

# TO ARBITRATE OR NOT TO ARBITRATE: A PRACTITIONER’S GUIDE TO ALTERNATIVE DISPUTE RESOLUTION IN THE AGRICULTURAL CONTEXT

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## I. INTRODUCTION

In recent years, the term Alternative Dispute Resolution (ADR) has become a buzzword throughout the legal arena. For example, as of July 1997, most Minnesota civil cases must use some form of ADR prior to trial,<sup>1</sup> prompting the requirement for mediation and arbitration services in all aspects of civil litigation.

How has the agriculture community responded to this new wave of ADR? For many individuals the terms “alternative dispute resolution” and “agriculture” go hand in hand. Agriculture historically has been on the leading edge of ADR. Mandatory mediation provisions in agricultural lending and foreclosure procedures have been in place for years. These statutes were enacted during the peak of the farm crisis and have served as valuable protection for the agricultural community. In 1986, the Minnesota Legislature passed the Farmer-Lender Mediation Act.<sup>2</sup> The Minnesota Legislature found:

That the agricultural sector of the state’s economy is under severe financial stress due to low farm commodity prices, continuing high interest rates, and reduced net farm income . . . . The agricultural economic emergency requires an orderly process with state assistance to adjust agricultural indebtedness to prevent civil unrest and to preserve the general welfare and fiscal integrity of the state.<sup>3</sup>

These mandatory provisions made agriculture a leader in the use of out-of-court dispute resolutions.

Recently, the Minnesota Legislature required mediation or arbitration clauses in all agricultural commodity contracts.<sup>4</sup> Under this statute parties are referred to the Minnesota Department of Agriculture to facilitate either mediation or arbitration.<sup>5</sup> This statute strengthened agriculture’s ability to resolve disputes through alternative dispute resolution.<sup>6</sup> The last tool the Minnesota Legislature placed in agriculture’s arsenal is Minnesota Statute § 17.94,<sup>7</sup> which requires good faith dealings by all parties to an agricultural contract.<sup>8</sup> Damages, court costs, and attorney fees may be recovered,<sup>9</sup> if the court finds that there has been a violation of this provision.

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1. MINN. RULES OF COURT, R. PRAC. DIST. CT., Rule 114 (West 1997).

2. MINN. STAT. ANN. § 583.20-.32 (West 1988).

3. MINN. STAT. ANN. § 583.21 (West 1988). The Iowa equivalent to this statute is found at IOWA CODE § 654A (1997).

4. See MINN. STAT. ANN. § 17.91 (West 1990).

5. See *id.*

6. See *id.*

7. MINN. STAT. ANN. § 17.94 (West 1997). Good faith is defined in MINN. STAT. ANN. § 336.1-201(18) (West 1997).

8. See *id.*

9. See *id.*

Armed with these legislative tools, the expectation was that out-of-court processes would easily incorporate and resolve agricultural disputes. The recent hedge-to-arrive (HTA) disputes, however, have tested the effectiveness and utility of ADR in agriculture. It is apparent that despite state legislatures enacting the tools, ADR is not being adopted as the primary dispute resolution procedure. To date, only three cases have been decided through arbitration.<sup>10</sup> The majority of cases continue pending in courtrooms across the country. This Article explores some of the reasons why this is occurring.

In the HTA dispute, two principle arbitration systems have emerged: (1) the American Arbitration Association and (2) the National Grain and Feed Association. In the midst of what many have referred to as the second farm crisis, a review of the status of ADR, specifically arbitration, in agriculture is appropriate.<sup>11</sup>

This Article will review recent decisions under both arbitration systems. Each system will be reviewed and critiqued for its ability to meet certain due process criteria. Based on this due process analysis, participation in arbitration may be counter to particular parties' interest in certain circumstances. In addition, certain disputes may be inappropriate for arbitration. For example, pre-contracting misrepresentation claims seem better resolved in the courtroom rather than through a contractually mandated arbitration system. Avenues may be available to avoid arbitration and have disputes settled in the courtroom.

To aid in this evaluation, a review of federal and state law is presented in the body of this Article. The Article then concludes with practical tips for those faced with the decision, "to arbitrate or not to arbitrate?" This Article is intended to provide a road map to help with that decision. If individuals decide the answer is "not to arbitrate" then their legal standing and options are presented. The hedge-to-arrive dispute is certain to raise comprehensive agricultural law issues and ADR's use in agriculture is one of many such issues.<sup>12</sup>

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<sup>10</sup>. See Hoffman v. Farmers Elevator Co., American Arbitration Association, Commercial Arbitration Tribunal, Case No. 56-181-459-96 (Apr. 15, 1997) (Laveau, Arb.) (on file with the *Drake Journal of Agricultural Law*); Madsen v. Wantonwan Farm Serv. Co., American Arbitration Association, Case No. 56-E-181-00156-97 (Aug. 7, 1997) (Sunde, Arb.) (on file with the *Drake Journal of Agricultural Law*); Andersons, Inc. v. Horton Farms, Inc., NGFA Case No. 1763 (N.G.F.A. July 7, 1997) (Norris, Gordon, Buttino, Arbs.).

<sup>11</sup>. See Donald B. Pederson, *Hedge-to-Arrive Contracts in the Courts—Part II*, 14 AGRIC. L. UPDATE, Sept. 1997, at 4; Matthew J. Cole, Note, *Hedge-to-Arrive Contracts: The Second Chapter of the Farm Crisis*, 1 DRAKE J. AGRIC. L. 243 (1996).

<sup>12</sup>. The difficulty presented with the HTA controversy is that it pits farmer against farmer, co-op member against co-op member, or farmer against agri-business. In the farm crisis it was the farmer against the bankers. The bankers during the farm crisis of the 1980s, even those with strong ties to the agriculture community, were not truly "agriculture." The present conflict within the agricultural community has made it politically impossible to "choose sides." In the HTA controversy, the conflict is between agri-business and pockets of farmers throughout the Midwest. As a politician with agricultural constituents, supporting either side is equivalent to choosing between friends. As a result, legislative action has been noticeably lacking from early resolutions to the HTA dispute.

## II. Analysis of Cases Decided Under NFGA and AAA Rules

### A. *Arbitration Between Brad Hoffman and Farmers Elevator Co.*<sup>13</sup>

This dispute involves two hedge-to-arrive contracts, entered into in November 1995, for a total of 160,000 bushels of corn (two 80,000 bushel contracts).<sup>14</sup> The contracts set May 1996 futures at \$3.34 and \$3.37.<sup>15</sup> In the negotiations leading up to the signing of the contracts, the Hoffmans (the farmer) insisted that they needed a price floor of \$2.85 to \$2.90 per bushel.<sup>16</sup> Farmers Elevator (the elevator) indicated that they could not give a fixed price commitment.<sup>17</sup> However, the elevator did state that the farmer could lock in a futures price and, if the market acted as it historically did, could realize their desired price.<sup>18</sup>

“Not long after the contracts had been signed, [the farmer] contacted [the elevator] because of having seen newspaper accounts” discussing problems caused by hedge-to-arrive contracts with other elevators.<sup>19</sup> The elevator assured the farmer that they were not at risk under the contracts.<sup>20</sup>

Later, concerns did arise over the possible risks involving the contracts, and the possibility of using put-options was discussed.<sup>21</sup> Contradictory testimony was offered regarding who initiated the discussion of using options.<sup>22</sup> Both parties admitted, however, that discussions occurred between the elevator and the farmer’s banker regarding options.<sup>23</sup> In a telephone conversation between the elevator and the banker, the elevator stated that the new plan would “enable the [farmer] to realize their \$2.85 price.”<sup>24</sup> The banker needed assurances that the farmer could meet his loan obligations and relied upon the statements of the elevator in conducting business with the farmer.<sup>25</sup>

The elevator subsequently rolled the contracts forward to December 1996.<sup>26</sup> The elevator then requested that the farmer deliver the grain at approximately \$1.45

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<sup>13</sup>. Hoffman v. Farmers Elevator Co., American Arbitration Association, Commercial Arbitration Tribunal, Case No. 56-181-459-96 (Apr. 15, 1997) (Lareau, Arb.) (on file with the *Drake Journal of Agricultural Law*).

<sup>14</sup>. *Id.* at 1.

<sup>15</sup>. *See id.*

<sup>16</sup>. *See id.* at 2 (the final price is determined by subtracting basis from the futures price. For example, a \$3.34 futures price less a \$.49 basis would result in the desired \$2.85 per bushel).

<sup>17</sup>. *See id.*

<sup>18</sup>. *See id.*

<sup>19</sup>. *See id.* at 3.

