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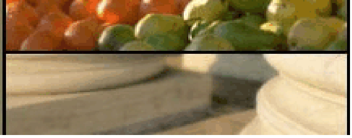

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An Agricultural Law Research Article

Federal and State Regulation of Grain Warehouses and Grain Warehouse Bankruptcy

by

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FEDERAL AND STATE REGULATION OF GRAIN WAREHOUSES AND GRAIN WAREHOUSE BANKRUPTCY

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INTRODUCTION

Junction, Illinois; Stockport, Iowa; Ristine, Missouri. These names have taken their places in the annuals of agricultural law as the locations of bankrupt grain elevators. Along with approximately 175 other grain eleva-

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tor bankruptcies in recent years, these bankruptcies have focused national attention upon the plight of farmers caught in the web of a grain elevator bankruptcy proceeding. According to an Illinois study, 110 elevators failed between 1974 and 1979, and the frequency of grain elevator bankruptcy has increased during recent years.[1] The United States Department of Agriculture estimates that 175 elevators have closed or reorganized since 1975.[2] While the total number of failures is not high, the effect can be dramatic on the individual farmer who has stored or sold grain to such an elevator and is unable to recover neither the grain nor payment for the grain sold.

The publicity generated by the efforts of some farmers[3] to recover losses without waiting for the conclusion of involved bankruptcy proceedings, has focused the attention of state legislatures, Congress, the General Accounting Office, and the United States Department of Agriculture on this problem. Many state legislatures have responded by modifying state regulatory provisions or by making changes in Uniform Commercial Code (U.C.C.) provisions related to the warehousing of grain. Congress has considered modifications in federal bankruptcy provisions that would give farmers special treatment when caught in the morass of a bankruptcy proceeding. Additionally, the General Accounting Office has offered a series of alternatives for the tighter regulation of warehouses. Further, the United States Department of Agriculture has modified rules relating to the regulation of federally licensed warehouses and those with which the Commodity Credit Corporation has contracts for the storage of program grain.

This article examines these proposed and adopted changes and analyzes and compares the attempts that have been made to improve the protection offered depositors in federally regulated grain elevators. This article also offers suggestions to increase the protection of these grain depositors.

The first section of this article deals with the role of bankruptcy law and the U.C.C. in grain elevator regulation. Initially, this section reviews the bankruptcy law as it relates to grain elevator bankruptcies, including the treatment in bankruptcy of traditional grain marketing contracts and documents. Then, this section examines the role that nontradtional grain marketing arrangements, such as deferred payment or price-later contracts, play in causing grain elevator bankruptcies and discusses case examples of recent major elevator bankruptcies. Additionally, this portion of the article assesses legislative proposals for altering the bankruptcy law as related to grain elevator bankruptcies.

The second section focuses on the federal grain warehouse licensing system and how it compares with state grain warehouse regulation. This

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1. ILLINOIS LEGISLATIVE COUNCIL, GRAIN ELEVATOR BANKRUPTCIES IN THE U.S. 1974 THROUGH 1979, File No. 90179 (1981).

2. U.S. DEP'T OF AGRICULTURE, FARMLINE, KEEPING HARVESTS SAFE FROM FAILING ELEVATORS (1981).

3. *See, e.g.*, Reynolds, *Elevators—The Ristine Rumor: How the Truth Got Buried Under the Drama of Grain Trucks and Wayne Cryts*, KAN. FARMER (1981); Schotsch, *Elevator Bankruptcies: Don't Get Caught Holding the Bag*, FARM J. (1981).

portion then reviews United States Department of Agriculture proposals to alter grain warehousing regulations and examines two reports: the General Accounting Office Report and United States Department of Agriculture Grain Elevator Task Force Report. Finally, the article examines a proposal to shift to an insurance based regulation system.

THE GRAIN MARKETING TRANSACTION

The majority of the grain transferred from farm to market passes through local inland elevators owned by co-operatives or private companies. The farmer uses the local elevator for both storage and sale of the grain. When the farmer delivers grain to the warehouse for either storage or sale the grain is weighed and a weight ticket or scale ticket is issued reflecting the quantity and grade of grain deposited by the farmer. This ticket serves as evidence of the transaction.

The elevator generally keeps a record of the transaction by posting delivered grain to customer accounts and by entering the transaction on the elevator's daily position record. If the grain is delivered for storage the warehouse may issue a warehouse receipt (negotiable or nonnegotiable) evidencing the contract. Some states control the printing and distribution of the receipts and require that elevators issue warehouse receipts.[4] The Agriculture Marketing Service of the United States Department of Agriculture controls receipts issued by federally licensed warehouses but similar procedures do not exist for warehouses which contract to store grain with the Commodity Credit Corporation.[5] Further, there is not a requirement that federally regulated warehouses even issue receipts and many storage transactions at such facilities are considered to be "open storage" obligations.[6]

The grain may be delivered under a sales contract providing for immediate payment or for a deferred-payment or deferred-pricing arrangement. These transactions are not evidenced by a warehouse receipt but rather, are evidenced by a sales contract exchanged for the scale ticket. When a grain elevator enters bankruptcy, the type of transaction involved determines the treatment of the stored grain.

Comparison of Warehouse Receipts and Scale Tickets

When grain is delivered to a warehouse in a storage transaction, a bailment is created.[7] Either the scale ticket or the warehouse receipt serves as evidence of the quantity and quality of grain deposited. The warehouse re-

4. GENERAL ACCOUNTING OFFICE, MORE CAN BE DONE TO PROTECT DEPOSITORS AT FEDERALLY EXAMINED GRAIN WAREHOUSES, CED-81-112, (1981) [hereinafter referred to as the G.A.O. REPORT].

5. *Id.*

6. *Id.*

7. The Uniform Commercial Code [hereinafter cited as U.C.C.] § 7-102(1)(a) (1978) defines a bailment by setting out the definition of "bailee". "Bailee" means the person who by a warehouse receipt, bill of lading or other document of title acknowledges possession of goods and contracts to deliver them.

ceipt is a document of title under the U.C.C.; the scale ticket, however, is not treated as a document of title.[8] For purposes of showing ownership, the two may be treated similarly if the scale ticket is combined with the elevator's customer account or settlement sheet and if the intent of the parties is clear.[9] Some courts have taken the position that holders of scale tickets should be treated the same as holders of warehouse receipts as to the ownership rights in stored grain. For example, in a line of Kansas cases the state and federal courts treat the owners of stored grain as tenants in common in the commingled mass of grain in bailment situations.[10] In the latest of these cases, *Farmers Elevator Insurance Co. v. Jewett*,[11] the Tenth Circuit Court of Appeals held that the surety for an elevator was required to pay both holders of warehouse receipts and holders of scale tickets where a shortage occurred. The issue of priority between the holders of warehouse receipts and scale tickets was not reached since the claims did not exceed the bond coverage. The result in these cases indicates that equal treatment may have been intended. The U.C.C. clearly establishes that the relationship among the depositors of fungible goods in a warehouse is that of tenants in common where the goods are commingled.[12] Since this U.C.C. section refers only to a warehouse receipt[13] it is not clear whether the holder of a scale ticket is on equal footing with the holder of a warehouse receipt.

