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Hedge to Arrive Contracts: Futures or Forwards

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Hedge To Arrive Contracts: Futures Or Forwards

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I. INTRODUCTION

Although the Commodity Futures Modernization Act of 2000[1] (CFMA) reformulated the Commodity Exchange Act[2] (CEA), Congress chose to preserve the distinctions between agricultural commodities and all others, leaving the pre-CFMA provisions largely intact.[3] This means that the pre-CFMA statutes and case law interpreting them continue to apply with full force to transactions involving agricultural commodities, and the agricultural markets seem therefore to have escaped the statutory modernization brought by the CFMA to the financial derivatives markets. Since the middle

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1. Commodity Futures Modernization Act of 2000 (CFMA), 7 U.S.C.A. §§ 1-25 (West Supp. 2004).

2. Commodity Exchange Act (CEA), 7 U.S.C. §§ 1-25 (2000), *amended by* 7 U.S.C. §§ 1-25 (Supp. II 2002), CFMA, 7 U.S.C.A. §§ 1-25 (West Supp. 2004).

3. Thus, CFMA sections 101(13) and 101(14) set forth three categories of commodities: excluded, exempt, and agricultural. The definition of commodity, with its specific recital of agricultural commodities in section 101(4), was left unchanged from the original CEA. *Compare* CEA § 101(3), 7 U.S.C. § 1a(3) (2000), *with* CFMA § 101(4), 7 U.S.C.A. § 1a(4) (West Supp. 2004). Transactions in excluded and exempt commodities received certain exclusions and exemptions from the application of the CFMA, while agricultural commodities did not. CFMA §§ 103, 105-106, 7 U.S.C. § 2(d), (g)-(h) (West Supp. 2004). CFTC Commissioner Sharon Brown-Hruska has pointed out that much needs to be done to bring innovation to the agricultural markets, and although that task is ultimately up to Congress to perform, the CFTC can also make a contribution by bringing "clarity to contracting practices in the agricultural markets so that innovators understand where the boundaries are between what are legal cash contracts and what crosses the line into the Commission's jurisdiction." CFTC Commissioner Sharon Brown-Hruska, Address at the National Grain and Feed Association Seminar on Trading, Trade Rules, and Dispute Resolution (May 4, 2004), *available at* http://www.cftc.gov/opa/speeches04/opabrown-hruska-13.htm [hereinafter Brown-Hruska Address, May 4, 2004].

1990s, transactions involving Hedge to Arrive Contracts (HTAs) between producers and grain merchants[4] have sparked controversy as well as litigation.[5] The central question arising with respect to HTA transactions is whether they are futures contracts to which the CEA applies, or whether they are excluded from the CEA as forward contracts.[6]

The distinction between futures and forwards is legally elusive and difficult to apply due in some measure to the risk-shifting functions shared by both. Futures contracts, it is agreed, are exclusively risk-shifting mechanisms in which the transaction is in the contract, and not in the commodity.[7] But forward contracts, though they are designed primarily for merchandizing commodities between parties in the industry, also perform risk management functions.[8] Moreover, both futures and forwards play an important role by underpinning a variety of financial instruments.[9] Therefore, the articulation of a clear and predictable legal standard for determining whether a contract is a futures or a forward contract has implications extending far beyond the HTA debate.[10]

The dominant paradigm for distinguishing futures from forwards has been the multifactor, holistic, or facts and circumstances approach[11] attributed to *CFTC v. Co Petro Marketing Group, Inc.*[12]

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4. The term "grain merchants" will be used to denote grain elevators, grain cooperatives, and any other commercial entity entering into HTAs with grain producers.

5. *See, e.g.*, Erik Askelsen, Comment, *Hedge-to-Arrive Contracts and the Commodity Exchange Act*, 7 KAN. J.L. & PUB. POL'Y, Spring 1998, at 122, 127 (describing the resulting lawsuits "challenging the legality of hedge-to-arrive contracts"); Jennifer Durham King & James J. Moylan, *Hedge-to-Arrive Contracts: Jurisdictional Issues Under the Commodity Exchange Act*, 18 N. ILL. U. L. REV. 481, 481 (1998) (describing the strain of otherwise good relations between farmers and grain elevators because of the resulting litigation).

6. *See, e.g.*, Johnson v. Land O' Lakes, Inc., 18 F. Supp. 2d 985, 988 (N.D. Iowa 1998) (finding that the "key question" in HTA cases is whether HTA contracts are "illegal off-exchange 'futures' contracts under the Commodities Exchange Act (CEA) . . . or valid 'cash forward' contracts not within the regulatory purview of the CEA"); Charles F. Reid, Note, *Risky Business: HTAs, the Cash Forward Exclusion and* Top of Iowa Cooperative v. Schewe, 44 VILL. L. REV. 125, 127 (1999) ("The most contentious issue . . . is whether HTAs are valid cash forward contracts or 'futures' contracts that can be traded only on exchanges subject to Commodity Futures Trading Commission ('CFTC') regulation.") (footnote omitted).

7. Oeltjenbrun v. CSA Investors, Inc., 3 F. Supp. 2d 1024, 1034 (N.D. Iowa 1998).

8. *Id.* at 1035-36.

9. *In re* Grain Land Coop. [2003] 2 Comm. Fut. L. Rep. (CCH) ¶ 29,636, at 55,750 (C.F.T.C. Nov. 25, 2003) (Brown-Hruska, Comm'r, concurring).

10. *Id. See also* CFTC v. Zelener, 373 F.3d 861, 867-69 (7th Cir. 2004) (holding that foreign currency rollover transactions, like HTA contracts, are forward contracts) (citing, *inter alia*, Nagel v. ADM Investor Servs., Inc., 217 F.3d 436 (7th Cir. 2000); Lachmund v. ADM Investor Servs., Inc., 191 F.3d 777 (7th Cir. 1999)).

11. The Commission prefers the term "facts and circumstances." *Id.* These terms will be used interchangeably throughout the Article.

12. CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d 573 (9th Cir. 1982); *see id.* at 581 (describing the facts and circumstances approach). However, some commentators have argued that the multifactor approach

This approach is fact-specific in viewing the totality of circumstances surrounding the transaction at issue.[13] In recent years, critics have argued that the multifactor approach fosters legal uncertainty, thereby promoting litigation with its attendant social costs.[14] In dissenting from the CFTC's conclusion that the HTA contracts in *In re Competitive Strategies for Agriculture*[15] were illegal off-exchange futures contracts,[16] Commissioner Sharon Brown-Hruska identified the weaknesses of the facts and circumstances approach,[17] echoing themes expressed in *In re Cargill, Inc.*[18] and by Judge Frank Easterbrook in *Nagel v. ADM Investor Services*.[19] Among its weaknesses, according to Commissioner Brown-Hruska, are "the incongruity of results arising from application of this standard," and that the approach "discourages . . . innovation in the agricultural markets" as well as impeding

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antedates *CFTC v. Co Petro Marketing Group, Inc.*, and owes its origins to the CFTC decision of *In re Stovall*. *See* Edward M. Mansfield, *Textualism Gone Astray: A Reply to Norris, Davison, and May on Hedge to Arrive Contracts*, 47 DRAKE L. REV. 745, 753 (1999) (citing *In re* Stovall, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,941 (C.F.T.C. Dec. 6, 1979)).

13. CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d at 581; Lachmund v. ADM Investor Servs., Inc., 191 F.3d 777, 787-88 (7th Cir. 1999).

14. *See, e.g.*, Glenn L. Norris et al., *Hedge to Arrive Contracts and the Commodity Exchange Act: A Textual Alternative*, 47 DRAKE L. REV. 319, 330-35 (1999) (arguing that the court's approach in *Co Petro* was flawed).

15. *In re* Competitive Strategies for Agric., Ltd., [2004] 2 Comm. Fut. L. Rep. (CCH) ¶ 29,635 (C.F.T.C. Mar. 15, 2004).

16. *Id.* at 55,735.

17. *Id.* at 55,735-38 (Brown-Hruska, Comm'r, dissenting).

18. *In re* Cargill, Inc., [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,425 (C.F.T.C. Nov. 22, 2000). ALJ Levine criticized "the uncertain law surrounding the forward contract exclusion," *id.* at 51,226, as it has been formulated under the holistic approach, pointing to abundant litigation surrounding HTA contracts:

> First a word (actually more than a word) about this "multifactor approach," before we proceed to apply it. Although the Commission recognizes that the approach's "holism" lacks clarity in application, it has continued (as recently as September 2000) to steadfastly defend it. The resulting uncertainty of the approach leaves in question the enforceability of all new contracts not specifically approved, thus increasing the costs of experimentation. This is something more than an academic concern. The recent wave of lawsuits arising out of Hedge-To-Arrive ("HTA") contracts demonstrates the high costs associated with experimenting under the uncertain law surrounding the forward contract exclusion. Over the last few years, producers who entered into HTA contracts have attempted to eliminate their obligations under these contracts by claiming that they are unenforceable as unregulated futures contracts in violation of the Act. Although the courts have been thwarting the producers' opportunistic behavior, the social costs associated with the commercial disruption and the eruption of litigation spawned by the producers' efforts are unrecoverable.

Id. at 51,225-26 (footnotes omitted).

19. Nagel v. ADM Investor Servs., Inc., 65 F. Supp. 2d 740, 750-52 (N.D. Ill. 1999) (criticizing and refusing to utilize the multifactor approach).

"efforts to provide clarity and legal certainty in both our statute and in our regulation."[20] Moreover, Commissioner Brown-Hruska found fault with the methodology of the approach, which relies on "*ex post* observation to deduce what the parties intended," rather than giving "controlling significance to contract terms."[21] In addition, Commissioner Brown-Hruska argued that this approach discourages innovation in agricultural markets and impedes the development of new structures and transactions facilitating commercial exchange.[22]

Though the multifactor approach has been the predominant analytic framework used by courts and the CFTC in determining whether HTAs are futures or forwards, dissatisfaction with the legal uncertainty has led to an alternate framework proposed in *Nagel*[23] and adopted by Commissioner Brown-Hruska in her concurring opinion in *In re Grain Land Cooperative*.[24] The *Nagel* approach identifies three specific factors (terms of the contract, status of the contracting parties, and the obligation of delivery) that are determinative of whether an HTA contract is a futures or a forward contract.[25] The objective of the *Nagel* framework is to offer greater prospective certainty as to the status and validity of a contract such as the HTA under the CEA.

Whether or not the multifactor approach or the *Nagel* three-factor approach is used, however, most courts considering disputes involving HTA contracts have found them to be forward contracts.[26] Yet the CFTC has viewed them as futures contracts and has filed enforcement actions against grain merchants and other commercial entities such as futures commission merchants (FCMs), introducing brokers (IBs), and agricultural marketing and consulting services that have promoted, marketed, sold, and entered into such contracts with agricultural producers.[27] Administrative Law Judges (ALJs) have

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20. *In re* Competitive Strategies for Agric., Ltd., [2004] 2 Comm. Fut. L. Rep. (CCH) at 55,735 (Brown-Hruska, Comm'r, dissenting).

21. *Id.*

22. Brown-Hruska Address, May 4, 2004, *supra* note 3.

23. Nagel v. ADM Investor Servs., Inc., 217 F.3d 436, 441 (7th Cir. 2000) (outlining the three factors).

24. *In re* Grain Land Coop., [2003] 2 Comm. Fut. L. Rep. (CCH) ¶ 29,636, at 55,752-53 (C.F.T.C. Nov. 25, 2003).

25. Nagel v. ADM Investor Servs. Inc., 217 F.3d at 441.

26. For example, all appellate courts reaching the issue have found that HTAs are valid cash forward contracts. *See*, *e.g.*, *id.*; Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d 983, 992 (8th Cir. 1999); Haren v. Conrad Coop., 198 F.3d 683, 684 (8th Cir. 1999); Lachmund v. ADM Investor Servs., Inc., 191 F.3d 777, 790 (7th Cir. 1999); Andersons, Inc. v. Horton Farms, Inc., 166 F.3d 308, 322 (6th Cir. 1998). Commissioner Brown-Hruska, in her dissenting opinion in *In re Competitive Strategies for Agriculture, Ltd.*, also noted that while courts and the CFTC have used the same analytic framework, they have reached differing conclusions as to whether HTAs are futures or forward contracts. *In re* Competitive Strategies for Agric., Ltd. [2004] 2 Comm. Fut. L. Rep. (CCH) at 55,737-38 & n.18 (C.F.T.C. Mar. 15, 2004).

27. *See, e.g.*, *In re* Competitive Strategies for Agric., Ltd., [2004] 2 Comm. Fut. L. Rep. (CCH) at 55,723; *In re* Grain Land Coop., [2004] 2 Comm. Fut. L. Rep. (CCH) at 55,740; *In re* Farmers Coop. Co., No. 99-6, 1999 CFTC LEXIS 9, at *1 (C.F.T.C. Jan. 12, 1999); *In re* Roger J. Wright, No. 97-2, 1996 CFTC LEXIS 221, at *1, 20-28 (C.F.T.C. Nov. 13, 1996); *see also* 1996 CFTC Ltr. LEXIS 90, at *1 (C.F.T.C. Nov. 13, 1996)

authored CFTC initial opinions wherein they have concluded that HTA contracts are futures contracts.[28] Subsequent decisions by the CFTC on appeal have produced inconsistent results.[29]

Why do federal courts and the CFTC disagree?[30] The reasons may lie in the disparate goals of courts resolving disputes between private litigants and the regulatory mandates of an agency. Commissioner Brown-Hruska attributes the difference, in part, to "a paternalistic concern for the welfare of individual farmers," who may require greater regulatory protection than ordinary commercial entities, which she says has a "long tradition" in the CFTC's jurisprudence.[31] However, it may also be the case that the dominant multifactor approach is conducive to inconsistent results, particularly when applied to new instruments such as the HTA contract.[32]

The purpose of this Article is to examine the case law surrounding HTA contracts and the CFTC's treatment of HTAs, focusing on the analysis used to categorize HTAs as futures or forward contracts. The Article concludes that although the *Nagel* approach appears to provide greater certainty than the traditional multifactor, holistic approach, the inherent ambiguities in the statutory scheme—which are enhanced when new instruments such as HTAs are involved—are not easily resolved.

(press release announcing filing of three separate administrative complaints related to HTAs).

28. *See, e.g.*, *In re* Grain Land Coop., No. 97-1, 1998 CFTC LEXIS 317, at *96 (C.F.T.C. Nov. 6, 1998) (resulting from administrative enforcement action brought by CFTC). This was the first case brought by the CFTC to reach a disposition on the merits. *Id.* at *63 & n.18; *In re* Competitive Strategies for Agric., Ltd., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 48,688-90 (concluding that HTA contracts between farmers and Great Plains Cooperative were futures contracts).

29. *See In re* Competitive Strategies for Agric., Ltd., [2004] 2 Comm. Fut. L. Rep. (CCH) at 55,735 (finding futures contracts). *But see In re* Grain Land Coop., [2003] Comm. Fut. L. Rep. (CCH) at 55,750 (finding cash forward contracts).

30. *See* Christina A. Barone, Note, *The Hedge-to-Arrive Controversy: Conflicting Outcomes in Administrative and Judicial Proceedings*, 52 ADMIN. L. REV. 1423, 1425-27 (2000) (discussing disparate results between courts and the CFTC's resolution of HTA disputes).

31. *In re* Competitive Strategies for Agric., Ltd., [2004] 2 Comm. Fut. L. Rep. (CCH) at 55,737 (Brown-Hruska, Comm'r, dissenting).

32. Barone concludes that the CFTC's view of the law surrounding futures and forward contracts rested on the traditional multifactor approach, while courts relied on a "narrow view of the contracts focusing on three factors" due to a concern that deeming HTAs to be illegal futures contracts probably would have resulted in thousands of producers being relieved of the obligation of delivering grain under the contracts. Barone, *supra* note 30, at 1439 & n.88. As discussed below, however, courts and the CFTC alike applied essentially the same multifactor paradigm. *See, e.g.*, Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d 983, 993 (8th Cir. 1999) (rejecting the CFTC's preliminary administrative findings of CEA violations "through [the elevator's] marketing and use of HTAs," but noting that the court had followed the CFTC's "general approach . . . by looking to the transaction's ultimate purpose" in determining the same HTAs to be enforceable forward contracts).

II. HEDGE TO ARRIVE CONTRACTS

Commercial transactions in agricultural commodities are inherently subject to uncertainty and seasonal variations in the price of those commodities.[33] Forward contracts are among the primary risk management devices that have been developed for merchandizing agricultural commodities. Forward contracts "delay or defer the delivery of a commodity for commercial reasons."[34] As the CFTC has noted, forward contracts "have been an integral part of the grain industry in the U.S. for well over a century."[35] Forward contracts are statutorily excluded from the CEA and the jurisdiction of the CFTC because they are deemed to be contracts for "any sale of any cash commodity for deferred shipment or delivery."[36]

In the early 1990s, in light of new marketing arrangements, HTA contracts between producers and grain merchants were developed. HTAs were long-term contracts between producers and grain merchants designed to "capture unusually attractive price levels for one or more years of expected production."[37] HTAs[38] provided for delivery, at an unspecified time, of a fixed quantity and grade of grain,[39] by the producer to the grain merchant. The contract price typically

> was determined by reference to a futures contract price from the Chicago Board of Trade (CBOT) . . . plus or minus a variable component referred to as "basis." Basis [was] the difference between the price of the designated futures contract and the cash price for that same commodity. While the CBOT reference price was fixed at the time of the contract, the basis was allowed to float until [the producer] elected to fix it,[40]

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33. CFTC Economic Analysis, No. 96-41, 1996 CFTC Ltr. LEXIS 145, at *3-4 (C.F.T.C. May 15, 1996).

34. *Id.* at *6.

35. *Id.* (footnote omitted).

36. *See* 7 U.S.C. § 1a(19) (2000).

37. Sergio H. Lence & Marvin L. Hayenga, *On the Pitfalls of Multi-Year Rollover Hedges: The Case of Hedge-to-Arrive Contracts*, 83 AM. J. AGRIC. ECON. 107, 107 (2001). Lence and Hayenga argue that it is economically infeasible for multiyear rollover hedges to succeed in locking in high current prices for crops to be harvested one or more years in the future. *Id.* at 116-19.

38. While obviously there was individual variation in the specific terms of HTA contracts, these contracts had significant structural commonalities, on which this discussion focuses. By and large, it is the "Flexible" or "Flex" HTAs that were the subject of dispute. The flex HTAs permitted rolling delivery dates, including an indefinite number of rolls. *See* Nagel v. ADM Investor Servs., Inc., 65 F. Supp. 2d 740, 748 (N.D. Ill. 1999) (defining a flex HTA as "a normal HTA plus an option to defer delivery").

39. For the most part, the agricultural product involved in HTA litigation was corn. Askelsen, *supra* note 5, at 139 n.4.

40. Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d 983, 987 (8th Cir. 1999).

which had to be done by a time specified in the contract.[41] If the producer failed to set the basis prior to the appointed time, the elevator was afforded the right to set the basis and thereby the sale price of the grain.[42]

The HTAs marketed by grain merchants typically allowed producers to "roll" the contract indefinitely, thereby deferring delivery of the grain to a later month, with the rolls corresponding to intervals separating delivery months for the futures contracts on the CBOT.[43] The price of the contract changed with each roll, and the extent of the change depended on "the spread between the prices of certain futures contracts on the CBOT."[44] The spread would be added to or subtracted from the original future reference price.[45] The producer could roll delivery on the contract without paying margins or commissions.[46] Because the producer could benefit from the fluctuating prices of the commodity by contracting to deliver, while avoiding costs attendant on the fluctuation, HTAs were attractive to producers. "A producer's main benefit under a hedge-to-arrive contract is that the elevator incurs the margin calls that result from the futures transaction. Margin calls are increased deposits required by brokers when the price of futures contracts increase."[47]

Grain merchants such as grain elevators, however, also benefited from the HTA contracts because they attracted business and generated revenue.[48] Elevators typically charged a fee to the producers for the sale of the contracts and an additional fee each time the contract was rolled.[49] In addition, grain merchants hedged their HTAs by buying an opposite exchange-traded futures contract which corresponded to the parameters of the HTA which they had sold to the producer.[50]

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41. *Id.*

42. *Id.*

43. Norris et al., *supra* note 14, at 322-23.

44. *Id.* at 323.

45. Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d at 987.

46. Top of Iowa Coop. v. Schewe, 6 F. Supp. 2d 843, 848 (N.D. Iowa 1998) (quoting HTA contract at issue). Lence and Hayenga note that "[a] distinctive feature of HTAs is that the corresponding futures transactions are performed by the elevator or merchandiser rather than by the farmer," with "the party responsible for the financial guarantees (margin requirements) required by the futures brokerage firm [being] the elevator or merchandiser, not the farmer." Lence & Hayenga, *supra* note 37, at 107.

47. Askelsen, *supra* note 5, at 124 (footnotes omitted); *see, e.g.*, *In re* Roger J. Wright, No. 97-2, 1996 CFTC LEXIS 221, at *4 (C.F.T.C. Nov. 13, 1996) (issuing an administrative complaint alleging a marketer stated that HTAs "would enable customers to speculate in the regulated futures and options markets without posting margin or paying option premiums in advance").

48. *See* Askelsen, *supra* note 5, at 125 (discussing the potential benefits of HTAs to grain elevators).

49. *See In re* Grain Land Coop., No. 97-1, 1998 CFTC LEXIS 270, at *84 n.28 (C.F.T.C. Nov. 6, 1998) (describing the two cent rolling fee charged by Grain Land, which was "subtracted before the new futures reference price [was] computed").

