



Arbitration Decision

National Grain and Feed Association

June 23, 1994

Arbitration Case Number 1704

Plaintiff: Farmland Industries Inc., Kansas City, Mo.

Defendant: Theco International Inc., Kenner, La.

Statement of the Case

This arbitration case arises from the purchase of cottonseed by Farmland Industries Inc. (Farmland) from Theco International Inc. (Theco) through Central Texas Commodities (Central), which acted as broker for the transaction. Neither of the principals in this transaction confirmed the purchase/sale with the other but relied totally on the broker's contract, which was sent to both parties to define the terms and conditions of the sale.

Subsequent to entering into the contract, Theco designated the loading points for the cottonseed. Initially, Farmland was able to load only a small amount of cottonseed that was considered to be of acceptable quality on the contract. Theco then provided another loading point, but the quality of the cottonseed apparently did not improve to any great extent.

After a period of apparently poor communications between the principals, Farmland declared Theco in default on the contract and proceeded to buy-in the balance of the contract. The parties' disagreements, in the order addressed by the arbitrators, were as follows:

- **Jurisdiction:** Theco contended that it would prefer to arbitrate under the rules of the National Cottonseed Products Association (NCPA).
- **Trade Rules:** Theco wanted to use NCPA trade rules in a NGFA arbitration.
- **Quality Delivered:** The quality, and thus the value, of the cottonseed that was delivered or attempted to be delivered on the contract.
- **Settlement:** The method of settlement for the unfulfilled part of the contract.

The Decision

The arbitrators reached the following decision on each of the items in dispute:

- **Jurisdiction:** The arbitrators ruled that Farmland had the

right to institute a case under NGFA Arbitration Rules. Theco was obligated to enter into the contract for arbitration and to abide by the award. NGFA Arbitration Rules clearly were applicable. NGFA's jurisdiction was established by the fact that Farmland and Theco are NGFA Active members (Arbitration is compulsory among Active members pursuant to Article II, Sec. 3(f) of the NGFA Bylaws [See also Section 3(a)(1) of the NGFA Arbitration Rules.] and because Farmland filed a timely complaint for arbitration. Therefore, Theco must participate in the arbitration. Theco's statement, "we only submit to arbitration under protest..." is without merit or standing.

■ **Trade Rules:** Neither Farmland nor Theco provided written contracts of their own. Instead, both Farmland and Theco referred to the broker's confirmation as the contract. Consequently, the terms contained in the broker's confirmation governed the transaction. It is noted that NGFA Feed Trade Rule 2.(b) is consistent with this conclusion.

The broker's confirmation provided, in preprinted letters, the following:

"Applicable Trade Association Rules to apply on all trades."

The broker's confirmation did not specify which "Trade Association Rules" were to apply to this particular transaction. Farmland argued that the NGFA's Trade Rules should apply. Whole cottonseed is a feedstuff that could be traded under either NGFA Feed Trade Rules or National Cottonseed Products Association Rules. Because this case is brought under NGFA Arbitration Rules, the arbitrators reviewed the NGFA Bylaws, NGFA Trade Rules and NGFA Arbitration Rules for guidance on which trade rules should apply.

Under Article II, Sec. 3(f) of the NGFA Bylaws, Active members agree to be bound by the NGFA Trade Rules, where applicable, when they become members of the Association. The NGFA Trade Rules and Arbitration Rules also are expressly incorporated into the NGFA Bylaws under Article XI of the Bylaws.

Section 3(a) and (b) of the NGFA Arbitration Rules provide some limited exceptions to the application of the NGFA Trade Rules or Arbitration Rules for disputes between NGFA Active members when both parties are "members of the same regularly organized Board of Trade or Grain Exchange" or "[w]hen transactions by their express provision are made subject to the terms of a regularly organized Grain Exchange." But neither exception was applicable to the facts of this case.¹ The arbitrators found that Section 3(c) of the NGFA Arbitration Rules specifically addresses the issue of which trade rules apply in this case, as follows:

"All other decisions shall be in accordance with the Bylaws and Trade Rules of this National Association, and all definitions included in the Trade Rules shall apply under these Arbitration Rules, likewise."