<sup>20</sup>. *See id.*

<sup>21</sup>. *See id.*

<sup>22</sup>. *See id.*

<sup>23</sup>. *See id.*

<sup>24</sup>. *Id.*

<sup>25</sup>. *See id.*

<sup>26</sup>. *See id.*

per bushel.<sup>27</sup> The farmer insisted that he was entitled to \$3.00 to \$3.05 per bushel (the basis had narrowed from \$0.40 to \$0.25, a difference of \$0.15, therefore,  $\$2.85 + \$0.15 = \$3.00$ ).<sup>28</sup> The elevator refused to pay the price the farmer requested and the farmer delivered the grain to another elevator on the cash market for \$2.38 per bushel.<sup>29</sup>

The arbitrator found that the farmer was entitled to receive \$3.00 per bushel for his corn.<sup>30</sup> The primary justification for this finding was that the elevator had a greater degree of responsibility and knowledge, and therefore should bear the losses.<sup>31</sup> In reaching this conclusion, the arbitrator made the following findings:

I do not feel that a clear-cut price guarantee was given, but [the elevator manager] did hold [himself] out as having sufficient expertise to guide the [farmer] through the transaction and aid them in achieving their price goal. [The elevator manager] did not operate entirely at arm's length but rather involved [himself] in their planning, working along with them to plan the rollouts and the puts and calls necessary to achieve their objective. They relied upon [his] expertise and guidance and [his] failure to advise them of the risks although the opportunity to do so was presented on more than one occasion, when the [farmer] might have taken protective measures had they been warned.<sup>32</sup>

The arbitrator calculated damages by taking the difference between the price to which the arbitrator found the farmer entitled and the price for which the grain was sold on the cash market ( $\$3.00 - \$2.38$ ).<sup>33</sup> Thus, the farmer received \$99,200 plus expert witness fees and attorney fees.<sup>34</sup>

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27. *See id.*

28. *See id.* at 4.

29. *See id.*

30. *See id.*

31. *See id.* at 5.

32. *Id.*

33. *See id.* at 4.

34. *See id.*

B. *Arbitration Between Madsen and Watonwan Farm Service Co.*<sup>35</sup>

In this American Arbitration case, Madsen (the farmer) initiated arbitration asserting a damages claim based on allegations of fraud by the elevator.<sup>36</sup> Watonwan Farm Service (the elevator) counterclaimed for non-delivery on a 25,000 bushel hedge-to-arrive contract.<sup>37</sup>

The contract in question was entered into on June 23, 1995.<sup>38</sup> According to the arbitrator's decision, the contract "provided for the delivery of 25,000 bushels of corn at a price of \$2.97 1/4 per bushel for July, 1996, corn futures on the Chicago Board of Trade."<sup>39</sup> The farmer was to determine the date of delivery by establishing the basis.<sup>40</sup> The arbitrator stated, "[c]laimant had the option, rather than delivering corn in July 1996, to 'Roll' the Contract. In other words, to extend the contract."<sup>41</sup>

The farmer did not have the 25,000 bushels of grain on hand, either at the time of entering into the contract or leading up to July 1996.<sup>42</sup> Rather than rolling into an inverted market, the farmer priced the contract on June 24, 1996 at a price of \$2.81 1/4 per bushel (basis of \$0.16).<sup>43</sup> With no corn on hand to deliver, and the prospect of having to purchase higher priced corn to fill the contract, the farmer did not deliver the grain.<sup>44</sup>

The arbitrator not only found that the farmer was aware of the contract risks, but also found that there was no fraud on the part of the elevator.<sup>45</sup> The arbitrator found that when the farmer set the basis, the contract "for all practical purposes" became a cash contract.<sup>46</sup> Because the farmer failed to deliver, the elevator was damaged.<sup>47</sup> However, the arbitrator was unable to calculate a dollar amount on the damages.<sup>48</sup>

The arbitrator explored two alternatives for calculating damages, both of which were too speculative to grant relief.<sup>49</sup> The first damage claim was that the elevator was entitled to a \$0.10 per bushel margin or profit.<sup>50</sup> No evidence was presented to

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<sup>35</sup>. Madsen v. Watonwan Farm Serv. Co., American Arbitration Association, Case No. 56-E-181-00156-97 (Aug. 7, 1997) (Sunde, Arb.) (on file with the *Drake Journal of Agricultural Law*).

<sup>36</sup>. *See id.*

<sup>37</sup>. *See id.*

<sup>38</sup>. *See id.* at 2.

<sup>39</sup>. *Id.*

<sup>40</sup>. *See id.*

<sup>41</sup>. *Id.*

<sup>42</sup>. *See id.* at 2-3.

<sup>43</sup>. *See id.* at 4.

<sup>44</sup>. *See id.* at 5.

<sup>45</sup>. *See id.*

<sup>46</sup>. *Id.*

<sup>47</sup>. *See id.*

<sup>48</sup>. *See id.*

<sup>49</sup>. *See id.*

<sup>50</sup>. *See id.*

support this claim.<sup>51</sup> For the second claim for the cost of “covering” the delivery obligation, testimony was presented as to the cash price of corn in July 1996.<sup>52</sup> The elevator, however, was unable to show a specific off-setting grain purchase for the contract in dispute.<sup>53</sup> Without this documentation, the arbitrator refused to award damages.<sup>54</sup> The arbitrator’s decision denied both claims and each party was responsible for their own costs and attorney fees.<sup>55</sup>

*C. Arbitration Between Andersons, Inc. and Horton Farms, Inc.*<sup>56</sup>

This case involved nine hedge-to-arrive contracts.<sup>57</sup> The Andersons (the elevator) alleged that “[f]ive of the contracts provided for December 1995 delivery . . . and four of the contracts provided for July 1996 delivery . . . .”<sup>58</sup> The Defendant, Horton Farms, (the farmer) alleged that delivery under the contracts “was not actually required” and that the “contracts could be repeatedly rolled forward . . . .”<sup>59</sup> The farmer also alleged that the elevator had represented to them that they could “easily get out of these agreements in the future, if necessary.”<sup>60</sup>

In finding in favor of the elevator, the arbitration committee relied heavily on past dealings between the parties.<sup>61</sup> In making their finding, the committee stated:

The [farmer] contended that [he] did not understand nor agree with the cancellation charges involved in the various amendments to the contracts. However, the long history of doing business between the two parties suggested otherwise. The evidence submitted in this case showed that both parties were willing participants in the workings of these types of contracts.<sup>62</sup>

The arbitration panel further stated, “it was clear that the [farmer] failed to make delivery on those contracts providing for delivery in December 1995.”<sup>63</sup> As a result of the farmer’s failure to deliver on the five December 1995 contracts, the

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<sup>51</sup>. *See id.*

<sup>52</sup>. *See id.*

<sup>53</sup>. *See id.*

<sup>54</sup>. *See id.* at 6.

<sup>55</sup>. *See id.*

<sup>56</sup>. *Andersons, Inc. v. Horton Farms, Inc.*, NGFA Case No. 1763 (N.G.F.A. July 2, 1997) (Norris, Gordon, Buttino, Arbs.).

<sup>57</sup>. *See id.* at 1.

<sup>58</sup>. *Id.*

<sup>59</sup>. *Id.*

<sup>60</sup>. *Id.*

<sup>61</sup>. *See id.* at 2.

<sup>62</sup>. *Id.*

<sup>63</sup>. *Id.* at 1.

elevator was justified in canceling the four July 1996 contracts.<sup>64</sup> All nine contracts were canceled on January 16, 1996.<sup>65</sup>

The arbitrator awarded damages of \$211,400 for 300,000 bushels of undelivered corn.<sup>66</sup> A cancellation fee of \$0.10 per bushel was included in that amount.<sup>67</sup> The average “damages” per bushel works out to \$0.605 per bushel ( $\$211,400 - \$30,000 = \$181,400$ ;  $\$181,400$  divided by  $300,000 = \$0.6046$ ).<sup>68</sup> In addition, attorney fees of \$29,000 were awarded to the elevator.<sup>69</sup> A footnote in the opinion indicates that parties ordinarily pay their own attorney fees incurred in an NGFA arbitration.<sup>70</sup> However, in this case the elevator was required to get a court order compelling arbitration.<sup>71</sup> The \$29,000 was to compensate the elevator for the cost of obtaining the court order.<sup>72</sup> Lastly, the elevator was awarded interest on the \$211,400 judgment at nine percent per annum from the date of the contract cancellation and nine percent per annum on the attorney fees from the date the elevator paid each invoice.<sup>73</sup>

### III. Comparing the Arbitration Systems of the American Arbitration Association (AAA) and the National Grain and Feed Association (NGFA)

The above opinions provide an overview of the AAA and NGFA systems in action. The two arbitration processes can be compared and rated on the level of basic due process provided by each system. Under the rules promulgated by the Commodity Futures Trading Commission (CFTC), a report card can be formulated.<sup>74</sup> A summary of the CFTC minimum requirements for a fair and equitable arbitration procedure when resolving disputes between members of a commodity market and their customers (*e.g.*, commodity broker) can be found at 17 C.F.R. § 180.2, titled “Fair and Equitable Procedure.” The requirements set forth in that rule can be summarized as follows:

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<sup>64</sup>. *See id.* at 2.

<sup>65</sup>. *See id.* The elevator’s attorney offered to extend the delivery period to January 6, 1996, but the farmers still refused to deliver. *See id.*

<sup>66</sup>. *See id.* at 3.