50. *See, e.g.*, *In re* Farmers Coop. Co., [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶

The Seventh Circuit Court of Appeals in *Harter v. Iowa Grain Co.*[51] provided a succinct explanation of HTA contracts:

> Farmers often contract to sell grain to grain elevators at some specific time in the future. Such contracts guarantee farmers a buyer for their grain and guarantee grain elevators a supply of a commodity. The contracts generally specify the quantity and quality of grain to be sold, as well as a delivery date and a price for the grain. Both parties, by agreeing in advance to the grain price, take a risk that the market will move against them. The farmer's risk is that grain prices will be higher at the time of delivery, thus causing him to forego profit by selling at too low a price; the elevator's risk is that prices will drop, causing it to purchase unduly expensive grain. "Hedge-to-arrive" contracts (HTA contracts) attempt to alleviate these risks by introducing price flexibility. HTA contracts use two price indices—a "futures reference price," set by the Chicago Board of Trade for some time in the future, and a "local cash basis level," which is a local adjustment to the national price. In an HTA contract, the parties generally agree at the time of contracting on the national portion of the price, and defer agreement on the local part of the price. Many HTA contracts are "flexible," meaning the parties may "roll" the established delivery date to some point in the future. When an elevator enters an HTA contract, it usually "hedges," or tries to offset the risk of paying unduly high prices, by buying an equal and opposite position in the futures market. If either party to an HTA contract rolls the delivery date forward, the elevator buys back its original hedge and rehedges by purchasing a new futures contract. The spread between the original hedge position and the "rolled" hedge position is attached to the price per bushel of the original HTA contract, and the farmer runs the risk of assuming a debit.[52]

In 1995 and 1996, however, events in the corn market changed the profit equation for HTAs, and the result was litigation over the validity of the contracts, calls for legislative action, and questions about the adequacy of regulatory scrutiny.[53] Unexpectedly, corn prices rose dramatically, more than doubling during that period.[54] As a result, it was more profitable for producers to sell their grain on the cash market. Therefore, producers rolled their HTA contracts to future delivery periods.[55] Elevators,

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28,043, at 49,469 (C.F.T.C. Mar. 9, 2000).

51. Harter v. Iowa Grain Co., 220 F.3d 544, 547 (7th Cir. 2000).

52. *Id*. at 547-48 (citations omitted); *see also* Nagel v. ADM Investor Servs., Inc., 65 F. Supp. 2d 740, 748-49 (N.D. Ill. 1999) (illustrating the differences between normal and flex HTAs).

53. Neil D. Hamilton, *Plowing New Ground: Emerging Policy Issues in a Changing Agriculture*, 2 DRAKE J. AGRIC. L. 181, 183 & nn.7-9 (1997); *see id.* at 183 ("[HTAs] do not fit well into the traditional structure of grain warehouse and dealer regulation.").

54. Reid, *supra* note 6, at 125; Barone, *supra* note 30, at 1442-43 (attributing the crisis in corn prices to two other historical factors). Barone first points out that the United States Department of Agriculture had encouraged farmers to enter into risk-shifting contracts that were quite similar to the HTAs. Barone, *supra* note 30, at 1442. Barone's analysis then turns to the passage of the Freedom to Farm Bill of 1996, which eliminated price supports for corn, causing a destabilization of corn prices. *Id.* at 1443. Both these factors, Barone concludes, "demonstrate[d] an environment conducive to and even supportive of the use of hybrid or semi-speculative contracts for risk management." *Id.*

55. *See, e.g.*, *In re* Grain Land Coop, 978 F. Supp. 1267, 1270 (D. Minn. 1997) (discussing how many

as a consequence, had to extend their margin commitments and pay margin calls.[56] Litigation ensued, with producers and elevators filing suits in state and federal courts, and with the CFTC filing enforcement actions.[57] The central question was whether HTAs were forward contracts excluded from the CEA and enforceable in a court of law, or whether HTAs were an illegal off-exchange futures contracts which could not be enforced.[58] The economic consequences of that decision were grave both for the producers, who sought to avoid their HTAs, and for the grain merchants, who sought to enforce them.

Harter v. Iowa Grain Co. highlights features of HTAs which arguably are exhibited by futures as well as forward contracts.[59] Viewed as futures, HTAs are transactions which appear to be consummated at an unspecified point in the future. They have delivery obligations that appear not to be fixed or binding and appear to serve the quintessential purpose of futures transactions, which is to shift risk.[60] Viewed as forward contracts, they are transactions between commercial parties, which have the capacity to make and take delivery of the underlying agricultural product, and for whom that product, but not necessarily the contract to purchase or sell the product, has intrinsic value.[61] The problem, however, with classifying HTAs as futures or forwards arises from the ambiguity of the statutory scheme and the judicial interpretations that have tried to make sense of it.[62]

III. THE STATUTORY SCHEME

The point of departure for any analysis must be the statute itself. For the purposes here, the pertinent features of the CEA are the provisions applying to futures and forward contracts that require futures contracts be traded on CFTC designated exchanges and giving the CFTC exclusive jurisdiction over futures contracts, registration provisions for persons dealing in futures contracts, and antifraud provisions.[63]

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producers "rolled," or deferred their grain delivery duties because of the market situation).

56. *See, e.g.*, *id.* at 1269 (noting Grain Land was required to cover margin commitments for HTAs made with producers).

57. Barone, *supra* note 30, at 1425.

58. *Id.* at 1425-26.

59. Harter v. Iowa Grain Co., 220 F.3d 544, 547-48 (7th Cir. 2000).

60. *Id.*

61. *See* Reid, *supra* note 6, at 148-49.

62. For a discussion that exemplifies the confusion surrounding the futures/forwards distinction, see *In re* Bybee, 945 F.2d 309 (9th Cir. 1991). *See id.* at 313-15 (finding certain metals margin purchase transactions to be futures contracts, but then determining that they were also forward contracts and hence excluded from the purview of the CEA).

63. 7 U.S.C. § 2(a)(1)(A) (2000).

The CEA applies to transactions involving future delivery in commodities.[64] "Commodity" is broadly defined to include a series of agricultural products such as corn, soybeans, "all other goods and articles except onions . . . and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in."[65] However, "'futures contracts' and 'cash forward contracts' are terms of art which do not appear in the [CEA],"[66] and are not defined in the CEA.[67] The CEA defines "contract of sale" broadly to include "sales, agreements of sale, and agreements to sell."[68] The CEA then excludes forward contracts by limiting the definition of "future delivery."[69] The applicable provision states that the term "'future delivery' does not include any sale of any cash commodity for deferred shipment or delivery."[70] Section 2 of the CEA confers exclusive jurisdiction on the CFTC of "transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated or derivatives transaction . . . exchange, or market."[71]

The statute specifies that all futures contracts must be traded on an exchange designated or registered with the CFTC, or else such contracts are illegal.[72] Section 6(a) makes it

> unlawful for any person to offer to enter into, to enter into, to execute, to confirm the execution of, or to conduct any office or business anywhere in the United States, its territories or possessions, for the purpose of soliciting or accepting any order for, or otherwise dealing in, any transaction in, or in connection with, a contract for the purchase or sale of a commodity for future delivery (other than a contract which is made on or subject to the rules of a board of trade, exchange, or market located outside the United States, its territories or possessions) unless (1) such transaction is conducted on or subject to the rules of a board of trade which has been designated or registered by the Commission as a contract market or derivatives transaction execution facility for such commodity; (2) such contract is executed or consummated by or through a contract market; and (3) such contract is evidenced by a record in writing which shows the date, the parties

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64. *Id.*

65. *Id.* § 1a(4).

66. CFTC v. Noble Metals Int'l, Inc., 67 F.3d 766, 772 n.4 (9th Cir. 1995).

67. Salomon Forex, Inc. v. Tauber, 8 F.3d 966, 971 (4th Cir. 1993).

68. 7 U.S.C. § 1a(7).

69. *Id*. § 1a(19).

70. *Id.*

71. *Id.* § 2(a)(1)(A). The CFTC was formed in 1974 as part of the 1974 amendments to the CEA. *See* Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, § 101, 88 Stat. 1389, 1389 (1974).

72. 7 U.S.C. § 6(a)(1).

to such contract and their addresses, the property covered and its price, and the terms of delivery.[73]

The CEA contains specific antifraud provisions. Section 6b makes it unlawful for any employee or agent of any member, in connection with "any contract of sale of any commodity for future delivery made . . . for or on behalf of any other person," to "cheat . . . or attempt to cheat or defraud" any other person.[74] In addition, under section 6b it is unlawful "willfully to make or cause to be made . . . any false report or statement; willfully to deceive or attempt to deceive [any] other person . . . in regard to any such order or contract . . . [or] any act of agency performed with respect to such order or contract . . .; or to bucket such order" or contract.[75]

Section 6c, entitled "Prohibited Transactions," prohibits transactions in any commodity regulated under the CEA which are of the character of or commonly known in the trade as an option unless they are under terms and conditions prescribed by the CFTC.[76] The CFTC has prescribed rules for options trading in parts 32 and 33 of its regulations.[77]

Section 6d requires any person acting as a futures commission merchant[78] or introducing broker[79] to register with the CFTC before "soliciting orders or accepting orders for the purchase or sale of any commodity for future delivery, or involving any contracts for sale of any commodity for future delivery."[80]

Section 6m makes it unlawful for a commodity trading advisor (CTA) or commodity pool operator (CPO) to use the mails or instrumentalities of "interstate commerce in connection with his business" unless he is registered with the CFTC.[81]

Section 6*o* makes it unlawful for a CTA, CPO, or an associated person of a CTA or CPO by means of the mails or instrumentalities of interstate commerce directly or indirectly "to employ any device, scheme, or artifice to defraud any client or participant or prospective client or participant . . . or

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73. *Id.* § 6(a).

74. *Id.* § 6b(a)(i).

75. *Id.* § 6b(a)(ii)-(iv).

76. *Id.* § 6c(b).

77. 17 C.F.R. §§ 32-33 (2004).

78. 7 U.S.C. § 1a(20) (defining "futures commission merchant").

79. *Id.* § 1a(23) (defining "introducing broker").

80. *Id.* § 6d(a).

81. *Id.* § 6m(1); *see id.* § 1a(6)(A)-(B) (defining "commodity trading advisor"); *id.* § 1a(5) (defining "commodity pool operator").

to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or participant or prospective client or participant."[82]

Section 25 of the CEA provides for a private right of action against any person for "actual damages" resulting from a violation of the Act, as well as an aider and abetter of a violation of the Act by any other person.[83]

A. *Legislative History*

The first congressional effort to regulate futures markets[84] was the Future Trading Act of 1921[85] (FTA); it contained an exclusion for cash forward contracts.[86] The FTA was passed "as a result of excessive speculation and price manipulations on the grain futures markets."[87] The FTA was designed to combat these perceived evils by "impos[ing] a prohibitive tax on all futures contracts," except "[those] made by owners and growers of grain, owners and renters of land on which grain was grown, and associations of such persons," and contracts made on designated futures markets.[88] However, during congressional hearings before Congress passed the FTA, there was concern that the class of persons exempted by the FTA was too narrow, and that it might not exclude cash grain markets "between farmers and grain elevator operators for the future delivery of grain."[89] Therefore, the Senate added language to section 2, excluding "'any sale of cash grain for deferred shipment' from the term 'future delivery.'"[90] Congress drew this exclusion "to meet a particular need such as that of a farmer to sell part of next season's harvest at a set price to a grain elevator or miller."[91] For the grain farmer, these transactions guaranteed a buyer and an assured price, in which "both parties

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82. *Id.* § 6*o*(1)(A)-(B).

83. *Id.* § 25(a)(1).

84. For a brief synopsis of the growth of futures markets, see Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353, 355-60 (1982).

85. Future Trading Act, Pub. L. No. 67-66, 42 Stat. 187 (1921).

86. *Id.* § 2, 42 Stat. at 187.

87. CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d 573, 577 (9th Cir. 1982); *see* William L. Stein, *The Exchange-Trading Requirement of the Commodity Exchange Act*, 41 VAND. L. REV. 473, 477 & n.23 (1988) (collecting relevant legislative history).

88. CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d at 577.

89. *Id.*; *In re* Stovall, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,941, at 23,779-81 (C.F.T.C. Dec. 6, 1979).

90. *In re* Stovall, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 23,780 (quoting Future Trading Act § 2, 42 Stat. at 187); *see also* CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d at 577 (noting Senate's addition to § 2 of the Future Trading Act) (citation omitted).

91. CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d at 577.

to the contract deal in and contemplate future delivery of the *actual* grain," and were not intended to come within the realm of futures contracts regulated by the CFTC.[92]

The FTA, however, was declared unconstitutional by the Supreme Court in *Hill v. Wallace*.[93] Congress then reenacted the FTA as the Grain Futures Act[94] (GFA), which sought to regulate futures trading under the commerce power of Congress rather than its taxing power.[95] The exclusion for forward contracts was transferred intact into the GFA.[96] The CEA, enacted in 1936, "expanded the scope of federal regulation to include certain specified commodities in addition to grain, and reworded the [forward contract] exclusion to ex[empt] 'any cash commodity for deferred shipment or delivery.'"[97] The specific exemption for contracts between persons such as owners, growers, and renters was deleted, on the rationale that the reworded exclusion served the same purposes.[98]

Although the CEA has been amended many times—most recently by the CFMA[99]—Congress has not changed the language excluding cash commodities for deferred shipment or delivery from the scope of the CEA and from the jurisdiction of the CFTC.[100] The legislative history of the 1974 Amendments to the CEA specifically demonstrates congressional understanding that a cash forward contract was based on transactions between parties for whom the underlying commodity had inherent commercial value and who contemplated physical transfer of the commodity.[101] In addition, the radical changes with respect to the treatment of securities futures products in the CFMA did not touch

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92. *Id.* at 577-78.

93. Hill v. Wallace, 259 U.S. 44, 68 (1922) (holding that the provisions of the FTA were impermissible attempts to regulate through Congress's taxing power).

94. Grain Futures Act, Pub. L. No. 67-331, 42 Stat. 998 (1922).

95. *See* Salomon Forex, Inc. v. Tauber, 8 F.3d 966, 970-71 (4th Cir. 1993) (outlining development of the GFA into the CEA); *see also In re* Grain Land Coop., No. 97-1, 1998 CFTC LEXIS 270, at *63 (C.F.T.C. Nov. 6, 1998) (noting that the GFA "utilized the Commerce Clause as means to the same regulatory ends").

96. *See* Grain Futures Act of 1922 § 2(a), 42 Stat. at 998 ("The term 'future delivery,' as used herein, shall not include any sale of cash grain for deferred shipment or delivery."); *In re* Grain Land Coop., 1998 CFTC LEXIS 270, at *63-64 (discussing the provisions of the GFA, which was enacted in response to the unconstitutionality of the FTA).

97. CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d at 578 (quoting CEA, Pub. L. No. 74-675, §§ 2-3, 49 Stat. 1491, 1491 (1936)).

98. *Id.*

99. CFMA, 7 U.S.C.A. §§ 1-25 (West Supp. 2004).

100. *In re* Grain Land Coop., 1998 CFTC LEXIS 270 at *64.

101. CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d at 578 (citing H.R. REP. NO. 93-975, at 129-30 (1974)).

agricultural commodities, demonstrating that the distinction between futures and forwards is very much alive and that its surrounding case law is still the point of reference for analyzing transactions, which involve future delivery of agricultural commodities.[102]

The underlying purposes of the forward contract exclusion and the distinctions between forwards and futures are explained in this often cited Fourth Circuit passage:

> Because the [CEA] was aimed at manipulation, speculation, and other abuses that could arise from the trading in futures contracts and options, as distinguished from the commodity itself, Congress never purported to regulate "spot" transactions (transactions for the immediate sale and delivery of a commodity) or "cash forward" transactions (in which the commodity is presently sold but its delivery is, by agreement, delayed or deferred). Thus § 2(a)(1)(A) of the [CEA], 7 U.S.C. § 2, provides that "futures" regulated by the Act do not include transactions involving actual physical delivery of the commodity, even on a deferred basis. Transactions in the commodity itself which anticipate actual delivery did not present the same opportunities for speculation, manipulation, and outright wagering that trading in futures and options presented. From the beginning, the [CEA] thus regulated transactions involving the purchase or sale of a commodity "for future delivery" but excluded transactions involving "any sale of any cash commodity for deferred shipment or delivery." The distinction, though semantically subtle, is what the trade refers to as the difference between "futures," which generally are regulated, and "cash forwards" or "forwards," which are not.[103]

B. *Development of the Multifactor Approach*

Because the statute offered little more than the elusive distinction between futures and forwards,[104] it was left to the courts and the CFTC to develop a framework within which commercial transactions ostensibly involving future delivery of commodities could be analyzed.[105] The consequences of the distinction, needless to say, were critical for parties entering into such transactions or seeking to avoid the effects of having entered into such transactions.[106] Moreover, judicial interpretations emerged out of litigation in which a party or the CFTC sought to challenge or enforce a contract involving such a transaction.[107] The approach that emerged and became the

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102. The CFMA excludes excluded commodities and exempt commodities from the CEA. CFMA, 7 U.S.C.A. § 1a(13)-(14). An exempt commodity is defined as a commodity that is neither an agricultural nor an excluded commodity. CFMA, 7 U.S.C.A. § 1a(14).

103. Salomon Forex, Inc. v. Tauber, 8 F.3d 966, 970-71 (4th Cir. 1993) (citation omitted).

104. *See, e.g.*, *In re* Bybee, 945 F.2d 309, 313-14 (9th Cir. 1991) (discussing the narrow distinction between futures and forwards).

105. 7 U.S.C. § 2(a)(1)(A) (2000) (providing the CFTC with jurisdiction, while simultaneously leaving the jurisdiction of state and federal courts intact).

106. *See In re* Bybee, 945 F.2d at 313-14 (disputing whether a contract is a futures or forward contract).

107. *In re* Stovall, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,941, at 23,775-76

dominant paradigm for distinguishing forward contracts from futures contracts was the multifactor or holistic approach.[108]

The earliest version of the multifactor paradigm was the CFTC decision in *In re Stovall*.[109] The CFTC initiated an enforcement proceeding against a floor broker and a futures commission merchant who allegedly marketed and sold illegal off-exchange futures contracts in violation of section 4 of the CEA.[110] The CFTC found that Stovall's grain contracts were indeed futures contracts and did not qualify for the forward contract exclusion.[111] The CFTC reached this conclusion after discussing the legislative history of legislation regulating the futures markets in depth, beginning with the FTA.[112] The CFTC described its method of analysis as one that "look[ed] at each operation in context and [did] not hesitate to look behind whatever label the parties may [have] give[n] to the instrument."[113] Based on this method, the CFTC isolated certain factors about the transactions at issue, which led to the conclusion that they were futures contracts within the purview of the CEA.[114] Prime among these factors was that with "excluded cash commodity-deferred delivery contract[s]," the parties shared "the generally fulfilled expectation that the contract will lead to the exchange of commodities for money."[115] The CFTC set forth typical characteristics of futures contracts as follows:

- They are standardized contracts primarily traded on exchanges;[116]
- "entered into primarily for the purpose of assuming or shifting the risk of change in value of commodities, rather than for transferring ownership of the actual commodities;"[117]
- in which most parties have little expectation that performance through delivery will occur;[118]

(C.F.T.C. Dec. 6, 1979).

108. *Id.* at 23,777-79.

109. *Id.*

110. *Id.* at 23,775-76.

111. *Id.* at 23,778.

112. *Id.* at 23,779-81.

113. *Id.* at 23,779.

114. *Id.* at 23,778-79.

115. *Id.* at 23,778.

116. *Id.* at 23,777.

117. *Id*.

118. *Id.*

- resulting in the parties "extinguish[ing] their legal obligations to make or take delivery by offsetting their contracts with equal and opposite transactions prior to the date on which delivery is called for."[119]

The analytic themes enunciated by the CFTC in *Stovall* were picked up and amplified by the Ninth Circuit three years later in the seminal case of *CFTC v. Co Petro Marketing Group*. The *Co Petro Marketing Group* framework for analyzing futures and forward contracts has been the prism through which courts and the CFTC alike have viewed transactions involving the future delivery of commodities, to the virtual exclusion of any other method of analysis.[120]

Co Petro Marketing Group involved an action brought by the CFTC under section 6(c) of the CEA to enjoin a gasoline broker from offering or selling "futures contracts in petroleum products . . . in violation of §§ 4 and 4h of the [CEA]."[121] A divided Ninth Circuit panel affirmed the district court's grant of injunctive relief, holding that the contracts at issue were futures contracts within the meaning of section 2(a)(1) of the CEA and violated section 4 of the CEA because they were not traded on a designated board of trade.[122] Co Petro operated a chain of gasoline retail outlets, acted as a petroleum products broker, and "offered and sold contracts for the future purchase of petroleum products pursuant to an 'Agency Agreement.'"[123] The contracts sold through the Agency Agreement were offered to the general public.[124] Under these contracts, Co Petro was appointed the "agent to purchase a specified quantity and type of fuel at a fixed price for delivery at an agreed upon future date, and [was] paid a deposit based upon a fixed percentage of the purchase price."[125] The customer, however, was not required to take delivery of this fuel, but could appoint Co Petro as its agent to sell the fuel before the time for delivery.[126] The price paid to the customer upon extinguishing its obligations for delivery on the contract depended on the cash price for the fuel, which was set off against the purchase price specified in the contract.[127]

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119. *Id.*

120. *See* Nagel v. ADM Investor Servs., 65 F. Supp. 2d 740, 750 (N.D. Ill. 1999) (noting that courts have routinely applied the "catalog" of factors listed in *Co Petro Marketing Group* to determine whether HTAs are futures or forward contracts).

121. CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d 573, 576 (9th Cir. 1982). CEA §§ 4, 4h, *codified at* 7 U.S.C. §§ 6, 6h (2000).

122. CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d at 582.

123. *Id.* at 576.

