National Grain and Feed Association

Arbitration Decision

1250 Eye St., N.W., Suite 1003, Washington, D.C. 20005-3922
Phone: (202) 289-0873, FAX: (202) 289-5388, E-Mail: ngfa@ngfa.org, Web Site: www.ngfa.org

November 19, 2009

Arbitration Case Number 2189

Plaintiff: **Western Milling LLC, Goshen, Calif.**

Defendant: **Phoenix Bio Industries LLC, Los Angeles, Calif.**

Statement of the Case

This case involved a dispute in which the plaintiff delivered corn to the defendant, which refused to pay for the corn, contending that it did not comply with the quality terms of the contract(s) and/or the underlying supply agreement that set the framework for transactions between the two parties.

Western Milling LLC (Western) and Phoenix Bio Industries LLC (Phoenix Bio), on June 30, 2006, entered into a Corn Supply Agreement. The purpose of this agreement was to establish the terms under which Western would supply Phoenix Bio with corn and other associated services to Phoenix Bio's ethanol plant at Goshen, Calif. The Supply Agreement and the individual contracts between the parties incorporated NGFA Trade Rules to govern the transaction, and stipulated that any disputes arising under the Corn Agreement and/or contracts would be resolved through NGFA arbitration. Neither party disputed those facts, and both parties executed the NGFA Arbitration Services Contract.

Western claimed to have delivered 895,490 bushels of corn to Phoenix Bio. Western alleged that Phoenix Bio accepted, used and subsequently refused to pay for this delivery. Western claimed to have delivered the corn in compliance with the contracts and Corn Supply Agreement, and that Phoenix Bio's failure to pay for this corn constituted a breach of the Supply Agreement, as well as a breach of the contracts themselves. As a result of this breach, Western elected to take a set-off of monies due to Phoenix Bio for wet distillers grains under a separate contract. The net amount of Western's claim was $4,070,506.13, plus compound interest at a rate of 18 percent per annum from Dec. 15, 2007, until all sums were paid, plus the costs of arbitration and attorney fees.

For its part, Phoenix Bio denied that Western sold and delivered corn to Phoenix Bio in accordance with the Corn Agreement, denied that Western performed all its obligations under the Corn Agreement, and denied that it breached the Corn Agreement by failing to pay the balance due. Therefore, Phoenix Bio disputed the damages claimed by Western. Phoenix Bio instead made a counterclaim against Western for alleged damage to Phoenix Bio's facilities resulting from delivery of corn that did not meet contract quality specifications, interruptions to corn deliveries, and negligence of Western under the agreement between the parties. Phoenix Bio's counterclaim was for up to $2,099,000 in damages related to the closure of the facility, and $3,586,000 in damages for loss of yield allegedly due to poor-quality corn. In the counterclaim, Phoenix Bio also sought attorney's fees and recovery of the $10,000 arbitration fee.

The individual sales confirmations sent by Western to Phoenix Bio called for "Corn, Yellow Whole" and gave no further quality specifications. The contracts stated, grades: "Origin submitted," and weights: "Certified Origin." It should be noted that Phoenix Bio did not provide any record that it issued confirmations for the purchase of corn.

The Corn Agreement was integral to the transactions between the parties of this dispute. **Article 1** of the Corn Agreement provided the following definitions: "***Delivery Point*** *means the location at the Plant where the Corn is unloaded from railcars, trucks, or storage to weigh device.…* ***Plant*** *means Phoenix Bio Industries' ethanol production plant to be located in Goshen, California.…* ***Scale*** *means plant scales maintained and operated by Phoenix Bio Industries at the Delivery Point as otherwise provided for in Paragraph 3.5(f).…* ***Scale of Discounts*** *means the schedule or scale of discounts negotiated by the Parties as specified for any Sales contract on terms to be no more burdensome to Western Milling as seller than the schedule or scale of discounts commonly used by Western Willing as a purchaser of corn for the time period of Delivery."*

The Corn Agreement further stated in paragraph 3.5(f) of **Article 3: Corn Supply Terms**: "*Western Milling shall (1) make available to Phoenix Bio Industries origin first certified weights and USDA grade or house origin grades for each rail Delivery, and (2) allow Phoenix Bio Industries the right to inspect, test, and grade any and all rail Deliveries, and at its own expense Phoenix Bio Industries*

may sample and test grain sent to weigh belt and may match grades to incoming Corn. In the event that Phoenix Bio Industries' test results materially conflict with the test weights and/or grades provided to Western Milling for such Delivery and indicate the corn does not meet the specifications in Paragraphs 5.1 and 5.2 of this Agreement, the parties agree to the process as described in Paragraph 5.3. If there is a claim then the claim will be on the supplier of origin."