<sup>67</sup>. *See id.*

<sup>68</sup>. *See id.* The presumption is that this amount was calculated by figuring the difference between the contract price and the replacement cost at the time of cancellation.

<sup>69</sup>. *See id.*

<sup>70</sup>. *See id.* at 3 n.3.

<sup>71</sup>. *See id.*

<sup>72</sup>. *See id.* at 3.

<sup>73</sup>. *See id.*

<sup>74</sup>. *See* 17 C.F.R. § 180.2 (1997).



- A) Objective and Impartial Procedure: “Customers must be provided with the choice of a panel, or other decision-maker,” who is “not a member or associated with any member of a contract market . . . .”;<sup>75</sup>
- B) Representation by Counsel: Participants have a right to be represented by an attorney;<sup>76</sup>
- C) Hearing and Adequate Notice: The CFTC rules require that each party be entitled to appear at a hearing. (The option of written arguments is presented for aggregate claims and counterclaims under \$5,000.)<sup>77</sup> Each party is also entitled to cross-examine the other parties’ witnesses;<sup>78</sup>
- D) Minimum Due Process: It is not required that the formal rules of evidence be applicable at hearings.<sup>79</sup> However, “the procedures established may not be so informal as to deny due process.”<sup>80</sup>
- E) Settlement: Prompt settlement award in writing and enforceable in court.<sup>81</sup>

#### A. Objective and Impartial Procedure

A distinct difference between the systems is the selection and composition of the decision-making panel. Under the American Arbitration Association (AAA) system, a list of arbitrators is sent to each party.<sup>82</sup> Each party may then strike three individuals in a single-arbitrator case and five individuals in a multi-arbitrator case.<sup>83</sup> They then rank their remaining choices and the arbitrator is selected accordingly.<sup>84</sup> The parties can also mutually agree to an arbitrator or method for selecting an arbitrator.<sup>85</sup>

The NGFA conducts their arbitration under a “committee system.”<sup>86</sup> Various committees are selected by the National Secretary of the NGFA and approved by the Chairman of the NGFA.<sup>87</sup> The committee members are drawn from the NGFA membership “with a view to forming each committee of prominent people

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<sup>75</sup>. *Id.* § 180.2(a).

<sup>76</sup>. *See id.* § 180.2(b).

<sup>77</sup>. *See id.* § 180.2(d)(1).

<sup>78</sup>. *See id.* § 180.2(d)(3).

<sup>79</sup>. *See id.* § 180.2(d)(2).

<sup>80</sup>. *Id.*

<sup>81</sup>. *See id.* § 180.2(c).

<sup>82</sup>. *See* AMERICAN ARBITRATION ASSOCIATION, COMMERCIAL ARBITRATION RULES, Rule 13 (1993) [hereinafter AAA RULES].

<sup>83</sup>. *See id.* Rule 17 (stating that unless the arbitration agreement provides for a multi-arbitrator panel, a single arbitrator will be used).

<sup>84</sup>. *See id.* Rule 13.

<sup>85</sup>. *See id.* Rule 14.

<sup>86</sup>. *See* NGFA TRADE RULES & ARBITRATION RULES, Arbitration Rule § 8(a) (1997) [hereinafter NGFA RULES].

<sup>87</sup>. *See id.* § 4(b).

experienced in the type of trade involved in cases to be brought before it.”<sup>88</sup> Once the case is fully briefed and prepared for hearing, the National Secretary assigns the case to one of the standing committees.<sup>89</sup> The committee members are then required to disclose any circumstances that may affect their impartiality. In addition, upon receipt of the names and addresses of the committee members, the participants in the arbitration may challenge the appointment of a committee member. If the National Secretary agrees, the committee member will be removed.<sup>90</sup>

### B. Participation by Attorneys

The NGFA and the AAA both allow for attorney participation in the process.<sup>91</sup>

### C. Hearing and Adequate Notice

First, and perhaps foremost in the minds of attorneys and parties in terms of fairness, is the ability to have a hearing. The NGFA provides a hearing only if specifically requested by a party.<sup>92</sup> The party requesting the hearing must bear the entire cost of the stenographic record along with the actual travel and lodging costs for the members of the committee, the National Secretary, and the Association’s legal counsel.<sup>93</sup> If the party requesting the hearing is not a member of the NGFA they are expected to pay the entire cost up front.<sup>94</sup> If both parties request a hearing, the costs will be shared between the parties.<sup>95</sup> As for the location of the hearings, they are most often held at the NGFA’s national headquarters in Washington, D.C.<sup>96</sup>

In contrast, under the AAA system an arbitration hearing is held as a matter of course.<sup>97</sup> Procedures are set out for providing oaths of witnesses,<sup>98</sup> discovery

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<sup>88</sup>. *Id.* The *Anderson* Arbitration, discussed above, lists the three members of the committee as “a Manager, Grain Merchandising,” (cooperative); a “General Manager” (grain growers); and “Grain Manager” (grain marketing). See *Andersons, Inc. v. Horton Farms, Inc.*, NGFA Case No. 1763, at 3 (N.G.F.A. July 2, 1997) (Norris, Gordon, Buttino, Arbs.).

<sup>89</sup>. See NGFA RULES, *supra* note 86, Arbitration Rule § 8(a) (stating, “the National Secretary shall assign it to one or another qualified committee as he may deem advisable for the expeditious handling of the case in the Association”).

<sup>90</sup>. See *id.*

<sup>91</sup>. See AAA RULES, *supra* note 82, Rule 22. The NGFA Rules do not specifically address participation by attorneys. However, there is nothing in the rules that appears to prohibit attorney involvement.

<sup>92</sup>. See NGFA RULES, *supra* note 86, Arbitration Rule § 8(f).

<sup>93</sup>. See *id.* § 8(g), (j).

<sup>94</sup>. See *id.* § 8(g).

<sup>95</sup>. See *id.*

<sup>96</sup>. See David C. Barrett, Jr., *Arbitrating Agricultural Disputes: The National Grain and Feed Association’s Experience*, 68 N.D. L. REV. 539, 546 (1992).

<sup>97</sup>. See AAA RULES, *supra* note 82, Rules 55-56.

<sup>98</sup>. See *id.* Rule 27.

proceedings,<sup>99</sup> guidance on the rules of evidence,<sup>100</sup> and post-hearing submission of evidence and affidavits.<sup>101</sup> As for the location of the hearing, it is held at a location mutually agreeable to both parties, subject to AAA approval.<sup>102</sup>

#### D. Minimum Due Process

The NGFA decision-making process relies heavily on the Trade Rules of the NGFA. For example, in the *Andersons* arbitration previously discussed, reference is made to NGFA Grain Trade Rules 43 and 10.<sup>103</sup> Grain Trade Rule 10 appears to provide the mechanism for the elevator's damages calculation.<sup>104</sup> Thus, the difficulty in proving the damages faced in the *Madsen* arbitration discussed above is easily overcome under the NGFA rules.

According to the text of the opinion, the farmer in the *Horton* arbitration alleged that delivery was not required under the contracts and that the elevator made certain representations or misrepresentations.<sup>105</sup> These traditional legal arguments—contract interpretation and misrepresentation—get lost in the opinion and are never addressed.<sup>106</sup> Instead, the panel relied on the NGFA trade rules and the parties course of dealing.<sup>107</sup> Even though course of dealing is a legal concept, it is not clear whether the analysis utilized traditional legal reasoning. For example, it is not clear whether the course of dealings involved hedge-to-arrive contracts or perhaps traditional cash forward contracts. Instead, the text refers to “these types of contracts.”<sup>108</sup> The farmer's misrepresentation and contract interpretation claims are never addressed.

In addition, the traditional legal argument of breach of contract or voidability of a contract is lost in the NGFA system. Trade Rule 43 reads, “[f]ailure to perform in keeping with the terms and conditions of a contract shall be grounds for the refusal only of such shipment or shipments, and not for rescission of the entire contract or any other contract between Buyer and Seller.”<sup>109</sup> Utilizing Rules 10 and 43 of the

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<sup>99</sup>. See *id.* Rule 10.

<sup>100</sup>. See *id.* Rule 31.

<sup>101</sup>. See *id.* Rule 32.

<sup>102</sup>. See *id.* Rule 11.

<sup>103</sup>. *Andersons, Inc. v. Horton Farms, Inc.*, NGFA Case No. 1763, at 2 (N.G.F.A. July 2, 1997) (Norris, Gordon, Buttino, Arbs.).

<sup>104</sup>. See NGFA RULES, *supra* note 86, Grain Trade Rule 10. Rule 10 is titled “Incomplete Shipment or Delivery.” This rule provides a mechanism for notifying a grain buyer that delivery will not occur. See *id.* The rule states, “after having given notice to the Seller to complete the contract, the Buyer will cancel the defaulted portion of the contract at fair market value based on the close of the market the next business day.” *Id.*

<sup>105</sup>. See *Andersons, Inc.*, NGFA Case No. 1763 at 1.

<sup>106</sup>. See *id.*

<sup>107</sup>. See *id.* at 2.