Documents of title under the U.C.C. are specifically defined to include a "dock receipt" and "any other document which in the regular course of business or financing is treated as adequately evidencing that the person in possession of it is entitled to receive, hold and dispose of the document and the goods it covers."[14] While a dock receipt may not be entirely analagous to a weight ticket, it is used for much the same purpose and the comments to the U.C.C. indicate that a dock receipt may be treated as a document of title if it "actually represents a storage obligation undertaken by the shipping company . . . regardless of the name given to the instrument."[15] Thus, in appropriate circumstances, arguably the weight ticket could be treated as a

8. A "document of title" is defined in U.C.C. § 1-201(15) (1978):

"Document of title" includes bill of lading, dock warrant, dock receipt, warehouse receipt or order for the delivery of goods, and also any other document which in the regular course of business or financing is treated as adequately evidencing that the person in possession of it is entitled to receive, hold and dispose of the document and the goods it covers. To be a document of title a document must purport to be issued by or addressed to a bailee and purport to cover goods in the bailee's possession which are either identified or are fungible portions of an identified mass.

9. *See, e.g.*, *In re* Bowling Green Milling Co., 132 F.2d 279 (6th Cir. 1942); Midland Bean Co. v. Farmers State Bank of Brush, 552 P.2d 317 (Colo. Ct. App. 1976).

10. United States v. Luther, 225 F.2d 499 (10th Cir. 1955), *cert. denied*, 350 U.S. 947 (1956); Central States Corp. v. Luther, 215 F.2d 38 (10th Cir. 1954); Flour Mills of Am., Inc. v. Burrus Mills, 174 Kan. 709, 258 P.2d 341 (1953). *See also* Farmers Elevator Mutual Ins. Co. v. Jewett, 394 F.2d 896 (10th Cir. 1968); Hartford Accident and Indem. Co. v. Kansas, 247 F.2d 315 (10th Cir. 1957); Stevens v. Farmers Elevator Mutual Ins. Co., 197 Kan. 74, 415 P.2d 236 (1966).

11. 394 F.2d 896 (10th Cir. 1968).

12. U.C.C. § 7-207(2) (1978).

13. U.C.C. § 7-207(1) (1978).

14. U.C.C. § 1-201(15) (1978). *See supra* note 8.

15. U.C.C. § 1-201(15) comment 15 (1978).

nonnegotiable warrant receipt. The limiting factor may be the latter portion of the definition of a document of title which specifies that "[t]o be a document of title a document must purport to be issued by or addressed to a bailee and purport to cover goods in the bailee's possession which are either identified or are fungible portions of an identified mass."[16] While the weight ticket clearly may be issued by a bailee and cover grain in the bailee's possession, a problem may arise when identifying the "mass" of goods covered. The problem in identifying the "mass" of goods includes: whether the "mass" is all grain in the bailee's possession; whether it is grain in a specific storage facility; or whether it includes both receipted obligations and open storage obligations of the warehouse.

In addition to the U.C.C., other state laws may also affect the treatment afforded weight tickets. For example, a state's regulatory provisions for grain warehouses may include provisions related to weight tickets as well as warehouse receipts. To illustrate, Iowa's statute defines a "depositor" as "any person who deposits an agricultural product in a warehouse for storage, handling, or shipment, or who is the owner or legal holder of an outstanding warehouse receipt, or who is lawfully entitled to possession of the agricultural product."[17] Thus, Iowa specifically recognizes that there may be those who are entitled to possession of the product who are not holders of a warehouse receipt. The Iowa statute also defines a scale ticket as evidence of ownership of grain in storage.[18] Additionally, the Iowa statutes require the warehouseman to either pay for the grain within six months of deposit or issue a warehouse receipt.[19] Apparently, Iowa treats scale ticket holders and warehouse receipt holders equally as far as ownership rights are concerned.

In comparison, some states require the issuance of a warehouse receipt. The Arkansas Public Grain Warehouse Law,[20] for example, requires that a warehouse operator issue a receipt for all stored grain.[21] If the warehouse operator fails to issue the receipt, presumably, he could be subject to criminal penalties.[22] So, the question arises as to what are the rights of a holder of a mere weight ticket; particularly, what are the rights with regard to weight tickets issued by those warehouses not covered by the state regulations. Even in the absence of the receipt, the farmer might still be considered as owner of the grain since the Arkansas legislature, in 1981, specifically provided that ownership of the grain does not change by delivery to a public grain warehouseman.[23] Further, under the authority of pre-U.C.C. cases in other jurisdictions, the warehouseman's failure to issue the receipt as required by law, may subject the warehouseman to liability for

16. U.C.C. § 1-201(15) (1978).
17. IOWA CODE ANN. § 543.1(13) (West. Supp. 1981-82).
18. IOWA CODE ANN. § 543.1(12) (West. Supp. 1981-82).
19. IOWA CODE ANN. § 543.17(1) (West. Supp. 1981-82).
20. ARK. STAT. ANN. § 77-1301-42 (1981).
21. ARK. STAT. ANN. § 77-1325 (1981).
22. ARK. STAT. ANN. § 77-1337 (1981).
23. ARK. STAT. ANN. § 77-1340 (1981).

any damages sustained as a result of the failure.[24]

Rights of Bailors in a Grain Elevator Bankruptcy

In a bailment situation, clearly created when a warehouse receipt is issued and arguably created when only a scale ticket is issued, the grain owner may request specific relief in the bankruptcy court when the grain elevator enters bankruptcy. The burden, however, is on the farmer-bailor to prove his superior ownership interest in the grain. The trustee in bankruptcy may raise a number of issues which serve to delay the owner's access to the grain. Initially, the trustee may contest the farmer's interest, claiming that the farmer is an unsecured creditor. Additionally, based on the trustee's duty to preserve the estate, the trustee may be reluctant to deliver any grain to the claimant because of competing claims, especially where the total amount of grain on hand is insufficient to cover all claims. Finally, where title to the grain is in dispute, the trustee may assert authority to sell all grain held in the facility as authorized in the Bankruptcy Code.[25] The following discusses these three issues.