Paragraph 3.6.1: **Title; Risk of Loss** offered the following provision: *"Title to and risk of loss of or damage to the corn shall transfer to Phoenix Bio Industries when the Corn reaches the Delivery Point. Until title passes to Phoenix Bio Industries, Western Milling shall be responsible for any loss or damage to such Corn."*

In addition to this provision, paragraph 5.2 of **Article 5, Corn Quality Specifications** provided the following specification: *"(b) Grade: Number 2 Yellow Corn, Scale of Discounts to apply,"* and Paragraph 5.3, **Non-conforming Corn** outlined the following procedure for properly rejecting delivery: *"Phoenix Bio Industries may, upon notice to Western Milling as a provided in paragraph 6.4, reasonably reject Delivery for corn that does not materially meet the specifications set forth in paragraphs 5.1 and 5.2 based on either the test weight or grade documentation. Phoenix Bio Industries shall not be obligated to make any payments for such rejected Corn. Western Milling shall dispose of any non-conforming Corn at Western Milling cost unless Phoenix Bio Industries elects, in its sole discretion, to accept Corn not meeting the quality specifications in Paragraphs 5.1 and 5.2(or in the applicable Sales Contract) upon mutually agreeable terms and conditions (including pricing)."*

The Decision

The arbitrators noted that the essence of this case involved: 1) The quality of the corn delivered to Phoenix Bio and which party was responsible for quality discounts; 2) the determination of the point at which title and risk of loss transferred from seller to buyer, and whether there was a fair determination of quality at that point; and 3) whether Phoenix Bio had the ability to keep and use the corn without paying for it under the supply agreement and contracts between the parties?

The arbitrators noted that the contracts, but more importantly in this case the Corn Agreement, while extensive, contained clauses that were minimal and sometimes vague in meaning. This brought into question whether both parties had an equal, complete and sound understanding of the workings of the agreement under which they were bound. The arbitrators determined that several important considerations and procedures that were omitted or left undetermined ultimately lead to the dispute.

The corn being supplied by Western was received into a rail/truck unloading facility and either could be directly elevated and conveyed to the Phoenix Bio scale or stored on a comingled basis with Western-owned inventory until it was conveyed to the Phoenix Bio scale or used by Western. Western submitted that it purchased all corn from one rail supplier during the time frame of this dispute, and made available to Phoenix Bio a record of all those grades and weights. Western stated that all of this corn was, in fact, U.S. Number 2 Yellow Corn, Scale of Discounts to apply. Further, Western claimed that Phoenix Bio would need to make any quality claims to the "supplier of origin" if there was a difference between the origin grades and the quality of the grain delivered to the "point of delivery." Phoenix Bio never made such a claim to the "Supplier of Origin." Troubling for the arbitrators was the fact that the supply agreement called for "Number 2 Yellow Corn, Scale of Discounts to apply," which implied that lesser quality than U.S. number 2 yellow corn could be supplied at a scale of discounts. This allowed Western to state that it was within contract compliance at all times, even though it could have delivered less than U.S. number 2 yellow corn in fulfillment of the agreement. In addition, the arbitrators noted that there was no evidence that an actual scale of discounts was ever negotiated or applied, even though one was requested in writing on Aug. 20, 2007 by Phoenix Bio.

The arbitrators determined that the buyer had the right to request that the grain being received at the rail-unload point be sampled and compared to the origin-official or origin-submitted grades; if there was a discrepancy, Phoenix Bio could attempt to assert a claim on the "supplier of origin." There was little indication that Phoenix Bio attempted to do assert such a claim, a number of origin grades appeared to have been of lesser quality than U.S. number 2 yellow corn and, therefore, Phoenix Bio could have been eligible for discounts. But unless corn was delivered directly from the railcar to the Point of Delivery – as defined by the supply agreement – the risk of loss and, therefore, the risk of quality remained with the seller until it was delivered at the "Point of Delivery," the "Scale." Western had the obligation to deliver corn from its commingled inventory to the buyer that was in compliance with the Supply Agreement; any claims of quality on deliveries at the Point of Delivery would be against Western and not back to the "Supplier of Origin." Therefore, the arbitrators determined that while Phoenix Bio could make claims of quality on rail shipments on an origin-versus-destination basis, this did not absolve Western from having to deliver corn at the "delivery point" in compliance with the quality contracted.