<sup>108</sup>. *Id.*

<sup>109</sup>. NGFA RULES, *supra* note 86, Grain Trade Rule 43.

NGFA, elevators are able to overcome the two largest hurdles in the HTA dispute: (1) the farmer's claim to breach of contract and/or misrepresentation; and (2) should be proving damages.<sup>110</sup>

Likewise, the AAA system does not rely on the traditional "rule of law" in making its decisions. The opinions, however, seem to rely on basic principles of law. For example, the *Hoffman* arbitration contains a detailed discussion interpreting the terms of the contracts between the parties.<sup>111</sup> In fact, the arbitrator, in his opinion, states "the primary issue relates to interpreting the meaning of 'hedge to arrive' in the context of the other contract provisions and the oral statements of [the elevator]."<sup>112</sup> A similar contract interpretation was conducted in the *Madsen* arbitration.<sup>113</sup> The representations and discussions of the parties are also discussed in detail, a fact absent from the NGFA decision.<sup>114</sup>

#### E. Prompt Settlement and Enforcement in Court

Under the AAA rules, a prompt award is required from the arbitrator, meaning thirty days or less unless otherwise agreed.<sup>115</sup> Consenting to arbitration under the AAA allows entry of a judgment in any state or federal court with jurisdiction.<sup>116</sup> Likewise, the NGFA system requires prompt action, meaning within thirty days of receipt of final papers.<sup>117</sup> The NGFA allows one appeal to the Arbitration Appeals Committee.<sup>118</sup> If a party does not appeal, or appeals and loses, the decision is final.<sup>119</sup>

#### IV. AAA and NGFA Comparison Conclusions

The AAA system appears to provide a fair and efficient alternative to a full-blown court proceeding. Furthermore, the system is able to handle a wide variety of disputes. The arbitrators who have heard the disputes to date have been able to comprehend the complexity of the hedge-to-arrive dispute. Well reasoned opinions seem to predominate. The structure of the system allows selection of an impartial

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<sup>110</sup>. See *Andersons, Inc.*, NGFA Case No. 1763 at 1.

<sup>111</sup>. See *Hoffman v. Farmers Elevator Co.*, American Arbitration Association, Commercial Arbitration Tribunal, Case No. 56-181-459-96, at 1-4 (Apr. 15, 1997) (Lareau, Arb.) (on file with *Drake Journal of Agricultural Law*).

<sup>112</sup>. *Id.* at 4.

<sup>113</sup>. See *Madsen v. Watonwan Farm Serv. Co.*, American Arbitration Association, Case No. 56-E-181-00156-97, at 4 (Aug. 7, 1997) (Sunde, Arb.) (on file with *Drake Journal of Agricultural Law*).

<sup>114</sup>. See *id.* at 2.

<sup>115</sup>. See AAA RULES, *supra* note 82, Rule 41.

<sup>116</sup>. See *id.* Rule 47.

<sup>117</sup>. See NGFA RULES, *supra* note 86, Arbitration Rules § 8(k).

<sup>118</sup>. See *id.* § 9.

<sup>119</sup>. See *id.*

decision-making body. Most important, the system provides enough formality that the participants feel they have been able to tell their side of the story and have their day in court. In short, minimum due process requirements are satisfied.

As far as efficiency goes, the NGFA appears to serve a valuable purpose for those familiar with the trade rules and procedures of the NGFA. In those circumstances, a full-blown hearing with expert witnesses, other live testimony, and the “rule of law” may be unduly burdensome and costly. As the rules state, “[t]he purpose of arbitration in this Association is to reduce friction among its members, avoid litigation, prevent misunderstandings, and adjust unsatisfactory conditions.”<sup>120</sup>

The clarity of the trade rules seems to provide a clear working relationship among the members. The NGFA system is less beneficial, however, when arbitrating disputes between members and non-members. The NGFA system, in the authors’ opinion, does not have the flexibility and impartiality necessary to properly address the intricacies of an agricultural dispute such as the hedge-to-arrive controversy. In addition, under the NGFA system, the lack of an impartial composition of the arbitration panel may be fundamentally unfair. Also, a hearing may be financially impractical when the petitioning party must pay all costs for themselves and their witness costs together with the full travel and lodging costs of the three person committee and NGFA members. Lastly, the reliance on NGFA rules, rather than traditional rules of law, makes the NGFA system unworkable for non-NGFA members. As set out in the September 1997 issue of the *Agricultural Law Update*, there are a number of legal theories under which suits may be brought.<sup>121</sup> It appears that most, if not all, of these theories are unavailable under NGFA rules. A party’s inability to be heard in a formal proceeding and to tell their story—the traditional concept of a day in court—contributes to a sense of fundamental unfairness. When considered in conjunction with the composition of the arbitration panel—in effect, friends and peers of the opposing party—the non-member may be justifiably concerned about the absence of basic due process.

## V. When Courts Send Disputes to Arbitration

### A. Historical Treatment of Arbitration

Historically, the judiciary has been reluctant to recognize arbitration as a legitimate alternative to litigating disputes.<sup>122</sup> For years, courts were hostile towards any form of “non-judicial” decision making.<sup>123</sup> In the early part of the twentieth century, legislative branches across America passed statutes designed to overcome

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<sup>120</sup>. See *id.* § 1.

<sup>121</sup>. See Pederson, *supra* note 11, at 4; Cole, *supra* note 11.

<sup>122</sup>. See Alison Brooke Overby, Note, *Arbitrability of Disputes Under the Federal Arbitration Act*, 71 IOWA L. REV. 1137, 1139 (1986).

<sup>123</sup>. See *id.* at 1141 & n.34 (citing H.R. REP. NO. 68-96, at 1-2 (1924)); Zhaodong Jiang, *Federal Arbitration Law and State Court Proceedings*, 23 LOY. L.A. L. REV. 473, 478-79 (1990).

the judiciary's reluctance to enforce arbitration agreements. "In 1920 New York enacted the first modern statute enforcing agreements to arbitrate future disputes."<sup>124</sup> The first Uniform Arbitration Act (UAA), adopted in 1925, provided that agreements used to arbitrate existing disputes would be irrevocable.<sup>125</sup> Later that year, "Congress enacted the Federal Arbitration Act (FAA) . . ."<sup>126</sup> The FAA empowered courts to enforce arbitration agreements by compelling arbitration,<sup>127</sup> staying proceedings pending arbitration,<sup>128</sup> and affirming arbitrable awards.<sup>129</sup> By 1990, "[f]ifty jurisdictions [had] adopted some type of modern arbitration statute with 32 states adopting the UAA."<sup>130</sup> "The current UAA was approved in 1955 by the National Conference of Commissioners on Uniform State Laws and the American Bar Association."<sup>131</sup>

The judiciary was slow to endorse the legislative policy that promoted arbitration. However, this began to change in 1959 when the Second Circuit decided *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*<sup>132</sup> The language Judge Medina chose when writing the opinion makes it clear that, at least in the Second Circuit, the old attitude toward arbitration was replaced with an enthusiasm for arbitration.

One of the dark chapters in legal history concerns the validity, interpretation and enforceability of arbitration agreements. From the standpoint of business men generally and of those immediately affected by such agreements they were beneficial and salutary in every way. But to the courts and to the judges they were anathema. In England and in America the courts resorted to a great variety of devices and formulas to destroy this encroachment on their monopoly of the administration of justice, protecting what they called their "jurisdiction."<sup>133</sup>

The court reached back to the 1925 United States Arbitration Act<sup>134</sup> (the Act) as the basis for closing this "dark chapter" in American history. The Act states:

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy

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<sup>124</sup>. Overby, *supra* note 122, at 1139.

<sup>125</sup>. *See id.*

<sup>126</sup>. *Id.* at 1141; *see* 9 U.S.C. § 1 (1994).

<sup>127</sup>. *See id.* at 1141 & n.36; 9 U.S.C. § 4 (1994).

<sup>128</sup>. *See id.* at 1141 & n.37; 9 U.S.C. § 3 (1994).

<sup>129</sup>. *See id.* at 1141 & n.38; 9 U.S.C. § 9 (1994).

<sup>130</sup>. Jiang, *supra* note 123, at 475 n.7 (listing U.S. and state codes pertaining to arbitration and noting those jurisdictions that have adopted the UAA).

<sup>131</sup>. *Id.*

<sup>132</sup>. *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402 (2d Cir. 1959), *cert. granted*, 362 U.S. 909 (1960), *dismissed under Rule 60*, 364 U.S. 801 (1960).

<sup>133</sup>. *Id.* at 406.

<sup>134</sup>. *See* 9 U.S.C. § 2 (1994).

thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.<sup>135</sup>

*Robert Lawrence* “heartily endorsed” the Act’s “liberal policy” of promoting arbitration in deference to legislative will and to help ease court calendars.<sup>136</sup>

In *Robert Lawrence*, the Second Circuit made an important distinction concerning the issues that were to be decided in arbitration and those to be decided by the judiciary.<sup>137</sup> The court found that fraudulent inducement to contract was an issue that could be decided in arbitration.<sup>138</sup> Fraudulent inducement relating solely to the signing of the arbitration clause, however, was an issue for the courts.<sup>139</sup> Under this rationale, the arbitration clause is separable from other portions of a contract, and worthy of judicial review. Had the plaintiff in *Robert Lawrence* argued that he was fraudulently induced to sign the arbitration provision alone, the outcome of the case would have been different.