This transaction, evidenced by the broker's confirmation, contained no express provision regarding NCPA or NGFA Trade Rules. Therefore, failing NGFA Arbitration Rules 3(b) and 3(c)'s ability to change jurisdiction or trade rules to those of NCPA, the last sentence of Arbitration Rule 3(c) required all other decisions to be in accordance with NGFA Bylaws and Trade Rules.

For this reason, the NGFA Feed Trade Rules were deemed to apply to this case.

■ The Quality of the Cottonseed that was Sold and the Quality that was Delivered or Attempted to be Delivered:

In resolving this aspect of the dispute, the first problem was that neither party to the arbitration submitted a contract for the other party to sign. The arbitrators therefore were left with the broker's contract as the ruling document. The broker's contract contained the following provision concerning grades: "Destination - 10% maximum damage allowed." Since grades were based on inspection at destination, it was incumbent upon the buyer to provide a grade that was mutually acceptable to both buyer and seller. No official or unofficial grade was taken by the buyer or the seller and presented as part of the arbitration case. There were several affidavits presented by one of the parties, but they did not meet the test of a disinterested third party in either drawing or testing the sample.

■ The arbitrators, however, were convinced that the cottonseed tendered did not meet the contract specifications. From the grade requirement of 10 percent maximum damage, it was not a contract for "prime cottonseed," which is defined

as 13 percent maximum moisture, minimum 34 percent protein, 3 percent or less free fatty acids, not musty, free from offensive odor. Some discount obviously was in order from the price for "prime cottonseed." The arbitrators determined that a \$15-per-ton discount should apply to cottonseed of 10 percent maximum damage.

■ **Method of Settlement for the Unfulfilled Portion of the Contract:** The contract was for 3,000 tons, of which 406.77 tons were shipped and were not in dispute. The remaining balance of 2,593.23 tons was in dispute.

The Award

The arbitrators found that neither party adhered to NGFA Feed Trade Rule 14 regarding default on the shipping period. Therefore, trade practice was used to determine the appropriate outcome. The most-used trade practice would be to measure the market difference between the contract price and the applicable market price on the day following the shipping period.

In accordance with this practice, the damages were calculated as follows:

Market price per <i>Cottonseed Digest</i> , Dec. 4, 1992: <i>(average price of \$150 to \$155 per ton)</i>	\$152.50
Discount for 10 percent maximum damage:	— 15.00
Market price:	\$137.50
Contract price, same freight basis:	\$122.50
Difference:	X \$15.00
Tons short on contract:	2,593.23
Award Due Farmland:	\$38,898.45

Interest is to be paid by Theco (the seller) to Farmland (the buyer) on the preceding amount at 6 percent from Dec. 1, 1992 -- or \$6.39 per day -- until the date payment is received.²

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

John Pearson, Chairman
Guthrie Corp.
Guthrie, Okla.

Steve Nail
Farmers Grain Terminal Inc.
Greenville, Miss.

John Wood
Commodity Specialists Inc.
Overland Park, Kan.

¹ NGFA Arbitration Rule 3(b) provides: No National Arbitration Committee shall, except by consent of both parties, assume jurisdiction over transactions between members of the same regularly organized Board of Trade or Grain Exchange when such transactions are subject to the terms of such Board of Trade or Grain Exchange.

Because Farmland and Theco disagree over applicable rules and even jurisdiction, there is obviously no consent under this provision by both parties for the NGFA to assume jurisdiction. However, even if both parties consented to using NCPA Rules, this Rule 3(b) would not apply because it concerns members of other exchanges (associations). While Farmland is a member of NCPA, Theco is not. Nor did the parties expressly provide that the transaction was "subject to the terms of a regularly organized Grain Exchange," an alternative provided in Section 3(c) of the NGFA Arbitration Rules.

² For example, from Dec. 1, 1992 through April 1, 1994 equals 486 days; interest would total \$3,105.54