National Grain and Feed Association

February 27, 1992

Arbitration Case Number 1673

PLAINTIFF: **Guthrie Corp., Guthrie, Okla.**

DEFENDANTS: **v. Continental Grain Co., Chicago, Ill.**
v. Consolidated Grain and Barge Co., St. Louis, Mo.
v. Peavey Grain Co., Minneapolis, Minn.
v. Louis Dreyfus Corp., Wilton, Conn.

Statement of the Case

This case involved the rights and obligations of the buyer and seller concerning two matters: 1) defining "grain of like kind" (Grain Trade Rule 13) and; 2) the application of the term "undue penalty to seller" (Grain Trade Rule 13).

A definable string trade attachment existed for the shipment involved in this transaction. Thus, the cross-defendants' and cross-claimant's cases were presented from the original seller (Guthrie Corp.) to the final buyer of record (Louis Dreyfus Corp.).

On June 14, 1989, Guthrie Corp. agreed to sell Continental Grain Co. 50,000 bushels of guaranteed U.S. No. 2 soft red winter wheat, with a maximum 13.5 percent moisture for shipment June 1-15, 1989 under an applicable bill of lading. It clearly was agreed and stated in both parties' contracts that a Federal Grain Inspection Service appeal grade certificate, basis origin official sampling, would govern the wheat shipped. Neither contract made provisions for quality of a lesser grade to apply. Nor did either contract specify, limit or restrict origins that would apply to this contract.

On Thursday June 15, 1989, the barge "SER 407" was loaded at Van Buren, Ark., by Guthrie Corp. containing an estimated 50,336 bushels. On Friday, June 16, the results of the federal appeal inspection, taken basis the state approved agency's file sample, determined that the shipment contained U.S. No. 3 soft red winter wheat, 57.5 pounds test weight with a moisture content of 13 percent. All other factors were U.S. No. 2 soft red winter wheat. While the federal appeal inspection certificate stated it was sampled on June 16, it further stated the date of service as June 20.

Guthrie Corp., upon receiving notification of the first appeal grade results, requested that a new sample be obtained by the state approved agency for submission to FGIS for inspection. The results of this subsequent sample, taken at the FGIS office in Stuttgart, Ark., on Wednesday, June 21, 1989, determined that the wheat was U.S. No. 3, with 57.6 pound test weight and a moisture content of 13 percent. All other factors were U.S. No. 2.

Concerning this inspection process, it should be noted that: 1) Guthrie Corp. stated in documents submitted in this case that it had requested the second federal appeal grade "with the belief" it would improve within contract tolerance. Neither of the two state inspection certificates were submitted as supporting documents to demonstrate a basis for that "belief" or confidence; and 2) there were no supporting documents presented as to

exactly when Guthrie Corp. was aware of the results of the federal appeal grades except that it was clear, in its statements, that Guthrie Corp. was aware of the first appeal results on or before Thursday, June 20, and aware of the results of the second appeal grade prior to 10:45 a.m. on Thursday, June 22, 1989.

On this basis, the arbitrators concluded that Guthrie Corp. knew that the quality of the wheat contained in this barge that was placed to satisfy its contract obligation to Continental Grain Co. potentially was at risk since it was outside contract specifications at least two trading days (first appeal) and at least 15 minutes (second appeal) before the applicability period for the barge expired. The last date and time of applicability to a June 1-15, 1989 contract was 11 a.m. Central Daylight Time on Thursday, June 22, 1989 (per Barge Trade Rule 7).

At approximately 10:45 a.m. on Thursday, June 22, 1989 -- 15 minutes prior to the expiration of applicability of the barge to a June 1-15 shipment period -- Guthrie Corp. attempted application of "SER 407" to Continental Grain Co. and requested a discount for the test weight of 57.6 pounds. Continental Grain Co. agreed to accept application of the barge, contingent upon Consolidated Grain and Barge Co. accepting application of the barge. In turn, Consolidated Grain and Barge Co. contingently applied the barge to Peavey Grain Co. until it reached its final buyer, Louis Dreyfus Corp. Concurrent with the passing of the contingent barge application, Guthrie Corp. contacted each of the principals as the barge flowed through the string until it reached Louis Dreyfus Corp. Guthrie Corp., making the same request for discount to Louis Dreyfus Corp., was informed clearly that it would reject the barge as tendered or alternatively accept either a U.S. No. 2 soft red winter wheat import barge or a U.S. No. 2 soft red winter wheat barge with an estimated time of gulf arrival (ETA). Guthrie Corp. submitted in its first argument that it: "in the limited time to expiration," unsuccessfully called a total of six principals and one broker "attempting to fulfill Louis Dreyfus Corp.'s request."

At approximately 11:20 a.m. on Thursday, June 22, 1989, Continental Grain Co. notified Guthrie Corp. that it was in default of the contract and declared Continental Grain Co.'s intention to "buy-in" under provisions of NGFA Grain Trade Rule 10. Guthrie Corp. responded with a final attempt to apply barge "SER 407" with discount but, upon Continental Grain Co.'s refusal, requested that its rights be upheld with respect to the "like kind" and "undue penalty" clauses contained in Grain Trade Rule 13. A well-documented flow of notices of default with intentions to buy-in were presented by all parties in this string trade verifying and making clear that the course of action of all buyers was linked directly to Louis Dreyfus Corp. at the end of the string trade.