### B. Contemporary Federal Law

*Robert Lawrence* was affirmed eight years later by the United States Supreme Court in *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*<sup>140</sup> *Prima Paint* affirmed the distinction drawn in *Robert Lawrence* between fraud in the inducement of the entire contract and fraud in the inducement of the arbitration clause alone.<sup>141</sup> The Court upheld the notion that “arbitration clauses as a matter of federal law are ‘separable’ from the contracts in which they are embedded,” and that the only instance where a court should stay arbitration and resolve the dispute itself is when fraudulent inducement is alleged in the “making” of the agreement to arbitrate.<sup>142</sup> According to *Prima Paint*, the statutory language of the FAA does not permit a federal court to consider claims of fraud in the inducement of the contract generally.<sup>143</sup> This decision was based on Section 4 of the FAA, which explicitly empowers courts to examine fraudulent inducement of the arbitration provision.<sup>144</sup>

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135. *Id.*

136. *See Robert Lawrence Co.*, 271 F.2d at 410.

137. *See id.*

138. *See id.* at 411-12.

139. *See id.* at 411.

140. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967).

141. *See id.* at 403-04.

142. *Id.* at 402.

143. *See id.* at 403-04.

144. *See id.*

The Court reasoned that because there was no language about fraudulent inducement of a contract generally, the intent of Congress was to arbitrate that issue.<sup>145</sup> The Court further reasoned that to rule otherwise would allow the claim of fraudulent inducement to be easily used as a tool to slow down and frustrate the arbitration process.<sup>146</sup>

The Supreme Court has established exceptions to the *Prima Paint* doctrine that are based on federal law that conflicts with the FAA. To this date, the exceptions are based solely on conflicting federal statutes.<sup>147</sup> The landmark case creating an exception to the FAA was *Wilko v. Swan*.<sup>148</sup> In *Wilko*, a customer purchased stock from a securities brokerage firm.<sup>149</sup> The value of the stock subsequently decreased and the customer sold the stock for a loss.<sup>150</sup> The stock purchaser filed suit in federal district court, claiming that the loss was due to the brokerage firm's misrepresentations and omissions of information in violation of the Securities Act of 1933.<sup>151</sup> Pursuant to the FAA, the brokerage firm moved to compel arbitration.<sup>152</sup> The Supreme Court found the arbitration clause void because it effectively waived compliance with a provision of the Securities Act.<sup>153</sup> The arbitration clause preempted the purchaser's statutory right to trial, creating a conflict between the mutually exclusive remedies afforded by the Securities and Arbitration Acts.<sup>154</sup> In support of their holding, the Court noted that Congress desired strict compliance with the Securities Act to protect disadvantaged buyers, many of whom stand in a bargaining position inferior to that of brokerage houses.<sup>155</sup>

The same conclusion was reached in *American Safety Equipment Corp. v. J.P. Maguire & Co.*,<sup>156</sup> where the court found that the policy behind the Sherman Antitrust Act was to preempt the FAA.<sup>157</sup> The court noted the public nature of antitrust law enforcement, observing that the Sherman Antitrust Act was designed to remedy violations that affect thousands of people and inflict staggering economic

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<sup>145</sup>. *See id.*

<sup>146</sup>. *See id.* at 404. This rule has withstood the test of time, as evidenced in *Houlihan* where the court compelled arbitration of a dispute over fraudulent inducement. *See Houlihan v. Offerman & Co.*, 31 F.3d 692 (8th Cir. 1997).

<sup>147</sup>. *See Southland Corp. v. Keating*, 465 U.S. 1, 16 n.11 (1983).

<sup>148</sup>. *Wilko v. Swan*, 346 U.S. 427 (1953).

<sup>149</sup>. *See id.* at 428-29.

<sup>150</sup>. *See id.* at 429.

<sup>151</sup>. *See id.* at 428-29.

<sup>152</sup>. *See id.* at 429-30.

<sup>153</sup>. *See id.* at 438.

<sup>154</sup>. *See id.*

<sup>155</sup>. *See id.* at 435.

<sup>156</sup>. *American Safety Equip. Corp. v. J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968).

<sup>157</sup>. *See id.* at 828.



damage.<sup>158</sup> *American Safety's* importance lies in the fact that the decision is predicated primarily on the public policy behind the legislation, and not a specific provision protecting the right to a jury trial.<sup>159</sup> Public interest arguments were also the basis for staying arbitration in *Beckman Instruments, Inc. v. Technical Development Corp.*<sup>160</sup> and *In re Cross Electric Co., Inc.*<sup>161</sup>

The Supreme Court's position on creating exceptions to *Prima Paint* based on commodities-trading disputes is not clear. The Commodity Futures Trading Commission Act (CFTCA), passed in 1974, was designed to create an independent federal regulatory commission patterned after, and similar to, the Securities and Exchange Commission.<sup>162</sup> An important mandate of the CFTCA is customer protection.<sup>163</sup> However, a 1982 amendment to the Commodity Exchange Act (CEA) encourages arbitration.<sup>164</sup> Early decisions by the court on commodities cases, before the 1982 amendment, favored an exception to the *Prima Paint* as when resolving commodities trading disputes,<sup>165</sup> but more recent decisions have clouded the issue.<sup>166</sup>

The precise issue of whether to compel arbitration in HTA disputes has been decided. In *Hodge Bros. v. DeLong Co.*, the contract states it "is made in accordance with the Trade Rules of the National Grain & Feed Association . . . and both parties agree to be bound thereby."<sup>167</sup> NGFA trade rules require any contractual disputes to be settled through NGFA arbitration.<sup>168</sup> The elevator successfully argued the *Prima Paint* policy enforcing arbitration directly applied to the case.<sup>169</sup>

The farmers countered that the *Prima Paint* standard was inapplicable because their case involved underlying contracts that called for the commission of criminal

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<sup>158</sup>. See *id.* at 826; William Lynch Schaller & Robert V. Schaller, *Applying the Wilko Doctrine's Anti-Arbitration Policy in Commodities Fraud Cases*, 61 CHI.-KENT L. REV. 515, 532 (1985).

<sup>159</sup>. See Schaller & Schaller, *supra* note 158, at 532.

<sup>160</sup>. *Beckman Instruments, Inc. v. Technical Dev. Corp.*, 433 F.2d 55 (7th Cir. 1970) (discussing the public interest in promoting free competition by allowing patent challengers to act as private attorney-generals).

<sup>161</sup>. *In re Cross Elec. Co.*, 9 B.R. 408 (Bankr. W.D. Va. 1981).

<sup>162</sup>. See Schaller & Schaller, *supra* note 158, at 524.

<sup>163</sup>. See *id.* at 525.

<sup>164</sup>. See Futures Trading Act of 1982, Pub. L. No. 97-444, 96 Stat. 2294, 2323 (codified as amended at 7 U.S.C. § 25(a)(2) (1994)).

<sup>165</sup>. For cases refusing to order arbitration, see *Milani v. Conticommodity Servs., Inc.*, 462 F. Supp. 405, 407 (N.D. Cal. 1976); *Bache Halsey Stuart, Inc. v. French*, 425 F. Supp. 1231 (D.D.C. 1977); *Breyer v. First Nat'l Monetary Corp.*, 548 F. Supp. 955, 961 (D.N.J. 1982). For cases ordering arbitration, see *Tamari v. Bache & Co.*, 565 F.2d 1194 (7th Cir. 1977), *cert. denied*, 435 U.S. 905 (1977); *Ingbar v. Drexel Burnham Lambert, Inc.*, 683 F.2d 603 (1st Cir. 1982); *Smoky Greenhaw Cotton v. Merrill Lynch Pierce Fenner & Smith, Inc.*, 720 F.2d 1446 (5th Cir. 1983); *Salcer v. Merrill Lynch Pierce Fenner & Smith, Inc.*, 682 F.2d 459 (3d Cir. 1982).

<sup>166</sup>. For a comprehensive review of cases in this field, see Schaller & Schaller, *supra* note 158, at 524.

<sup>167</sup>. *Hodge Bros. v. DeLong Co.*, 942 F. Supp. 412, 414 (W.D. Wis. 1996).

<sup>168</sup>. See *id.* The NGFA rules are contained in a booklet that is separate from the contract.