The relationship between the farmer and the elevator should be the same regardless of whether the grain elevator has filed a bankruptcy petition for liquidation under Chapter 7 of the Bankruptcy Code or for reorganization under Chapter 11. State law determines the relationship.[26] Under the U.C.C., the relationship clearly should be a bailment if the farmer pays a storage fee and has given up only possession, not title, of the goods.[27] The fact that the goods are part of a commingled, fungible mass should not change the basic relationship.[28] Arguably, the commonly accepted definition of bailment requires that the *exact* goods be returned upon demand of the bailor. This contention fails, however, since the U.C.C. provision establishing a tenancy in common among the various depositors of commingled, fungible goods removes any doubt that a bailment is, in fact, intended and created.[29]

A bankruptcy court is given pervasive authority from the point a bankruptcy petition is filed. All actions must go through the bankruptcy court and an automatic stay of all judicial and other proceedings is imposed.[30] Thus, even a farmer who is clearly a bailor of stored grain will find it necessary to go through the bankruptcy court to assert an ownership interest in the grain. The farmer has a number of procedural options. The farmer may

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24. *See* Annot., 168 A.L.R. 945 (1947).

25. 11 U.S.C. § 363(f)(4) (Supp. IV 1980).

26. *See* Missouri v. United States Bankr. Court (*In re* Cox Cotton Co.), 647 F.2d 768 (8th Cir. 1981, *cert. denied*, 102 S. Ct. 1035 (1982).

27. U.C.C. § 7-102(1)(a) (1978).

28. *See, e.g.*, United States v. Luther, 225 F.2d 499 (10th Cir. 1955); *cert. denied*, 350 U.S. 947 (1956); State v. Folger, 204 Iowa 1296, 210 N.W. 580 (1926); Sexton & Abbott v. Graham, 53 Iowa 181, 4 N.W. 1090 (1880).

29. U.C.C. § 7-207(2) (1978). *See* Flour Mill of Am., Inc. v. Burruss Mills, 174 Kan. 709, 258 P.2d 341 (1953).

30. 11 U.S.C. § 362 (Supp. IV 1980).

petition the court for an order compelling the trustee to release grain held in storage if a liquidation proceeding has been filed.[31] An alternative is to petition the court for relief from the automatic stay so that a state court may determine the title.[32] The farmer may also petition for an order to the trustee to abandon the property where the interest of the estate in bankruptcy is insubstantial.[33] In all these cases the farmer is likely to be liable for storage and handling charges which may be set-off against any claim for deficiency if the amount of grain is insufficient to cover all bailment claims.[34]

Regardless of the procedure selected, the farmer who has stored grain is still faced with the prospect of having to prove title to the grain and must bear the consequence of the delay associated with the court proceedings. Delays such as these led to confrontations between farmers and federal marshals in the celebrated case of Missouri v. United States Bankr. Court (*In re Cox Cotton Co.*) commonly referred to as the *James Brothers* case. This case involved the bankruptcy of the grain elevator located in Ristine, Missouri during 1981.[35]

When grain elevator bankruptcies occur, the amount of stored grain may be insufficient to cover all demands; the amount of grain may not even cover the demands of holders of warehouse receipts. An Illinois study indicated that one of the most common causes of grain elevator bankruptcy was speculation in the commodities market.[36] In such cases, the elevator may have sold grain belonging to farmers in order to cover losses in commodity speculation. These sales result in shortages of stored grain. Where the mass of commingled, fungible goods is insufficient to cover all the receipts issued, all holders of duly negotiated warehouse receipts are entitled to share in the remaining mass.[37] Given the possibility that the claims may exceed the amount of stored grain, the trustee will likely be reluctant to release grain to any one holder of a receipt.[38] This reluctance results in part from the fiduciary duty of the trustee to act on behalf of all creditors of the estate. Due to the effect of the automatic stay, any attempt to take an action to enforce an individual farmer's claim without the permission of the bankruptcy court

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31. 11 U.S.C. § 725 (Supp. IV 1980).

    After the commencement of a case under this chapter, but before final distribution under section 726 of this title, the trustee, after notice and a hearing, shall dispose of any property in which an entity other than the estate has an interest, such as a lien, and that has not been disposed of under another section of this title.

32. 11 U.S.C. § 362(d) (Supp. IV 1980).
33. 11 U.S.C. § 554(b) (Supp. IV 1980).
34. *See* 11 U.S.C. § 553 (Supp. IV 1980).
35. *See* Missouri v. United States Bankr. Court (*In re* Cox Cotton Co.), 647 F.2d 768 (8th Cir. 1981). The facts in this case are outlined in a later section of this article. *See infra* text accompanying note 56.
36. *See supra* note 1.
37. U.C.C. § 7-207(2) (1978).
38. Presumably all sharing would be pro rata and will include holders of duly negotiated warehouse receipts under U.C.C. § 7-207(2) (1978), although this section refers to "overissue" of receipts rather than a shortage in goods.

may result in the imposition of penalties by the court.[39]

A third problem encountered in the storage situation is that arising from the trustee's power to sell property where ownership is in dispute.[40] The bankruptcy court is given exclusive jurisdiction over the property of the debtor's estate as of the commencement of the bankruptcy proceedings.[41] The trustee is authorized to sell the property free and clear of any interest. The court, however, is obligated to see that adequate protection is afforded those who have an interest in the estate. Moreover, if the dispute as to title exists only between third parties, the court must "particularly examine" its authority to order the sale (of the grain) if title documents indicate that the estate possesses no substantial ownership rights to the grain.[42] Nevertheless, the pervasive authority of the court can create problems for the farmer-bailor and result in delay in obtaining access to the grain or to the proceeds of sale.

Rights of Unpaid Sellers in a Grain Elevator Bankruptcy

Several circumstances may cause a farmer to find himself in the position of a creditor in an elevator bankruptcy. First, the farmer may have contracted to sell grain to the elevator under a forward contract, often called a forward cash contract. Forward contracting is used frequently as a marketing strategy to "lock in" a price for the farmer's future production. The farmer who has contracted in this fashion with an elevator that later files for bankruptcy may either refuse to deliver except for cash[43] or demand adequate assurance for performance.[44] Should the farmer refuse to deliver under the contract he may face a suit for specific performance by the trustee where the contract was made before the bankruptcy petition was filed and calls for delivery after the commencement of the proceeding. *In re Cox Cotton Co.*[45] illustrates this point. In that case, one of several proceedings arising from the *James Brothers* bankruptcies, such contracts were held to be specifically enforceable.

