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HEDGE-TO-ARRIVE CONTRACTS:
TWO FEDERAL COURT CASES

— by Neil E. Harl

Cases filed in recent months involving hedge-to-arrive contracts are continuing to filter out at the trial court level.¹ The cases were filed after a run-up in grain prices in late 1995 and early 1996 boosted the cost of rolling futures contracts forward to later contract months.² Many of the contracts, dubbed hedge-to-arrive contracts, involved the sale of more grain than the producer had in storage and were typically hedged on a nearby futures month. In a typical HTA contract, entered into in October of 1995, the grain sold was hedged by the elevator with a March, 1996, futures contract. That necessitated “rolling” the futures obligation to May or July and ultimately to the December 1996 contract—or even later.

A major issue has been whether such contracts are “cash forward contracts” which are outside the scope of federal regulations³ or are not within the cash forward contract exception to federal regulatory law.⁴ In the latter event, the contracts run the risk of being “off-exchange” contracts which are illegal.

In a case decided September 25, 1997, by the Minnesota Federal District Court involving Grain Land Coop,⁵ the contracts permitted the producers to roll their delivery obligations to a later futures month. The coop was obligated to cover margin obligations and, apparently, the costs involved in rolling the obligations forward.

The case involved lawsuits brought by the cooperative against approximately 160 producers who had not delivered grain under the contracts. The actions were originally filed in state court but were shifted to federal court at the request of the producers on the ground that a federal question was involved—possible applicability of federal commodity law.

The case was further complicated by complaints of fraud, misrepresentation and breach of fiduciary duty by the producers against the coop.

The court reviewed the history of federal law regulating commodity futures transactions and concluded that the contracts in question were within the cash forward contract exception.⁶ That meant the contracts did not violate federal regulations governing futures transactions.⁷ The court noted that the contracts were only entered into with grain producers and each of the producers had the ability to deliver the grain.

As for the capacity of the producers to deliver, which has been considered an important element of the cash forward contract exception,⁸ the court stated that “each of the producers had the ability to make delivery on the contracts.” The court then concluded that “the cash forward contract exclusion...is available for cash contracts for the sale of grain that are made between persons engaged in the grain business and that are predicated on the expectation of actual, albeit deferred, delivery.”⁹ If that language is meant to say that all contracts for the sale of commodities by a farmer are within the cash forward contract exception, a genuine question arises as to whether CFTC, other trial courts and courts of appeal will agree. Clearly, the Minnesota decision is not the last word on this issue.

The court also tossed out the producers’ claims of fraud and misrepresentation. The court reasoned that the contracts were governed by the Uniform Commercial Code and thus tort claims for fraud and misrepresentation were barred.

More HTA

A case decided recently by the Federal District Court for the Western District of Missouri also involved hedge-to-arrive contracts.⁹ In that case, the contracts were for one year and the farmer apparently had enough commodity (corn and soybeans) on hand or was expected to produce enough in the current production cycle to cover the amount specified in the contracts.

The farmer argued that the contracts were governed by the Commodity Exchange Act¹⁰ and were outside the scope of the cash forward contract exception. The elevator’s position was that the contracts were merely cash forward contracts and were not subject to federal regulation.

¹ Charles F. Curtiss Distinguished Professor in Agriculture and Professor of Economics, Iowa State University; member of the Iowa Bar.
The Missouri Federal District Court identified several factors in analyzing whether the contracts in question were futures contracts, subject to the Commodity Exchange Act, or were cash forward contracts not subject to CEA. The factors included—(1) whether the contracts had “inherent value,” (2) market characteristics; (3) whether delivery is contemplated; (4) the underlying purpose of the contracts; (5) whether standardized form contracts were used; and (6) the nature of the parties to the transactions involved in the dispute.

The court sided with the elevator and held that the contracts were within the cash forward contract exception. Accordingly, the federal court dismissed the action. The case now goes back to state court.

The two cases, in Minnesota and Missouri, both found the contracts in question to be cash forward contracts. The Minnesota case, however, did not involve a focus on sales of crops beyond what was in storage or could be produced in the current production cycle. More court decisions are expected—and these two may be appealed.

FOOTNOTES

1 See generally 10 Harl, Agricultural Law § 74.04 (1997).
5 In re Grain Land Coop Case, Civ. No. 3-96-1209 (D. Minn. 1997).
6 See n. 4 supra.
10 See n. 2 supra.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL-ALM § 13.03.*

CLAIMS. Two banks had obtained judgments against the debtor on loans made to the debtor for agricultural operations. The debtor then filed for Chapter 12. Because the value of the collateral securing the loans was much less than the judgments, the debtor’s Chapter 12 plan classified the judgments as partially unsecured. The banks and the debtor negotiated the value of the collateral securing the claims and the plan included the agreed-to value which was higher than the value originally attributed to the property. The court found that the value agreed to was a negotiated value and not a value determined by appraisal. The negotiated value was incorporated into the Chapter 12 plan. The plan did not mention the unsecured portion of the banks’ claims but did list other unsecured claims. Under the plan, the unsecured claims would not receive any payments. The plan was confirmed. During the plan period, the debtor received an inheritance which was eventually included in the debtor’s disposable income available for payment of unsecured claims. The banks sought a modification of the plan to include their unsecured claims. The debtor argued that the banks had waived the unsecured claims. The court agreed, holding that, because the banks had negotiated a higher value of the collateral under the original plan in exchange for the release of their unsecured claims, the banks had waived those unsecured claims. First Nat’l Bank v. Allen, 118 F.3d 1289 (8th Cir. 1997).

EXECUTORY CONTRACTS. The debtor had purchased a farm from a bank for $40,000 in cash and a contract to pay the remainder in installments. The contract provided that the bank remained the title holder until the final installment was paid. At that time, the bank was to provide a warranty deed to the property. Title insurance was purchased for the debtor and the contract was recorded. The bank claimed that the contract was executory, requiring the debtor to affirm or reject the contract. The debtor argued that the contract was a secured financing device, allowing the debtor to modify the terms of the contract under the Chapter 11 plan. Although the court noted that several other courts have held that all land sale installment contracts were or were not executory, the court followed In re Robert L. Helms Contr. & Dev. Co., 110 F.3d 1470 (9th Cir. 1997) in examining all the circumstances to determine the nature of the contract. The court examined Idaho law to determine the nature of the contract rights and obligations. Under Idaho law, when the debtor’s equity exceeded the seller’s damages from a breach of the contract, the contract must be foreclosed in the same manner as a mortgage. The court found that, under the contract, the bank’s only remaining obligation under the contract was to supply title to the property and the debtor’s only obligation was to pay the remaining obligation. The bank argued that it also had the obligation to provide marketable title. The court found no basis for this distinction, noting that the bank would have no motivation for clouding the title. The court also ignored the characterization in the contract that the contract was executory, holding that the true nature of the contract was to operate as security for the debtor’s obligation to make

* Agricultural Law Manual (ALM). For information about ordering the Manual, see the last page of this issue.