There was no evidence that a scale of discounts ever was agreed to by the parties, something which the arbitrators concluded both parties should have been diligent in establishing. From the record and circumstantial evidence supplied, it appeared likely to the arbitrators that, at times, corn of less than U.S. number 2 yellow corn was supplied to Phoenix Bio. However, the arbitrators had no way to determine if this did, in fact, happen and what quantities of corn were supplied with a grade lower than U.S. number 2 yellow corn.

The arbitrators determined that if Phoenix Bio had evidence that the corn being supplied at the delivery point did not meet contract specifications, it at minimum needed to: 1) Provide notice of this determination; 2) demand a scale of discounts; and 3) agree to a sampling scheme with the seller that could officially determine quality and quantity for specific lots at the "delivery point" so the discounts

could be applied. The buyer failed to do this, and the independent sampling of corn was not done in a manner that could be commercially applied to determine discounts. Instead, Phoenix Bio's chosen remedy was two fold: first, spot-check transfers on a unilateral basis; and, second, reject the corn being delivered while still using and refusing to pay for it.

The arbitrators determined that the proper use of "rejection" was "the physical act of returning corn that was determined to be outside the contract specifications," and not the act of making a statement of rejection and then proceeding to use the corn and refusing to pay for it. The arbitrators noted that, without refusing to take deliveries, the ability of Phoenix Bio to reject corn did not appear to be a real physical possibility based upon the material supplied as evidence, which strongly indicated that the Supply Agreement did not fully contemplate the intricacies of the physical process of supplying corn. However, if the consequences were as significant for Phoenix Bio as it alleged, then refusing further deliveries until a sampling scheme was established should have been its course of action. Without an agreed-upon procedure to determine quality at the point of delivery, the arbitrators had no basis to find in favor of the defendant.

The arbitrators' final consideration involved the plaintiff's damage claim. The plaintiff claimed breach of contract as the result of Phoenix Bio taking delivery of corn and withholding payment. Article 8, paragraph 8.2 of the corn supply agreement stated that "in the event of a payment default, under paragraph 4.3 (corrected to read 4.2) Western Milling may, upon the occurrence of a payment default, immediately suspend further performance with or without the giving of notice of default or notice of termination." Further, clause 5 of the terms and conditions, as stated on the confirmation of sale provided by Western to Phoenix Bio, allowed Western to defer deliveries, or at its option to cancel that or any other contract with the buyer for non-payment on the confirmed sale. The arbitrators found that clause 8.10 of Article 8 did allow Western the right, as the non-defaulting party, to set-off. In addition, the right to set-off was provided in clause 17 of the sales confirmation.

As for the matter of the plaintiff's claim of reasonable attorney's fees, clause 11 of the sales confirmation entitled the prevailing party to recover reasonable attorney's fees and court costs. However, the arbitrators did not believe this clause allowed Western to claim recovery of payment of its arbitration fee. Concerning the finance charges on unpaid balances, the arbitrators found this, too, was covered in clause 12 of the terms and conditions of the sales confirmation between the two parties.

The Award

The arbitrators determined that the plaintiff's claim should only include the outstanding amounts invoiced for corn between Oct. 22, 2007 and Nov. 28, 2007 – totaling $3,673,551.51 – as well as the finance charges associated with these corn invoices through Dec. 15, 2007. These finance charges amounted to $51,263.16 using the method described in exhibit C of the plaintiff's first argument. The arbitrators rejected the plaintiff's claim of $396,954.62 in damages resulting from finance charges incurred on invoices issued prior to Oct 22, 2007. The arbitrators established that the damages had been inflated by the plaintiff, and that these invoices were not, in fact, part of this case, but rather late payment fees on contracts unrelated to the corn contracts involved in this case.

The arbitrators concluded that neither party did a very good job of presenting or justifying their damage claims. Western did not tie out its invoices to contracts, bushels or prices (though Phoenix Bio did not object to any of the invoice amounts). Meanwhile, Phoenix Bio did not provide lot-specific grades or tie out the specific yield loss associated with using the grain it claimed to reject.