A particular problem arises in cases of forward contracts when the contracting farmer also has stored the grain with the forward contracting elevator. Although the contract may be repudiated if storage shortages exist, the farmer is in the position of a bailor as to a pro rata share in the grain remaining in the facility because the trustee may be unable to grant "adequate assurance" or pay cash. Should the trustee not repudiate the contract, the

39. This was the result in the James Brothers case where contempt proceedings were imposed against farmers who took direct action and against Missouri authorities who attempted to take control of the elevators. Missouri v. United States Bankr. Court (*In re* Cox Cotton Co., *In re* Missouri), 647 F.2d 768, 771-72 (8th Cir. 1981). *See infra* text accompanying note 60.

40. 11 U.S.C. § 363(f) (Supp. IV. 1980).

41. Missouri v. United States Bankr. Court (*In re* Cox Cotton Co., *In re* Missouri), 647 F.2d 768, 774 (8th Cir. 1981).

42. *Id.* at 778.

43. U.C.C. § 2-702(1) (1978).

44. U.C.C. § 2-609 (1978).

45. 8 B.R. 682 (Bankr. E.D. Ark. 1981).

farmer may become a general creditor for the full amount under the contract.

A similar problem may exist for the farmer who has either sold grain to the elevator for cash and is unpaid or has sold the grain under a deferred-pricing or deferred-payment contract. In these circumstances, the farmer has a right to reclaim the goods if a demand is made within ten days of delivery.[46] The credit seller's right is specified in U.C.C. Section 2-702(2):

> Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten day limitation does not apply.[47]

But even this right to reclaim may be subject to provisions of the Bankruptcy Code once a bankruptcy petition is filed.[48] The court may deny reclamation but if so, the seller's claim is given priority as an administrative expense in the bankruptcy proceeding.[49]

In *Thomas v. Reliance Insurance Co.*[50] the status of farmers who sold grain to an elevator under various deferred sales arrangements was that of creditors and not depositors under the Texas Grain Warehouse Act. The court indicated that the statutory bond covered losses from the receiving, storing, shipping or handling of grain but did not cover those losses resulting from default in payment.[51]

Illinois has addressed the problem of price-later contracts by specific legislative provisions which control the printing of price-later contracts.[52] Such contracts must be consecutively numbered and may be printed only for those having a valid Illinois Grain Dealer's License. Such dealers must indicate their intent to use price-later contracts and indicate the method of price protection utilized. Dealers must maintain grain, rights in grain, proceeds from the sale of grain, or a combination thereof totaling ninety percent of the dealer's obligation for commodities purchased under such arrangements. The Illinois Department of Agriculture has considerable authority to prohibit grain dealers from disposing of grain owned or held in possession in order to protect producers who have dealt with the elevator under price-later contracts.[53]

The application of legislation similar to that of Illinois may yield the

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46. U.C.C. § 2-507 (1978) (cash seller); U.C.C. § 2-702 (1978) (credit seller).
47. U.C.C. § 2-702(2) (1978).
48. 11 U.S.C. § 546(c)(1), (2) (Supp. IV. 1980).
49. 11 U.S.C. § 546(c)(2) (Supp. IV 1980). For an excellent discussion of the unpaid seller's right to reclaim see Wallach, *The Unpaid Seller's Right to Reclaim Goods: The Impact of the Uniform Commercial Code and the Bankruptcy Acts of 1898 and 1978*, 34 ARK. L. REV. 252 (1980).
50. 617 F.2d 122 (5th Cir. 1980).
51. *Id.* at 127.
52. *See* Illinois Grain Dealers' Act, ILL. ANN. STAT. ch. 111, § 301-311 (Smith-Hurd Supp. 1981). Sections 310-311 relate specifically to price later contracts. ILL. ANN. STAT. ch. 111 § 310-311 (Smith-Hurd Supp. 1981).
53. ILL. ANN. STAT. ch. 111, § 309-311 (Smith-Hurd Supp. 1981).

results similar to that provided in the federal Packers and Stockyards Act[54] in which the sale of livestock establishes a statutory trust for the benefit of unpaid farmers.[55] This legislation resulted from the effect of the ruling in *In re Samuels & Co.*[56] where farmers who had delivered livestock to Samuels received checks that were subsequently dishonored. In a bankruptcy proceeding, inventory financers took priority over unpaid cash sellers as to the livestock in the debtor's possession. Following *In re Samuels* the Packers & Stockyards Act was amended to create the statutory trust for the benefit of unpaid sellers. No similar rights exist for those who deal with grain dealers in federal bankruptcy law or under the federal regulations relating to warehouses.

SAGA OF THE JAMES BROTHERS

Background

The frustration felt by farmers who deal with grain elevators that declare bankruptcy is vividly demonstrated in the events arising from the bankruptcy proceedings of the James brothers in Arkansas.[57] These proceedings are commonly referred to as the *James Brothers* case. The James brothers operated public grain elevators in both Arkansas and Missouri under various partnership identities and one affiliated corporation. Bankruptcy proceedings were filed in early August 1980[58] and a trustee was appointed for the purpose of operating and liquidating the various partnerships. In the meantime, the Missouri Department of Agriculture filed receivership petitions in the Missouri counties where the elevators were located under the applicable state law. The Director of the Missouri Department of Agriculture was authorized to operate the warehouses under Missouri law. These actions set the stage for larger conflicts.

The trustee in bankruptcy sought and was granted authority to assume certain purchase contracts with farmers executed by the debtors and to resell the contracted grain according to contractual arrangements with other parties.[59] Farmers in the area, who held warehouse receipts to stored grain, believed this action deprived them of their rightful possession of stored grain. They barricaded a warehouse in Ristine, Missouri until United States Marshals, under order of the bankruptcy court, interceded and broke the blockade.[60]

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54. 7 U.S.C. § 181-231 (1976).
55. 7 U.S.C. § 196 (1976).
56. 510 F.2d 139 (5th Cir. 1975).
57. *See* Missouri v. United States Bankr. Court (*In re* Cox Cotton Co., *In re* Missouri), 647 F.2d 768 (8th Cir. 1981). The facts surrounding the James Brothers bankruptcy proceedings may be gleaned from the court's summations. As indicated by the court no actual adversary factual record has been made but the pleadings, affidavits and representations in the briefs provide the factual background to these complex proceedings. *Id.* at 771 n.5.
58. *Id.* at 771.
59. *Id.*
60. *Id.* at 771-72.

In late September, 1980, the trustee requested authorization of the bankruptcy court to sell grain in the elevators free and clear of all liens pursuant to the provisions of the Bankruptcy Code which permits the trustee to sell property owned by an entity other than the estate where ownership is in bona fide dispute.[61] The trustee also filed fourteen adversary proceedings seeking specific performance of grain contracts with Arkansas and Missouri farmers. The State of Missouri filed an action in the local Missouri state court for a temporary restraining order against the trustee to restrain the trustee from interfering with the Director's control and liquidation of the Missouri grain. An order was issued by the state court on October 20, 1980.[62] The bankruptcy trustee reacted by filing a petition with the bankruptcy court for a contempt citation against the Missouri authorities and a request for an injunction to prevent their interference with the trustee in the operation of the debtor's business.

