

LEGAL CORNER

By Gerry Whitty



When does a contract become real?

Many assume, incorrectly so, that a contract exists only when it is written and signed by both parties. In fact, a contract may be either written or oral, but in respect to oral contracts, certain conditions must be met in order for the contract to be enforceable.

Whether it's a lease agreement, signing on to take a new job or buying a home or other big-ticket item, sooner or later we all are faced with having to review and sign a contract to close the deal. Once we've "signed our life away," on the dotted line, we are now obligated to live up to the terms of the signed contract.

While this scenario is played out a countless number of times per day, a markedly different protocol

is engaged when executing a grain contract. FEED & GRAIN again turns to attorneys Jacob D. Bylund and Kim J. Walker of the law firm Faegre & Benson LLP, to help wade through the vagaries of what constitutes an enforceable grain contract.

F&G: What makes a grain contract difficult to enforce vs. a more traditional signed contract?

Bylund: When thinking of a "contract," most people

think of a document stating the terms of the parties' agreement signed by both parties. However, since grain contract agreements are typically conducted over the phone and because of the oral nature of such agreements, issues of enforceability can often arise when a dispute occurs. Fortunately, however, problems can be easily avoided with some attention to detail and clearly understanding the rules of how an "oral agreement" followed by a written confirmation, results in an enforceable contract.

F&G: What is the proper procedure which helps get the contracting process underway?

Walker: Reviewing and understanding Rule 3 in the NGFA Grain Trade Rules is a good place to start. In it, it states that both the buyer and seller shall send a written confirmation, to each other, no later than the close of the business day FOLLOWING the date of trade or on an agreed amendment.

F&G: And if something is amiss in the contract what happens next?

Walker: First of all, when you receive the written confirmation, you should check it immediately for accuracy. Upon finding any material differences, that party should immediately notify the other party to the contract by telephone and confirm in writing the correct terms and conditions of the agreement as previously agreed. Now, let's suppose one of the involved parties fails to send a confirmation. In that case, the confirmation actually sent by the other party then becomes binding upon both parties, because that confirming party has not been immediately notified by the nonconfirming party as described in Rule 3(A), of any disagreement with the confirmation received.

F&G: What other protections or policies are used to confirm an oral agreement?

Bylund: NGFA Trade Rule 3 tracks with the Uniform Commercial Code (UCC), which is generally applicable to grain contracts. Confirmations are addressed in three separate sections of the UCC — namely sections 2-201, 2-202 and 2-207.

Section 2-207 allows for the inclusion of additional terms in a confirmation as proposals to add to the contract's terms, while section 2-202 precludes the introduction of evidence contrary to terms set forth in writing between the parties. For example, if the confirmation states a price of \$4.00, the seller can't later

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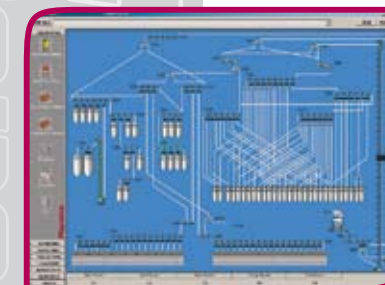
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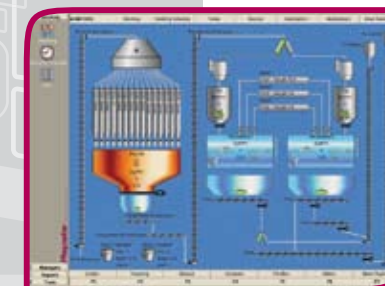
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introduce evidence in a proceeding where the contract is in dispute of a promise to pay \$5.00. Section 2-201 outlines the Statute of Frauds which refers to the legal requirement that certain types of contracts be in writing to be enforceable.

F&G: *How does Section 2-201, the Statute of Frauds, relate to grain contracts?*

Bylund: The Statute of Frauds provides that a contract for the sale of goods for the price of \$5,000 or more is not enforceable unless there is some record sufficient to indicate that a contract for sale has been made between the parties and signed by the party against which enforcement is sought or by the party's authorized agent or broker. There is an exception to the Statute of Frauds for contracts between "merchants." Between merchants, if one party sends the other party a confirmation and the receiving party does not object within a specified period, the contract is enforceable against the receiving party even if the receiving party never signed the confirmation.