Therefore, the arbitrators determined that Phoenix Bio owed Western for the corn received between Oct 22, 2007 and Nov. 28, 2007 in the amount of $3,673,551.51, plus accrued finance charges of $51,263.16, for a total of $3,724,814.67 as of Dec. 15, 2007. The invoice amounts and the applicable finance charges relevant to this case are summarized in the table below. The awarded finance charges are to accrue from Dec. 16, 2007 until final payment is received at a rate of 18 percent per annum. Based upon the terms of the contracts, Phoenix Bio also is to pay Western its reasonable attorney's fees incurred in association with this case, which amount to $13,805.00. Each party to this arbitration case is responsible for paying its own arbitration fees.

The arbitrators, therefore, ordered Phoenix Bio to pay a total of $3,738,619.67 to Western Milling for the applicable corn invoices, finance charges, and attorney's fees.

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

Eric Wilkey, *Chair*
President
Arizona Grain, Inc.
Casa Grande, Ariz.

David Kier
President
DFS, Inc.
Newell, Iowa

Ron Finck
Executive Vice President
Abengoa Bioenergy Trading
Chesterfield, Mo.

Damages Calculation

Finance Charges: 18%

Corn Invoices:	Invoice Date	Amount	Totals		
	10/22/07	$42,563.09			
	10/22/07	$16,625.60			
	10/24/07	$626.92			
	10/24/07	$44,586.88			
	10/24/07	$46,348.89			
	10/25/07	$46,302.17			
	10/25/07	$47,718.88			
	10/26/07	$49,648.70			
	10/26/07	$48,609.38			
	10/27/07	$45,780.66			
	10/27/07	$50,862.04			
	10/28/07	$50,860.18			
	10/28/07	$50,234.63			
	10/29/07	$46,173.90			
	10/29/07	$49,916.97			
	10/30/07	$48,030.48		Finance	
	10/30/07	$47,617.84		Charges	
	10/31/07	$48,192.79		Dec 15	Days
Due Nov. 1	10/31/07	$47,616.95	$828,316.95	$18,381.83	45
	Invoice Date	Amount			
	11/1/07	$52,665.32			
	11/1/07	$53,770.73			
	11/2/07	$45,660.95			
	11/2/07	$7,531.80			
	11/2/07	$48,709.89			
	11/3/07	$58,401.47			
	11/3/07	$34,098.62			
	11/4/07	$2,013.43			
	11/4/07	$50,152.24			
	11/4/07	$48,332.18			
	11/5/07	$16,990.57			
	11/5/07	$53,396.34			
	11/5/07	$52,128.71			
	11/6/07	$52,292.52			
	11/6/07	$50,970.19			
	11/7/07	$53,664.85			
	11/7/07	$50,979.64			
	11/8/07	$54,211.22			
	11/8/07	$54,216.50			
	11/9/07	$53,721.92			
	11/9/07	$52,073.85			
	11/10/07	$55,375.53			
	11/10/07	$54,383.30			
	11/11/07	$53,839.48			
	11/11/07	$54,048.01			
	11/12/07	$52,050.68			
	11/12/07	$55,688.25			
	11/13/07	$54,411.83			
	11/13/07	$53,582.47			
	11/14/07	$38,755.51			
	11/14/07	$59,036.26		Finance Charges	
	11/15/07	$62,026.00		Dec 15	Days
Due Nov. 16	11/15/07	$60,654.00	$1,599,834.26	$23,668.78	30

	Invoice Date	Amount			
	11/16/07	$58,376.26			
	11/16/07	$56,097.55			
	11/17/07	$55,251.16			
	11/17/07	$56,052.41			
	11/18/07	$59,808.66			
	11/18/07	$60,842.34			
	11/19/07	$59,019.32			
	11/19/07	$24,917.29			
	11/20/07	$19,731.63			
	11/21/07	$54,662.24			
	11/21/07	$56,434.12			
	11/22/07	$55,923.58			
	11/22/07	$55,750.32			
	11/23/07	$56,149.13			
	11/23/07	$53,066.36			
	11/24/07	$46,621.83			
	11/24/07	$47,134.48			
	11/25/07	$52,849.89			
	11/25/07	$53,303.73			
	11/26/07	$45,198.95			
	11/26/07	$60,095.14		Finance	
	11/27/07	$56,739.11		Charges	
	11/27/07	$60,774.80		Dec 15	Days
Due Dec. 1	11/28/07	$40,600.00	**$1,245,400.30**	**$9,212.55**	15

Total Invoice (WM)	$3,673,551.51
Total Corn	**$3,673,551.51**
Total Finance Charges	**$51,263.16**

Total corn invoices plus calculated finance charges **$3,724,814.67** Due: Dec 15, 2007