<sup>169</sup>. See *id.* at 416-17.

acts, “while *Prima Paint* involved a claim where the underlying contract was fraudulently induced . . . .”<sup>170</sup> The *Hodge Bros.* court labeled this a “distinction without a difference,”<sup>171</sup> and stated that the “rule is not limited by the type of challenge that a party makes to the underlying contract.”<sup>172</sup> The farmers also argued the *Prima Paint* rule did not apply because CFTC regulations were violated.<sup>173</sup> The court rejected this argument, again stating that resolution on this line of reasoning “would amount to resolution of the entire case in violation of both the *Prima Paint* rule and the strong federal policy favoring arbitration of disputes.”<sup>174</sup>

### C. State Law

Courts in twenty-five states have instituted, as state law, the *Prima Paint* distinction between fraud in the inducement of the contract and fraud in the inducement of the arbitration clause alone.<sup>175</sup> Six other states have no specific ruling on fraudulent inducement, but generally follow federal law on such matters.<sup>176</sup> Three

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<sup>170</sup> *Id.* at 416.

<sup>171</sup> *Id.* at 417.

<sup>172</sup> *Id.*

<sup>173</sup> *See id.*

<sup>174</sup> *Id.*

<sup>175</sup> *See* Heinig v. Hudman, 865 P.2d 110, 117-18 (Ariz. Ct. App. 1994); Rosenthal v. Great Western Fin. Sec. Corp., 926 P.2d 1061, 1074 (Cal. 1996); National Camera, Inc. v. Love, 644 P.2d 94, 95 (Colo. Ct. App. 1982); Two Sisters, Inc. v. Gosch & Co., 370 A.2d 1020, 1023 (Conn. 1976); Hercules & Co. v. Shama Restaurant Corp., 613 A.2d 916, 924 (D.C. 1992); Ronbeck Constr., Inc. v. Savanna Club Corp., 592 So. 2d 344, 346-47 (Fla. Dist. Ct. App. 1992); Robinson-Humphrey Co. v. Williams, 389 S.E.2d 345, 347 (Ga. Ct. App. 1989); Lee v. Heffel, 911 P.2d 721, 723-24 (Haw. 1996); Hecla Mining Co. v. Bunker-Hill Co., 617 P.2d 861, 865-66 (Idaho 1980); Nelson v. Roger J. Langer Co., 594 N.E.2d 391, 392-93 (Ill. App. Ct. 1992); Goebel v. Blocks & Marbles Brand Toys, Inc., 568 N.E.2d 552, 556 (Ind. Ct. App. 1991); Dacres v. John Deere Ins. Co., 548 N.W.2d 576, 578 (Iowa 1991); Holmes v. Coverall, 649 A.2d 365, 370 (Md. 1994); Quirk v. Data Terminal Sys., Inc., 400 N.E.2d 858, 861 (Mass. 1980); Frates v. Edward D. Jones, Co., 760 P.2d 748, 750-51 (Mont. 1980); Graber v. Comstock Bank, 905 P.2d 1112, 1117 (Nev. 1995); Weinrott v. Carp, 298 N.E.2d 42, 47 (N.Y. 1973); Red Springs Presbyterian Church v. Terminix Co., 458 S.E.2d 270, 273 (N.C. Ct. App. 1995); Van Syoc v. Walter, 613 A.2d 490, 491-92 (N.J. 1992); Krafcik v. USA Energy Consultants Inc., 667 N.E.2d 1027, 1029 (Ohio Ct. App. 1995); Schneider, Inc. v. Research-Cottrell, Inc., 474 F. Supp 1179, 1185 (W.D. Pa. 1979); South Carolina Pub. Serv. Auth. v. Great Western Coal Inc., 437 S.E.2d 22, 24 (S.C. 1993); Holk v. Biard, 920 S.W.2d 803, 807 (Tex. App. 1995); Pinkis v. Network Cinema Corp., 512 P.2d 751, 754-55 (Wash. Ct. App. 1973).

<sup>176</sup> *See* American Ins. Co., NAP v. Cazort, 871 S.W.2d 575, 578 (Ark. 1994); Anthony v. Kaplan, 918 S.W.2d 174, 177 (Ark. 1996); Pettinaro Constr. Co. v. Harry C. Portridge, Jr. & Sons, 408 A.2d 957, 961 (Del. Ch. 1979); Fite & Warmath Constr. Co. v. MYS Corp., 559 S.W.2d 729, 732-33 (Ky. 1977); Scalon v. P & J Enter., Inc., 451 N.W.2d 616, 617 (Mich. Ct. App. 1990); Country Kitchen of Mount Vernon, Inc. v. Country Kitchen of Western America, Inc., 293 N.W.2d 118, 119 (N.D. 1980).

states, however, have specifically deviated from the *Prima Paint* rule.<sup>177</sup> In the 1990s, these three states were joined by two other states.<sup>178</sup>

Minnesota, one of the states that deviates from the *Prima Paint* rule, has also resolved several HTA disputes. Minnesota's rule dictating when agreements to arbitrate are to be enforced when fraudulent inducement is alleged show how important this distinction can be. Under Minnesota law, disputes that would be arbitrated under the *Prima Paint* rule have been litigated in Minnesota courts.

The language of the Minnesota arbitration statutes is nearly identical to the FAA, *supra* part V. A:

A written agreement to submit any existing controversy to arbitration or a provision in a written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable, and irrevocable, save upon the grounds as exist at law or in equity for the revocation of any contract.<sup>179</sup>

Minnesota courts have chosen to interpret this language in a way entirely different than federal courts have interpreted the similarly worded FAA. *Atcas v. Credit Clearing Corp. of America*<sup>180</sup> is the watershed Minnesota case that refuses to accept the notion of a separable contract and provides that if fraud in the inducement of an entire contract is alleged, it is a matter to be resolved in court and not in an arbitration proceeding.<sup>181</sup> In *Atcas*, the Minnesota Supreme Court held that because fraud in the inducement, if proven, would invalidate the parties' contract, the same fraud would also invalidate the arbitration agreement; therefore, the issue should be resolved in court.<sup>182</sup> Similarly, the court in *Freeman v. Duluth Clinic, Ltd.*<sup>183</sup> held that a lack of consideration would invalidate a contract and thus requires court adjudication.<sup>184</sup>

Minnesota courts have recognized that the language of the arbitration clause is the linchpin that determines whether the dispute is decided in court or in arbitration. The court created a two prong test to determine if the parties to a contract intended to arbitrate a claim of fraud in the inducement of a contract. The arbitration agreement

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<sup>177</sup>. See *George Engine Co. v. Southern Shipbuilding Corp.*, 350 So. 2d 881 (La. 1977); *Atcas v. Credit Clearing Corp. of America*, 197 N.W.2d 448 (Minn. 1972); see also *Dowd v. First Omaha Sec. Corp.*, 495 N.W.2d 36, 40 (Neb. 1993) (noting a court will follow federal rule closely when interstate commerce is present).

<sup>178</sup>. See, e.g., *Shaffer v. Jeffery*, 915 P.2d 910 (Okla. 1996); *City of Blane v. John Coleman Hayes & Assoc.*, 818 S.W.2d 33, 36-38 (Tenn. Ct. App. 1991).

<sup>179</sup>. MINN. STAT. ANN. § 572.08 (West 1997).

<sup>180</sup>. *Atcas v. Credit Clearing Corp. of America*, 197 N.W.2d 448 (Minn. 1972).

<sup>181</sup>. See *id.*

<sup>182</sup>. See *id.* at 456.

<sup>183</sup>. *Freeman v. Duluth Clinic, Ltd.*, 334 N.W.2d 626 (Minn. 1983).

<sup>184</sup>. See *id.* at 629.

must either (1) specifically show such an intention, or (2) be “sufficiently broad to comprehend” the issue of fraud in the inducement.<sup>185</sup>

If the first prong is not met—specific language showing an intent to resolve an inducement dispute through arbitration—the question becomes whether the language is “sufficiently broad to comprehend” an intent to arbitrate an inducement dispute. The landmark case of *Michael-Curry Co. v. Knutson Shareholders Liquidating Trust*<sup>186</sup> states that language mandating arbitration of claims arising from “the making” of the contract is to be enforced by the courts. Included in “the making” of a contract is a claim for fraudulent inducement.<sup>187</sup> A claim of fraud in the inducement is “an issue which goes to the making of the agreement.”<sup>188</sup> The language of the disputed *Michael-Curry* contract stated: “13.01 Arbitration. Any controversy or claim arising out of, or relating to, this Agreement, or the making, performance or interpretation thereof, shall be settled by arbitration.”<sup>189</sup>

However, contracts mandating arbitration of disputes without wording such as “the making” of the contract are to be resolved by the courts as a matter of law.<sup>190</sup> The *Atcas* arbitration provision stated, “[a]ny controversy whatsoever, relating to this Agreement shall be settled by arbitration . . . .”<sup>191</sup> The court ruled this language “did not comprehend arbitration of issue of fraud in the inducement,” and thus arbitration had to be stayed pending resolution of the issue of fraudulent inducement.<sup>192</sup>

In *Stahl v. McGenty*,<sup>193</sup> arbitration of a fraudulent inducement claim was not mandated by arbitration clause.<sup>194</sup> However, because the challenging party chose to pursue damages rather than rescission, he vitiated the contract.<sup>195</sup> A person validates a contract by asking for damages.