F&G: *Does anything change when dealing with farmers?*

Walker: In most states the status of a party as a merchant, including the status of a "farmer as a merchant" is a question for the "trier of fact," which determines if the farmer/merchant has the knowledge or skill to be deemed a merchant. In considering whether a farmer is a merchant, the trier of fact may consider evidence regarding the following:

- Length of time the farmer has been engaged in the practice of selling their product
- Degree of business acumen demonstrated by the farmer in their dealings with other parties
- Farmer's awareness of the operation and existence of farm markets, and
- Past experiences with or knowledge of the customs and practices which are unique to the particular marketing of the product they sell.

F&G: *All right, let's suppose the party receiving the confirmation, a farmer for example, does not sign it and return a copy to the grain company. How does that affect processes like arbitration?*

Bylund: When a farmer has not signed the confirmation, the farmer may be more likely to assert that the contract is not enforceable and that the farmer is not a merchant. This can affect the grain company's ability to enforce the contract in the event of default and can

materially affect the cost of enforcement. Section 5 of the NGFA Arbitration Rule sets out the procedure for initiating the arbitration process whereby, the National Secretary prepares a "contract for arbitration" for signatures by the parties. The Section 5 "contract for arbitration" is a contract between the parties and NGFA to administer the resolution of the parties' dispute.

If the responding party fails to sign the confirmation and the party claims that no contract exists, the party may also refuse to sign the "contract for arbitration" with the NGFA, and the NGFA may refuse to hear the matter until the respondent is "compelled" to participate.

A party is "compelled" to arbitration by one party going into either state or federal court to secure an

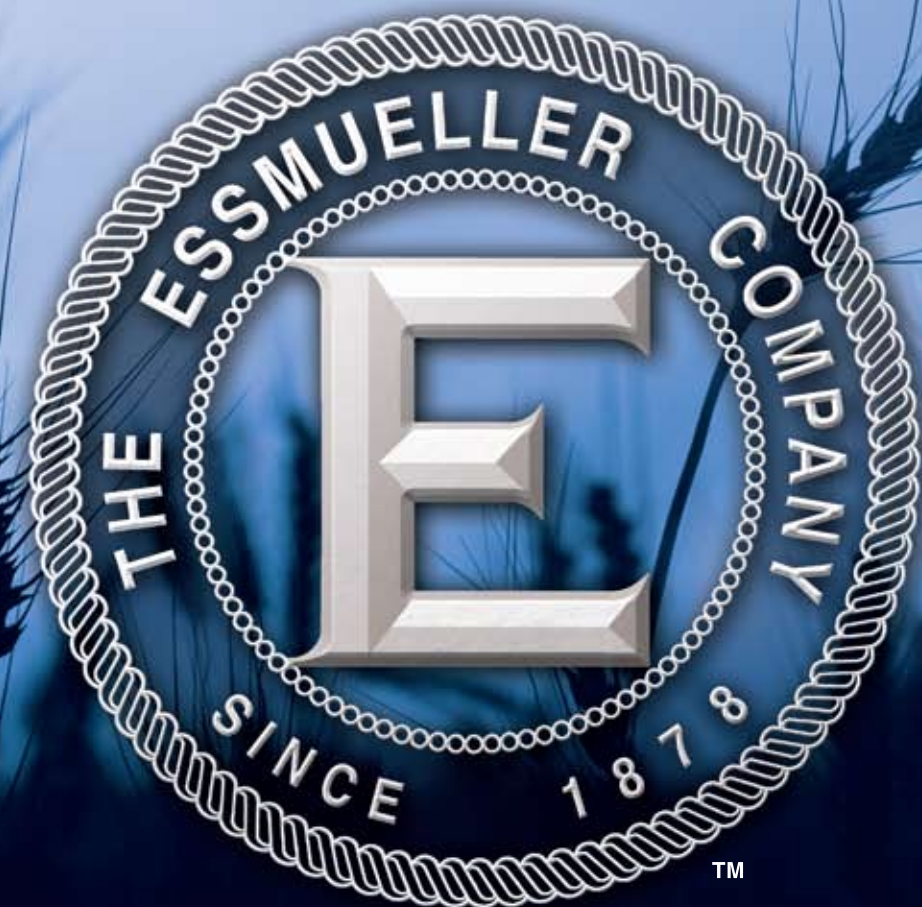
"Section 5 of the NGFA Arbitration Rule sets out the procedure for initiating the arbitration process whereby, the National Secretary prepares a 'contract for arbitration' for signatures by the parties."