At 3:10 p.m. on June 23, 1989, Guthrie Corp. received a facsimile notice from Continental Grain Co. notifying Guthrie Corp. that barge "OGB 233" had been bought at 43 cents over the Chicago Board of Trade July wheat futures contract to cover the obligation resulting in a cancellation of the Guthrie Corp. sale to Continental Grain Co. at the same price. The specifications of the "OGB 233" barge were U.S. No. 2 soft red winter wheat, with a 13.9 percent moisture content. This wheat was purchased using a bill of lading dated June 18, 1989 and it was in port at New Orleans. Guthrie Corp., upon receiving that notification, disputed the cancellation via a facsimile response to Continental Grain Co., in which it stated that the quality of the barge was not "like kind" (because the wheat contained moisture of 13.9 percent - the bill of lading was after June 15; and the barge had an estimated time of arrival as compared to the "SER 407" barge, which still was on station at origin). Guthrie Corp.'s response further proposed a more fair settlement should be 27 cents per bushel over the option, which was derived from a spread trade between FH June and a June shipment on or about the time of default. Subsequent letters of protest contained documentation that clearly linked the dissatisfaction of the parties at both ends of the string trade -- namely Guthrie Corp. and Louis Dreyfus Corp.

The arbitrators were provided ample verification of trading values during the period June 1-23, 1989, which served as a basis for this decision. It should be noted that among the submitted documents was a recap of the events by the broker, who ultimately was successful in securing an offer for the defaulted barge, as well as evidence verifying the mutually agreed level of a default cancellation of 50,000 bushels (one barge) of June 1-15, 1989 of U.S. No. 2 soft red winter wheat, involving Louis Dreyfus Corp., Peavey Co., and Consolidated Grain and Barge Co., which occurred after 11 a.m. on June 22, 1989. The latter is relevant to the price agreed upon among parties other than Guthrie Corp.

The plaintiff, Guthrie Corp. claimed damages in the amount of $8,000, plus accrued interest, disputing that neither the aspects of "like kind" or "fair market value" were adhered to by appropriate contractual parties.

The Decision

The essence of the plaintiff's claim for damages involved: 1) the right of the buyer to determine, without prior mutual consent, what constitutes "like kind" in a

declared default situation; and 2) the extent of the privilege, referenced in Grain Trade Rule 13, of the buyer to establish a fair market value when it is deemed not feasible to "buy-in"; and 3) the relevance of the last reported market value to the establishment of fair market value in a default situation.

The arbitrators found in favor of the defendant(s) (Continental Grain Co., et. al.), using the following rationale as a basis for this decision:

- Guthrie Corp. was aware that it was at risk of being outside of contract specifications at least two, and perhaps as many as four (i.e. June 16), business days prior to the expiration of its contracted commitment. Its elected course of remedy was to call for a subsequent inspection with the belief the shipment would be found within contract specifications.

- Based upon the submitted record of trades and values, it was apparent that an inverse market relationship existed. In fact, June 1-15 values gained over later shipment periods from June 16 until expiration of all June 1-15 applicability at 11 a.m. CST on June 22.

- The market for June 1-15 applicable barges was fluid and trading either outright or via spreads to subsequent shipment periods during the June 16-22 timeframe.

- No evidence was submitted to suggest that the plaintiff attempted to limit risk and exposure of default by participating in the trading market, except for the efforts made between 10:45 and 11 a.m. in the last moments of applicability on June 22, 1989.

- The plaintiff conceded the illiquidity of the market in existence in the final moments of applicability when it stated that its attempts to secure a barge were unsuccessful despite contacts with six principals and one broker.

- A key aspect of the arbitrators' decision was based on the statement by the plaintiff that it made "attempts to satisfy the defendant's request" of an in-port barge prior to the actual expiration of applicability. If it was apparent to the plaintiff that such an alternative was unfair, its choices for remedy still included, at that time (10:45 a.m.), buying and applying a barge that met the original contract terms or, alternatively, voicing (and documenting) its dissatisfaction and opinion of unfairness at the time the alternative was presented. By consciously attempting to seek out a barge that would meet the buyer's alternative, the plaintiff tacitly agreed the alternative solution was to provide wheat of "like kind."

- Having established the plaintiff's tacit approval of the "like kind" solution, only the issue of "fair market value" remained to be resolved. Based upon the recap of the broker who performed a buy-in for Louis Dreyfus Corp., the arbitrators were satisfied that the defendant acted to balance both the issues of timeliness and fair price. In short, attempts to secure a lower price offer were unsuccessful, and the quality and location of the barge purchased represented similarities not appreciably different than were indicated to the plaintiff, who in turn attempted unsuccessfully to secure another barge to apply to the contract immediately prior to the default. The fact that a subsequent cancellation price at 43 cents over the Chicago Board of Trade July wheat futures contract occurred further supported the defendant's position.

Given these considerations and the supporting facts presented, the arbitrators unanimously denied the plaintiff's claim for damages.[1]

Submitted with the consent and approval of the arbitration committee, whose names are listed below.

Ken Morrison, *Chairman*
Cargill Inc.
Peoria, Ill.

Charlie Orso
Bunge Corp.
St. Louis, Mo.

Ron Stuckey
Hyline Seven Cooperative
Shawnee Mission, Kan.

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[1] ***Arbitrators' Note:*** *The arbitrators considered the aspects of due diligence and the responsibility of the buyer, in a default situation, to communicate to the seller a specific timeframe (and perhaps terms and price parameters) by which the buyer would exercise the privilege to cancel at fair market value, conceding that a buy-in is impractical. The arbitrators believed, in this particular case, that while the plaintiff (Guthrie Corp.) could have acted more responsively to secure an applicable barge at the time its risk of default became apparent, the firm did make a responsible effort in the final moments to reach an acceptable alternative with the buyer(s). There was insufficient supporting documentation as to whether reciprocal efforts of mutual communication occurred.*

The arbitrators believed that the NGFA's Trade Rules Committee should examine whether a more specific definition of "due diligence" in the Trade Rules would minimize future disputes of this nature, and have communicated this view to the committee.