124. *Id.*

125. *Id.*

126. *Id.*

127. *Id.*

The court began its analysis by declaring that the statutory definitions of futures and forwards were facially ambiguous, making it therefore necessary to examine legislative history to determine the meaning of the statute on the basis of congressional intent.[128] The court then went through the same legislative history cited in *Stovall*[129] to conclude that the forward contract exclusion was designed solely "to meet a particular need such as that of a farmer to sell part of next season's harvest at a set price to a grain elevator or miller,"[130] where, "[m]ost important, both parties to the contract deal in and contemplate future delivery of the *actual* grain."[131]

After deciding that Co Petro's Agency Agreement contracts did not qualify for the forward contract exclusion, because they were entered into for the purpose of speculation when the underlying commodity had no inherent value and delivery of the underlying product was neither intended nor expected,[132] the court turned to the question of whether they were futures contracts.[133] The court identified the same features of futures contracts which had previously been identified by the CFTC in *Stovall*:[134]

- Futures contracts are fungible in that they are identical in all respects save price;[135]
- therefore, they "facilitate[] offsetting transactions by which purchasers or sellers can liquidate their positions by forming opposite contracts;"[136] and

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128. *Id.* at 577. The *Co Petro Marketing Group* court's conclusion that the statute is ambiguous on its face has been vigorously criticized. *See* Norris et al., *supra* note 14, at 330-32. Norris argued that recourse to legislative history is unnecessary because the statutory language is unambiguous, and reference to the Uniform Commercial Code's definition of sale and the Internal Revenue Code in conjunction with the statutory dictates would be the proper method for determining whether a contract is a futures or a forward contract. *Id.* at 331-32, 335-40. Norris states that based on this approach, the HTAs would be viewed as futures contracts unless at the time of entering into the HTA, the farmer had planted the crops. *Id.* at 339-40. However, Norris's approach has been rejected by at least one court. *See* Haren v. Conrad Coop., Inc., 198 F.3d 683, 684 (8th Cir. 1999) (citing Mansfield, *supra* note 12, at 748-52).

129. CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d at 577-78; *see In re* Stovall, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,941, at 23,779-81, 23,781 n.27 (C.F.T.C. Dec. 6, 1979) (summarizing legislative histories of the FTA, GFA, and CEA).

130. CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d at 577.

131. *Id.* at 578.

132. *Id.* at 579.

133. *Id.*

134. *In re* Stovall, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 23,778-79.

135. CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d at 579.

136. *Id.* at 579-80.

- "the price differential between the opposite contracts then determines the investor's profit or loss."[137]

Comparing Co Petro's Agency Agreement contracts to these characteristics of futures contracts, the court decided that they were indeed futures contracts that must be traded on a designated board of trade or contract market because they were speculative ventures "marketed to those for whom delivery was not an expectation."[138] In so doing, however, the court stated that when analyzing commodity transactions involving future delivery, "no bright-line definition or list of characterizing elements is determinative."[139] Instead, "[t]he transaction must be viewed as a whole with a critical eye toward its underlying purpose."[140] The key factors include whether the transacting parties are in the cash commodity business for whom the commodity has intrinsic value, whether they are capable of making and taking delivery, and whether delivery is anticipated.[141] The problem with this approach is that it is retrospective, and offers little by way of guidance for parties attempting to structure their transactions in such a way as to avoid challenges, which if successful, would invalidate contracts involving those transactions.

Nevertheless, the *Co Petro Marketing Group* approach has been faithfully followed both by courts and the CFTC.[142] In fact, the CFTC has added to the factors identified by *Co Petro Marketing Group*, including whether the parties are commercially sophisticated and can bear extra risk, and whether the transaction is structured so that the risk can be magnified before its completion.[143]

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137. *Id.* at 580.

138. *Id.* at 581.

139. *Id.*

140. *Id.*

141. *See id.* at 578-81 (describing cash forward contracts and future delivery as components used to evaluate the transaction).

142. *See, e.g.*, Lachmund v. ADM Investor Servs., Inc., 191 F.3d 777, 788 (7th Cir. 1999) (stating that courts will not only look at the contract itself but also at prior dealings between parties); Andersons, Inc. v. Horton Farms, Inc., 166 F.3d 308, 318 (6th Cir. 1998) (explaining that courts must look at "whether there is a legitimate expectation that physical delivery . . . will occur in the future"); Transnor (Bermuda) Ltd. v. BP N. Am. Petroleum, 738 F. Supp. 1472, 1490 (S.D.N.Y. 1990) (stating that a forwards contract "is one in which the parties contemplate the future transfer of the commodity"); *In re Cargill, Inc.*, [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,425, at 51,225 (C.F.T.C. Nov. 22, 2000) (recognizing that the CFTC continues to adhere to multifactor, holistic approach).

143. Statutory Interpretation Concerning Forward Transactions, 55 Fed. Reg. 39,188, 39,191 & n.10 (Sept. 25, 1990). Characteristics include: (1) if the contract was "entered into for commercial purposes related to the business of a producer, processor, fabricator, refiner or merchandiser who may wish to purchase or sell a commodity for deferred shipment or delivery in connection with the conduct of its business;" (2) if the contract was entered into "to shift future price risks incident to commercial operations and other forward commitments;" (3) if the counterparties "have the capacity to make or take delivery;" (4) if the contract was an "individually and privately negotiated principal-to-principal transaction[];" (5) if the contract could not be assigned "without the consent of the parties, and [did] not provide for exchange-style offset;" (6) if the contract was not subject to

Some courts resolving HTA disputes have, however, expressed dissatisfaction with the multifactor approach. Judge Easterbrook, sitting by designation in *Nagel v. ADM Investor Services, Inc.*, advanced a thorough critique of the multifactor approach on several grounds.[144] First, he said that the statutory language in CEA section 1a(11)[145] has a technical meaning confined to "the kind of contracts that trade in futures markets."[146] Second, he explained that the multifactor approach's emphasis on delivery is misplaced because holders of contracts traded on the futures markets have "the right to hold the contract through expiration and to deliver or receive the cash commodity."[147] Therefore, the utilization of the term "delivery" to differentiate between futures and forwards only leads to "indeterminacy, because it treats as the dividing line something the two forms of contract have in common—not only in the statutory text but also in the commercial world."[148] Third, according to Judge Easterbrook, focusing on the language of section 1a(11) leads one to the conclusion that a forward contract is a contract for deferred delivery of a commodity, whereas a futures contract involves the sale of the contract.[149] Finally, the court rejected the "multifactor-balancing approach," in part, because it produces undesirable uncertainty.[150] The court reasoned that parties needed

> to know *beforehand* whether a contract is a futures or a forward. The answer determines who, if anyone, may enter into such a contract, and where trading may occur. Contracts allocate price risk, and they fail in that office if it can't be known until years after the fact whether a given contract was lawful. Nothing is worse than an approach that asks what the parties "intended" or that scrutinizes the percentage of contracts that led to delivery *ex post*. What sense would it make—either business sense, or statutory-interpretation sense—to say that the same contract is either a future or a forward contract depending on whether the person obliged to deliver keeps his promise?[151]

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variation margining or to clearinghouse and settlement systems; and (7) if the contract was entered into "with the expectation that delivery of the actual commodity will eventually occur through performance on the contract." *Id.* at 39,191 & n.10. The CFTC issued this interpretation after the Brent Oil decision in *Transnor (Bermuda) Ltd. v. BP North America Petroleum*, 738 F. Supp. 1472 (S.D.N.Y. 1990), threw the oil industry into turmoil because it invalidated Brent Oil contracts, which were the linchpin of the oil market. Statutory Interpretation Concerning Forward Transactions, 55 Fed. Reg. at 39,189 & n.1.

144. Nagel v. ADM Investor Servs., Inc., 65 F. Supp. 2d 740, 750-52 (N.D. Ill. 1999). For a substantive discussion of this case with respect to the court's disposition of the HTA dispute, see *infra* Part V.A.4.

145. 7 U.S.C. § 1a(11) (2000) ("The term 'future delivery' does not include any sale of any cash commodity for deferred shipment or delivery.").

146. Nagel v. ADM Investor Servs., Inc., 65 F. Supp. 2d at 751.

147. *Id.*

148. *Id.*

149. *Id.*

150. *Id.* at 752.

151. *Id.*

In affirming Judge Easterbrook in *Nagel*, the Seventh Circuit formulated a three-factor analysis by "collapsing [the multifactor approach] . . . into a handful of objective and readily ascertainable circumstances."[152] The court determined that as long as each of the three factors were present, a contract would be deemed a forward contract excluded from the CEA.[153] These factors are:

> (1) The contract specifies idiosyncratic terms regarding place of delivery, quantity, or other terms, and is not so fungible with other contracts for sale of the commodity, as securities are fungible . . . .
>
> (2) The contract is between industry participants, such as farmers and grain merchants, rather than the arbitrageurs and other speculators who are interested in transacting in contracts rather than actual commodities.
>
> (3) Delivery cannot be deferred forever . . . .[154]

This framework was adopted by ALJ Bruce Levine in *In re Cargill, Inc.*, to analyze certain non-HTA contracts offered by Cargill as premium pricing if the producer held a typical forward contract (the "underlying contract").[155] The Premium Offer Contract (POC) was "an addendum agreement to the underlying contract," and according to its terms, "Cargill offer[ed] to accept delivery of additional bushels at a later specified period, and pay a premium on all bushels committed in the underlying contract for the nearby period, if the producer agree[d] to deliver [the] additional bushels [at] a 'strike price' selected by the producer."[156] However, neither party was obligated to perform "if the exchange-traded futures price for the grain [was not] at or above the specified strike price on the pricing date set forth in the contract."[157] If the futures cost of the grain was below the strike price and neither party performed, the producer could keep both the additional bushels as well as the premium paid by Cargill.[158] The POCs had been challenged by the CFTC on the grounds that they were in the nature of illegal off-exchange agricultural call options prohibited by section 4c(b) of the CEA and CFTC Regulation 32.2 because Cargill was only obligated to take delivery when the market price equaled or exceeded the strike price.[159] ALJ Levine rejected the Division of Enforcement's arguments, and

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152. *See* Nagel v. ADM Investor Servs., Inc., 217 F.3d 436, 441 (7th Cir. 2000) (formulating three factor test).

153. *In re* Cargill, Inc., [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,425, at 51,227 n.93 (C.F.T.C. Nov. 22, 2000).

154. *Id.*

155. *See id.* at 51,214-15 (describing the agreement in question).

156. *Id.* at 51,214, 51,216 n.27.

157. *Id.* at 51,215 (footnote omitted).

158. *Id.*

159. *Id.* at 51,215-16.

instead found that Cargill's POCs were cash forward contracts excluded from the CEA.[160] The POCs were not agricultural trade options or in the nature of agricultural trade options because they obligated both parties and did not confer anything resembling a right on either.[161] The POCs lacked the "fundamental characteristic of free choice which makes an option optional," and they were subject for their execution to market forces over which neither party had any control.[162]

In his opinion, ALJ Levine provided a thorough analysis of the case law surrounding the futures/forwards distinction, paying special attention to what he viewed as the shortcomings of the multifactor approach associated with *Co Petro Marketing Group*.[163] He observed that the CEA did not offer much more than the "less than self-evident distinction" contained in 7 U.S.C. §§ 6(a) and 1a(11).[164] Moreover, according to ALJ Levine, the interpretations offered by courts and the agency as encompassed in the multifactor approach interposed a "laundry list" of factors to be considered in judging whether a contract is a futures contract or a forward contract.[165] ALJ Levine asserted that the uncertainty engendered by this approach "leaves in question the enforceability of all new contracts not specifically approved, thus increasing the costs of experimentation" for hybrid arrangements such as the POCs, which were developed to manage risk in a moving and liquid market.[166] He then pointed specifically to the "waive [sic] of lawsuits arising out of [HTA] contracts," which, "demonstrat[ed] the high costs associated with experimenting under the uncertain law surrounding the forward contract exclusion."[167] Further, he stated that producers who entered into HTAs have tried to eliminate their obligations by claiming that the contracts are "unenforceable as unregulated futures contracts in violation of the [CEA]."[168] He credited the courts with "thwarting the producers' opportunistic behavior," but then, on a somber note, opined that "the social costs associated with the commercial disruption and the eruption of litigation spawned by the producers' efforts are unrecoverable."[169] Commissioner Brown-Hruska also expressed dissatisfaction with the multifactor approach on similar grounds in her dissenting opinion in *In re Competitive Strategies for Agriculture, Ltd.* and in an

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160. *Id.* at 51,230-31, 51,234. Interestingly, in *In re Gray*, the court determined that an HTA which bore significant resemblance to the Cargill POCs was an illegal off-exchange futures contract because it functioned like a call option. *In re* Gray, 252 B.R. 689, 710 (Bankr. S.D. Ohio 2000).

161. *In re* Cargill, Inc., [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 51,217.

162. *Id.*

163. *Id.* at 51,224-30.

164. *Id.* at 51,224 (noting that the definition of "future delivery" does not include any sale of cash commodities for deferred delivery or shipment).

165. *Id.* at 51,225.

166. *Id.* at 51,226.

167. *Id.*

168. *Id.*

169. *Id.* (footnote omitted).

address on May 4, 2004, by criticizing the burdens and costs placed on those attempting to devise innovative contracting arrangements in the agricultural markets.[170]

A subsequent HTA district court case[171] applied the *Nagel*/*Cargill* approach only after going through the *Co Petro Marketing Group* analysis.[172]

IV. HTA LITIGATION[173]

A. *Overview*

Fallout from the inverse market conditions in the grain market led to an abundance of litigation in the federal courts and in CFTC proceedings beginning in 1996.[174] This portion of the Article seeks to analyze HTA cases in terms of the parties involved, the claims advanced, and the outcome. As a general rule, the litigated cases pitted agricultural producers against grain merchants such as grain elevators and agricultural cooperatives that operated elevators.[175] In cases where producers were the

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170. *In re* Competitive Strategies for Agric., Ltd., [2004] 2 Comm. Fut. L. Rep. (CCH) ¶ 29,635, at 55,735-3 (C.F.T.C. Mar. 15, 2004) (Brown-Hruska, Comm'r, dissenting); Brown-Hruska Address, May 4, 2004, *supra* note 3.

171. Asa-Brandt, Inc. v. ADM Investor Servs., Inc., 138 F. Supp. 2d 1144 (N.D. Iowa 2001).

172. *Id.* at 1156-65.

173. HTA litigation involved, almost exclusively, disputes over corn contracts. Askelsen, *supra* note 5, at 139 n.4.

174. A LEXIS search (hedge /s arrive /s contract /s future or forward) performed by the Author on September 30, 2004 yielded thirty-five federal cases and eight state cases. Of the federal cases, eight were court of appeals cases (one in the Sixth Circuit, three in the Seventh Circuit, and four in the Eighth Circuit). A similar LEXIS search, performed on October 12, 2001, resulted in thirty-one hits, though that number encompasses decisions, CFTC opinion letters, and CFTC guidance. A more detailed description of the CFTC proceedings is given in a later section of this Article. *See infra* Parts IV.B.2., E.2. This Article does not consider state court decisions, except to note that there has also been litigation in state courts involving HTAs. In *Sack Brothers v. Tri-Valley Cooperative, Inc.*, the Supreme Court of Nebraska ruled that HTA contracts are cash forwards not subject to the CEA, following the rationale used in federal cases such as *Nagel v. ADM Investor Services, Inc*., 65 F. Supp. 2d 740 (N.D. Ill. 1999). Sack Bros. v. Tri-Valley Coop., Inc., 616 N.W.2d 786, 793-95 (Neb. 2000); *see also* Farmer Comm'n Co. v. Burks, 719 N.E.2d 980, 988-91 (Ohio Ct. App. 1998) (affirming summary judgment in favor of an entity that had contracted to purchase corn from the farmer pursuant to HTA contracts, when the farmer breached the contracts and failed to deliver the grain, rejecting claims by the farmer that the HTAs were illegal futures contracts and also violated state law); Champaign Landmark, Inc. v. Thomas Prince, Nos. 97 CA 28, 97 CA 29, 97 CA 30, 1998 Ohio App. LEXIS 4948, at *8-9 (Ohio Ct. App. Oct. 23, 1998) (enforcing an arbitration clause in an HTA contract and determining that the contracts were arbitrable though the defendant farmers contended that the HTAs were illegal under the CEA).

175. *See, e.g.*, Top of Iowa Coop. v. Schewe, 324 F.3d 627, 629-30 (8th Cir. 2003) (pitting an operator at a 500-acre farm against an Iowa cooperative); Nagel v. ADM Investor Servs., 217 F.3d 436, 438 (7th Cir. 2000) (pitting farmers against grain elevators and other such merchants); Haren v. Conrad Coop., 198 F.3d 683, 683 (8th Cir. 1999) (pitting Iowa farmers against four Iowa grain elevators).

plaintiffs, the actions sought a declaratory judgment that the HTA contracts were unenforceable because they were illegal off-exchange contracts.[176] Where elevators were the plaintiffs, the action sought to enforce the contract, and was brought as a breach of contract action.[177] The claims asserted by producer plaintiffs included claims under the CEA, federal securities laws, RICO, and state tort, contract, agency, and consumer protection laws. Producers also sought to include as defendants elevators, FCMs,[178] and IBs.[179] By and large, the outcome of the litigated cases was favorable to parties who sought to enforce the HTA contract, arguing that the contract was a cash forward contract excluded from the CEA.[180]

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176. *See, e.g.*, Haren v. Conrad Coop., 198 F.3d at 684 (noting that appellant farmers were "seeking, *inter alia*, a declaration that the contracts were illegal off-market futures contracts"); Patten Farms, Ltd. v. Farmers Coop. Co., No. 4-97-CV-90599, 2000 U.S. Dist. LEXIS 21650, at *6 (S.D. Iowa June 1, 2000) (alleging "that the HTA contracts are unenforceable because they constitute off-exchange futures contracts"); Johnson v. Land O' Lakes, 18 F. Supp. 2d 985, 988 (N.D. Iowa 1998) ("seek[ing] declaratory judgment that the HTA's [the plaintiffs] entered into . . . are void, voidable, and unenforceable" off-exchange future's contracts).

177. *See, e.g.*, Top of Iowa Coop. v. Schewe, 324 F.3d at 629 (referencing "Top of Iowa's successful breach-of-contract claim"); Grain Land Coop v. Kar Kim Farms, 199 F.3d 983, 988 (8th Cir. 1999) ("Grain Land also brought state-law claims against the farmers for breach of contract."); Farmers Co-op. Elevator of Buffalo Ctr. v. Abels, 950 F. Supp. 931, 932 (N.D. Iowa 1996) (adjudicating "fifty-two lawsuits originally filed in Iowa district courts by grain elevators . . . asserting claims arising from alleged breach or repudiation of contracts by the defendant grain producers").

178. 7 U.S.C. § 1a(20) (2000). An FCM is defined in the CEA as

> an individual, association, partnership, corporation, or trust that—
>
> (A) is engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market; and
>
> (B) in or in connection with such solicitation or acceptance of orders, accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom.

Id.

179. *Id.* § 1a(23). An IB is defined in the CEA as

> any person (except an individual who elects to be and is registered as an associated person of a futures commission merchant) engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market or derivatives transaction execution facility who does not accept any money, securities, or property (or extend credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom.

Id.

180. *See infra* Part IV.B.

B. *Parties*

1. *Federal Cases*

The adversaries in the HTA litigation are agricultural producers on the one hand and grain merchants—including commercial entities such as grain elevators, grain cooperatives, FCMs, IBs, and commodity trading advisors[181] (CTAs)—on the other. However, federal courts have also entertained actions brought by commercial entities against the CFTC as a means to short circuit administrative proceedings brought by the CFTC against them on the grounds that their activities with respect to HTAs violated the CEA.[182] In addition, bankruptcy proceedings have also involved HTA issues.[183]

In the early case of *North Central F.S., Inc. v. Brown*,[184] a district court decided the threshold question of subject matter jurisdiction when a grain elevator plaintiff located in Iowa sought a declaratory judgment that the HTA contracts it had entered into with Iowa grain producers were valid, enforceable, and binding under the CEA and that each of the defendants was obligated to deliver corn to the elevator under the terms specified in the HTA contracts.[185] The defendants asserted

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181. 7 U.S.C. § 1a(6)(A). A CTA is defined in the CEA as

> any person who—
>
> (i) for compensation or profit, engages in the business of advising others, either directly or through publications, writings, or electronic media, as to the value of or the advisability of trading in—
>
>> (I) any contract of sale of a commodity for future delivery made or to be made on or subject to the rules of a contract market . . .;
>>
>> (II) any commodity option authorized under section 6c of this title; or
>>
>> (III) any leverage transaction authorized under section 23 of this title; or
>
> (ii) for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any of the activities referred to in clause (i).

Id.

182. *See* discussion *infra* Part IV.B.3., C., E.1.

183. *See, e.g.*, *In re* Gray, 252 B.R. 689, 693-96 (Bankr. S.D. Ohio 2000). Gray (the debtor) formed an HTA contract with his cooperative, but alleged that the HTA contract violated the CEA. *Id.*

184. North Cent. F.S., Inc. v. Brown, 951 F. Supp. 1383 (N.D. Iowa 1996).

185. *Id*. at 1385-87. This litigation involved several cases and tortuous procedural wrangling. *See id.* at 1385-89. In related cases, elevators filed breach of contract actions in state court, which were then removed to federal court by the defendant grain producers who asserted that the issue of legality or illegality of the contracts under the CEA invoked the subject matter jurisdiction of the federal court. *See, e.g.*, Farmers Co-op. Elevator of Buffalo Ctr. v. Abels, 950 F. Supp. 931, 932-35 (N.D. Iowa 1996) ("The principal question before the court is whether the plaintiffs' common-law contract claims, alleging breach of so-called 'hedge-to-arrive' contracts

counterclaims, which presented an independent basis for jurisdiction because federal courts have exclusive jurisdiction over claims for damages for fraud in violation of CEA section 4b,[186] based on CEA section 22(c).[187]

Other HTA cases also pitted grain producers against elevators. For example, in *Oeltjenbrun v. CSA Investors, Inc.*,[188] a case initiated in 1996, a plaintiff producer sought a "declaratory judgment that the HTAs he ha[d] entered into [with several elevators] [we]re void, voidable, and unenforceable, because they [we]re illegal off-exchange futures contracts under the CEA."[189] Similarly, *Barz v. Geneva Elevator Co.*[190] and *Johnson v. Land O' Lakes, Inc.*[191] were also declaratory judgment actions, each brought by a group of grain producers against a grain elevator and its parent corporation and an agricultural cooperative that operated a grain elevator.[192] In *Haren v. Conrad Cooperative*,[193] the Eight Circuit Court of Appeals affirmed a grant of summary judgment for a grain elevator in a declaratory judgment action brought by farmers against a grain elevator, alleging their HTAs were illegal under the CEA and violated state law.[194] In *CoBank, ACB Corp. v. Alexander*,[195] the assignee of a grain elevator's HTA contracts sued farmers for breach, with each party seeking summary judgment.[196] The court concluded that certain HTA contracts were enforceable against the farmers, but other HTAs were illegal option contracts and therefore unenforceable.[197]

(HTAs) for the sale and purchase of grain, however pleaded, actually 'arise under' the Commodity Exchange Act (CEA), 7 U.S.C. §§ 1-25."); *see id.* at 936-39 (declining to assert jurisdiction on the grounds that federal question upon which federal jurisdiction would have been based was raised only as a defense to a state law cause of action).

