



Arbitration Decision

National Grain and Feed Association

October 21, 1993

Arbitration Case Number 1702

PLAINTIFF: William Prah, Mequon, Wis.

DEFENDANT: Didion Inc., Johnson Creek, Wis.

Statement of the Case

This case¹ involved a claim by plaintiff-seller, William Prah ("Prah"), against defendant-buyer, Didion Inc. ("Didion"), arising from Didion's pricing and close out of one soybean basis contract and two corn basis contracts with Prah. Didion priced the contracts after notifying Prah that market conditions had declined to the point where Prah had no equity remaining in the contract and that Prah would have to repay a portion of monies previously advanced against the contracts. The essence of Prah's complaint was that Didion allegedly breached the contracts by pricing them without Prah's written consent. Prah sought damages in the amount of \$2,800, plus costs and attorney fees.

Didion and Prah entered into the three basis contracts during November 1990. Prah acknowledged the terms of the basis contracts by signing documents titled "Purchase Confirmation and Contract." Both parties proceeded to honor the terms of the contract; that is, Prah delivered the grain and Didion advanced Prah 80 percent of the grain's then-market value upon delivery, typical of basis grain contracts.

The basis contracts subsequently were "rolled" various times per written modifications executed by Prah. Rolling the basis contracts permitted Prah to remain unpriced. If prices rose, Prah's final settlement on the contract would be greater. During this period, however, prices declined to a point that during the month of June

1991, Prah had little or no equity remaining on his open grain contracts.

Didion informed Prah that to maintain 80 percent of the net value of the contracts and keep the contracts open, Prah would be required to repay \$1,000 of the advance payment. Prah refused to repay any of the advance, whereupon Didion priced out the contracts on July 3, 1991.

Prah argued that the request for additional funds and the possibility of discretionary pricing by Didion was not a term of the contracts because it was not referenced in the written terms. Prah maintained that Didion's failure to include explicit repayment terms in the contract precluded Didion from requesting additional funds and from closing the contract when he refused to deposit additional funds. Didion countered that the right to require Prah to repay a portion of the advance was a term of the contracts discussed with Prah prior to entering into the contracts, and that Prah had acknowledged that he understood the contracts at that time. In addition, Didion contended that the right to require repayment of advances on basis contracts was an inherent term in all basis contracts -- just as would happen on a futures contract through a margin call -- since it is the producer that is "playing the market" under a basis contract.

Didion argued that such a practice was standard or typical in the grain trade. Didion also stated that its contract was written to provide the seller with price flexibility.

¹ This case was arbitrated pursuant to stipulation of the parties and court order issued in: Prah v. Didion, Inc., Case No. 92-CV-249-B3 (Ozaukee County, Wis. Cir. Ct., Dec. 14, 1992).

The Decision

In this case, the parties expressly agreed in the written terms that "any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration in accordance with the rules and regulations of the National Grain & Feed Association."

Under a basis contract, the seller has an opportunity to garner an improved final price, if the futures market moves higher. But such an instrument also entails risk if the futures market moves lower, as occurred in Prah's case. If the seller's equity position in the contract erodes to a point of little or no equity, the buyer who has advanced funds to the seller has the right to ask for repayment of an amount sufficient to protect the buyer's position. Such a practice was standard for Didion and is typical in the grain industry. The seller of grain pursuant to a basis contract is the party assuming the risk of a decline in futures market prices.

The central issue in this case was whether the agreement of the parties when entering into the basis contracts included a right by Didion to request additional funds from Prah in the event of equity erosion as well as the consequences of Prah's subsequent refusal to repay prior advances. Did Didion have the right to price the contracts once Prah refused to comply with Didion's requests?

In reaching their decision, the arbitrators recognized their first responsibility was to enforce the terms of the contract. When the express written terms are insufficient on their own merits to determine the contract terms, NGFA arbitrators generally rely upon the NGFA Trade Rules, when applicable, and then trade custom or practice.

First, the arbitrators concluded that the written terms failed to explain the entire agreement of the parties. The written terms were contained in a confirmation memorandum form intended to summarize the parties' oral agreements and understandings. This conclusion was reinforced by the documents executed by Prah, which directly above or below Prah's signature contained the following statement: "I have read the above **Purchase Confirmation** and it accurately reflects my oral contract with Didion Inc. [emphasis added]."

Consequently, the arbitrators concluded that Didion's oral explanations of the contract terms to Prah prior to executing the written documents, as well as trade custom, were relevant to determining the complete agreement of the parties. The right to request repayment of advances to maintain the seller's equity in the contract is entirely consistent with, and essential to an understanding of, the express written terms contained in each confirmation memorandum, stating it was a "basis contract."

Further, Prah was offered an opportunity to allow the contracts to continue once the net value approached the level equaling the amounts initially advanced to Prah. It was clear that Didion, although requesting repayment of previously advanced funds, offered this option to Prah. Didion also informed Prah that a refusal to comply with the request would result in Didion's closing or pricing of the contracts pursuant to standard grain trade practice and company policy. Prah made a conscious choice not to maintain an equity position in the contracts by refusing to repay a portion of the previous advances, which was necessary to keep the contracts open.

The arbitrators concluded that the customary and standard practice in the grain industry is to require payment of additional funds or repayment of previously advanced funds in the event a seller's equity position erodes to near zero. It also is standard practice that if such a request is refused, the buyer (who has not assumed the risk of price fluctuations) prices or closes the contract. This practice was the policy of Didion and was not a unique or unusual request because it is the seller who had assumed the risk of price fluctuations when entering into a basis contract.

Therefore, the arbitrators unanimously found in favor of Didion Inc. Prah's claim for damages was denied.

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

Robert Obrock, *Chairman*
Farmers Commodities Corp.
Perrysburg, Ohio

Tom Kuhn
Countrymark Cooperative, Inc.
Indianapolis, Ind.

Fred Lawton
Badger Grain Co. Inc.
Darien, Wis.