— Jacob D. Bylund

order compelling arbitration. This requires that the party establish that an agreement to arbitrate before NGFA exists and is enforceable. If the confirmation is unsigned — and no master agreement exists between the parties — then to prove up the arbitration requirement a party may need to submit evidence, engage in limited discovery and possibly an evidentiary hearing to determine if the respondent is a "merchant," and, therefore, the Statute of Frauds is defeated. These proceedings are costly and entirely avoidable if proper contracting procedures are employed.

Walker: Other risks, unrelated to the counterparty farmer, can also flow from the unsigned confirmations. In times of high market volatility the likes of which we experienced last year or, in the uncertain economic times seen today, a grain company's contracting practices may present an issue with respect to obtaining credit, for example. Lenders may inquire regarding the debtor's portfolio of grain contracts. If a pattern of an unusually high number of unsigned confirmations

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begins to reveal itself, it could most certainly affect the debtor's ability to obtain credit or continue a relationship. Simply put, unsigned confirmations present a higher likelihood of counterparty default.

F&G: *Essentially what you're saying here is, like anything, adhering to proper contracting procedures will save you time, money and needless hassles. What are the keys to proper contracting procedure?*

Bylund: In the grain business, proper procedure begins at the original point of contact between the contracting

"If the signed confirmation is not received within five to seven business days the date of confirmation was mailed, follow up with a call to the other party to request a meeting to sign the confirmation . . ."

— Kim J. Walker

parties. Document each oral agreement at its inception including names of the parties, contracting party, name of caller, time/date of the call, contract pricing and quantity information.

Then send the contract confirmation no later than the close of the business day following the date of the trade, or an agreed amendment (see Rule 3, NGFA Trade Rules), mail that confirmation and a return-stamped envelope to the other party, retaining a copy of the confirmation noting the date on which it was mailed to the other party.

Walker: Upon receipt of the confirmation, the other party should take the time to carefully review and check all specifications therein, and if any notable or material differences are found, immediately notify the other party to the contract by telephone and confirm by written communication.

F&G: *What's the recommended timing for executing the contract confirmation procedure?*

Walker: After the first step of mailing the confirmation and after three business days or more as the business may determine you should consider contact with the

other party to confirm receipt of the confirmation, answer questions and verify the immediate return of a signed copy. This step is not required by NGFA rules or the UCC; it just makes good business sense.

If the signed confirmation is not received within five to seven business days the date of confirmation was mailed, follow up with a call to the other party to request a meeting to sign the confirmation, or resend the confirmation via a confirmed delivery service (certified mail, UPS, FedEx, etc.)

That second copy of the confirmation should be accompanied by a notice to the other party that the contract will be cancelled and that the party is responsible for damages, if the confirmation is not signed and returned immediately. If the second confirmation is not signed within five to seven business days of its issuance, terminate the agreement, notify the other party of their breach of contract and close any corresponding hedge positions.

F&G: *Why is it important to close hedge positions?*

Bylund: Under the UCC and NGFA rules, damages are generally fixed on or about the date the nondefaulting party receives written notice of default by the counterparty. If a grain company closes out a contract and does not close out the associated hedge position, any hedging losses subsequent to the default may not be recoverable in subsequent legal proceedings.

As you can see, there is no replacement for following proper procedures. As mentioned earlier, the cost of doing business goes up dramatically relative to time lost, possible legal/court costs and maybe most importantly, lost trust between potential trading partners, when poor procedural practices are used when creating contracts. ■



Kim J. Walker Jacob D. Bylund

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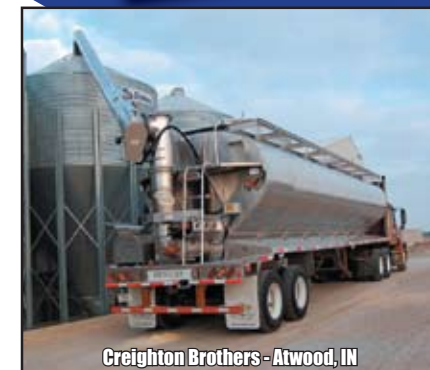
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