186. CEA § 4b, *codified at* 7 U.S.C. § 6b.

187. North Cent. F.S., Inc. v. Brown, 951 F. Supp. at 1401. CEA § 22(c), *codified at* 7 U.S.C. § 25(c). *See also* 7 U.S.C. § 25(a) (providing a private right of action for actual damages for injury resulting from a violation of the CEA).

188. Oeltjenbrun v. CSA Investors, Inc., 3 F. Supp. 2d 1024 (N.D. Iowa 1998).

189. *Id.* at 1030.

190. Barz v. Geneva Elevator Co., 12 F. Supp. 2d 943 (N.D. Iowa 1998).

191. Johnson v. Land O' Lakes, Inc., 18 F. Supp. 2d 985 (N.D. Iowa 1998).

192. *Id.* at 988; Barz v. Geneva Elevator Co., 12 F. Supp. 2d at 946.

193. Haren v. Conrad Coop., 198 F.3d 683 (8th Cir. 1999).

194. *Id.* at 684.

195. CoBank, ACB Corp. v. Alexander, No. 3:96CV7687, 1999 U.S. Dist. LEXIS 17288 (N.D. Ohio July 27, 1999).

196. *Id.* at *2.

197. *Id.* at *38-39. The option contracts were corn calls sold by the producers to the elevator. *Id.* at *2-3,

In a case brought by an elevator against a producer, the plaintiff sought to compel arbitration when a dispute arose over the parties' HTAs.[198] The producer asserted violations of the CEA as a defense, on the grounds "that the arbitration clause failed to contain the boldface notification of rights required by the [CFTC]."[199] However, the court found, *ab initio*, that the CEA did not apply to the dispute because the contracts were not futures contracts subject to the CEA.[200] Therefore, the court granted the elevator's summary judgment to compel arbitration.[201]

Another case involved producers and various defendants, including grain elevators, an FCM, a CTA, and IBs of the FCM.[202] Agricultural producers sued IBs and FCMs on an agency liability theory.[203] Similarly, in *Lachmund v. ADM Investor Services, Inc.*,[204] an Indiana farmer sued an FCM, an IB, an agricultural consulting firm, and a corporation that operated a grain elevator, alleging that the HTAs which he had entered into were in violation of the CEA, the Racketeer Influenced and

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13. The producers received fixed fees which were credited to their accounts in exchange for including the option clauses with their HTAs. *Id.* at *7-8. The producers were obligated to sell corn at a certain price when the option was exercised. *Id.* at *6-7. However, when the elevator exercised the option, the producers did not have any corn to sell. *Id.* at *10. Consequently, they entered into new HTAs in the amount of their new obligations. *Id.* at *13. These HTAs, the "resultant HTAs," were deemed to be illegal because the options clauses out of which they were formed were illegal under § 6c(b) of the CEA. *Id.* at *33-34.

198. The Andersons, Inc. v. Crotser, 7 F. Supp. 2d 931, 932 (W.D. Mich. 1998).

199. *Id.* at 933.

200. *Id.* at 934, 936.

201. *Id*. at 936. Another case involving a motion to compel arbitration (which was granted) based on the arbitration clause in the HTA contract was *Heithoff v. Cargill, Inc*. Heithoff v. Cargill, Inc., No. 4:CV96-337, 1997 U.S. Dist. LEXIS 23550, at *1, 7 (D. Neb. March 21, 1997). In *Robinson v. Champaign Landmark, Inc*., the Sixth Circuit Court of Appeals affirmed the Bankruptcy Court's judgment as to an arbitration award in favor of Champaign Landmark, Inc. and against the debtor farmer. Robinson v. Champaign Landmark, Inc., 326 F.3d 767, 771-72 (6th Cir. 2003). This case had an involved history, beginning as an action brought in Ohio state court by Champaign Landmark to enforce the arbitration provision; proceeding to a National Grain and Feed Association (NFGA) arbitration panel (which rendered an award in favor of Champaign Landmark); then to a Bankruptcy proceeding brought by the debtor in which Champaign Landmark filed a claim based on the NFGA's arbitration award and the debtor's objection to the claim was overruled; then to the Bankruptcy Appellate Panel for the Sixth Circuit on an appeal by the debtor farmer; and finally to the Sixth Circuit. *Id.* at 768-70. The Sixth Circuit affirmed the award on the procedural grounds that Robinson had not timely filed a motion to vacate the award. *Id*. at 771-72.

202. Gunderson v. ADM Investor Servs., Inc., Nos. C96-3148-MWB, C96-3151-MWB, 2001 U.S. Dist. LEXIS 3383 (N.D. Iowa Feb. 13, 2001). For an account of the procedural background of the *Gunderson* litigation, see *Asa-Brandt v. ADM Investor Servs., Inc*., 138 F. Supp. 2d 1144, 1147-51 (N.D. Iowa 2001). *Asa-Brandt* also involved agricultural producers versus a grain elevator, an FCM, a CTA, and an IB. *Id.* at 1147, 1151.

203. *See, e.g.*, Abels v. Farmers Commodities Corp., No. 98-3033-MWB, 1999 U.S. Dist. LEXIS 14186, at *23 (N.D. Iowa Mar. 26, 1999) (finding an insufficient agency allegation in the complaint).

204. Lachmund v. ADM Investor Servs., Inc., 191 F.3d 777 (7th Cir. 1999).

Corrupt Organizations Act[205] (RICO), and state law.[206] The theory of liability to hold the FCM liable for the actions of the IB was that the FCM had executed a guaranty agreement on behalf of the IB under which it guaranteed the IB's performance and was liable for its obligations.[207] However, relying on a CFTC opinion, the court said that the guaranty agreement standing alone was "not sufficient to give [the] IB the status of an agent."[208]

As in *Lachmund*, the parties in *Asa-Brandt, Inc. v. ADM Investor Services, Inc.* consisted of agricultural producers on the one hand, and an FCM, IB, CTA, and a grain elevator on the other.[209] In this case, the theory of liability to hold the FCM liable for the actions of the IB was agency.[210] The court found, at the summary judgment stage, that the plaintiffs had failed to adduce sufficient evidence of agency.[211] However, interestingly, the court found that a genuine issue of material fact had been raised as to whether the grain elevator had breached a fiduciary duty to the plaintiffs.[212] Based on deposition testimony, the court concluded that the farmers appeared to rely on the advice of the representatives of the grain elevator in entering into HTA contracts, and such evidence was sufficient to defeat a motion for summary judgment on this issue.[213]

2. *CFTC Proceedings*

CFTC proceedings[214] have involved actions brought by the CFTC against entities and individuals that have promoted, marketed, and sold HTAs to agricultural producers such as grain cooperatives,[215]

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205. 18 U.S.C. § 1962(d) (2000).

206. Lachmund v. ADM Investor Servs., Inc., 191 F.3d at 779.

207. *Id.* at 780 n.1.

208. *Id.* at 783 (citing Violette v. First Options of Chi., Inc., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,951, at 44,624 (C.F.T.C. Feb. 20, 1997)); *see also* Gunderson v. ADM Investor Servs., Inc., 43 F. Supp. 2d 1058, 1066 (N.D. Iowa 1999) (granting defendant FCM's motion to dismiss where plaintiffs had alleged that the FCM was liable on an agency theory for the actions of the IB); Abels v. Farmers Commodities Corp., 1999 U.S. Dist. LEXIS 14186, at *23. *See generally* The Committee on Futures Regulations, *Secondary and Supervisory Liability Under the Commodity Exchange Act: An Update*, 56 REC. OF ASS'N OF B. OF CITY OF N.Y. 239, 241-55 (2001) (discussing the theory of liability advanced in *Gunderson*).

209. Asa-Brandt, Inc. v. ADM Investor Servs., Inc., 138 F. Supp. 2d 1144, 1151 (N.D. Iowa 2001).

210. *Id.* at 1150.

211. *Id.* at 1174.

212. *Id.*

213. *Id.* at 1171-73.

214. The major series of CFTC proceedings have involved Grain Land and Competitive Strategies for Agriculture. *See infra* Part V.C. The *Grain Land* litigation has been especially hard fought and has included attempts by Grain Land to enjoin the CFTC proceedings against it. *See infra* Part V.C.2; *supra* note 212.

grain elevators,[216] marketing advisors,[217] FCMs, and IBs.[218] In addition, agricultural producers have initiated reparations proceedings before the CFTC to seek damages for losses resulting from their HTA contracts.[219] The *Grain Land* and *Competitive Strategies* litigations have resulted in initial opinions by ALJ George H. Painter, deciding that the HTAs at issue were illegal off-exchange futures contracts which violated the CEA.[220] Interestingly, a federal court of appeals decision, also involving the Grain Land HTAs, came to the opposite conclusion.[221] The CFTC's decisions on appeal from the

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215. *See, e.g.*, *In re* Farmers Coop. Co., [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,043, at 49,468 (C.F.T.C. Mar. 9, 2000) (involving settlement order of complaint filed against grain cooperative that bought, stored, and sold corn and soybeans, and two employees alleging that HTAs entered into were illegal futures contracts).

216. *See, e.g.*, *In re* Southern Thumb, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,783, at 48,734 (C.F.T.C. Oct. 7, 1999) (alleging, in settlement order of complaint filed against grain elevator, violations of CEA in marketing HTAs which CFTC alleged were off-exchange agricultural call option contracts); *In re* Grain Land Coop., No. 97-1, 1998 CFTC LEXIS 317, at *96 (C.F.T.C. Nov. 6, 1998) (finding that HTA contracts sold by grain elevator were illegal futures contracts in violation of § 4(a) of the CEA, and issuing a cease and desist order).

217. *See, e.g.*, *In re* Roger G. Wright, No. 97-2, 1996 CFTC LEXIS 221, at *2-5 (C.F.T.C. Nov. 13, 1996) (reciting the details of an administrative complaint filed against person who held himself out as a marketing advisor, a cooperative that operated grain elevators, and an FCM; this person was not registered with the CFTC, but offered advice to farmers and operated a commodity pool).

218. *In re* Competitive Strategies for Agric., Ltd., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,771, at 48,691 (C.F.T.C. Sept. 17, 1999) (finding bucket shop, with respect to activities by Great Plain Coop, in violation of § 4(a) of the CEA, and issuing cease and desist order).

219. Murray v. Cargill, Inc., [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,932, at 48,964 (C.F.T.C. Nov. 29, 1999). *Murray v. Cargill, Inc.* involved a proceeding for "actual damages" brought by a farmer under § 4m(1) of the CEA when there was a pending arbitration against him by Cargill with respect to the breach of his HTA contract. *Id.* at 48,964-65. The damages Murray sought were the amounts Cargill was seeking to recover in the arbitration. *Id*. at 48,965. Murray also sought declaratory judgment that the HTAs were void and unenforceable. *Id*. at 48,964. The Commission rejected Murray's claims, stating that he had failed to show actual damages and that declaratory relief was not available in the reparations forum. *Id*. at 48,967; *see also* Schaefer v. Cargill, Inc., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,962, at 44,662 (C.F.T.C. Feb. 27, 1997) (involving reparations complainants' damages claims). In *Harter v. Iowa Grain Co*., a farmer who had previously filed suit in federal district court to invalidate HTA contracts he had entered into, and then lost an arbitration ordered by the court, sought to bring a reparations action before the CFTC. Harter v. Iowa Grain Co., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,644, at 48,074 (C.F.T.C. May 20, 1999). The Commission dismissed the action on the grounds that it was barred by collateral estoppel. *Id.* at 48,077.

220. *In re* Grain Land Coop., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,459, at 47,197 (C.F.T.C. Nov. 6, 1998), *vacated by* [2003] 2 Comm. Fut. L. Rep. (CCH) ¶ 29,636 (C.F.T.C. Nov. 25, 2003); *In re* Competitive Strategies for Agric., Ltd., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,771, at 48,690 (C.F.T.C. Sept. 17, 1999), *aff'd*, [2004] 2 Comm. Fut. L. Rep. (CCH) ¶ 29,635 (C.F.T.C. Mar. 15, 2004).

221. *See* Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d 983, 992 (8th Cir. 1999) (holding that the Grain Land HTAs contemplated actual delivery of grain and as such, were "cash-forward contracts outside the reach of the CEA").

ALJ opinions were inconsistent. It affirmed the ALJ in *Competitive Strategies*,[222] but vacated his decision him in *Grain Land*.[223]

3. *Other Federal Litigation: Grain Merchants Versus the CFTC*

In addition to litigation involving agricultural producers and grain merchants, including entities such as grain elevators and FCMs, these entities have also engaged in litigation with the CFTC in federal court. For example, in *Great Plains Coop v. CFTC*,[224] Great Plains, a cooperative that purchased grain from producers using HTAs, filed a complaint against the CFTC seeking to halt the CFTC's administrative proceedings against it.[225] The CFTC filed an administrative complaint alleging that Great Plains's HTAs "were futures contracts subject to the strictures of the CEA, and that Great Plains had failed to comply with the relevant CFTC regulations."[226] Though Great Plains had argued in the CFTC administrative proceedings that because a number of courts had determined HTAs to be forward and not futures contracts, and that the CFTC's action against it should be terminated, the ALJ allowed the proceedings against Great Plains to continue.[227] Great Plains then sought injunctive relief and a writ of prohibition or mandamus against the CFTC's administrative proceedings in federal court or a declaratory judgment that the HTAs were not futures contracts under the meaning of the CEA.[228] The district court dismissed Great Plains's complaint on the grounds that it lacked "jurisdiction to enjoin or otherwise interfere in the administrative proceedings of the CFTC because[,] under 7 U.S.C. § 9, a federal court of appeals ha[d] exclusive jurisdiction to review final orders of the CFTC."[229] The Eighth Circuit Court of Appeals affirmed, holding that Great Plains's federal action was an "impermissible attempt to make an 'end run' around the [CEA's] statutory scheme," and that whether HTAs were futures or forwards in this context could only be decided after the CFTC had rendered a final order.[230] These cases will be discussed in depth in a succeeding section of the Article.[231]

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222. *In re* Competitive Strategies for Agric., Ltd., [2004] 2 Comm. Fut. L. Rep. (CCH) ¶ 29,635, at 55,735 (C.F.T.C. Mar. 15, 2004) (affirming decision finding Great Plains and Gerdes liable for violating § 4(a) of the CEA).

223. *In re* Grain Land Coop., [2003] 2 Comm. Fut. L. Rep. (CCH) ¶ 29,636, at 55,750 (C.F.T.C. Nov. 25, 2003) (holding that the transactions were cash forward contracts).

224. Great Plains Coop v. CFTC, 205 F.3d 353 (8th Cir. 2000).

225. *Id.* at 354.

226. *Id.* (quotations omitted).

227. *Id.*

228. *Id.*

229. *Id.*

230. *Id.* at 355-56.

231. *See* discussion *infra* Parts IV.E.1., V.A.

C. *Claims*

Because the focal point of attack by producers on the HTA contracts has been that they are illegal off-exchange futures contracts, the claims advanced in HTA litigation have been primarily based on the CEA and CFTC Regulations.[232] Specifically, producers have alleged that the HTAs are illegal under CEA sections 4(a) and (d),[233] that they are fraudulent in violation of section 4b,[234] and that they are entitled to a declaratory judgment that the HTAs in question "are illegal, void and unenforceable, because they violate § 4(a)-(c) of the CEA."[235] These claims have also been interposed as defenses when producers have been sued for breach of contract for failing to deliver on the HTAs.[236] In addition, claims under other federal statutes, such as the Racketeer Influenced and Corrupt Practices Act (RICO),[237] the Securities Act of 1933,[238] and Securities Exchange Act of 1934,[239] have been advanced. State common law claims based on tort (fraud and breach of fiduciary duty) and contract, as well as claims based on state consumer protection and deceptive trade practices statutes have been brought.[240] Other permutations of HTA litigation include motions by

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232. *E.g.*, Asa-Brandt, Inc. v. ADM Investor Servs., Inc., 138 F. Supp. 2d 1144, 1156 (N.D. Iowa 2001), *aff'd in part, rev'd in part*, 344 F.3d 738 (8th Cir. 2003) (discussing whether the HTA contracts are within the purview of the CEA); Great Plains Coop v. CFTC, 205 F.3d 353, 354-56 (8th Cir. 2000) (discussing whether certain HTA contracts were futures contracts subject to CEA and CFTC regulations).

233. CEA § 4(a), (d), *codified at* 7 U.S.C. § 6(a), (d) (2000).

234. CEA § 4b, *codified at* 7 U.S.C. § 6b.

235. *See, e.g.*, Asa-Brandt, Inc. v. ADM Investor Servs., Inc., 138 F. Supp. 2d at 1148 n.3; Gunderson v. ADM Investor Servs., Inc., Nos. C96-3148-MWB, C96-3151-MWB, 2001 U.S. Dist. LEXIS 3383, at *13 (N.D. Iowa Feb. 13, 2001) (bringing a similar claim). The following textual discussion is, for the most part, based on these cases because they appear to advance the most inclusive set of claims.

236. *See, e.g.*, CoBank, ACB Corp. v. Alexander, No. 3:96CV7687, 1999 U.S. Dist. LEXIS 17288, at *14 (N.D. Ohio July 27, 1999) (noting "[d]efendants' first defense to the breach of contract claim is that the HTAs are illegal 'off exchange' futures contracts").

237. 18 U.S.C. § 1962(d) (2000); *see, e.g.*, Gunderson v. ADM Servs., Inc., 2001 U.S. Dist. LEXIS 3383, at *19 (noting plaintiff producers alleged that the defendants (including an FCM, CTA, IBs, and grain elevators) entered into a conspiracy to evade the CEA and CFTC regulations in order to achieve their objective of controlling grain merchandising in North Central Iowa); *see also* Carr v. Countrymark Coop., Inc., No. C-2-96-1248, 1998 U.S. Dist. LEXIS 23000, at *12 (S.D. Ohio Jan. 29, 1998) (alleging HTAs violated federal securities laws and commodities laws in RICO action brought by farmers against cooperatives).

238. 15 U.S.C.A. § 77(a) (2000 & Supp. 2004).

239. 15 U.S.C. § 78(a) (2000); *see, e.g.*, Top of Iowa Coop. v. Schewe, 6 F. Supp. 2d 843, 847, 850-53 (N.D. Iowa 1998) (addressing the question of whether the HTAs were "'securities' within the meaning of the [federal securities laws]").

240. *See, e.g.*, Asa-Brandt, Inc. v. ADM Investor Servs., Inc., 138 F. Supp. 2d at 1148 n.3 (noting claim made under the Illinois Consumer Fraud and Deceptive Trade Practices Act, 815 ILL. COMP. STAT. ANN. 505/2 (West 1999)); Oeltjenbrun v. CSA Investors, Inc., 3 F. Supp. 2d 1024, 1053-54 (N.D. Iowa 1998) (ruling on

defendant elevators or cooperatives to compel arbitration and stay proceedings on the basis of an arbitration clause in the HTA contract and under the Federal Arbitration Act[241] when plaintiff farmers have sought to invalidate the contract under the CEA.[242] A common pattern appears: the court grants summary judgment or motions to dismiss on the federal claims and then declines jurisdiction over the state law claims.[243]

D. *Typical HTA Fact Pattern*

Between 1993 and 1995, grain producers encountered the HTA contract, a new contractual arrangement through which they could sell their grain to agribusinesses such as cooperatives and grain elevators. The HTA was described as a method[244] which allowed the producer to lock in what he determined to be an attractive price while still retaining the flexibility to take advantage of price movements in the futures markets and basis improvements. The HTA permitted the producer to lock in a specific quantity and quality of grain, delivery period, and the futures price. The basis level could be locked in any time prior to the pricing deadline, which could be either the first day of delivery or the last trading day preceding the futures month. The final contract price was determined by taking the final futures price, and adding or subtracting the basis, adding or subtracting the gains or losses from any lifting of the futures price, and subtracting the applicable service fees. The producer could benefit from potential price swings in the futures market by lifting and reestablishing the futures price and also by rolling delivery to a later period.

Producers typically learned about HTAs through marketing meetings, seminars, church meetings offered by their cooperatives or grain elevators,[245] or through information obtained from agricultural marketing and consulting services.[246] Not infrequently, the medium through which producers agreed

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federal claims under the CEA and CFTC regulations in addition to state law contract and tort claims).

241. 9 U.S.C. §§ 3-4 (2000).

242. *See, e.g.*, Herwig v. Hahnaman-Albrecht, Inc., No. 96 C 6107, 1997 U.S. Dist. LEXIS 1650, at *13 (N.D. Ill. Feb. 10, 1997) (granting defendant's motion by ordering arbitration and a stay of proceedings under the Federal Arbitration Act).

243. *See, e.g.*, Nagel v. ADM Investor Servs., Inc., 65 F. Supp. 2d 740, 755 (N.D. Ill. 1999) (relinquishing supplemental jurisdiction over state law claims where federal claims had been dismissed).

244. This description of what was termed a "Flex HTA" is taken from Cargill Aghorizons. *See* http://www.cargill.com (last visited Nov. 22, 2004).

245. *See* Gunderson v. ADM Investor Servs., Inc., 85 F. Supp. 2d 892, 901 (N.D. Iowa 2000) (detailing how plaintiffs learned about HTAs at a church meeting attended by 700 patrons at which representatives of an elevator spoke regarding HTAs); *In re* Grain Land Coop., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,459, at 47,181 (C.F.T.C. Nov. 6, 1998) (describing marketing meetings which were held for women only, specifically for wives of the producers).