The Missouri officials sought a writ of prohibition in the Eighth Circuit Court of Appeals. The Court of Appeals denied the writ but the bankruptcy proceedings were stayed pending further order of the court. The Missouri officials then sought a writ of prohibition in the Federal District Court for the Eastern District of Arkansas in which the question of jurisdiction of grain stored in the public warehouses was the central issue.[63] The trustee was permitted to intervene since the grain was claimed as an asset of the estate in bankruptcy. Approximately forty-five Arkansas farmers, who claimed a substantial portion of the grain, also intervened. The Missouri officials argued that the bankruptcy court did not have subject matter jurisdiction since a substantial portion of the grain in the debtors' warehouses was not owned by the debtors and therefore, was not an asset of the estate. It was conceded that the debtors owned 2.3% of the grain. The petitioners contended that the State of Missouri, in exercising its police or regulatory powers, had the exclusive possession of the grain for the use and benefit of the depositor-owners.

The district court determined that while the interests of the debtor in property are determined by state law, the basic question of whether the property is actually property of the debtor's estate, is a federal question and must be resolved under the federal bankruptcy law.[64] The court also found that where a state provision conflicts with the federal bankruptcy law, it is suspended to the extent enforcement would conflict with the bankruptcy code or with congressional policy. The bankruptcy court had to determine ownership before affording any relief on the trustee's application to sell the grain. The court specifically found that the Missouri officials were not enforcing a police or regulatory power, and therefore did not fall within an exception to the bankruptcy court's jurisdiction. The court denied the peti-

61. *Id.* at 772.
62. *Id.* at 772-73.
63. *Id.* at 773.
64. *In re* Missouri, 7 B.R. 974 (Bankr. E.D. Ark. 1980).

tioner's writ of prohibition.[65]

On appeal the Eighth Circuit found that the debtor's interest in Missouri grain consists of possession and a minute ownership interest and that this is sufficient, under section 541 of the Bankruptcy Code, to trigger preliminary jurisdiction in a bankruptcy court.[66] Consequently, the bankruptcy court not only has jurisdiction, but also must make a final determination of the property interests involved. The court pointed out "that the bankruptcy court must administer the debtor's limited interest consistent with the ownership rights of [the] holders of documents of title. . . ."[67]

During the pendency of the case on appeal, a number of farmers appeared at the Ristine, Missouri elevator and removed some thirty thousand bushels of soybeans allegedly belonging to Wayne Cryts. The farmers were confronted by Federal Bureau of Investigation agents and federal marshals who informed them of the laws that they would be violating, but then stepped aside and allowed the farmers to remove the soybeans to a warehouse in a neighboring town. This action focused national attention on the plight of Wayne Cryts and the other farmers who felt that the log jam created in the courts was delaying their access to grain that was rightfully theirs. Since the farmers' actions violated the orders of the bankruptcy court, in March, 1981, Mr. Cryts was arraigned on federal charges related to these acts. Subsequently, a federal grand jury dropped the charges.[68]

Resulting Amendments to Federal Law

Senators Robert Dole of Kansas and John Danforth of Missouri introduced Senate Bill 839 on March 31, 1981 designed to amend the Bankruptcy Act and the United States Warehouse Act regarding farm produce storage facilities.[69] The bill was designed to solve some of the problems encountered by situations such as the *James Brothers* bankruptcies, by detailing specific procedures and timetables for the distribution of grain from bankrupt elevators. Hearings were scheduled before the Subcommittee on Courts, of the Senate Committee on the Judiciary in order to develop a full and complete understanding of the problems created in elevator and grain storage facilities bankruptcies.[70] The hearings discussed the problems arising from the *James Brothers* bankruptcy, the hardships created for agricultural communities in which bankrupt facilities are located, the economic stress placed on farmers who were individually caught in the bankruptcy

65. *Id.* at 983.

66. Missouri v. United States Bankr. Court (*In re* Cox Cotton Co., *In re* Missouri), 647 F.2d 768, 774 (8th Cir. 1981).

67. *Id.*

68. *Id.* The James Brothers' case is further complicated by the claims of creditors who hold secured interests as good faith purchasers of warehouse receipts and by counterclaims and claims of setoff filed by various farmers and others against the debtors during the various bankruptcy proceedings.

69. *Bankruptcy Reform Act of 1978 (Grain Elevator Insolvencies), Hearings before the Subcomm. on Courts of the Senate Comm. on the Judiciary*, 97th Cong., 1st Sess. (1981).

70. *Id.*

proceeding, and the resulting tensions that could arise between local farmers, businesses and government officials involved in the resolution of the proceedings. Following these hearings, the original Senate Bill, S.839, was amended and a substitute bill, S.1365, was introduced in June, 1981.

The Senate Report, designed to accompany S.1365, concludes that the *James Brothers* cases illustrate a number of problems that are typically encountered by farmer producer groups during farm produce storage facility bankruptcies.[71] These include:

1. delay in abandonment of crop assets owned by parties who have delivered such assets to the debtor upon a contract of bailment, with delays in excess of two years not uncommon;
2. conflicts in jurisdiction between the bankruptcy courts and the state agencies charged with the responsibility of supervising the liquidation of insolvent storage facilities;
3. the requirements of present law which mandate that owners of crop assets held by the debtor solely on the basis of his status as a bailee must share grain assets held by the trustee in bankruptcy on a pro rata basis with any creditor holding a security interest in assets of a similar type which are owned by the debtor, such that the bailors of such storage contract crop assets have the value of their property diminished for the benefit of such creditors when there is a shortage of produce on hand;
4. the unprotected status, as unsecured creditors in bankruptcy, of farmers who have sold crops to a farm produce storage facility but have not received payment for that crop;
5. the reluctance of some courts to accept warehouse receipts and scale tickets, the principal documents used in warehouse business to establish record of ownership of crop assets stored in warehouse facilities on bailment contracts, as evidence of ownership in bankruptcy abandonment proceedings; and,
6. the tendency of certain bankruptcy courts to attach bailed property for the payment of trustees fees and expenses incurred in performing services unrelated to that bailed property.[72]

The Dole bill mandates timetables governing the abandonment of farm produce in a bankruptcy of the farm produce facility by setting an outside limit of 110 days from the filing of the petition. The bill further establishes a two-tiered method of distribution of the crop assets to protect the ownership interests of parties who deliver under a bailment contract.[73]

