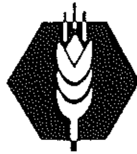

Arbitration Decision

National Grain and Feed Association

November 20, 1997

Arbitration Case Number 1813

Plaintiff: SunMark, Ltd., Mansfield, Ohio

Defendant: Valley Vista Farms, Jeromesville, Ohio

Statement of the Case

This case involved a dispute over a "futures-only" contract for 5,000 bushels of corn entered into on June 19, 1995 between the plaintiff, SunMark, Ltd., and the defendant, Valley Vista Farms.

The terms of the contract (plaintiff contract number 1311), signed by both parties, called for October/November 1996 delivery to Mansfield, Ohio. The futures reference price[1] on the contract was $2.95 per bushel based upon the July 1996 corn futures price. The terms for completing the contract pricing were not specified clearly in the contract. However, the contract clearly provided that it was subject to both the Trade Rules of the National Grain and Feed Association and NGFA arbitration.

On May 8, 1996, the plaintiff and defendant had a telephone discussion; what was discussed or agreed upon in this conversation was unclear. After the conversation, the plaintiff "lifted" the hedge of the futures-only contract at a price of $4.735 per bushel. In addition, the plaintiff bought a July $4.60 call option at a cost of 28 cents per bushel. On June 18, the call option was sold for 7 cents per bushel. The plaintiff sent contract amendments to contract 1311 for these three transactions on May 8 and June 16. Notations in the amendments related these transactions to the contract by making the following price adjustments:

May 8 Amendment Calculations	
Original Futures Only Price	$2.950
— minus Lifting Hedge Price	$4.735
— minus Call Option Purchase Price	$0.280
May 8 "Equity"	($2.085)
June 18 Amendment Calculations	
May 8 "Equity"	$2.085
+ plus Call Option Sale Price	$0.070
— minus Service Fee	$0.020
June 18 "Equity"	($2.015)

The defendant delivered corn to the plaintiff during the 1996 harvest, but none of that corn was applied to contract 1311. On Jan. 27, 1997, the plaintiff asked the defendant when corn owed on contract 1311 would be delivered. The defendant said it was unaware of any outstanding contract obligation. The plaintiff subsequently gave the defendant a copy of contract 1311. The defendant continued to maintain that corn was not owed on that contract, and later said that it was not aware delivery was required on a contract with a contract price of negative $2.015 per bushel.

Unable to agree on a resolution, the plaintiff considered the contract breached and requested that the defendant pay damages of $10,075. This amount for damages was based on the calculations of the two contract amendments shown previously ($2.015 multiplied by 5,000 bushels). The plaintiff's full claim in this case was for $10,075, plus interest at 10 percent APR from Dec. 1, 1996, and reimbursement of its $400 filing fee for NGFA arbitration. The defendant denied that the obligations of the contract were as alleged by the plaintiff. The defendant asked to be allowed to deliver corn on the contract at the original $2.95 per bushel contract price, plus or minus the current basis. If this request was denied, the defendant requested that the contract be canceled with no further obligation.

The Decision

The arbitrators concluded that the defendant breached a valid and enforceable cash-delivery contract.

The defendant did not dispute entering into the original purchase contract, but did not deliver the bushels called for in the contract. While the contract had an unpriced component, this aspect had no bearing on the validity of the underlying contract. Further, an incorrect or unauthorized pricing could not be resolved by disregarding the contract, even if it resulted

[1] The term "futures only" as used in the contract referred to the pricing formula agreed to by the parties.

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in a negative price. Thus, the defendant had an obligation to deliver 5,000 bushels of corn to the plaintiff at Mansfield, Ohio, during October/November 1996. The price was $2.95 per bushel (based upon the July 1996 futures price), less the applicable basis. By not delivering the corn, the defendant breached the cor ~~t.