246. *See* Lachmund v. ADM Investor Servs., Inc., 191 F.3d 777, 780 (7th Cir. 1999) (describing the advice and consultation given to a client of ADM Investor Services, Inc.); *In re* Roger J. Wright, No. 97-2, 1996 CFTC LEXIS 221 at *3-4 (C.F.T.C. Nov. 13, 1996) (explaining the advisory services offered by Wright to clients).

to enter into HTA contracts was individuals whom they were acquainted with and in whom they had reposed trust.[247] Sometimes producers hired consulting services to act as their agents in negotiating HTA contracts with cooperatives or grain elevators.[248]

To protect against a decrease in the cash price of corn, producers then entered into numerous HTA contracts, some for delivery of crops in future crop years.[249] In 1996, however, an unprecedented market inversion occurred, and cash prices for corn exceeded, even doubled, the prices on the futures markets.[250] As a result, producers rolled the delivery dates on their HTAs, and many sold their corn on the cash market in order to take advantage of the favorable prices.[251] Producers were also in a bind because they had to buy corn on the cash market (for which they had to pay more) to satisfy their delivery obligations.[252] Elevators, however, who had hedged their contracts with the producers by purchasing short futures contracts on the futures markets, began to incur margin calls for the maintenance of those positions as the producers rolled their delivery dates forward.[253] Litigation over the validity and enforceability of the HTA contracts ensued, with numerous cases being filed in state and federal court.[254] Elevators sued to enforce delivery obligations, farmers declined, elevators sold out their futures positions and sued for breach of contract, and farmers sought to void the HTAs on the grounds that they were illegal off-exchange contracts.[255]

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247. *See* Asa-Brandt, Inc. v. ADM Investor Servs., Inc., 138 F. Supp. 2d 1144, 1154 (N.D. Iowa 2001) (noting that trust was a factor in deciding to invest in HTAs).

248. *See, e.g.*, Sack Bros. v. Tri-Valley Coop., Inc., 616 N.W.2d 786, 790 (Neb. 2000) (stating that a grain marketing consulting business was hired to negotiate contracts with a cooperative).

249. *See, e.g.*, *In re* Grain Land Coop., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 47,180-90 (detailing the contracts at issue, containing delivery plans for multiple years, some for as long as five years).

250. Askelsen, *supra* note 5, at 125. Askelsen also discusses the causes of the market inversion, which include legislative changes, changes in the hog production industry, global market conditions, and weather factors. *Id*. at 126.

251. *Id.* at 127; *see* Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d 983, 987 (8th Cir. 1999) (detailing a rolling provision in an HTA contract that allowed defendant "to take advantage of rising cash prices by selling his grain on the cash market and deferring delivery under the HTA").

252. Askelsen, *supra* note 5, at 126-27. Askelsen gives the example of farmers who had contracted in 1995 to sell their 1996 corn crop at less than three dollars per bushel, but could have sold the same crop in May 1996 for more than five dollars a bushel. *Id.* (citing Fred Vogelstein & Scott Kilman, *Some Grain Accords Leave Farmers in Bushels of Debt*, WALL ST. J., May 20, 1996, at C1.).

253. CoBank, ACB Corp. v. Alexander, No. 3:96CV7687, 1999 U.S. Dist. LEXIS 17288, at *10-11 (N.D. Ohio July 27, 1999) (noting that elevator who faced margin calls, for which it utilized a line of credit from its bank, ultimately defaulted and assigned its HTA claims to bank); *see id.* at *9 n.6 (defining "margin call").

254. Cases filed in state court were often removed to federal court. *See, e.g.*, Top of Iowa Coop. v. Schewe, 6 F. Supp. 2d 843, 847 (N.D. Iowa 1998) (asserting diversity of citizenship claim and arguing the amount in controversy element was satisfied); *cf.* Askelsen, *supra* note 5, at 125-26 (noting the plethora of lawsuits "filed throughout the corn producing regions of the United States").

E. *Examples of HTA Contracts*

In examining HTA contracts, as in any other contract, courts typically start with the terms themselves, on the basis that "[t]he contract's terms will provide several indications of the nature of the transaction it memorializes."[256] HTA contracts typically contained terms regarding quantity of grain to be delivered, the reference price, method for setting price and time for final pricing, and conditions of delivery.[257] While some HTAs contained provisions governing rolling the delivery dates, others did not have explicit provisions.[258] The following are some examples of HTA contracts that were disputed in both federal cases and CFTC proceedings.

1. *Federal Cases*

In *Barz v. Geneva Elevator Co.*,[259] the court analyzed in detail HTA contracts between a group of producers and grain elevators.[260] The court had no trouble concluding that the contracts, which consisted of a grain contract and an addendum or "backer" entitled "Grain Pricing Procedure Futures Only Contract," were in actuality forward contracts not subject to the CEA.[261] The grain contract was a preprinted form prepared by the elevator with spaces left for the name of the producer, the quantity and quality of corn to be delivered to the elevator, and the date of delivery.[262] The grain contract had provisions regarding damaged and inferior quality corn and problems of delivery resulting from shortage, unavailability of transportation, or breakdown of elevator facilities.[263] The court determined with alacrity that the grain contract was undoubtedly "a contract for actual physical delivery of corn at a future date."[264] The court took more time to conclude the backers (there were four types of backers at issue in the case) were also forward contracts, notwithstanding the fact that some of them were multiyear contracts that permitted rolling over crop years and involved the delivery of more grain than the producer ordinarily grew in a single crop year.[265]

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255. Askelsen, *supra* note 5, at 125-28.

256. Lachmund v. ADM Investor Servs., Inc., 191 F.3d 777, 787 (7th Cir. 1999).

257. *See infra* Part IV.E.1-2.

258. *See infra* Part IV.E.1-2.

259. Barz v. Geneva Elevator Co., 12 F. Supp. 2d 943 (N.D. Iowa 1998).

260. *Id.* at 953-54.

261. *Id.* at 947, 950; *see also id.* at 955-57 (holding that the addendum did not change the contract into an illegal futures contract).

262. *Id.* at 947-49.

263. *Id.* at 947.

264. *Id.* at 953.

265. *Id.* at 954-57.

Similarly, in *Asa-Brandt, Inc. v. ADM Investor Services, Inc.*, the court concluded that a "Flex Hedge Contract" in which "The Buyer (Merchandizer) and the Seller (Producer) [agreed] not [to] write Flex Hedge Contracts or Multiple Year contracts for more than can be produced or will be delivered in a normal crop year by the producer"[266] was a cash forward contract.[267] Along with the above-quoted provision, this contract contained the following terms:

> The Buyer has the discretion to be informed of the Producers past and current record of production.
>
> Final Pricing (Setting of the Basis Level and the Basis Delivery Month) will be done at the Sellers discretion, but [at] least two (2) days before the first notice day and before delivery occurs.
>
> Final pricing will be done at Merchandizers quoted (Basis Bid) for applicable delivery period. Once a basis is applied to a particular Flex Hedge Contract, all standard delivery contract terms will apply.
>
> This Flex Hedge Contract must be priced (Basis Set) or rolled to another futures month at a cost of one (1) cent plus or minus the spread to that futures month, prior to the first notice day of the underlying futures month currently held, by the Seller.
>
> If the underlying futures hedge is not rolled by the first notice day. The merchandizer will elect to roll.
>
> Multiple year Flex Hedges must be scaled up in subsequent price levels of proportionate and ascending levels.
>
> The Buyer and seller must be in agreement regarding a multiple year Flex-Hedge plan before it is submitted for implementation in the futures market.
>
> If a Multi year plan is implemented and the Seller because of higher prices at harvest elects to roll the lower price level Flex Hedges for future use, the Seller will be obligated to deliver the harvested bushels to the buyer of the Flex Hedge Contracts rolled, at the Buyer quoted bid for the applicable period. The Seller may also elect to use an implemented Flex Hedge Contract equal to the current futures price for the applicable period.
>
> The implementation or Rolling of Flex Hedge futures will be done during open and trading hours at the Chicago Board of Trade.

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266. Asa-Brandt, Inc. v. ADM Investor Servs., Inc., 138 F. Supp. 2d 1144, 1152, 1163 (N.D. Iowa 2001).

267. *Id.* at 1165.

> If it is determined by the Buyer and Seller that contract bushels are undeliverable, the Producer may elect to buy out of the Flex Hedge Contract at the net equity of the trade plus a cost of five (5) cents per bushel.
>
> Failure by the Seller to advise the Buyer within 15 days of receipt of this confirmation will be understood by the Buyer as an acceptance of the terms.[268]

In *Top of Iowa Cooperative v. Schewe*,[269] Minnesota farmer Virgil Schewe entered into five contracts with Top of Iowa Cooperative.[270] All five contracts were printed on the same standardized form, with individual handwritten entries.[271] Each contract stated that the cooperative had taken, on behalf of Schewe, a short position on the Chicago Board of Trade (CBOT).[272] The handwritten entries, filled in separately on each of the five contracts, specified the commodity (corn), the quantity, the futures delivery month (the month in which Schewe expected to deliver), and the current futures price for that delivery month.[273] The contracts did not directly impose any obligation to deliver grain to the elevator, and also did not contain any specific provision allowing Schewe to roll the contract into any other month.[274] However, each contract was rolled to a later delivery month, and repriced accordingly.[275] Schewe never delivered on any of the contracts.[276] The court concluded that the contracts were forward contracts, and granted summary judgment to the elevator.[277]

In *Oeltjenbrun v. CSA Investors, Inc.*, a grain farmer with an annual corn production per year of approximately 100,000 bushels, entered into several HTA contracts with various grain elevators.[278] These contracts were written from February to November of 1995, and contemplated, at various

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268. *Id.* at 1152, 1163-64 (citation omitted).

269. Top of Iowa Coop. v. Schewe, 6 F. Supp. 2d 843 (N.D. Iowa 1998).

270. *Id.* at 847.

271. *Id.* at 847-48.

272. *Id.* at 848.

273. *Id.*

274. *Id.* at 847-48 (finding no such terms or provisions).

275. *Id.* at 848.

276. *Id.* at 849.

277. *Id.* at 859. *See* discussion *infra* Part V.A.2. For an analysis of this case, *see generally* Reid, *supra* note 6, at 144-54 (analyzing the facts and holding of *Top of Iowa Cooperative v. Schewe*).

278. Oeltjenbrun v. CSA Investors, Inc., 3 F. Supp. 2d 1024, 1028-29 (N.D. Iowa 1998). The CFTC initiated administrative proceedings against one of the grain elevators in this case, Farmers Cooperative Company, which resulted in a settlement. *In re* Farmers Coop. Co., [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,043, at 49,474-76 (C.F.T.C. Mar. 9, 2000). The CFTC's findings will be discussed below. *See* discussion *infra* Part IV.E.2.

intervals during 1996, the delivery ("Arrival Period") of 130,000 bushels of corn.[279] Six of the contracts were denominated as HTA contracts, and were entered into with Farmers Cooperative Company (FCC) and Farmers Cooperative Society (FCS).[280] The contracts specified either a CBOT reference price for the price per bushel, or a futures option price, but did not specify a cash price.[281] Oeltjenbrun rolled the HTAs to later delivery dates at least once, sometimes several times, and did not deliver any corn on any of his HTAs with FCS.[282] "Oeltjenbrun was also allowed to roll each of his HTAs with FCC, but in each case by canceling the original contract and entering into a new contract with a different initial 'Arrival Period' and 'Futures Option Price.'"[283] The court concluded, however, that the rolling feature of the contracts did not negate a delivery obligation—because there was a price to be paid for each roll—and did not mean that delivery could never take place.[284] Therefore, the HTAs fit within the cash forward contract exception to the CEA.[285]

In re James Allen Gray[286] presented a different result. In that case, which involved a debtor farmer's objections to claims advanced by a creditor, an agricultural cooperative with which the farmer had entered into three HTA contracts,[287] the bankruptcy court decided that one HTA, the "resultant HTA," was void and unenforceable under the CEA.[288] That contract arose out of the terms of a prior HTA which the court upheld.[289] The resultant HTA, which was executed on May 31, 1995, granted the cooperative fourteen options to buy corn in July 1995.[290] It imposed delivery obligations of 70,000 bushels on the farmer, which were due sixty days after the contract's inception, in addition to the 70,000 bushels already required for delivery under the prior contract.[291] The court concluded that the

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279. Oeltjenbrun v. CSA Investors, Inc., 3 F. Supp. 2d at 1028-29.

280. *Id.*

281. *Id.*

282. *Id.* at 1029-30.

283. *Id.* at 1029.

284. *Id.* at 1044.

285. *Id.*

286. *In re* James Allen Gray, 252 B.R. 689 (Bankr. S.D. Ohio 2000).

287. *Id.* at 693-95.

288. *Id.* at 700 (finding Contract 5436 to be a futures contract).

289. *Id.* at 695 ("Contract 5436 . . . arose from certain terms contained within Contract 2681.").

290. *Id.* An option to buy corn is also referred to as a "call."

291. *Id.*

parties could not have had a legitimate expectation of delivery under the resultant May 1995 HTA[292] because the combined delivery obligations exceeded the capacity of the debtor's farming operations.[293] The court said that in order to satisfy those delivery obligations, the farmer would have had to plant corn on every square inch of land that he farmed.[294] The court also held that the resultant HTA was in the nature of an agricultural option, which was proscribed under sections 6(a) and 6c(b) of the CEA.[295]

2. *CFTC Proceedings and CFTC Guidance on HTAs*[296]

In response to inquiries regarding HTAs, and the unprecedented inverse market conditions, the CFTC put forward a Statement of Guidance on "the risk implications of particular features of [HTA contracts involving] the delivery of grain."[297] The Commission acknowledged that instruments "giv[ing] rise to questions regarding the applicability of the forward contract exclusion" had historically been treated with caution both by the CFTC and courts because of the disruption that could ensue in the commercial markets.[298] The CFTC then specified certain features that HTAs should display in order for the CFTC to deem them to fall within the forward exclusion.[299] These preferred features would:

> 1. [R]equire mandatory delivery, absent an intervening event such as a crop failure, of a specified quantity and grade of grain at a specified location and reference price by a specified date within the crop-year during which the crop is harvested;
>
> 2. [B]e for a quantity to be delivered which is reasonably related to the producer's annual production, not committed elsewhere and normally available for merchandizing and at a location whereby delivery can be made by the producer under normal merchandizing practices;

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292. *Id.* at 696.

293. *Id.* at 695-96.

294. *Id.* at 696.

295. *Id.* at 701. *Compare id.* (finding the contract to be an HTA that was in the nature of an agricultural option), *with In re* Cargill, Inc., [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,425, at 51,224 (finding that a similar, but non-HTA contract was not an agricultural option or of the nature of such an option).

296. Courts have not given deference to the CFTC's decisions on HTAs on the grounds that it is not the type of agency pronouncement that even rises to the level of an "interpretive rule," and is not a definitive statutory interpretation that has gone through "notice and comment" procedures. Barz v. Geneva Elevator Co., 12 F. Supp. 2d 943, 956 (N.D. Iowa 1998).

297. Blake Imel, Acting Director, Division of Economic Analysis, CFTC Economic Analysis, Ltr. No. 96-41, 1996 CFTC Ltr. LEXIS 145, at *1-2 (May 15, 1996).

298. *Id.* at *8 n.10.

299. *Id.* at *14-16.

3. [S]pecify a delivery date and futures contract month reference price which coincides with the crop-year during which the grain will be harvested; and

4. [P]ermit, where such contracts include provisions allowing the "rolling" of reference prices, that reference prices only be rolled sequentially from a nearby to a more deferred futures contract month in the same crop-year within which the grain is, or will be, harvested, to reflect the production and inventory-carrying nature of the cash position.[300]

HTA contracts that did not exhibit the features described in the Statement of Guidance would not get the benefit of the cash forward exception, and were subsequently challenged by the CFTC.[301] Some representative actions of this sort are discussed in the following section.[302]

In *In re Farmers Cooperative Co.*, the CFTC entered a Settlement Order in a proceeding brought against FCC, a grain elevator which had also been involved in litigation with producers as discussed above.[303] In the CFTC case,

> [p]roducers entered into Farmers Co-op's HTAs by making a verbal request to [representatives of FCC] in order to establish a futures reference price for the HTA, as well as a quantity of grain, and a contract month for delivery that was tied to the futures reference price. The quantity of grain and contract months matched the quantity of grain and contract months for futures contracts traded on the Chicago Board of Trade ("CBOT") or the Mid-America Commodity Exchange ("MACE"). [FCC] hedged the HTAs it held with producers . . . [and] placed an order to sell an exchange-traded futures contract corresponding to the parameters requested by the producer. On their face, Farmers Co-op's HTA contracts required delivery of the underlying commodity and stated that they would be canceled "only upon sufficient proof of inability to deliver."[304]

The CFTC, however, went beyond the face of the contracts to conclude that "[i]n marketing the HTAs and through a course of dealing . . . [FCC] allowed producers to satisfy their delivery obligations by 'buying back' the HTAs . . . [and that of] the approximately 300 producers who entered into HTAs with Farmers Co-op, approximately 40% bought back at least one contract."[305] When the producer

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300. *Id.* at *14-15.

301. *See, e.g.*, *In re* Farmers Coop. Co., [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,043, at 49,471-72 (C.F.T.C. Mar. 9, 2000) (challenging HTA contracts based upon the futures reference price when the producers were either credited or debited for the profits or losses generated by the difference between the agreed upon futures reference and the actual exchange price).

302. *See infra* Part V.B.

303. *In re* Farmers Coop. Co., [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 49,468.

304. *Id.* at 49,469.

305. *Id.* *But see* Asa-Brandt, Inc. v. ADM Investor Servs., 138 F. Supp. 2d 1144, 1164-65 (N.D. Iowa 2001) (holding that HTAs with similar arrangements for buying back the contracts were cash-forward and not futures contracts).

bought back his contract, FCC "bought exchange-traded futures contracts to offset the exchange-traded futures contracts made at the time the HTA contracts were initiated . . . [and] the profits or losses generated by the offsetting exchange-traded futures contracts were credited or debited to the producers."[306]

Moreover, producers were also allowed to roll HTA contracts to a future date, with approximately seventy percent of the producers who entered into such contracts rolling at least one HTA contract.[307] FCC then "offset the exchange-traded short futures position which established the original futures reference price and then entered into another short exchange-traded futures position . . . in order to establish a new futures reference price for the rolled HTA."[308] Under the arrangement, "[p]rofits and losses generated by the offset of the exchange-traded futures positions were credited or debited to producers."[309] The Settlement Order found these HTAs to be illegal off-exchange futures contracts.[310]

In *Grain Land Coop.*, there were three types of standardized HTA contracts[311] which ALJ Painter found to be illegal futures contracts.[312] These contracts were marketed and sold to agricultural producers, including livestock producers.[313] Two of these contained a rolling provision, a cancellation provision, an arrival period as "open," and a stated destination.[314] Two of the standardized flex HTAs had set rolling fees and cancellation fees which did not vary from contract to contract and were preprinted on the Grain Land form.[315] The third type of flex HTA was used only for soybeans and did not have a rolling or cancellation provision, but a majority showed evidence of both characteristics.[316] The price of the initial flex HTA was the price of a futures reference price selected by the producer,

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306. *In re* Farmers Coop. Co., [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 49,469.

307. *Id.* at 49,469-70.

308. *Id.* at 49,470.

309. *Id.* In this case, the CFTC also found fault with what it deemed short call option contracts in corn and soybeans. *Id.* These contracts were added on to the HTAs, and "credited producers with premiums for the right to purchase corn or soybeans from the producers by the dates and prices listed on the option contracts." *Id.* This resulted in additional delivery obligations for the producers. *Id.* The short call option contracts could be rolled and also bought back. *Id.* The CFTC found that these contracts violated § 4c(b) of the CEA and CFTC Regulation 32.2. *Id*. at 49,473.

310. *Id.* at 49,474.

311. *In re* Grain Land Coop., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,459, at 47,183 (C.F.T.C. Nov. 6, 1998).

312. *Id.* at 47,194-97.

313. *Id.* at 47,177.

314. *Id.* at 47,183.

315. *Id.*

316. *Id.*

and "was the futures price of a specific futures contract month . . . traded on the CBOT."[317] For multiple year flex HTAs, the futures reference price "was in the nearby crop year, [and required] that the producer exercise the rolling provision if delivery was intended."[318] Once the producer entered into the flex HTA contract, Grain Land would open "a [futures] position on the CBOT corresponding to the futures reference price requested by the producer."[319] "The futures position was held in Grain Land's name," and Grain Land paid all margin requirements for it, although the producer was liable for any losses sustained by Grain Land.[320]

Under the rolling provision of the flex HTA, the producer could roll the delivery date as often as he wished at his discretion, provided it was done before the twenty-fifth day of the month which preceeded the "delivery month."[321] The flex HTAs also contained a cancellation provision which gave the producer the unequivocal right to extinguish the flex HTA contract "by paying a cancellation fee in addition to paying . . . Grain Land [for] any losses or gains . . . accrued."[322] The flex HTAs also had a "redelivery procedure" which allowed producers "to simultaneously 'purchase' from Grain Land the grain pledged under their Flex HTAs and 'redeliver[]' it to Grain Land, thereby effectuating a 'delivery' without any physical movement of grain."[323] ALJ Painter concluded that Grain Land's flex HTAs were illegal off-exchange futures contracts.[324] His legal analysis will be discussed in the next section.[325]

In another initial opinion, *In re Competitive Strategies for Agriculture*, *Ltd.*, ALJ Painter also concluded that the HTAs at issue were illegal futures contracts.[326] This case involved HTAs that were marketed and sold by a cooperative, Great Plains (that operated grain elevators in Nebraska), and the employee in charge of its grain department.[327] Other respondents in the litigation included CSA, a corporation that provided marketing advice and services to producers, an affiliate IB that provided brokerage services, and the control persons of CSA and its affiliate.[328] Great Plains "Cross Country

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317. *Id.*

318. *Id.*

319. *Id.* at 47,184.