Additionally, the bill provides that warehouse receipts and scale tickets will be accepted as proof of ownership of crop assets under bailment contracts. A statutory lien is created in favor of farm producers who have transferred farm products to a facility but have not yet been paid. The lien is good for sixty days from the date of execution of the contract of sale. Producers are also given a priority position in the distribution of assets of the debt-

71. S. REP. No. 168, 97th Cong., 1st Sess. (1981).
72. *Id.* at 5.
73. *Id.*

ors to general unsecured creditors when the producers have suffered loss from the sale or conversion of farm produce to or by a debtor operating a storage facility.[74]

The bill prohibits a person engaged in the business of operating a farm produce storage facility from seeking relief under Chapter 13, "wage-earner" proceedings, of the Bankruptcy Code as far as the scheduling of business debts are concerned. Also, if such a person seeks reorganization of the business under Chapter 11 of the Bankruptcy Code, the involuntary bailment of crop assets owned by third parties to such a farm produce storage facility would be prohibited.[75]

The bill was passed by the Senate on September 17, 1981 as part of the original version of the 1981 farm bill and separately on September 22, 1981.[76] The provisions of the bill, however, were not included in the House version nor in the final version of the Agriculture and Food Act of 1981.[77]

Although the legislation was designed to address the problems arising from grain elevator bankruptcies, it actually would have amended federal bankruptcy law in significant ways. Additionally, the bill's provisions actually would have applied to a number of agri-businesses other than grain elevators. More importantly, the proposed legislation provided some additional remedies for the resolution of problems arising from a bankruptcy but did not address the critical issue of preventing bankruptcies in the first place. While arguably farmers deserve special protection in cases of grain facility bankruptcies, it is not clear that the bill, as passed by the Senate, would resolve the conflicts between farmers who are holders of warehouse receipts and farmers who are unpaid credit sellers under a deferred pricing or deferred payment arrangement. In some bankruptcies, these conflicts pit farmer against farmer especially where shortages are involved. In the *James Brothers* litigation, for example, some farmers who were holding valid warehouse receipts were not anxious to support those farmers who wished to remove grain from the warehouse because this action could affect their future rights. The Senate bill, similar to those passed by some individual states, is directed only at treatment of the disease, i.e. elevator bankruptcies, not at its prevention.

Government Regulation of the Grain Warehouse Industry

Protecting the financial interests of agricultural producers in their grain is a major function of government as it relates to the private sector. The government protects these interests through insuring and protecting the grain while in storage and in promoting the security of the legal documents which represent stored or previously marketed grain. This function is pres-

74. *Id.*
75. *Id.*
76. *See* 127 CONG. REC. 129 (daily ed. Sept. 17, 1981); 127 CONG. REC. 132 (daily ed. Sept. 22, 1981).
77. Pub. L. No. 97-98, 95 Stat. 1213 (1981).

ently carried out through a combination of authorities including: the United States Warehouse Act,[78] various state grain warehouse and marketing laws;[79] and the Commodity Credit Corporation's (C.C.C.) standards of approval for warehouses participating in federal loan and storage programs for grain.[80] This function of government, as contrasted to the operation of the bankruptcy laws, is preventative in nature rather than remedial. That is, if properly designed and adequately enforced, these laws may prevent many grain elevator financial problems. Therefore, this area of regulation offers the greatest potential for protecting agricultural producers from the hardships that are associated with elevator failures. For this reason, it is especially important to consider how the grain storage regulatory system operates and how it can be improved.

While the present multi-faceted system may appear confusing, and does have problems of overlapping authority, the small number of elevator bankruptcies and incidence of actual losses indicates that the system has been effective.[81] This overall appearance of success overlooks, of course, the severe localized effect that such a collapse can have on agricultural producers. While the relatively small number of elevator failures may give rise to a general perception of success, obviously improvements could be made in the sometimes overlapping and confusing regulation of the grain handling industry. During the last two years, the occurrence and subsequent newscoverage of several major elevator collapses in the midwest has resulted in a greater awareness of the potential dangers in the present system, both in agricultural circles and with government policymakers.[82] This increased awareness offers an opportunity to improve the grain storage and marketing regulatory system. One direct response to the increased attention was the creation at the federal level of a Grain Elevator Task Force, within the United States Department of Agriculture, to study the grain industry and recommend means to improve current regulatory programs.[83] The Department of Agriculture is currently acting upon several of these recommendations and Congress is considering other ways to improve the system. Additionally, several states have recently undertaken efforts to improve state law regulating the storage and marketing of grain.

This process of changing the grain regulatory system is now underway. This section of the article describes these proposed changes and provides an understanding of how the grain storage regulatory system works. First, the structure of the current federal regulatory system and how it relates to state

78. United States Warehouse Act, Pub. L. No. 39-190, 39 Stat. 486 (1916) (codified at 7 U.S.C. § 241-73 (1976)).

79. *See infra* text accompanying note 125.

80. 7 C.F.R. § 1421.5551-57 (1981).

81. *See* G.A.O. REPORT, *supra* note 1, at 6.

82. *See, e.g.*, United States Dep't of Agriculture press release of Feb. 26, 1981 announcing the formation of the United States Dep't of Agriculture Grain Elevator Task Force referred to in the James Brothers' case. *See supra* text accompanying note 57 for discussion of facts in the James Brothers' case.

83. United States Dep't of Agriculture press release of Feb. 26, 1981.

grain warehouse acts will be reviewed. The article next considers the Department of Agriculture Grain Elevator Task Force's recommendations and the General Accounting Office's report concerning how to improve that system. Then, this article examines the regulatory changes that have been proposed or enacted as a result of those reports and several recent changes in state law. In addition, several other proposals for regulatory changes that might be considered by Congress in the next year are discussed.

United States Warehouse Act

An integral part of the grain marketing regulatory system is the federal regulation of grain warehouses under the United States Warehouse Act.[84] Passed in 1916, the Act is a voluntary program which authorizes the Secretary of Agriculture to license those warehouses that wish to participate and that can meet the standards for participation. The present system uses a combination of annual licensing[85] and physical inspections[86] in connection with establishing minimum financial and operating standards and bonding requirements[87] to create a standard for sound warehouse operation and to thereby promote the financial well being of federally licensed facilities. The main objectives of the regulatory system are, first, to protect agricultural producers who store their grain in warehouses and, second, to insure the integrity of warehouse receipts issued by federally licensed warehouses so they are "uniformly dependable and acceptable in financial circles." By insuring the integrity of warehouse receipts as documents of title, their use as collateral for loans is enhanced and the interstate trade in agricultural commodities is facilitated. Currently, over 1,800 grain elevators with storage capacity of over three billion bushels are federally licensed.[88] While this number represents only 20% of the more than 10,000 grain elevator facilities in the United States, it represents 43% of all commercial grain storage.[89]

84. 7 U.S.C. § 241-73 (1976). The Act defines a "warehouse" as "every building, structure, or other protected inclosure in which any agricultural product is or may be stored for interstate or foreign commerce, or, if located within any place under the exclusive jurisdiction of the United States, in which any agricultural product is or may be stored." 7 U.S.C. § 242 (1976).

