requesting that The Andersons mitigate damages.

In arriving at their decision, the arbitrators looked to the terms of the original contracts, the sequence of amendments made to the contracts and to the actions taken by both parties.

Each contract specifically established a delivery period agreed to by both parties. The arbitrators reasoned that had the contracts been of a speculative nature with no intention of delivery, a specified delivery date would not have been necessary. In addition, there was nothing in the contracts that would indicate that non-delivery was an option available to the seller (Harter). Under the terms of the contracts, the seller (Harter) was obligated to make delivery and the buyer (The Andersons) was obligated to accept delivery during the delivery period specified in the contracts. Subsequent amendments changed the delivery period by mutual agreement, the arbitrators noted, but left intact the delivery and receipt obligations of the contracting parties.

Harter contended that he entered into the contracts only as a speculative venture, and did not intend to make delivery. However, the arbitrators noted that Harter entered into three contracts that did not establish a price, two of which remained as unpriced on the date of cancellation. When these contracts were entered into, no price was established and, thus, no speculative price feature existed. Instead, these contracts only established volume and time of delivery. The only apparent factor that came into existence at the time of contracting was an obligation to deliver during a set period by Harter and an obligation to receive during a set period by The Andersons. The Andersons' position -- that they intended and expected delivery to occur, and presumed Harter thought likewise when the contracts were entered into -- was further supported by the fact that the unpriced contracts were entered into concurrently with, or subsequent to, the time that the priced contracts were executed. Therefore, the arbitrators concluded that valid cash contracts existed for delivery and acceptance of the corn.

The amendments to the contracts that changed the delivery periods and rolled the futures reference months for purposes of the pricing formulas were an accommodation to the seller (Harter). Only Harter, the seller, stood the chance to gain materially from the rolling. The Andersons, as an elevator operator, generated earnings through the elevating of grain. These earnings, or margins, represent the difference between the paying price to its customers for delivery to its elevator and the selling price The Andersons would receive for reloading the grain at its elevator. It is unlikely that The Andersons' margins would have materially improved by accommodating Harter's "rolling" requests. Indeed, the "rolling" probably created additional uncompensated risk for The Andersons, since margins normally are relatively static, varying by a matter of a few cents.

During the 18-month existence of the contracts, Harter was obligated to deliver the contracted volume of corn during the stated delivery periods and The Andersons was obligated to accept the delivery of the corn. The contract restricted the origin (source) of the corn only to the United States. Harter had the flexibility to obtain and deliver the corn by whatever means he saw fit.

The arbitrators found that Harter was responsible for delivery, and that non-delivery and the request for mitigation by Harter created a default on the contracts by Harter. The arbitrators also found that The Andersons acted quickly and properly in canceling the contracts at the market price on May 21, 1996.

During the 18 months of contract existence, the rolling forward of the reference futures price at prevailing market differences acted to decrease the amended reference futures price of the contracts. At the time of cancellation, the actual market price had risen significantly above the amended reference futures price. This combination created a situation in which there was a

[2] The Harters, notwithstanding the court's decision, continued to contest the arbitration requirements of the parties' contracts. At a hearing conducted in federal court on Nov. 22, 1996, Judge Milton I. Shadur noted, among other things, that: "As is said here in the first sentence of the Andersons' response, 'This Court already has ruled three times that the Harters must arbitrate their claims against the Andersons.' And yet to give us a third metaphor, although it's probably going to be more expensive than that, like a bad penny you keep showing up again. And so first of all I am going to deny your motion. Whatever it may be labeled, it's mislabeled. But however it may be labeled, it gets denied." [Transcript of Harter proceedings in Docket No. 96 C 2936 at p. 8 (Nov. 22, 1996)]

substantial difference between the amended contract reference prices and the market-determined cancellation price on May 21, 1996. The arbitrators found that cancellation methods used by The Andersons were appropriate in determining the amount of its claim.

Notwithstanding the federal court's clear order compelling arbitration, the defendant continued to argue in this proceeding that the arbitration provisions in the parties' contracts were unenforceable. However, the contracts included the following provision in numbered paragraph 13:

"Both parties agree:

"a. this transaction is made in accordance with the Grain Trade Rules of the National Grain & Feed Association and the parties will be bound thereby; and

"b. any disputes or controversies arising out of this contract shall be arbitrated by the National Grain & Feed Association, pursuant to its arbitration rules."

The arbitrators were in complete agreement with the federal district judge concerning the application of arbitration to this case, concluding that the arbitration provisions in the contracts at issue clearly provided for NGFA arbitration of any disputes.

In addition, the contracts (in numbered paragraph 5) clearly provided for the damages sought by The Andersons, stating:

"Failure to fulfill this contract will result in minimum contract cancellation charges to the Seller, the total of which will be the difference between the contract price and the replacement cost at the time of cancellation, plus the cancellation charge in effect. Seller shall also be liable for The Andersons' attorney fees, costs of collection, plus interest [emphasis added]."

The parties' contracts clearly provided that any disputes arising out of the contracts were to be resolved through NGFA arbitration. Moreover, the contracts clearly provided that Harter would be responsible for The Andersons' attorney fees. The Andersons indicated that outside counsel fees and costs totaled approximately $85,000 through November 1996 in connection with the federal court case resulting from Harter's refusal to arbitrate the dispute pursuant to the NGFA Arbitration Rules, as required by the parties' contracts.

The Award

The arbitrators unanimously found in favor of the plaintiff, The Andersons Inc. and against the defendant, Lowell E. Harter, as follows:

The arbitrators awarded damages of $52,850 for the actual market difference in cancellation of the contracts, plus $2,500 in cancellation fees to The Andersons. Compound interest on the contract and cancellation fees on $55,2350 were awarded to The Andersons from May 21, 1996 until paid at a rate of 9 percent per annum.

The arbitrators further awarded attorney fees and costs associated with the costly and unnecessary (given the clear arbitration provisions contained in the parties' contracts) court proceedings initiated by Harter against The Andersons on the contracts. The Andersons were awarded – and the defendant, Lowell E. Harter, was ordered to pay to The Andersons – costs and attorney fees totaling $85,000, plus compound interest from Dec. 1, 1996 until paid at a rate of 9 percent per annum[3].

The arbitrators concluded that Harter's claims asserted against The Andersons were not supported by the evidence. Thus, Harter's claims were denied.

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

Andy Riffe, *Chairman*
Marketing Manager
Stratford Grain Co.
Stratford, Texas

Roger Caffrey
Director, Grain Operations
MFA Inc.
Columbia, Mo.

Jerry Freudenthal
Manager
Oahe Grain Corp.
Onida, S.D.

[3] The Andersons is to provide an itemized statement to the National Secretary of the NGFA verifying the expenditure of at least this amount in connection with the court case. In addition, the arbitrators did not intend to limit The Andersons' legal or contractual rights to seek additional court-awarded attorney fees or costs against the defendant or his counsel in any pending or future court proceedings related to enforcing this Arbitration Decision.