320. *Id.*

321. *Id.*

322. *Id.* at 47,185.

323. *Id.* at 47,187.

324. *Id.* at 47,194, 47,197.

325. *See* discussion *infra* Part V.B.2.

326. *In re* Competitive Strategies for Agric., Ltd., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,771, at 48,689-91 (C.F.T.C. Sept. 17, 1999).

327. *Id.* at 48,678-80.

HTA contracts" were entered into with customers of CSA who were located outside of Great Plains's traditional territory, CSA customers that operated seed corn and feedlot businesses, and people who neither farmed nor owned farmland.[329] Delivery on the HTAs was not mandatory, and customers were allowed "to cash[,] liquidate[,] and roll [the contracts] without regard for whether the[y] had grain or whether it had been sold to the local elevator."[330] Customers could also sell their HTAs, and Great Plains knew that customers intended to roll their contracts.[331] The HTAs could also be offset.[332] None of the contract holders ever delivered corn to Great Plains.[333] The ALJ determined from those factual findings that the HTAs at issue were futures and not forward contracts.[334]

V. ANALYSIS OF HTA CONTRACTS

A. *Federal Courts*

Virtually all federal courts confronted with HTA litigation have determined that the contracts in dispute are forward contracts that are not subject to the CEA, and have enforced such contracts against parties seeking to avoid them.[335] Most federal courts have arrived at this decision at the summary judgment stage and with the benefit of extensive discovery, including deposition testimony.[336] Moreover, the analytic framework used in arriving at this determination is, by and large,

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328. *Id.* at 48,679.

329. *Id.* at 48,681.

330. *Id.* at 48,682 n.52.

331. *Id.* at 48,682 & n.54.

332. *Id.* at 48,682.

333. *Id.* at 48,681.

334. *See id.* at 48,688-90 (discussing the fundamental identifying characteristics of a futures contract and finding contracts at issue to be futures contracts).

335. *See, e.g.*, Top of Iowa Coop. v. Schewe, 324 F.3d 627, 632 (8th Cir. 2003) (holding that the contracts at issue were cash forward contracts not subject to the CEA); Nagel v. ADM Investor Servs., Inc., 217 F.3d 436, 441 (7th Cir. 2000) (same); Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d 983, 996 (8th Cir. 1999) (same); Haren v. Conrad Coop., 198 F.3d 683, 684 (8th Cir. 1999) (same); Lachmund v. ADM Investor Servs., Inc., 191 F.3d 777, 790 (7th Cir. 1999) (same); Andersons, Inc. v. Horton Farms, Inc., 166 F.3d 308, 322 (6th Cir. 1998) (same). District courts have also reached the same results. *See, e.g.*, Asa-Brandt, Inc. v. ADM Investor Servs., Inc., 138 F. Supp. 2d 1144, 1165 (N.D. Iowa 2001) (holding that the HTAs in question were cash forward contracts not subject to the CEA); Oeltjenbrun v. CSA Investors, Inc., 3 F. Supp. 2d 1024, 1040-41, 1044, 1047 (N.D. Iowa 1998). While it is beyond the scope of this Article to thoroughly canvas state HTA cases, the sampling that the Author has done indicates that state courts have come to the same conclusion as federal courts. *See supra* note 174.

336. *See, e.g.*, Haren v. Conrad Coop., 198 F.3d at 684 (issuing opinion during summary judgment stage); Andersons, Inc. v. Horton Farms, Inc., 166 F.3d at 330 (same); Asa-Brandt, Inc. v. ADM Investor Servs., 138 F. Supp. 2d at 1174 (same); Oeltjenbrun v. CSA Investors, Inc., 3 F. Supp. 2d at 1054 (same). *But see*

the multifactor approach based on the *Co Petro Marketing Group* case.[337] The discussion below focuses on a few major cases at the district court and appellate court levels.

1. Asa-Brandt, Inc. v. ADM Investor Services, Inc.

In *Asa-Brandt, Inc. v. ADM Investor Services, Inc.*, the Eighth Circuit Court of Appeals affirmed the district court's rejection of RICO claims.[338] However, the Eighth Circuit found that there was sufficient evidence from which a jury could find an agency relationship between the plaintiff farmers and the grain elevator, Cooperative Society of Wesley, Iowa (Wesley), and with respect to the agency relationship between four of the farmer plaintiffs and ADM Investor Services, Inc. (ADM), an FCM.[339] Accordingly, the court reversed the grant of summary judgment to ADM on the CEA claims brought before the court below.[340] First, as to the relationship between the farmers and Wesley, the district court found that a fiduciary relationship

> arose through the Farmers' reliance upon their cooperative, its manager, and his advice to them with respect to growing and marketing their grain, advice which included measures to improve their yield, when to sell their grain, and most importantly, how to use HTAs to enhance the profitability of their operations.[341]

The Eighth Circuit chose not to disturb this finding based on the evidence presented.[342] The court noted that there was "precedent for a jury to find a fiduciary relationship between a farmer and a cooperative."[343] The court then considered the farmers' claims against ADM, the FCM, which were based on an agency theory.[344] The court's focus was whether the FCM exerted sufficient control over the IBs to be liable as a principal for the fraudulent promotion of HTAs.[345] The court found sufficient evidence from which a jury could conclude that the IBs acted with apparent authority stemming from

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Lachmund v. ADM Investor Servs., Inc., 191 F.3d at 781-83 (affirming grant of motion to dismiss based solely on complaint).

337. *See, e.g.*, discussion *infra* Part V.A.4-5.

338. Asa-Brandt, Inc. v. ADM Investor Servs., Inc., 344 F.3d 738, 753 (8th Cir. 2003). The court reversed in part on other grounds. *See id.* (reversing and remanding Farmers' Cooperative Society's state law claims).

339. *Id.* at 748-51.

340. *Id.* at 753.

341. *Id.* at 745.

342. *Id.*

343. *Id.* at 744 (citing Top of Iowa Coop. v. Schewe, 324 F.3d 627, 634 (8th Cir. 2003)).

344. *Id.* at 748-51.

345. *Id.* at 749-51.

the FCM.[346] Most pertinent was the fact that some evidence showed the FCM required farmers to open futures accounts in order to enter into an HTA contract, and when the farmers started losing money on their HTAs, they were encouraged to become active in trading their futures so as to cover any losses.[347] Four of the plaintiff farmers produced evidence which established a nexus between their futures accounts with ADM and their HTA contracts.[348] Accordingly, summary judgment on the CEA claims in favor of ADM as to those four plaintiffs was reversed.[349] The court also reversed summary judgment in favor of ADM on the state law claims.[350] The court remanded for proceedings consistent with its opinion.[351]

2. Top of Iowa Cooperative v. Schewe

In *Top of Iowa Cooperative v. Schewe*, the district court had entered judgment as a matter of law that the HTA contracts between Schewe and Top of Iowa Cooperative were cash forward contracts and not illegal futures contracts.[352] A jury had rendered a verdict for the plaintiff cooperative on a breach of contract claim, awarding $60,900 in damages, and for the defendant on the breach of fiduciary duty counterclaim, with an award of $3,400 in damages.[353] Both parties appealed.[354] Applying the test articulated in *Grain Land Coop v. Kar Kim Farms*, the Eighth Circuit affirmed the district court's judgment as to the legality of the HTAs as valid cash forward contracts.[355] Quoting *Grain Land Coop*, the court held that "a legitimate expectation that physical delivery of the actual commodity . . . will occur in the future" was sufficient to conclude that the contract was not an illegal futures contract.[356] The court rejected Schewe's argument that it should expand the *Grain Land* test to include a consideration of the underlying purposes of the HTAs to discern whether they are subject to regulation by the CEA.[357] Instead, the court found that both parties expected that the corn's

346. *Id.* at 751.

347. *Id.* at 751-52.

348. *Id.* at 751.

349. *Id.* at 752.

350. *Id.*

351. *Id.* at 753.

352. Top of Iowa Coop. v. Schewe, 324 F.3d 627, 629 (8th Cir. 2003).

353. *Id.* at 631.

354. *Id.*

355. *Id.* at 631-32.

356. *Id.* at 631 (quoting Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d 983, 991 (8th Cir. 1999) (citation omitted)).

physical delivery would take place in the future.[358] The court then went on to consider the seemingly inconsistent verdicts—i.e., the district court's finding of a breach of fiduciary duty but no breach of contract.[359] Schewe had argued that it was not possible that there was a meeting of the minds sufficient to form a contract because the jury found that Top of Iowa had breached its fiduciary duty to explain the riskiness of the HTAs to him.[360] The court ruled that the breach of fiduciary duty pertained to the relationship between Schewe and Top of Iowa, and did not involve the contracts.[361] However, the Eighth Circuit recounted that the district court stated it would have reached a different result as to the breach of fiduciary duty claim, but an evidentiary basis existed for the result reached by the jury.[362] That basis was that the Top of Iowa representatives had more experience and knowledge as to hedging on the CBOT and the volatility of corn markets, and because they possessed knowledge superior to Schewe's, a fiduciary duty could have existed between the cooperative and Schewe.[363] The appellate court affirmed the judgment below.[364]

3. Grain Land Coop v. Kar Kim Farms, Inc.

In *Grain Land Coop* the court considered five HTA contracts between Grain Land Coop and Paul Obermeyer, a grain farmer.[365] Under the HTA arrangement:

> Obermeyer agreed to deliver at an unspecified time a fixed quantity and grade of grain to Grain Land. The per-bushel sale price was determined by reference to a futures contract price from the Chicago Board of Trade (CBOT) for March 1996, plus or minus a variable component referred to as "basis." Basis is the difference between the price of the designated futures contract and the cash price for that same commodity. While the CBOT reference price was fixed at the time of the contract, the basis was allowed to float until Obermeyer elected to fix it, at a point prior to the "twenty-fifth day preceding the futures month of delivery." If Obermeyer failed to set basis prior to that day, Grain Land had the right to set basis and thereby set the sale price for the grain.

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357. *Id.* at 632.

358. *Id.*

359. *Id.* 632-33.

360. *Id.* at 633.

361. *Id.*

362. *Id.*

363. *Id.* at 634.

364. *Id.* at 634-35.

365. Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d 983, 987 (8th Cir. 1999). *Grain Land Coop v. Kar Kim Farms, Inc.* had a tortuous procedural history, in the judicial as well as the administrative forum, which is not relevant here except to note the fierce litigation surrounding HTA contracts. *See id.* at 988-90. The ALJ opinion in *Grain Land Coop* will be discussed below. *See supra* Part V.B.2.

> The contract also called for Grain Land to establish an offsetting "hedge" transaction by taking a "short," or sell, position on the CBOT equal to its buy obligation under the HTA. The elevator maintained a margin account with the exchange, and assumed responsibility for "margin calls" on the hedge position, increasing the account if rising futures prices caused the equity in the account to decline, as well as covering any commissions resulting from the CBOT transaction. Obermeyer's HTA contract for corn allowed him to "roll," or postpone, delivery to a later date. When Obermeyer elected to defer delivery, Grain Land also rolled its hedge, buying back its existing short position and taking a new position in the new delivery month. Any gain or loss Grain Land realized in rolling the hedge was added to or subtracted from the original futures reference price. In essence, the rolling provision allowed Obermeyer to take advantage of rising cash prices by selling his grain on the cash market and deferring delivery under the HTA.[366]

The court then described the unprecedented market inversion in which the price of corn rose sharply, creating a strong demand for immediate delivery of corn, and "causing prices for futures contracts with more immediate delivery dates to exceed prices for futures contracts with delivery dates that were further out."[367] As a result, farmers rolled their futures contracts and sold their "grain on the cash market."[368] But instead of falling, corn prices continued to rise, prompting farmers "to further roll their contracts, which caused their HTA per-bushel prices to drop accordingly."[369] Each time a farmer rolled his HTA contract, "Grain Land realized losses on [its] short futures positions and had to meet mounting margin calls."[370] The court noted that for each "penny the price of corn gained on the futures market, Grain Land had to meet approximately $200,000 in margin calls on its outstanding HTA hedge transactions."[371] The HTA contracts in *Grain Land Coop*, the court noted, were "less than clear."[372]

> They begin by reciting the terms of the hedge transaction (grain, grade, quantity, and futures month), and list a destination of Kiester (a small town in south-central Minnesota) and an "Arrival Period" designated "OPEN." The contracts go on to define basis and the provisions for setting basis, and establish Grain Land's responsibility for margin and commissions resulting from the hedge. The contracts further provide that Obermeyer must set basis on or before the "twenty-fifth day preceding the futures month of delivery"; that Obermeyer must pay two cents per bushel to roll; and that Obermeyer "has the right to cancel [the] futures contract" for five cents per bushel plus or minus the accumulated

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366. Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d at 987.

367. *Id.*

368. *Id.* at 988.

369. *Id.*

370. *Id.*

371. *Id.* at n.2.

372. *Id.* at 987.

spread. Finally, the contracts provide that in order to collect gains, Obermeyer "must make a delivery of grain sometime."[373]

The court then analyzed the HTAs to determine whether they were futures or forwards, stating that "it is the contemplation of physical delivery of the subject commodity that is the hallmark of an unregulated cash-forward contract."[374] The court stated that an appropriate analytic framework for viewing HTA contracts is an

> individualized, multi-factor approach [that] scrutinizes each transaction for such characteristics as whether the parties are in the business of obtaining or producing the subject commodity; whether they are capable of delivering or receiving the commodity in the quantities provided for in the contract; whether there is a definite date of delivery; whether the agreement explicitly requires actual delivery, as opposed to allowing the delivery obligation to be rolled indefinitely; whether payment takes place only upon delivery; and whether the contract's terms are individualized, rather than standardized.[375]

Based on this approach, the court concluded that the Grain Land HTAs were cash forward contracts excluded from the CEA.[376] It began its analysis by noting "that the existence of a delivery obligation [was] less than clear from the face of the contract[s],"[377] but recognized "that the language of the contracts, taken as a whole, suggest[s] a delivery obligation."[378] The court pointed to a designated delivery location and a "'designated arrival period'"[379] as an indication that the contracts contemplated actual delivery of the corn.[380] The court, however, went beyond the face of the contracts to look at the parties: both were commercials who had the capacity to make and take delivery, and for whom the underlying commodity held intrinsic value.[381] The court also found that the terms of the contract were individually negotiated and not standardized, and therefore did not permit

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373. *Id.*

374. *Id.* at 990; *see also* CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d 573, 577-79 nn.4-6 (9th Cir. 1982) (interpreting congressional intent as illustrated in the CEA's legislative history).

375. Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d at 991 (citing Lachmund v. ADM Investor Servs., Inc., 191 F.3d 777, 787 (7th Cir. 1999); Andersons, Inc. v. Horton Farms, Inc., 166 F.3d 308, 320 (6th Cir. 1998); CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d at 578-79).

376. Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d at 992.

377. *Id.* at 991; *see also* Johnson v. Land O' Lakes, Inc., 18 F. Supp. 2d 985, 989-90, 994-95 (N.D. Iowa 1998) (concluding that HTAs were cash forward contracts that could rest on the implication of a delivery obligation).

378. Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d at 991.

379. *Id.*

380. *Id.* at 992.

381. *Id.* at 991-92.

offsetting transactions.[382] The HTAs also were not offered to the general public, further reinforcing the conclusion that they were cash-forward contracts and not futures contracts subject to the CEA.[383]

The court rejected Obermeyer's contention that because the HTAs permitted him to "'unilaterally and unequivocally avoid setting basis and avoid delivery for any reason,'" they "permitt[ed] him to defer delivery indefinitely," therefore imposing no actual obligation to deliver grain.[384] Moreover, the court discounted the argument that the cancellation provision also permitted Obermeyer to avoid delivery, holding instead that "[h]is ability to roll the contracts merely allowed him to delay his delivery obligation rather than avoid it altogether."[385] The cancellation provision did not allow Obermeyer "to use the HTAs to engage in unadulterated futures speculation" because the contracts required delivery at some time to collect gains.[386] Moreover, the court noted that Obermeyer never attempted to cancel his contracts. Although there was evidence that Grain Land did permit "a handful of farmers to cancel their HTAs and realize gains on the futures position,"[387] that evidence had no bearing on the dispute between Grain Land and Obermeyer which the court had to decide.[388]

The court also rejected the suggestion "that a mutually enforceable delivery obligation is *necessary* to place a transaction outside the reach of the CEA."[389] Further, the court refused to confine its analysis to the terms of the contract itself, on the grounds that "such a myopic approach would expand the gravitational pull of the CEA beyond what is suggested by the congressional policies underlying the vague text of § 1a(11)."[390] Instead, the court focused on the "'legitimate expectation that physical delivery of the actual commodity by the seller to the original contracting buyer will occur in the future.'"[391]

Finally, the court refused to be guided by the ALJ opinion in the CFTC proceeding against Grain Land, stating that it need not defer to the agency's interpretation of the statute it is empowered to administer because the CFTC proceedings had a different focus involving the course of dealings

382. *Id.* at 992.

383. *Id.* (quoting Brief for Appellee at 42, Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d 983 (8th Cir. 1999) (Nos. 98-3217, 98-3304)).

384. *Id.* (quoting Brief for Appellee at 42, Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d 983 (8th Cir. 1999) (Nos. 98-3217, 98-3304)).

385. *Id.*

386. *Id.*

387. *Id.* at n.7.

388. *Id.*

389. *Id.* at 992.

390. *Id.*

391. *Id*. (citing Andersons, Inc. v. Horton Farms, Inc., 166 F.3d 308, 318 (6th Cir. 1998)).

between grain elevators and producers over a number of years.[392] The court's inquiry was limited to whether Obermeyer's contracts with Grain Land were enforceable cash-forward contracts.[393] The court did, however, follow the CFTC's "general approach . . . by looking to the transaction's ultimate purpose."[394]

4. Nagel v. ADM Investor Services, Inc.

Judge Richard Posner affirmed in short order the dismissal of plaintiff farmers' suit against grain elevators and grain merchants and confirming arbitral awards in favor of the defendants.[395] The farmers had entered into "flexible" or "enhanced" HTAs, which allowed them to defer delivery or "roll" the contract to a future date upon the payment of a rolling fee and a price adjustment to reflect changed conditions.[396] The court acknowledged that "[t]he flex feature thus enables the farmer to speculate on fluctuations in the market price of his grain,"[397] which "move[d] these contracts in the direction of futures contracts by attenuating the obligation to deliver, and there is anxiety that by loading such features onto what would otherwise seem to be garden-variety forward contracts the regulatory scheme will be evaded."[398] Judge Posner also recognized that the "'totality of the circumstances' approach for determining whether a contract is a futures contract or a forward contract" could create undesirable legal uncertainty.[399] However, he stated that in practice, the multifactor approach gave "controlling significance to a handful of circumstances," which could "usually be ascertained just by reading the contract."[400] He then refined the multifactor approach, collapsing it into three factors, the presence of which will generally signal the existence of a forward contract:

> (1) The contract specifies idiosyncratic terms regarding place of delivery, quantity, or other terms, and so is not fungible with other contracts for the sale of the commodity, as securities are fungible. But there is an exception for the case in which the seller of the contract promises to sell another contract against which the buyer can offset the first contract, as in *In re Bybee*, 945 F.2d 309, 313 (9th Cir. 1991), and *CFTC v. Co Petro*

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392. *Id.* at 993 (citing *In re* Grain Land Coop., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,459, at 47,178 (C.F.T.C. Nov. 6, 1998)); *see* discussion *supra* Part V.B.2.

393. Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d at 993.

394. *Id.*

395. Nagel v. ADM Investor Servs., Inc., 217 F.3d 436, 443 (7th Cir. 2000).
396. *Id.* at 439.

397. *Id.*

398. *Id.* at 440.

399. *Id.* at 441.

400. *Id.*

Marketing Group, Inc., *supra*, 680 F.2d at 580. That promise could create a futures contract.

(2) The contract is between industry participants, such as farmers and grain merchants, rather than arbitrageurs and other speculators who are interested in transacting in contracts rather than in actual commodities.

(3) Delivery cannot be deferred forever, because the contract requires the farmer to pay an additional charge every time he rolls the hedge.[401]

Judge Posner suggested that oral terms outside the written contract could also be taken into account, but that in this case, plaintiffs had not alleged any oral terms that "would prevent eventual delivery or cancel the fee for rolling, which places a practical limit on how long delivery can be deferred."[402] Under this formulation, a contract which allowed indefinite rolls, but charged a rolling fee per roll, would still be considered a forward contract.

5. Lachmund v. ADM Investor Services, Inc.

The Seventh Circuit Court of Appeals affirmed the grant of a motion to dismiss federal claims under the CEA and other statutes brought by an Indiana farmer against an FCM, an IB, an agricultural consulting firm, and a corporation operating a grain elevator.[403] The court's opinion turned on its analysis of the futures/forwards distinction.[404]

Tom Lachmund's HTAs were with Demeter Incorporated, the corporation operating the grain elevator, and contained a rolling feature which allowed him to "roll the undelivered amounts forward to later crop futures months, [and] even to the next crop year."[405] However, after a series of rolls, Demeter informed Lachmund that his contracts could no longer be rolled beyond the conclusion of the crop year. Thus, each HTA had to be settled by the end of the 1995 crop year, either by delivery or by cash transaction.[406] Demeter then charged Lachmund's account a debit of $304,597.26.[407] Lachmund then brought suit under state law, the CEA, and RICO, alleging claims against the defendants that they "conspired to evade the CFTC's futures markets regulations by engaging in off-exchange futures markets activities through HTA contracts with farmers."[408] Lachmund claimed that

401. *Id.*

402. *Id.* at 441-42.

403. Lachmund v. ADM Investor Servs., Inc., 191 F.3d 777, 789-90 (7th Cir. 1999).

404. *Id.* at 786-88.

405. *Id.* at 780.