85. 7 U.S.C. § 244 (1976).

86. 7 U.S.C. § 243 (1976) provides:

> The Secretary of Agriculture is authorized to investigate the storage, warehousing, classifying according to grade and otherwise, weighing, and certification of agricultural products; upon application to him by any person applying for license to conduct a warehouse under this chapter, to inspect such warehouse or cause it to be inspected; at any time, with or without application to him, to inspect or cause to be inspected all warehouses licensed under this chapter; to determine whether warehouses for which licenses are applied for or have been issued under this chapter are suitable for the proper storage of any agricultural product or products; to classify warehouses licensed or applying for a license in accordance with their ownership, location, surroundings, capacity, conditions, and other qualities, and as to the kinds of licenses issued or that may be issued for them pursuant to this chapter; and to prescribe, within the limitations of this chapter the duties of the warehousemen conducting warehouses licensed under this chapter with respect to their care of and responsibility for agricultural products stored therein.

87. 7 U.S.C. § 247 (1976).

88. *See* U.S. DEP'T OF AGRICULTURE, GRAIN ELEVATOR TASK FORCE: REPORT TO THE SECRETARY OF AGRICULTURE (Aug. 13, 1981) [hereinafter TASK FORCE REPORT].

89. *Id.*

To obtain a federal license, a warehouse operator must meet certain standards and comply with a number of duties set forth by law and regulation.[90] These standards include a suitable and properly equipped facility for the storage of grain,[91] a good business reputation and a minimum net worth computed on the basis of warehouse capacity.[92] The warehouseman must also submit to the Department of Agriculture an acceptable bond determined pursuant to a set schedule and pay initial inspection and license fees.[93]

Once the Secretary of the Department of Agriculture determines that a facility conforms to these requirements and meets the minimum standards, the Secretary can license the facility. Once licensed its operation is subject to a number of requirements and duties. To the extent of their capacity, licensed warehouses must accept grain on a nondiscriminatory basis.[94] Each warehouseman is under a duty to "at all times. . . exercise such care in regard to grain in his custody as a reasonably careful owner would exercise under the same circumstances and conditions."[95] The tariff or schedule of charges that a warehouseman can charge for receiving, delivering, storing, insuring, and for other warehouse services must be posted and must be submitted to the Department of Agriculture, which cannot accept them if exorbitant or discriminatory.[96] Warehousemen also must maintain complete and correct records of all agricultural products stored and of the documents issued for them.[97]

Perhaps most significantly, the Act requires the issuance of a warehouse receipt for all agricultural products actually stored in the warehouse to evidence that the depositor's products are in storage.[98] The issuance and cancellation of such receipts is stringently regulated by the Department of Agriculture to insure their integrity.[99] The act specifies in detail the contents of the receipts[100] and regulations specify when and how they are to be is-

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90. 7 U.S.C. § 248 (1976). *See* 7 C.F.R. ch. 1, pt. 102 (1981) (Agricultural Marketing Service: Grain Warehouse Regulations).
91. 7 C.F.R. § 102.7 (1981).
92. 7 C.F.R. § 102.6 (1981).
93. 7 C.F.R. § 102.14 (1981).
94. 7 U.S.C. § 254 (1976).
95. 7 C.F.R. § 102.40 (1980).
96. *See* 7 C.F.R. § 102.35 (1981).
97. 7 U.S.C. § 264 (1976).
98. 7 U.S.C. § 259 (1976) provides:

> For all agricultural products stored for interstate or foreign commerce, or in any place under the exclusive jurisdiction of the United States, in a warehouse licensed under this chapter original receipts shall be issued by the warehouseman conducting the same, but no receipts shall be issued except for agricultrual products actually stored in the warehouse at the time of the issuance thereof.

99. *See* 7 U.S.C. §§ 259-263 (1976). *See also* 7 C.F.R. §§ 102.18-102.32 (1981) (federal regulations governing form, issuance and cancellation of warehouse receipts).
100. 7 U.S.C. § 260 (1976) provides:

> Every receipt issued for agricultural products stored in a warehouse licensed under this chapter shall embody within its written or printed terms (a) the location of the warehouse in which the agricultural products are stored; (b) the date of issue of the receipt; (c) the consecutive number of the receipt; (d) a statement whether the agricultural products received will be delivered to the bearer, to a specified person, or to a specified person or his

sued.[101] Regulations require receipts shall be "printed by a printer with whom the United States has a subsisting contract and bond for such printing."[102] Further, regulations require that negotiable receipts must be surrendered to and cancelled by the warehouseman upon or prior to delivery of the agricultural products.[103]

The United States Warehouse Act is administered by the Agricultural Marketing Service (A.M.S.) within the Department of Agriculture[104] which is responsible for the initial licensing and bonding requirements.[105] Compliance with the act is enforced through a system of comprehensive warehouse examinations. Approximately twice a year, on an unannounced basis, federal examiners visit each licensed warehouse, at which time the examiners inventory the physical storage and review the warehouseman's obligations such as warehouse receipts, scale tickets, and accounts to compare the obligations.[106] Further, the examiners inspect the warehouseman's recordkeeping practices, housekeeping practices, storage facilities, insurance coverage, and the quality of the stored grain to insure compliance with regulatory requirements.[107] If minor discrepancies or deficiencies are found, warehousemen are required to bring the operation into compliance. If more serious problems are discovered, the law provides for suspension of licenses and

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order; (e) the rate of storage charges; (f) a description of the agricultural products received, showing the quantity thereof, or, in case of agricultural products customarily put up in bales or packages, a description of such bales or packages by marks, numbers, or other means of identification and the weight of such bales or packages; (g) the grade or other class of the agricultural products received and the standard or description in accordance with which such classification has been made: *Provided*, That such grade or other class shall be stated according to the official standard of the United States applicable to such agricultural products as the same may be fixed and promulgated under authority of law: *Provided further*, That until such official standards of the United States for any agricultural product or products have been fixed and promulgated, the grade or other class thereof may be stated in accordance with any recognized standard or in accordance with such rules and regulations not inconsistent herewith as may be prescribed by the Secretary of Agriculture; (h) a statement that the receipt is issued subject to this chapter and the rules and regulations prescribed thereunder; (i) if the receipt be issued for agricultural products of which the warehouseman is owner, either solely or jointly or in common with others, the fact of such ownership; (j) a statement of the amount of advances made and of liabilities incurred for which the warehouseman claims a lien: *Provided*, That if the precise amount of such advances made or of such liabilities incurred be at the time of the issue of the receipt unknown to the warehouseman or his agent who issues it, a statement of the fact that advances have been made or liabilities incurred and the purpose thereof shall be sufficient; (k) such other terms and conditions within the limitations of this chapter as may be required by the Secretary of Agriculture; and (l) the signature of the warehouseman, which may be made by his authorized agent: *Provided*, That unless otherwise required by the law of the State in which the warehouse is located, when requested by the depositor of other than fungible agricultural products, a receipt omitting compliance with subdivision (g) of this section may be issued: *Provided, however*, That the Secretary of Agriculture may in his discretion require that such receipt have plainly and conspicuously embodied in its written or printed terms a provision that such receipt is not negotiable.