*Fouquette v. First American National Securities, Inc.*<sup>196</sup> established the rule that a party cannot rescind a contract in part, and affirm in part, and then make a motion to stay arbitration on the grounds of fraudulent inducement.<sup>197</sup>

Minnesota courts have labored to keep federal law, as articulated in *Prima Paint*, at bay.<sup>198</sup> The Minnesota Supreme Court, in *Thayer v. American Financial*

<sup>185</sup>. *Atcas*, 197 N.W.2d at 456; see *Heyer v. Moldenhauer*, 538 N.W.2d 714, 716 (Minn. Ct. App. 1995).

<sup>186</sup>. *Michael-Curry Co. v. Knutson Shareholders Liquidating Trust*, 434 N.W.2d 671, 674 (Minn. Ct. App. 1989).

<sup>187</sup>. *See id.* at 676.

<sup>188</sup>. *Id.* at 675-76.

<sup>189</sup>. *Id.* at 674.

<sup>190</sup>. *See Atcas v. Credit Clearing Corp. of America*, 197 N.W.2d 448, 451 (Minn. 1972).

<sup>191</sup>. *Id.*

<sup>192</sup>. *Id.*

<sup>193</sup>. *Stahl v. McGenty*, 486 N.W.2d 157 (Minn. Ct. App. 1992).

<sup>194</sup>. *See id.* at 159.

<sup>195</sup>. *See id.* at 159.

<sup>196</sup>. *Fouquette v. First Am. Nat'l Sec., Inc.*, 464 N.W.2d 760 (Minn. Ct. App. 1991).

<sup>197</sup>. *See id.* at 763.

*Advisers, Inc.*, held that the FAA does not preempt application of state law in cases brought in state courts involving arbitration agreements contained in interstate contracts.<sup>199</sup> The Minnesota Appellate Court, in *Fouquette*<sup>200</sup> held that the FAA does not preempt the Minnesota Uniform Arbitration Act and, if the requirements of state law are met, an arbitration clause is non-severable from the underlying contract, thus a fraudulent inducement claim is not arbitrable.<sup>201</sup> The court ruled that just because state and federal laws reached different results in a case, they do not “conflict” under these facts. The court also said the history and language of the FAA does not indicate an intention to preempt state regulation of arbitration agreements that are a part of contracts involving interstate commerce—an opinion of questionable validity, given *Prima Paint*,<sup>202</sup> *Southland Corp. v. Keating*,<sup>203</sup> and *Allied-Bruce Terminix Cos. v. Dobson*.<sup>204</sup>

The Minnesota distinction between contracts “arising under” and “in the making” has been rigorously applied to HTA disputes in Minnesota courts. This year, Minnesota District Court Judge Lawrence E. Agerter has twice ruled on compelling HTA disputes to go to NGFA arbitration when fraudulent inducement has been alleged. Both times he has strictly applied the *Atcas* and *Michael-Curry* rules. In *Hunting Elevator v. Kraetsch Bros.*,<sup>205</sup> the Judge stayed a motion to compel arbitration because he held the following contract term fell within the *Atcas* rule: “The parties to this contract agree that the sole remedy for resolution of any and all disagreements or disputes arising *under this contract* shall be through arbitration proceedings before the NGFA under NGFA arbitration rules.”<sup>206</sup>

A few months earlier, a judge compelled arbitration in *Cannon Valley Cooperative v. Gibbs Family Farms, Inc.*<sup>207</sup> The judge based the decision on a finding that the following provision fell within the *Michael-Curry* rule: “Resolution of any and all disagreements or disputes arising under or related to this contract

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<sup>198</sup>. See *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 409 (1967).

<sup>199</sup>. *Thayer v. American Fin. Advisers, Inc.*, 322 N.W.2d 599, 603 (Minn. 1982).

<sup>200</sup>. See *Fouquette*, 464 N.W.2d at 760.

<sup>201</sup>. See *id.* at 763.

<sup>202</sup>. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967).

<sup>203</sup>. *Southland Corp. v. Keating*, 465 U.S. 1 (1984) (stating that FAA preempts state law in state courts in arbitration contracts evidencing interstate commerce).

<sup>204</sup>. *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 266 (1995) (eliminating finding the intent of parties to contract evidencing commerce; evidencing commerce is a functionally different standard from interstate commerce). For a full discussion, see Scott R. Sweir, *The Tenuous Tale of the Terrible Termites: The Federal Arbitration Act and the Court's Decision to Interpret Section Two in the Broadest Possible Manner: Allied-Bruce Terminix Companies, Inc. v. Dobson*, 41 S.D. L. Rev. 131 (1996).

<sup>205</sup>. *Hunting Elevator v. Kraetsch Bros.*, No. C7-97-273 (3d Dist. Minn. July 30, 1997) (mem.) (Findings of Fact, Conclusions of Law, and Order).

<sup>206</sup>. *Id.* at 6 (emphasis added).

<sup>207</sup>. *Cannon Valley Coop. v. Gibbs Family Farms, Inc.*, No. C6-96-528 (3d Dist. Minn. Apr. 24, 1997) (mem.) (Findings of Fact, Conclusions of Law, and Order).

(including disputes as to whether a contract has been validly formed) shall be through arbitration proceedings.”<sup>208</sup> Furthermore, the defendant sought actual and treble damages. As discussed previously, this form of pleading negates the validity of the *Atcas* rule.<sup>209</sup>

#### D. Outcome of Differing Law on HTA Cases

HTA disputes arising in federal and Minnesota courts illustrate the different approach each jurisdiction takes to arbitrating fraudulent inducement and how that approach determines the outcome of motions to compel arbitration. Given the factual similarities of *Hodge Bros.*,<sup>210</sup> and *Kraetsch Bros.*,<sup>211</sup> an analysis of the two cases provides a useful comparison. In both cases elevators wrote HTA contracts under which all disputes were to be resolved through NGFA arbitration committees. The contract provisions bound the parties by reference to the NGFA’s Trade Rules that were outlined in a booklet separate from the signed contract.

Ironically, the *Kraetsch Bros.* contract more specifically bound the parties to NGFA arbitration than did the contract in *Hodge Bros.* The relevant language in *Kraetsch Bros.* stated that resolution of the disputes “arising under this contract shall be through arbitration proceedings before the NGFA under NGFA Arbitration Rules,”<sup>212</sup> whereas the *Hodge Bros.* contract only states it is made “in accordance with Trade Rules” of the NGFA.<sup>213</sup> Yet *Hodge Bros.* was sent to arbitration and *Kraetsch Bros.* was not. The federal court’s liberal policy toward arbitration is clear. Even if the farmers in *Hodge Bros.* had access to the trade rules booklet, they had to find and read Rule 42 to discover that any disputes had to be submitted to the NGFA Arbitration Committee.<sup>214</sup>

The preamble to the NGFA Trade Rules is cited in both decisions.<sup>215</sup> According to the preamble, the scope of the rules includes “all disputes of a financial, mercantile, or commercial character connected with grain.”<sup>216</sup> Also, Rule 42 requires arbitration of such disputes through the NGFA.<sup>217</sup> In *Kraetsch Bros.*, the court states that the *Hodge Bros.* decision “took a leap of faith to find that the issue of fraud in the inducement was arbitrable, which the courts of this state, including this court, will

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<sup>208</sup>. *Id.* at 4.

<sup>209</sup>. *See id.* at 5.

<sup>210</sup>. *Hodge Bros. v. DeLong Co.*, 942 F. Supp. 412 (W.D. Wis. 1996).

<sup>211</sup>. *Hunting Elevator v. Kraetsch Bros.*, No. C7-97-273 (3d Dist. Minn. July 30, 1997) (mem.) (Findings of Fact, Conclusions of Law, and Order).

<sup>212</sup>. *See id.* at 6.

<sup>213</sup>. *See Hodge Bros.*, 942 F. Supp. at 414.

<sup>214</sup>. *See* NGFA RULES, *supra* note 86, Grain Trade Rule 42.

<sup>215</sup>. *See Kraetsch Bros.*, No. C7-97-273 at 4; *Hodge Bros.*, 942 F. Supp. at 412.

<sup>216</sup>. NGFA RULES, *supra* note 86, Grain Trade Rule 1.