406. *Id.*

407. *Id*.

the HTAs were "illegal off-exchange futures contracts because the grain . . . did not have to be delivered within the crop year."[409] The intent of the contracts was not to physically transfer grain because the farmers, according to Lachmund, (1) were encouraged into entering contracts for more grain than could be delivered in one crop year; (2) many HTAs failed to specify a delivery date; (3) "the farmers could engage in unlimited rolling of their delivery obligations"; and (4) the "contracts could be settled by a cash buy-out at any time."[410]

The court began its analysis of Lachmund's CEA claims by stating that its initial task was "to establish a methodology for determining whether a particular contract is a cash forward contract exempt from regulation under the CEA or a futures contract subject to the requirements of the CEA."[411] As an initial matter, the court examined the contract's words, for the terms provided indications of the transaction the document memorializes.[412] The court identified the following terms which were indicative of whether the parties contemplated delivery:

> [1] whether the parties to the contract are in the business of producing or obtaining grain; [2] whether the parties are capable of delivering or receiving actual grain in the quantities provided for in the contract; . . . [3] whether the agreement explicitly requires actual delivery, as opposed to allowing delivery obligations to be rolled indefinitely into the future; . . . [4] whether the contract's terms are individualized, as opposed to standardized.[413]

However, the court cautioned that the "list of factors characterizing cash forward contracts . . . is neither exhaustive nor definitive," and that the analysis required an examination of "the course of dealing[s] between the parties and the totality of the business relationship."[414] Noting the CFTC's Amicus Brief, a 1985 Interpretative Statement, and *CFTC v. Co Petro Marketing Group, Inc.*, among other authorities, the court underscored the need to "'look beyond the four corners of [the contracts] and take into account all relevant circumstances [when] deciding the issue of the underlying nature of the transaction.'"[415]

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408. *Id.* at 780-81.

409. *Id.* at 781.

410. *Id.*

411. *Id.* at 787. The CFTC had filed an amicus brief in the case. *Id.* at n.15.

412. *Id.* at 787.

413. *Id.* (citing Andersons, Inc. v. Horton Farms, Inc., 166 F.3d 308, 320 (6th Cir. 1998); CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d 573, 578 (9th Cir. 1982); *In re* Grain Land Coop, 978 F. Supp. 1267, 1273-74 (D. Minn. 1997); Characteristics Distinguishing Cash and Forward Contracts and "Trade" Options, 50 Fed. Reg. 39,656, 39,658 (Sept. 30, 1985)).

414. Lachmund v. ADM Investor Servs., Inc., 191 F.3d at 787.

415. *Id.* (quoting Brief of Amicus Curiae CFTC at 4, Lachmund v. ADM Investor Servs., Inc., 191 F.3d 777 (7th Cir. 1999) (No. 98-3467); citing CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d at 581; Characteristics Distinguishing Cash and Forward Contracts and "Trade" Options, 50 Fed. Reg. at 39,657, 39,658).

The court then applied the framework it had developed to Lachmund's HTA contracts.[416] First, pointing to specific terms (such as time of shipment and delivery location, among others), it found that the terms of the contracts clearly contemplated actual delivery of the grain.[417] Second, the parties were clearly in the business of obtaining or producing grain, and were reasonably capable of receiving or delivering grain in the contracted amounts.[418] Third, the contracts contained a specific time of delivery, and no term explicitly allowed rolling.[419] Fourth, the contracts were individualized with respect to terms such as the grain quantity, the time and point of delivery, and the overall purpose (which was "to buy and sell grain rather than to engage in price speculation on the futures market").[420] From its analysis of the face of the contracts, the court concluded the contracts contained all the features characteristic of cash forward contracts.[421]

However, the court's inquiry did not end there. Looking at the allegations of the complaint, the court determined that the parties' course of dealing demonstrated that they did not engage in "unlimited and indefinite rolling of delivery obligations."[422] Accordingly, the court affirmed the dismissal of Lachmund's complaint on the grounds that the HTA contracts were forwards, exempt from the CEA.[423]

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416. *Id.* at 788.

417. *Id.*

418. *Id.*; *see also id.* ("Mr. Lachmund's complaint avers that the grain quantities in the contracts were based on his estimated annual crop yield.").

419. *Id.* at 788-89.

420. *Id.* at 789-90.

421. *Id.*

422. *Id*.

423. *Id.*

6. Nagel v. ADM Investor Services, Inc.[424]

In *Nagel*, Judge Easterbrook held that flexible or enhanced HTA contracts for corn, entered into by five farmers with grain merchants, including grain elevators, were enforceable as cash forward contracts excluded from the CEA.[425] The case is notable for its criticism of the multifactor approach[426] and its formulation of an alternate framework.[427]

Characterizing the flex HTAs at issue as "normal HTA[s] plus an option to defer delivery,"[428] the court explained that the ability to defer delivery did not mean that the farmer could "cancel the obligation by buying an offsetting contract (a distinguishing feature of a futures market) or to pay cash in lieu of delivery."[429] Under a flex HTA, the farmer could choose the timing of his delivery, and extend that choice over several months, or even to future growing seasons.[430]

After discussing the risks accruing to both elevators and farmers as a result of the flex HTAs to which they had contracted, the court declared the following: "What the farmers in these cases want me to do is to say that the flex HTA agreements really were futures contracts, making them invalid because futures contracts must be traded by futures commission merchants on boards of trade."[431] This the court declined to do.[432]

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424. This case was a consolidation of five separate actions. Nagel v. ADM Investor Servs., Inc., 65 F. Supp. 2d 740, 742 (N.D. Ill. 1999). The case contained a number of interesting procedural issues, including an attempt to set aside an arbitration award and an attempt by the plaintiff farmers to certify a class of similarly situated grain farmers. *Id.* at 744, 746. Both attempts failed. *Id.* at 744-47. The plaintiffs argued, *inter alia*, that the arbitration award should be set aside because the CEA prohibits arbitration of conflicts arising out of HTA futures contracts. *Id.* at 745. The court construed 17 C.F.R. § 180.3(b) as applying only to claims and disputes arising out of futures contracts executed on contract markets and applying only to FCMs, IBs, floor brokers, CPOs, CTAs or associated persons—none of which the defendants were in the arbitration proceeding. *Id.* The court's reasons for not granting certification rested squarely on the law surrounding Federal Rule of Civil Procedure 23, because the plaintiffs did not adequately represent the interests of the class they purported to represent. *Id.* at 746-47. *See* FED. R. CIV. P. 23.

425. *Id.* at 755.

426. *Id.* at 750-53; *see supra* notes 144-51 and accompanying text (discussing the multifactor approach as applied in several cases).

427. Nagel v. ADM Investor Servs., Inc., 65 F. Supp. 2d at 752-55.

428. *Id.* at 748.

429. *Id.*

430. *Id*.

431. *Id.* at 749-50.

432. *Id.* at 755.

After concluding that the multifactor approach engendered undesirable uncertainty, the court analyzed the HTAs before it.[433] The focus of the court's analysis was that HTAs were contracts in the commodity and not "in the contract," in which the farmer was required to deliver corn pursuant to their terms, though the timing of delivery could be chosen by the farmer.[434] The court explained as follows:

> [The f]armers' ability to defer delivery is just that: a power to defer. The contract authorizes in advance what parties to contracts always can arrange by negotiation. Delivery dates are flexible, especially for agricultural commodities, which are subject to weather and other hazards. A flex HTA establishes the terms on which delay occurs. It may well be that farmers who elected to go short in a rising market made a blunder. If farmers were able to bear that kind of market price risk, why did they use fixed-price contracts in the first place? Erroneous business judgments many months after a contract was formed do not, however, change the nature of the contract from a forward to a future.[435]

Moreover, the court noted that the hallmark of a futures contract was "futurity," which the court explained as meaning that "[p]arties who enter futures contracts do not agree to pay the price that prevails when they buy the contracts; they agree to pay the price that prevails when the contracts *expire* (or the positions are closed by offsetting transactions)."[436] In addition, futurity meant that "the parties' ultimate obligation is not known until long after they buy the contracts."[437] In contrast, flex HTA arrangements lacked futurity because "[t]he price the farmer is to receive on delivery is set when the contract is formed (and reset when delivery is deferred); the price of the market when the farmer delivers is irrelevant."[438] Flex HTAs simply allow the farmer to "transfer[] market price risk to the grain merchant, who makes a *fixed* commitment to pay, and then hedges that commitment by selling a futures contract whose payoff (or cost) will be determined in the future."[439] Therefore, the flex HTAs were not futures contracts.[440]

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433. *Id.* at 752. The court ultimately determined that even if it had applied the multifactor approach, it would have still concluded the HTAs were forward contracts. *Id.* at 750.

434. *Id.* at 751-52.

435. *Id.* at 750.

436. *Id.* at 753.

437. *Id.*

438. *Id.*

439. *Id.* at 753-54.

440. *Id.* at 754. In making this decision, the court categorically rejected any deference to the CFTC position that HTAs are futures contracts. *Id.*

7. Asa-Brandt, Inc. v. ADM Investor Services, Inc.

This case was brought by grain producers against several grain elevators, an FCM (ADM), a CTA (CTA), and IBs (Agri-Plan and CSA) on the grounds that the defendants engaged in the promotion and marketing of HTAs in violation of the CEA.[441] The case came before the district court on cross motions for summary judgment.[442] The court granted summary judgment to the FCM as to all the claims against it, the CTA and IB were granted summary judgment as to one of the plaintiffs' claims, and the grain elevator was granted summary judgment as to three of the CEA claims but denied summary judgment as to the breach of fiduciary duty claims.[443] The CEA claims were brought under CEA section 4b (fraud against ADM and CSA) and sections 4(a) and (d) (illegality of the HTAs).[444] Additionally, the plaintiffs sought a declaratory judgment as to the rights of parties to the HTAs, and the legality of the HTAs under sections 4(a)-(c) of the CEA.[445] Producers entered into HTAs (the terms of which have been described above[446]) with grain elevators.[447] The FCM (ADM) was not a party to any of the contracts.[448]

The starting point for the *Asa-Brandt* court's analysis was the question of "'whether there is a legitimate expectation that physical delivery of the actual commodity by the seller to the original contracting buyer will occur in the future.'"[449] The court then said that the following multifactor analysis should be applied:

> [C]ourts should examine each transaction for such characteristics as whether the parties are in the business of obtaining or producing the subject commodity; whether they are capable of delivering or receiving the commodity in the quantities provided for in the contract; whether there is a definite date of delivery; whether the agreement explicitly requires actual delivery, as opposed to allowing the delivery obligation to be rolled

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441. Asa-Brandt, Inc. v. ADM Investor Servs., Inc., 138 F. Supp. 2d 1144, 1147-49, 1151 (N.D. Iowa 2001) (involving RICO, federal securities laws, and state statutory and common law claims), *aff'd in part, rev'd in part*, 344 F.3d 738 (8th Cir. 2003).

442. *Id.* at 1150-51.

443. *Id.* at 1174.

444. *Id.* at 1149.

445. *Id.*

446. *See supra* notes 266-68 and accompanying text; *see also* Asa-Brandt, Inc. v. ADM Investor Servs., Inc., 138 F. Supp. 2d at 1151-52, 1163-64 (setting out the HTA contract at issue).

447. Asa-Brandt, Inc. v. ADM Investor Servs., Inc., 138 F. Supp. 2d at 1151.

448. *Id.*

449. *Id.* at 1162 (quoting Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d 983, 991 (8th Cir. 1999)).

> indefinitely; whether payment takes place only upon delivery; and whether the contract's terms are individualized, rather than standardized.[450]

The court began with the terms of the contracts themselves.[451] The HTA contracts in *Asa-Brandt* were on identical form contracts, with blank spaces provided for "'Contract No.,' the name of the 'Seller-producer,' 'Customer No.,' 'Merchandizer of delivery,' 'Broker,' 'Quantity,' 'Grain and Grade,' 'CBOT Futures Month and Price,' 'Delivery Mode,' 'Grades to Govern,' and 'Weights to Govern.'"[452] Following the standards set forth in *Lachmund v. ADM Investor Services, Inc.*, the court identified the terms in HTA contracts that typically determine whether the contracts were futures or forwards:

> "In determining whether a contract is a cash forward contract or a futures contract, our starting point must always be the words of the contract itself. The contract's terms will provide several indications of the nature of the transaction it memorializes. The document itself will reveal whether the agreement contemplates actual delivery, by indicating the following: whether the parties to the contract are in the business of producing or obtaining grain; whether the parties are capable of delivering or receiving actual grain in the quantities provided for in the contract; whether there is a definite date of delivery; whether the agreement explicitly requires actual delivery, as opposed to allowing delivery obligations to be rolled indefinitely into the future; whether payment takes place only upon delivery; and whether the contract's terms are individualized, as opposed to standardized."[453]

The court then recited the terms of the HTA contracts.[454] Next, the court determined that the parties to the contracts were indisputably industry participants "'in the business of obtaining or producing the subject commodity,'" which was a central characteristic of a cash forward contract.[455] Citing *Grain Land Coop*, the court explained that

> [t]he Eighth Circuit Court of Appeals has adopted a multi-factor approach to determining whether contracts are cash forward contracts and instructed that a court should consider the intentions of the parties, the terms of the contract, the course of dealing between the

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450. *Id.* (quoting Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d at 991; citing Nagel v. ADM Investor Servs., Inc., 217 F.3d 436, 441 (7th Cir. 2000) (adopting the "totality of the circumstances" analysis)).

451. *Id.* at 1163.

452. *Id.*

453. *Id.* (quoting Lachmund v. ADM Investor Servs., Inc., 191 F.3d 777, 787 (7th Cir. 1999)).

454. *Id.* at 1163-64.

455. *Id.* at 1162 (quoting Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d at 991).

> parties, and any other relevant factors to determine whether the parties contemplated physical delivery of the grain, "the hallmark of . . . unregulated cash-forward contracts."[456]

The court then concluded, however, that when the following three essential factors identified in *Nagel*[457] were present—as was the case *Asa-Brandt*—the HTA would be deemed a cash forward contract excluded from the CEA:

> (1) The contract specifie[d] idiosyncratic terms regarding place of delivery, quantity, or other terms, and so is not fungible with other contracts for the sale of the commodity, as securities are fungible. . . .
>
> (2) The contract [was] between industry participants, such as farmers and grain merchants, rather than arbitrageurs and other speculators who [we]re interested in transacting in contracts rather than in the actual commodities.
>
> (3) Delivery [could not] be deferred forever, because the contract require[d] the farmer to pay an additional charge every time he roll[ed] the hedge.[458]

The *Asa-Brandt* court, after proceeding through a multifactor analysis, extracted the three factors identified in the *Nagel*/*Cargill* approach to determine that the HTAs before it were forwards, and on that basis, enforceable against the producers.[459] However, based on deposition testimony from the producers as to their reliance on the expertise and advice rendered by the manager of the grain elevator (Farmer's Cooperative Society of Wesley, Iowa) for their grain marketing arrangements, the court concluded that the producers generated a genuine issue of material fact as to the breach of fiduciary duty claim.[460]

B. *CFTC Initial Opinions: Futures not Forwards*

In the two initial opinions to emerge thus far in the HTA litigation brought by the CFTC, ALJ Painter, applying the multifactor approach, found the HTAs at issue to be futures contracts subject to the CEA.[461] However, both initial decisions were appealed to the full Commission, which in November 2003 rendered differing opinions: concluding that the HTAs at issue in *Competitive Strategies* were

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456. *Id.* at 1157 (quoting Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d at 990-91).

457. *See* Nagel v. ADM Investor Servs., Inc., 217 F.3d 436, 441 (7th Cir. 2000) (outlining the three-factor approach).

458. Asa-Brandt v. ADM Investor Servs., Inc., 138 F. Supp. 2d at 1158.

459. *Id.* at 1173-74.

460. *Id.* at 1171-73.

461. *In re* Competitive Strategies for Agric., Ltd., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,771, at 48,688-90 (C.F.T.C. Sept. 17, 1999); *In re* Grain Land Coop., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,459, at 47,196-97 (C.F.T.C. Nov. 6, 1998).

off-exchange futures contracts,[462] yet holding that the HTAs in *Grain Land* were forward contracts excluded from the CEA.[463]

1. In re Competitive Strategies for Agriculture, Ltd.

This opinion resolved a six count complaint brought by the Division of Enforcement against an entity providing marketing services to farmers (CSA), an IB affiliated with CSA, controlling persons of CSA, various individuals associated with CSA, a grain cooperative that operated grain elevators in Nebraska (Great Plains), and Great Plains's Manager (Herman Gerdes), alleging that they had marketed and sold illegal off-exchange futures contracts in violation of sections 4a and 4d, and record-keeping provision 4g(c) of the CEA.[464] CSA customers were directed to Great Plains, with whom they entered into the HTAs.[465] ALJ Painter stated at the outset that the HTAs fit "four square" with the Seventh Circuit's definition of a futures contract[466] in *Chicago Mercantile Exchange v. SEC*:[467]

> A futures contract, roughly speaking, is a fungible promise to buy or sell a particular commodity at a fixed date in the future. Futures contracts are fungible because they have standard terms and each side's obligations are guaranteed by a clearing house. Contracts are entered into without prepayment, although the markets and clearing house will set a margin to protect their own interests. *Trading occurs in "the contract" not in the commodity*.[468]

The ALJ first determined that the Great Plains HTAs did not fit within the cash forward exclusion, which was demonstrated not only by the function of the contracts but evinced by the intent of the parties.[469] The ALJ explained that "[t]he cash forward exclusion primarily 'entails not only the legal obligation to perform, but also the generally fulfilled *expectation* that the contract will lead to the exchange of commodities for money.'"[470] Here, the evidence showed both that delivery did not occur

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462. *In re* Competitive Strategies for Agric., Ltd., [2004] 2 Comm. Fut. L. Rep. (CCH) ¶ 29,635, at 55,735 (C.F.T.C. Mar. 15, 2004).

463. *In re* Grain Land Coop., [2003] 2 Comm. Fut. L. Rep. (CCH) ¶ 29,636, at 55,750 (C.F.T.C. Nov. 25, 2003).

464. *In re* Competitive Strategies for Agric., Ltd., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 48,678.

465. *Id.* at 48,681.

466. *Id.* at 48,684.

467. Chi. Mercantile Exch. v. SEC, 883 F.2d 537 (7th Cir. 1989).

468. *In re* Competitive Strategies for Agric., Ltd., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 48,683-84 (quoting Chi. Mercantile Exch. v. SEC, 883 F.2d at 542) (emphasis added in *Competitive Strategies*).

469. *Id.* at 48,684.

as a result of the Great Plains HTAs, and that the parties had no expectation that delivery would in fact occur.[471] The ALJ determined that the critical fact was the group of people to whom the HTAs were marketed and sold.[472] The facts marshaled by the ALJ were that most customers who entered into the contracts were located well outside the traditional territory of Great Plains.[473] This required the price paid for the grain to take into account the distance for delivery, so delivery would be more expensive.[474] Moreover, many of the customers "were seed corn producers whose grain was contractually bound for delivery to seed corn buyers."[475] In addition, "some of the producers introduced to Great Plains by CSA were feedlot operators, meaning that their grain was raised exclusively to feed livestock."[476] Even more telling was that some of the parties entering into HTAs with Great Plains were neither farmers nor owners of farmland—further evidence that the grain merchants "could not have intended delivery to occur."[477] Furthermore, the promotional brochure regarding the flex HTAs distributed by Great Plains stated that "'[*o*]*ffsetting the contract* is less costly in the event the producer can't or *would rather not make delivery of the grain*.'"[478] From this, the ALJ concluded it was clear that "customers who enter into Cross Country Hedge-to-Arrive contracts can decide that they would rather not make delivery and simply cash liquidate their contracts."[479] In short, the Great Plains flex HTAs did not qualify for the cash forward exclusion because there was no expectation of delivery of the underlying commodity, and customers had the unilateral right to liquidate the contracts.[480]

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470. *Id.* (quoting *In re* Stovall, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,941, at 23,778 (C.F.T.C. Dec. 6, 1979)) (emphasis added in *Competitive Strategies*).

471. *Id.* at 48,682.

472. *Id.* at 48,684-85.

473. *Id.* at 48,685.

474. *Id.* The ALJ ruled "that Great Plains entered into a contract with any producer that CSA sent to it regardless of the impracticality or sheer burden of delivery." *Id.* This suggested that delivery was not intended.

475. *Id.* at 48,685-86; *see id.* (citing testimony of seed corn producers whose grain was contractually bound for delivery) (footnotes omitted).

476. *Id.* at 48,686.

477. *Id.* (footnotes omitted).

478. *Id.* at 48,687 (quoting promotional materials from one of the defendants).

479. *Id.*

480. *Id.* at 48,688.

Next, "[viewing] the 'transaction as a whole with a critical eye toward its underlying purpose,'"[481] the ALJ determined that the Great Plains flex HTAs were in fact "illegally traded off-exchange futures contracts."[482] The ALJ determined that "[a]lthough 'no bright line definition or list of characterizing elements is determinative' of what constitutes a futures contract, there are fundamental identifying characteristics."[483] Here,

> [t]he identifying characteristics that are of significance in the determination that the Cross Country HTA contracts are futures contracts are: (1) Respondents' designation of these transactions on paper; (2) the unlimited rolling that Respondents allowed Cross Country HTA contract holders; and (3) the fact that delivery never occurred in order to satisfy a Cross Country HTA contract.[484]

The purpose of the flex HTAs was to "'shift price risk without transferring the underlying commodity,'" which is the purpose of futures contracts.[485]

> All CSA customers who entered into Cross Country HTA contracts used these contracts to try to profit from the price differential on the futures market. Just as Respondents did not expect them to deliver, the CSA customers knew that they did not have to deliver and used the contracts to speculate.[486]

Also of prime significance in the analysis was the fact that "[f]or all intents and purposes, the CSA customers who entered into Cross Country CSA contracts did not serve as producers intending to sell their grain," but rather their role "was precisely analogous to the role of the general public in futures trading."[487]

ALJ Painter concluded:

> The probative evidence of record proves beyond peradventure that the Great Plains-CSA enterprise was a bucket shop operation masquerading as a "cash forward hedge-to-arrive business." Great Plains took not one bushel from a CSA customer. The Great Plains-CSA operation could have been housed in the backroom of a tavern or pawn shop. There was certainly no need for a grain elevator.

