

News & Types: Commercial, Competition & Trade Update

Statute of Frauds Defense Fails Based on Course of Dealing

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The statute of frauds requires certain contracts to be evidenced by a writing to be enforceable. It is based on an English statute from the 17th century which prevented any suit on certain contracts unless there was a writing to evidence the contract. The statute does not have a good reputation, as, contrary to its original intent to prevent frauds and perjuries, in its strictest application, it actually seemed to defeat worthy claimants on a technicality. So, over the years, the statute has been less strictly applied and become subject to a number of exceptions.

The Uniform Commercial Code (the law applicable to sales) has its own statute of frauds. (Uniform Commercial Code 2-201) The UCC's version prevents enforcement of contracts for the sale of goods of more than \$500 unless there is a writing to evidence the agreement. But there are numerous exceptions in the UCC and in the manner the statute of frauds is applied by the courts. This is well illustrated in a recent Illinois case. (*Irvington Elevator Company, Inc. v. Robert Hesper et. al.* No. 5-11-0184, Illinois Appellate Court, 5th District, October 24, 2012)

Irvington Elevator Company operates a grain elevator in Irvington, Illinois. Beginning in May 2006, Irvington began transacting business with members of the Hesper family, a father and two sons who are grain farmers, on the basis of verbal "hedge-to-arrive" contracts with respect to the sale of grain. A hedge-to-arrive contract is an agreement for the sale of grain of a certain amount and type from the farmer to the grain elevator at some time in the future. The grain elevator will hedge the price by selling futures contracts on the Chicago Board of Trade, set to expire in the month of delivery of the grain. In turn, the farmer determines the final contract price by contacting the grain elevator and selecting a "basis", i.e., the difference, on any given day, between the futures price for the grain on the Chicago Board of Trade and the cash price offered by the grain elevator to the farmer. Once the farmer determines the basis, the hedge-to-arrive contract becomes a cash contract and the farmer delivers the grain and receives the final contract price.

Irvington dealt with the Hesper family through Irvington's grain marketer, Clark Schnitker who, in an unusual coincidence, was the cousin of the Hesper brothers. One Hesper brother, Bobby, was the only person responsible for selling the Hesper grain to Irvington and Bobby only used hedge-to-arrive contracts. In 2006 and 2007, the parties apparently used hedge-to-arrive contracts without incident. But this changed in 2008 when Irvington filed suit on several hedge-to-arrive contracts, which the Hesper family denied were enforceable. The trial court agreed with the Hesper family and denied Irvington's claim on summary judgment. But the appeals court reversed and allowed Irvington's claim to continue.

In the course of the parties' dealings, Bobby Hesper would call and negotiate a grain contract, and then Schnitker would enter the information in the system, such as the date, type and quantity of grain, price and delivery date. According to Schnitker, it was standard practice for the Hesper family to either lock in a price or "roll", paying a fee to postpone delivery for another month. After the Hesper family delivered the grain, they would instruct Schnitker how to divide the payment among the family members. Schnitker also testified that it was his standard practice to deliver confirmations to the defendants, usually at least two months prior to the time the defendants would need to decide whether to set the price or "roll" the contract. The confirmations were hand-delivered to Bobby Hesper so that Schnitker could make sure they were received and because Bobby Hesper lived near Schnitker.

In July 2008, grain prices spiked to historic highs. The result was that the Hesper family could get much better prices if they could avoid the application of the hedge-to-arrive contracts. The grain that was the subject of the lawsuit was actually eventually sold at a price much better than the hedge-to-arrive contracts negotiated with Irvington. By denying the existence of the contracts and selling the grain separately, defendants made approximately \$1 million profit and forced Irvington to cover the unperformed contracts, thus losing thousands of dollars. So the stakes were high.

The Hesper family asserted that the hedge-to-arrive contracts at issue were not enforceable because they were not formed without a confirmation. The contracts at issue were confirmed 16 days to 4 months after the alleged contract date. Lacking an enforceable writing, argued the defendants, the Hesper family was free to sell its grain to whomever it wanted. The Hesper family had some strong case support which persuaded the trial court. They cited cases in Illinois and other states holding that unreasonable delays in sending a written confirmation could make the alleged agreement unenforceable.

But the appeals court was not convinced. The appeals court went back to the statute of frauds in the Uniform Commercial Code, looking at one of the many exceptions. One exception applied to contracts "between merchants if within a reasonable time a writing in confirmation of the contract . . . is received . . ." The key word is "reasonable." The appeals court went on to find that a "course of dealing" between parties with a history of dealings could be used to determine what is reasonable.

The Hesper family went so far as to argue there was no course of dealing between the parties, a point strongly rejected by the appeals court. The court also rejected cases which required a shorter confirmation period as inapplicable to the contracts between Irvington and the Hesper family based on their prior course of dealing, in which confirmations were issued months after the verbal hedge-to-arrive contract was formed.

Based on the prior course of dealings and the need to determine what would be a "reasonable" time to confirm the hedge-to-arrive contract, the appeals court sent the case back for "further proceedings consistent with this opinion."

The Irvington Elevator case again illustrates the importance of a binding written contract, to avoid the statute of frauds, since the case would never have been brought if there had been a written contract. At the same time, the case illustrates that all is not lost to a claimant even if there is no written contract, based on the numerous exceptions to the statute of frauds applied by the courts.