Thus, the arbitrators concluded the plaintiff was owed damages. However, assessing damages was complicated, since accepted industry contract administration practices were not followed consistently in this case. The original contract did not specifically state how pricing was to be determined. Further, the defendant and plaintiff did not discuss the failed delivery on the contract in question until more than 45 days after the end of the shipment period. Neither the defendant nor the plaintiff attempted to complete the pricing of the contract. Most important for purposes of calculating damages, the two contract amendments were in dispute – a discovery made more than six months after the amendments were made. *[Note: The spirit of the NGFA Trade Rules is to discover all disputes immediately so as to mitigate damages. This is evident by all of the requirements in the Trade Rules for timely confirmations, signed confirmations and documentable communications.]*

In calculating damages, the arbitrators did not consider the two amendments to the contract valid. The defendant said it did not instruct the plaintiff to lift the hedge or to purchase or sell a call option. Neither the plaintiff nor the defendant clarified what was said during their May 8 telephone conversation. The defendant said in its filings in this case that it did not receive confirmation on either contract amendment.

In considering the two amendments to the contract to be invalid, the arbitrators did not render a judgment on which party was correct. Instead, the arbitrators concluded that it was not necessary to use disputed facts in calculating damages.

To arrive at damages, the arbitrators reconstructed the pricing of the contract according to the NGFA Trade Rules. Grain Trade Rule 10, "Incomplete Shipment or Delivery" and Grain Trade Rule 13, "Buying In" were used as guidelines. In this case, damages were calculated based upon when the contract was known to have been breached, which was Jan. 27, 1997, since no notice was given by either party until the plaintiff talked to the defendant on that date. A Jan. 27, 1997, cancellation price made it necessary to roll the original contract price based upon July 1996 futures to March 1997 futures. In rolling forward the contract, the arbitrators adhered to NGFA Grain Trade Rule 30, which provides that a contract must be priced no later than the day before first notice day. Using prices the day before first notice day, the contract price was rolled to $1.7175 per bushel (based upon March 1997 corn futures) from the original $2.95 (based upon July 1996 futures).[2]

Purchase contract 1311 allowed for a cancellation fee. The plaintiff, therefore, was entitled to an additional cancellation fee of 10 cents per bushel per item 4 in contract 1311.

The Award

Thus, the arbitrators calculated the damages due to the plaintiff as follows:

Damages from contract cancellation:	$5,162.50
Cancellation fee:	$ 500.00
Total damages	$5,662.50

Plus interest at 9 percent APR from Jan. 27, 1997 until paid.

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

Ben Baer, *Chairman*
Executive Vice President and General Manager
Guthrie Corp.
Guthrie, Okla.

Vickie Kennedy
President and General Manager
Lewis Commodities Inc.
Lewis, Kan.

Michael Peery
Manager
Central Marketing Co-op
Shelby, Neb.

[2] June 27, 1996 was the day before July First Notice Day. CBOT closes were: $4.815 for July 1996 corn and $3.8575 for September 1996 corn. The spread for rolling from July to September was $0.9575, plus a 1-cent transaction charge. $0.9675 was deducted from the initial contract price of $2.95, which became $1.9825 based on September 1996 corn futures. This was done once again to roll to December 1996 futures on Aug. 29, 1996. September 1996 futures were $3.705 and December 1996 futures were $3.445. The spread for rolling from September to December was 26-cents, plus a 1-cent transaction charge. The result was $1.7125, based upon the December 1996 corn futures. Technically, the contract was breached when the corn was not delivered by Nov. 30. However, damages were calculated from the notification date. On Nov. 27, 1996, the contract was rolled one final time to March 1997: December 1996 futures were $2.72 and March 1997 was $2.735. The resulting spread of $0.015 was added this time net of the 1-cent transaction charge. Therefore, the futures-only price was $1.7175 basis March 1997 corn futures. On Jan. 27, 1997 March futures closed at $2.75. This created a loss of $1.0325 per bushel, or $5162.50 per the contract.