<sup>217</sup>. *See id.* Rule 42.

not take.”<sup>218</sup> Not only was the language of the contract in *Kraetsch Bros.* too narrow for the court to hold that fraudulent inducement was contemplated when the contract was signed, but the language of the NGFA Trade Rules was also insufficiently broad.<sup>219</sup> This was not the case in *Hodge Bros.*, where the judge felt the reference to NGFA Trade Rules was sufficient to comprehend fraudulent inducement.<sup>220</sup>

#### E. Summary

The federal court’s interpretation of the FAA and the rule fashioned in *Prima Paint* is one that subverts a legal principle fundamental to our system of justice: legal disputes are to be adjudicated by the judiciary. Fraudulent inducement of a contract is, by any standard, a legal issue encompassing statutory and common law rules. Justice Black eloquently stated the profound implications of abandoning this legal principle in his dissenting opinion in *Prima Paint*:

The Court holds, what is to me fantastic, that the legal issue of a contract’s voidness because of fraud is to be decided by persons designated to arbitrate factual controversies arising out of a valid contract between parties. And the arbitrators who the Court holds are to adjudicate the legal validity of the contract need not even be lawyers, and in all probability will be nonlawyers, wholly unqualified to decide legal issues, and even if qualified to apply the law, not bound to do so.<sup>221</sup>

These concerns have been realized in the HTA crisis throughout the Midwest. *Hodge Bros.* shows that the federal courts are willing to send to arbitration HTA disputes that include accusations of fraudulent inducement to contract. The federal courts have clearly based their arbitration position on policy reasons. In support of its liberal policy toward arbitration, the *Robert Lawrence* court held it was honoring the intent of Congress and those who sign contracts with arbitration provisions.<sup>222</sup> The court also noted that its liberal policy toward arbitration would help ease crowded court calendars.<sup>223</sup>

The challenge of easing court calendars should not be met by subverting the time honored principle of resolving legal disputes in a court room. The Second Circuit stated that its decision honors the intent of those who sign contracts with arbitration provisions.<sup>224</sup> Yet, if fraudulent inducement to a contract is alleged, the true intent of the parties is unknown. Deceptive practices could induce a party to

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<sup>218</sup>. See *Kraetsch Bros.*, No. C7-97-273 at 4.

<sup>219</sup>. See *id.*

<sup>220</sup>. See *Hodge Bros. v. Delong Co.*, 942 F. Supp. 412 (W.D. Wis. 1996).

<sup>221</sup>. *Prima Paint v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 407 (1967) (Black, J., dissenting).

<sup>222</sup>. See *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402, 406 (2d. Cir. 1959).

<sup>223</sup>. See *id.* at 410.

<sup>224</sup>. See *id.* at 411-12.

sign a contract and the deception could extend to how disputes would be arbitrated and federal courts would still compel arbitration. Courts in Minnesota,<sup>225</sup> Louisiana,<sup>226</sup> Nebraska,<sup>227</sup> and more recently Tennessee<sup>228</sup> and Oklahoma,<sup>229</sup> have recognized this policy as unfair, unjust, and untenable in their respective jurisdictions.

Both *Robert Lawrence* and *Prima Paint* state that they are upholding the will of Congress, as it is codified in the FAA.<sup>230</sup> But, Justice Black in his *Prima Paint* dissent<sup>231</sup> and Justice O'Connor in her *Southland* dissent<sup>232</sup> disagree with this interpretation as a comprehensive and compelling reading of the FAA's history. Justice Black stated in his dissent that "35 years after the passage of the Arbitration Act, the Second Circuit [in *Robert Lawrence*] completely rewrote it."<sup>233</sup> Black felt it was clear Congress never intended to "trespass upon the courts' prerogative to decide the legal question of whether" an arbitration provision is legally valid.<sup>234</sup> Justice Black quotes § 2 of the Act which states that arbitration agreements are valid and enforceable, "save upon such grounds as exist at law or in equity for the revocation of any contract."<sup>235</sup> He correctly notes that "[f]raud, of course, is one of the most common grounds for revoking a contract."<sup>236</sup> Besides textual analysis, legislative history is cited to support this understanding, which includes a quote from an ABA member who lobbied for the FAA,<sup>237</sup> and an ABA member who drafted the Act.<sup>238</sup>

Justice O'Connor picks up the torch from Justice Black in her 1984 dissenting opinion in *Southland*, providing even more evidence that the FAA was not intended to create federal substantive law, and certainly was not applicable in state court.<sup>239</sup>

The federal rule on arbitration is based on the policy preference of the court. It is an unfair and unjust policy not only because at a philosophical level legal disputes should be resolved in a court of law, but also because the outcome of this policy has had a profound and negative impact on persons alleging fraudulent inducement. Justice Black, a fierce critic of arbitration, found two reasons to enforce arbitration

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225. See *Atcas v. Credit Clearing Corp. of America*, 197 N.W.2d 448 (Minn. 1972).

226. See *George Engine Co. v. Southern Shipbuilding Corp.*, 350 So. 2d 881 (La. 1977).

227. See *Dowd v. First Omaha Sec. Corp.*, 495 N.W.2d 36 (Neb. 1993).

228. See *City of Blane v. John Coleman Hayes & Assoc.*, 818 S.W.2d 33 (Tenn. Ct. App. 1991).

229. See *Shaffer v. Jeffery*, 915 P.2d 910 (Okla. 1996).

230. See *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402, 406 (2d. Cir. 1959); *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 403-04 (1967).

231. See *Prima Paint Corp.*, 388 U.S. at 401.

232. See *Southland Corp. v. Keating*, 465 U.S. 1, 21 (1984).

233. See *Prima Paint Corp.*, 388 U.S. at 421.

234. See *id.* at 408.

235. *Id.* at 412.

236. *Id.*

237. See *id.*

238. See *id.*

239. See *Southland Corp. v. Keating*, 465 U.S. 1, 23 (1984).



agreements: (1) the expertise of an arbitrator to decide factual questions in regard to the day-to-day performance of contractual obligations, and (2) the speed with which arbitration could resolve disputes, thus allowing continued performance under the contract in dispute.<sup>240</sup> Arbitration, however, serves neither of these functions where contract rescission is sought on the ground of fraud. Clearly fraud in the inducement is not a question of fact. It is a question of law, and arbitration organizations such as the NGFA do not have the expertise to handle legal disputes with skill and fairness. Furthermore, when fraudulent inducement is alleged, rarely would the disputing parties intend to resume performance under the contract.

Choosing not to conceal his mistrust of arbitration, Justice Black also mentioned his concern over due process when enforcing arbitration contracts:

The only advantage of submitting the issue of fraud to arbitration is for the arbitrators. Their compensation corresponds to the volume of arbitration they perform. If they determine that a contract is void because of fraud, there is nothing further for them to arbitrate. I think it raises serious questions of due process to submit to an arbitrator an issue which will determine his compensation.<sup>241</sup>

While this dark view of arbitration may not be applicable to all arbitration organizations, certainly the federal courts have devised no mechanism to address due process concerns for arbitration organizations. Beyond the issue of individual arbitrators having conflicts of interest, many arbitration organizations are instituted for the benefit of a parent organization. This is the case with the NGFA, an organization created and maintained for the good of its members.<sup>242</sup>

If the federal courts are unwilling to re-examine the basis for their arbitration policy, the immediate alternative is to reconsider revitalizing the exception set out in *Wilko*.<sup>243</sup> Under the *Wilko* doctrine, courts have effectively enforced statutory rules that prevent arbitration of disputes in the field of securities law, patent law, and others. The doctrine has been applied to commodities cases before, and could be applied to them again.

The court in *American Safety* correctly went beyond the explicit congressional mandates found in the Sherman Antitrust Act to examine the Act's underlying premise.<sup>244</sup> The court held that arbitration of antitrust disputes was contrary to the Congress' intent to protect consumers.<sup>245</sup> Similarly, the policy behind the CFTCA is to protect consumers from unscrupulous commodities traders. Even with the 1982

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<sup>240</sup>. See *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 415 (1967).

<sup>241</sup>. *Id.* at 416.

<sup>242</sup>. See NGFA RULES, *supra* note 86, Arbitration Rule § 1.

<sup>243</sup>. For a discussion of the *Wilko* doctrine, see *supra* Part V.B.

<sup>244</sup>. See *American Safety Equip. Corp. v. J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968).

<sup>245</sup>. See *id.* at 826-27.

amendment endorsing arbitration, the policy of protecting consumers from unethical behavior including fraudulent inducement to contract remains.

It is incumbent upon the federal judiciary to provide some guarantee that arbitration is fair. One way to alter the *Prima Paint* holding while respecting *stare decisis* is to make an addition to the two prong rule. After determining whether there is a provision that mandates arbitration, and if there is an intent to arbitrate disputes arising from the making of the contract, a third standard should be met for validating an arbitration provision. Standards such as those promulgated by the CFTC, *supra* Part III, for fair arbitration provide a ready basis for the courts to fashion a third prong.

## VI. PRACTITIONER'S GUIDE

### A. Federal Court

When a practitioner is in federal court with a case involving an HTA arbitration clause, the following alternatives are available:

- (1) Plead fraudulent inducement of the arbitration clause;
- (2) Argue for the U.S. Supreme Court reversal of *Prima Paint*;
- (3) Argue for expansion of the *Wilko* doctrine to cover HTA disputes on the basis of CEA and public policy; or
- (4) Argue that the court should review the arbitration process to determine that the procedure is fair and equitable.

### B. Minnesota

Practitioners fortunate enough to be docketed in Minnesota have realistic options available to them if they plead fraudulent inducement of the contract. The argument could be made that other theories could also be litigated rather than arbitrated. The first step would be to review the language of the arbitration clause. If there is no language referring to the "making of the contract," then a close analysis of the *Atcas* doctrine is in order. As a final word of caution, pleading rescission and damages in the alternative, even though a normal practice, will preclude the use of the *Atcas* doctrine.