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481. *Id.* (quoting Policy Statement Concerning Swap Transactions, 54 Fed. Reg. 30,694, 30,694 (July 21, 1989)).

482. *Id.*

483. *Id.* (citing CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d 573, 581 (9th Cir. 1982)).

484. *Id.*

485. *Id.* (citing Policy Statement Concerning Swap Transactions, 54 Fed. Reg. at 30,695).

486. *Id.* at 48,690.

487. *Id.*

> In the case at bar, Great Plains took the opposite side of CSA clinets [sic] who bought or sold futures contracts. Great Plains maintained a futures account with Farmers Commodity Corporation (FCC), a futures commission merchant, and it hedged its bets with the CSA customers by taking futures positions through FCC. The hedge, however, did nothing to protect the CSA customer. The CSA customers owned no interest in the account, and could make no claim against FCC or the designated exchange. As noted by the Seventh Circuit, the exchange clearinghouse guarantees the obligations of both sides of a contract traded on a designated futures exchange. In the case at bar, the CSA customers were strangers to the futures exchanges and to the future commission merchant handling the Great Plains' hedge account. Unfortunately, the CSA customers had none of the protections afforded to persons trading on a designated futres [sic] exchange.[488]

The ALJ then declared that "the overwhelming weight of the evidence establishe[d] that Great Plains operated a bucket shop in contravention of Section 4(a) of the Commodity Exchange Act," and issued a cease and desist prder prohibiting Great Plains and its manager Herman Gerdes from further violations of section 4(a).[489]

2. In re Grain Land Coop.[490]

In re Grain Land Coop., an opinion also issued by ALJ Painter, held that flex HTAs marketed and sold by Grain Land Cooperative were illegal off-exchange futures contracts.[491] The Division of Enforcement had filed a one-count complaint on November 12, 1996, alleging that Grain Land had violated section 4(a) of the CEA.[492] Focusing on the plain language of the contracts, the ALJ first determined that the primary obstacle to finding that the Grain Land flex HTAs were excluded from the CEA as cash forwards was that the contracts "permit[ted] the producer to unilaterally and unequivocally avoid delivery for any reason by canceling the contract."[493]

> A producer who entered respondent's Flex HTA contract was not binding himself, at the time he signed the Flex HTA contract, to deliver grain—but only to deliver grain *if the producer chose to set basis or if the producer failed to set basis by a certain time and respondent did.* This distinction is of critical importance when coupled with the fact that the original Flex HTA contract gave the producer sole discretion to utilize the cancellation provision for any reason as a means to avoid setting basis.[494]

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488. *Id.* (citing Chi. Mercantile Exch. v. SEC, 883 F.2d 537, 542 (7th Cir. 1989)).

489. *Id.* at 48,691.

490. *In re* Grain Land Coop., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,459 (C.F.T.C. Nov. 6, 1998). The Grain Land litigation had a protracted and involved procedural history and was waged in numerous fora. *See* discussion *supra* Part IV.B.2.

491. *Id.* at 47,197.

492. *Id.* at 47,196.

493. *Id.* at 47,191.

The cancellation provision precluded the producer's obligation to deliver, and the expectation of delivery of the physical commodity was found to be the defining characteristic of a cash forward contract.[495] The ALJ stated the following:

> In sum, the contractual terms of respondent's Flex HTA contracts, consistent with the way they were marketed, readily allowed a producer to unilaterally and unequivocally avoid delivery for any reason. This "privilege" is fundamentally at odds with the rationale underlying a cash forward contract—the desire to dispose of or acquire grain. A necessary result of such a provision is that it precludes a finding that Grain Land legitimately anticipated delivery from each producer, based on the contractual language of the Flex HTA. The cancellation provision which existed in the Flex HTA contract is anathema to the cash forward contract exclusion.[496]

ALJ Painter then explained that "[t]he contractual [provisions], respondent's marketing of the contract, and the way in which the contracts were administered, mandate[d] a finding that respondent[']s Flex HTA contracts were the functional equivalent of a futures contract."[497] Painter made this conclusion because these factors provided the parties with the same risk transferring advantages as a futures contract traded on a contract exchange "'*without the forced burden of delivery*.'"[498] The ALJ emphasized that there is no bright line test or exclusive list of factors for this determination,[499] and the adjudicator had to look beyond the self-serving labels attached to the transaction by the parties.[500] First, the underlying purpose of the Grain Land HTAs was speculation, which allowed "an opportunity for producers to obtain futures position financed by Grain Land," in which price risk could be hedged.[501] The ALJ acknowledged that some deliveries occurred, but stressed that delivery was not the main purpose of the contracts.[502] The ALJ pointed to specific

494. *Id.*

495. *Id.*

496. *Id.* at 47,193-94. Respondents argued that the cancellation provision was analogous to a liquidated damages clause, and similar to the bookouts in the fifteen-day Brent Oil contracts that the CFTC exempted as cash forward contracts in *Statutory Interpretation Concerning Forward Transactions*, 55 Fed. Reg. 39,188, 39,191-92 (Sept. 25, 1990). *In re* Grain Land Coop., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 47,193. The Brent Oil contracts in the CFTC's analysis were privately negotiated transactions between commercial parties in the same line of business. *Id.* In contrast, the ALJ determined the flex HTAs contained standardized cancellation provisions, which were part of the original transaction and not a subsequent and unrelated provision. *Id*.

497. *Id.* at 47,194.

498. *Id.* (quoting *In re* First Nat'l Monetary Corp., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,698, at 30,976 (C.F.T.C. Aug. 7, 1985) (citations omitted)) (emphasis added in *Grain Land*).

499. *Id.* (citing CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d 573, 581 (9th Cir. 1982)).

500. *Id.* (citations omitted).

501. *Id.*

language in the flex HTAs, which he said demonstrated (along with the testimony at the hearing) that the flex HTAs were "a superior means to fund a futures position," with the profits ultimately accruing to the producer.[503] The costs associated with a futures position—margin calls, margin financing, and commissions—were all borne by Grain Land, and the producer alone had the power to decide when to exit the contract.[504] Thus producers could access the futures market and accrue gains and losses, with Grain Land acting as the middleman.[505]

The Grain Land flex HTAs computed gains and losses by comparing the contract price to the futures price and making commensurate adjustments each time the contract was rolled by adding the differential to, or subtracting it from, the price of establishing a new futures position.[506] ALJ Painter said that this feature of the flex HTA "permitted customers 'to deal in commodity futures without the forced burden of delivery.'"[507] Moreover, it was the producer who had the unequivocal and unilateral right to roll his contract whenever he chose, which constituted further proof that the flex HTA was a means of speculation on the futures markets.[508] The standardized terms of the flex HTAs, according to the ALJ, were further evidence that they were futures contracts.[509] Relying on *Co Petro Marketing Group*, the ALJ explained that "the rationale for standardization in futures trading is to 'facilitate the formation of offsetting or liquidating transactions [which] is essential since investors rarely take delivery against the contracts.'"[510] So, the "real reason," according to the ALJ, for using standardized terms in the flex HTAs was "because it was a rarity for producers to deliver against the contract as *initially entered*—a direct result of Grain Land providing unilateral rolling and cancellation privileges."[511]

Finally, ALJ Painter noted there was no expectation that physical delivery would take place on the part of some of the livestock producers who entered into the contracts.[512] Even though there were few producers such as these, who entered into the flex HTAs, that did not "diminish the significance of

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502. *Id.*

503. *Id.* at 47,195.

504. *Id.*

505. *Id.*

506. *Id.* (citations omitted).

507. *Id.* (quoting CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d 573, 580 (9th Cir. 1982)).

508. *Id.*

509. *Id.* at 47,195-96.

510. *Id.* at 47,196 (quoting CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d at 580).

511. *Id.*

512. *Id.*

their existence which attests to the fact that the Flex HTA was constructed and administered to function as a futures contract."[513]

Accordingly, the ALJ found that Grain Land had violated CEA section 4(a) and issued a cease and desist order, but no civil monetary penalty.[514]

C. *The Commission's Opinions: Inconsistent Results*

Despite acknowledging that the *Competitive Strategies* and *Grain Land* situations presented certain similar circumstances as to the nature of the parties and the contracts used,[515] the CFTC affirmed ALJ Painter's disposition in the former case while vacating his decision in the latter.[516] In both cases, the CFTC applied the multifactor, or as the CFTC chose to term it, the "facts and circumstances" approach.[517] In forceful dissenting and concurring opinions, Commissioner Brown-Hruska pointed out the limitations of that approach and called on the CFTC to take on the task of articulating a clear legal standard that parties could use prospectively to structure contracts relating to new financial instruments.[518] This standard, she noted, could be located in the *Nagel* framework.[519]

1. In re Competitive Strategies

Focusing on the parties' intent to effect delivery as demonstrated by their conduct, the CFTC affirmed the ALJ's findings, holding that the Cross Country HTAs were illegal off-exchange futures contracts.[520] The CFTC focused on the parties' intent to make or take delivery, and looked at their conduct for evidence.[521] The CFTC held that the record developed by the Division of Enforcement showed that no delivery had been taken on the Great Plains HTA contracts, and cash settlement had

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513. *Id.*

514. *Id.* at 47,197.

515. *In re* Competitive Strategies for Agric., Ltd., [2004] 2 Comm. Fut. L. Rep. (CCH) ¶ 29,635, at 55,731 (C.F.T.C. Mar. 15, 2004).

516. *Id.* at 55,735 (affirming ALJ decision); *In re* Grain Land Coop., [2003] 2 Comm. Fut. L. Rep. (CCH) ¶ 29,636, at 55,750 (C.F.T.C. Nov. 25, 2003) (vacating ALJ decision).

517. *In re* Competitive Strategies for Agric., Ltd., [2004] 2 Comm. Fut. L. Rep. (CCH) at 55,731; *In re* Grain Land Coop., [2003] 2 Comm. Fut. L. Rep. (CCH) at 55,748-50.

518. *In re* Competitive Strategies for Agric., Ltd., [2004] 2 Comm. Fut. L. Rep. (CCH) at 55,735-40 (Brown-Hruska, Comm'r, dissenting); *In re* Grain Land Coop., [2003] 2 Comm. Fut. L. Rep. (CCH) at 55,750-53 (Brown-Hruska, Comm'r, concurring).

519. *In re* Grain Land Coop., [2004] 2 Comm. Fut. L. Rep. (CCH) at 55,752-53 (Brown-Hruska, Comm'r, concurring).

520. *In re* Competitive Strategies for Agric., Ltd., [2004] 2 Comm. Fut. L. Rep. (CCH) at 55,735.

521. *Id.* at 55,732-33.

been permitted,[522] even though the written contracts did not contain a provision granting a cancellation right or the right to roll delivery dates, as was the case with the Grain Land HTA contracts.[523] Further evidence of the fact that the parties did not intend delivery was that Great Plains entered into Cross Country HTAs with producers every two years, and cash settled over fifty contracts without direct or indirect delivery occurring.[524] Accordingly, the Cross Country HTAs were used as a hedging device, rendering them illegal futures contracts.[525] The CFTC imposed a cease and desist order on Great Plains and a ten-year trading prohibition on Gerdes.[526] The CFTC held "that a civil money penalty would generally be appropriate to deter the type of off-exchange activity committed by Great Plains and Gerdes."[527] However, mitigating circumstances such as the facts that the grain elevator lost money on its HTA business and had ceased doing active business in 1996, as well as Gerdes's semi-retired status, militated against imposing monetary sanctions.[528] The CFTC emphasized that it would not hesitate to impose such sanctions in an appropriate case.[529]

A strong dissent by Commissioner Brown-Hruska criticized both the facts and circumstances approach used by the CFTC and the result it reached: "Apart from the incongruity of results arising from application of this standard, continued adherence to this approach discourages those contemplating innovation in the agricultural markets from doing so, and is contrary to our efforts to provide clarity and legal certainty in both our statute and in our regulation."[530]

The Commissioner located the "adverse decision" reached by the CFTC majority in "a standard that fails to give controlling significance to contract terms and relies upon *ex post* observation to deduce what the parties intended."[531] Moreover, rather than examining the parties' intentions *at the time* they entered into the HTAs, the Commissioner said the majority's focus was what the parties did *after* they had agreed to those contracts.[532] While that approach could illuminate whether the parties lived up to their agreement, it did not reveal what they intended in the first place, which instead, could

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522. *Id.* at 55,731.

523. *Id.*

524. *Id.* at 55,733.

525. *Id.*

526. *Id.* at 55,735.

527. *Id.*

528. *Id.*

529. *Id.*

530. *Id.* (Brown-Hruska, Comm'r, dissenting).

531. *Id.*

532. *Id.* at 55,735-3.

be ascertained from what they wrote in their contract.[533] The Commissioner also reproached the CFTC majority for departing from the CFTC's Brent Interpretation[534] as well as the Seventh Circuit's opinion in *Nagel*.[535] She ascribed this to the "paternalistic concern for the welfare of individual farmers," which she noted has long been a tradition in the CFTC's body of law.[536] While acknowledging that agricultural producers might "require a fuller panoply of regulatory protections than do other commercial users," the identity of the counter-party did not transform the essential nature of the transaction from a forward contract into a futures contract.[537]

Commissioner Brown-Hruska also took exception with the factual conclusions drawn by the majority with respect to delivery under the Cross Country HTAs at issue.[538] She said that the majority's "[d]ecoupling the deliveries to local elevators from the HTAs enables the conclusion that contracts were cash settled without physical deliveries occurring."[539] Yet according to the Commissioner, the Cross Country HTAs were innovative in that they "allowed farmers to lock in a forward price while also enabling delivery by a farmer to a third party elevator at his option."[540] The CFTC's invalidation of these innovative contractual arrangements in the agricultural sector, in Commissioner Brown-Hruska's view, discouraged "inventive ways" of merchandising activities, something with which the CFTC should not interfere.[541]

2. In re Grain Land Cooperative

In *In re Grain Land Cooperative*, the CFTC applied the facts and circumstances approach and vacated the ALJ's decision.[542] The CFTC held that the record did not reliably establish that the HTA

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533. *Id.*

534. *Id.* at 55,735-3 to 55,737; Statutory Interpretation Concerning Forward Transactions, 55 Fed. Reg. 39,188 (Sept. 25, 1990). The CFTC in *Competitive Strategies* found there was "no basis" for applying the Brent approach in this case because of the enduring distinctions Congress has drawn between the agricultural sector and other commodity sectors regulated by the CEA. *See* Statutory Interpretation Concerning Forward Transactions, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,925, at 37,368 (C.F.T.C. Sept. 25, 1990) (ruling that 15-day Brent Oil contracts were forward contracts despite some transactions that resulted in cash settlement as an alternative to physical delivery of the commodity).

535. *In re* Competitive Strategies for Agric., Ltd., [2004] 2 Comm. Fut. L. Rep. (CCH) at 55,735-3 to 55,737.

536. *Id.* at 55,737.

537. *Id.*

538. *Id.* at 55,738-39.

539. *Id.* at 55,738.

540. *Id.* at 55,739.

541. *Id.*

transactions at issue involved futures contracts.[543] The CFTC examined the legal approach and factual findings of the ALJ in detail,[544] concluding that he adopted an "unduly narrow legal approach," and that his factual findings were flawed.[545]

In the CFTC's view, the Division of Enforcement had "relie[d] primarily on the existence of the rolling and cancellation options as evidence that the parties to Grain Land's FHTAs did not intend to deliver the underlying commodity," and intended the HTAs "to serve as a vehicle for hedging and speculating on CBOT futures price movements without the delivery of grain."[546] The CFTC was not convinced that indefinite rolling would be of benefit to agricultural producers[547] and focused on the Division's "fail[ure] to develop the record on either the reasons for cancellation or the circumstances in which producers . . . exercise[d] this option."[548] In short, the CFTC targeted the evidentiary lacunae in the record, stating that the factors tending to show that the HTA transactions were futures contracts did not outweigh those factors tending to show that they were forward contracts and, therefore, vacated the ALJ's decision.[549]

Commissioner Brown-Hruska, in her concurring opinion, stated that the facts and circumstances approach used by the majority opinion was also flawed, and failed to offer a clear legal standard that informed parties in advance as to whether the transaction was legal and enforceable.[550] Following the analysis of the *Nagel* decision, she stated that the "facts and circumstances approach" forces an "examination of the parties' actions *ex post* to make a determination, . . . [thereby] undermin[ing] the weight given to the substance of contractual provisions," resulting in legal uncertainty.[551] Thus, she advocated the three-factor approach proposed by Judge Posner in *Nagel*, allowing an *ex ante* determination of the substance of the transaction, and obviating the need to look at the parties' subjective intentions because of all the evidentiary problems that arise.[552] Commissioner Brown-Hruska also emphasized that the debate is broader than the distinction between futures and forward

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542. *In re* Grain Land Coop., [2003] 2 Comm. Fut. L. Rep. (CCH) ¶ 29,636, at 55,750 (C.F.T.C. Nov. 25, 2003).

543. *Id.*

544. *Id.* at 55,747.

545. *Id.*

546. *Id.* at 55,748.

547. *Id.* at 55,749; *see* Norris et al., *supra* note 14, at 323 (explaining that rolling is not determinative of contract prices).

548. *In re* Grain Land Coop., [2003] 2 Comm. Fut. L. Rep. (CCH) at 55,749.

549. *Id*. at 55,749-50.

550. *Id*. at 55,750-51.

551. *Id.* at 55,751.

552. *Id.* at 55,752-53.

contracts with respect to HTA transactions—that it goes to the heart of the CFTC's jurisdiction and regulatory authority, and perhaps even more importantly, has implications for innovation in the financial markets.[553]

VI. Conclusion

The determination of whether HTA contracts are forward contracts excluded from the CEA or futures contracts subject to the CEA has been a laborious endeavor. This has had critical economic consequences for producers and grain merchants that entered into HTAs with the expectation that futures prices on the corn market would exceed those on the cash market. Unfortunately, this expectation regarding the future direction of corn prices was not borne out, with the result that both sets of parties were faced with losses and the possibility of even more catastrophic losses. Recourse to the courts appeared to offer the only solution, as grain merchants sought to enforce HTAs or sue producers for breach of contract, while producers sought to invalidate their HTAs by claiming that they were illegal off-exchange futures contracts.[554] In the courts, producers did not fare well, as judges declined to permit them to walk away from what had turned out to be bad bargains.[555]

The situation was complicated even more by the CFTC entering the fray. First, in an attempt to provide guidance to parties seeking to structure their transactions, the CFTC issued its 1996 Guidance.[556] This Policy Statement, however, received scant deference from courts.[557] The CFTC also brought enforcement actions against grain merchants for alleged violations of the CEA.[558] Before administrative panels, the producers prevailed in two initial opinions and one CFTC opinion.[559]

Both the courts and the CFTC have used virtually the same analytic framework to determine whether HTAs in question are forwards or futures. This framework, which has its genesis in the CFTC's opinion in *In re Stovall* and the Ninth Circuit case *Co Petro Marketing Group*, identifies a series of factors that revolve around the transaction as a whole, the intent of the parties, the status of

553. *Id.*

554. *See* discussion *supra* Part IV.D.

555. *See* discussion *supra* Part V.A.

556. *See* Blake Imel, Acting Director, Division of Economic Analysis, CFTC Economic Analysis, Ltr. No. 96-41, 1996 CFTC Ltr. LEXIS 145, at *9-16 (May 15, 1996); *see also* discussion *supra* Part IV.E.2.

557. *See* discussion *supra* Part IV.A.

558. *See, e.g.*, *In re* Competitive Strategies for Agric., Ltd., [2004] 2 Comm. Fut. L. Rep. (CCH) ¶ 29,635, at 55,723 (C.F.T.C. Mar. 15, 2004); *In re* Grain Land Coop., [2003] 2 Comm. Fut. L. Rep. (CCH) ¶ 29,636, at 55,740 (C.F.T.C. Nov. 25, 2003); *In re* Farmers Coop. Co., No. 99-6, 1999 CFTC LEXIS 9, at *1 (C.F.T.C. Jan. 12, 1999); *In re* Roger J. Wright, No. 97-2, 1996 CFTC LEXIS 221, at *1, 20-28 (C.F.T.C. Nov. 13, 1996); *see also* 1996 CFTC Ltr. LEXIS 90, at *1 (C.F.T.C. Nov. 13, 1996) (press release announcing filing of three separate administrative complaints related to HTAs).

559. *See* discussion *supra* Part IV.B.2-3.

the parties, and the purpose of the transaction—all of which may only be seen from a retrospective vantage point. The reasons for this, it appears, lie in the indeterminacy of the statutory scheme and the lack of clear definition of what is a futures or forward contract. While in recent years courts and the CFTC have voiced dissatisfaction with the multifactor approach and have called for greater legal certainty by formulating three factors—the presence of which will deem a contract to be classified as a forward—it is hard to escape from the intensely fact-specific and inevitably retrospective inquiry that the classification demands. As Commissioner Brown-Hruska has so cogently argued in her dissenting opinion in *Competitive Strategies*,[560] her concurring opinion in *Grain Land*, [561] and in her May 4, 2004 address, [562] the continued adherence to the facts and circumstances approach has adverse consequences for innovation and experimentation with new frameworks for structuring financial transactions. This means that the CEA, its ambiguities, and the dominant analytic paradigm for classifying futures and forward contracts will continue to color the legal treatment of hybrid contracts such as HTAs.

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http://students.law.drake.edu/lawReview/.

560. *See In re* Competitive Strategies for Agric., Ltd., [2004] 2 Comm. Fut. L. Rep. (CCH) at 55,735 (Brown-Hruska, Comm'r, dissenting) (stating that "continued adherence to this approach discourages those contemplating innovation in the agricultural markets from doing so").

561. *See In re* Grain Land Coop., [2003] 2 Comm. Fut. L. Rep. (CCH) at 55,751 (Brown-Hruska, Comm'r, concurring) (stating that the "[facts and circumstances] approach lacks clarity and spawns legal uncertainty").

562. Brown-Hruska Address, May 4, 2004, *supra* note 3 (arguing that "the result [of using the facts and circumstances approach] is to legally discourage an innovative financial tool").