101. *See* 7 C.F.R. §§ 102.28, 102.29 (1981).
102. 7 C.F.R. § 102.22 (1981).
103. 7 U.S.C. § 263 (1976); 7 C.F.R. § 102.24 (1981).
104. 7 C.F.R. § 2.50(a)(3)(xvi) (1981). *See* G.A.O. REPORT, *supra* note 4, at 1.
105. *See* 7 U.S.C. §§ 244, 247 (1976).
106. 7 C.F.R. § 102.39 (1981).
107. 7 C.F.R. §§ 102.33-102.56 (1981).

possible fines and sentences for criminal improprieties.[108]

The system of physical inspections is designed to insure compliance with the law and to provide assurance that the obligations of licensed warehouses match the actual commodities in storage. The extensive regulatory system implemented under the United States Warehouse Act protects the integrity of federal warehouse receipts and promotes an effective and efficient grain warehousing industry.[109] The Department of Agriculture and the General Accounting Office reports, however, indicate there are problems with the system which are now being addressed.

Commodity Credit Corporation Contract Warehouses

Because only a modest percentage of all grain elevators in the nation are federally licensed, changes in the federal law cannot be relied upon to correct problems in the grain storage industry. For federal changes to be effective, their application must be made as broad as possible. Another sizeable category of warehouses that are subject to federal regulations, are those that contract with the Commodity Credit Corporation (C.C.C.) to handle commodities under certain federal price support programs, such as the direct loan program and the farmer held grain reserve.[110] In administering such programs, the C.C.C. comes into possession of large amounts of commodities either as the owner or as a holder of the commodity which is pledged as collateral for a government loan. To obtain storage for this grain the C.C.C. enters into contracts with public elevators through a standard Uniform Grain Storage Agreement.[111] This lengthy agreement establishes the conditions under which elevators can participate in federal programs and sets out the duties and obligations of the contracting parties.[112] The C.C.C. has established standards of approval which an elevator must meet to be eligible for participation in C.C.C. programs.[113] Because these standards set forth the requirements for participation in the government storage programs, they offer a mechanism for requiring elevators to conform to high standards of operation, even if the elevators are not federally licensed.[114]

Direct administration of C.C.C. programs is carried out by employees of the Agricultural Stabilization and Conservation Service (A.S.C.S.).[115] The A.S.C.S. is responsible for establishing the standards of approval that warehouses wishing to participate in the Uniform Grain Storage Agreement must meet. The standards established by A.S.C.S. are similar to those set by the A.M.S. for federally licensed warehouses. The major exception is that

108. 7 U.S.C. § 270 (1976); 7 C.F.R. § 102.9 (1981).
109. TASK FORCE REPORT, *supra* note 88, at 1.
110. 15 U.S.C. § 714 (1976).
111. U.S. DEP'T OF AGRICULTURE Uniform Grain Storage Agreement, Commodity Credit Corporation Form No. 25 & Commodity Credit Corporation Form No. 25, Amendments 1 and 2.
112. *Id.*
113. 7 C.F.R § 1421.5551-1421.5557 (1981).
114. *See Revolutionary Changes Being Considered in Government Warehouse Program*, 33 GOV'T AND GRAIN (newsletter of the Nat'l Grain and Feed Ass'n) No. 19, Oct. 15, 1981.
115. 7 C.F.R. § 2.65(a)(28), (31) (1981).

the A.S.C.S. does not require the bonding of warehouse operators, although the large majority of operators are subject to bonding requirements of the federal or various state licensing requirements.[116]

Currently, over 6,320 warehouses are under contract with the C.C.C. to store grain.[117] Of these, 1,757 are federally licensed, while 4,393 are state licensed and 171 are unlicensed.[118] These warehouses have a combined authorized capacity of over 5.9 billion bushels.[119] The number of nonfederally licensed elevators participating in C.C.C. programs indicate that the standards for participation in C.C.C. programs offer a convenient and effective way for expanding federal control over warehouse operations. This opportunity has been seized upon by the Grain Elevator Task Force in its recommendations and by the A.S.C.S. in proposed rule changes.[120]

Through a memorandum of understanding, the A.S.C.S. has arranged with the A.M.S. to be responsible for determining the eligibility of warehouses to participate in the Uniform Grain Storage Agreement.[121] This includes responsibility for protecting the government's interest in the C.C.C. owned or loaned grain. The A.M.S. carries out this responsibility in a number of ways. First, it conducts initial examinations and investigations of warehouses when Uniform Grain Storage Agreement applications are filed. Secondly, the A.M.S. or cooperating state agencies conduct periodic examinations of the warehouses and the commodities in storage. Thirdly, the A.M.S. conducts a continuing review of the warehouse's operations and financial capability.

The A.M.S.'s goal is to inspect each C.C.C. contract warehouse at least once a year. In fiscal year 1980, this goal was exceeded, in that each warehouse was examined an average of 1.55 times.[122] While the A.M.S. conducts the majority of such investigations, in ten states, state personnel rather than A.M.S. personnel perform the inspection functions. Nine of these states, i.e., Idaho, Illinois, Iowa, Kansas, Missouri, Nebraska, Oregon, Washington, and Wyoming operate under cooperative agreements. The tenth state, Minnesota, operates under a collaboration agreement.[123] In these ten states, however, A.M.S. personnel still conduct the inspections of those warehouses that are federally licensed even if they do have Uniform Grain Storage Agreement contracts. As of March 1, 1981, these ten states were responsible for 2,279 C.C.C. contract grain warehouses; approximately 36% of those were under the Uniform Grain Storage Agreement.[124]

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116. G.A.O. REPORT, *supra* note 4, at 4.
117. G.A.O. REPORT, *supra* note 4, at 3.
118. *Id.*
119. *Id.*
120. *See infra* text accompanying notes 157-58.
121. G.A.O. REPORT, *supra* note 4, at 2.
122. *Id.*
123. *Id.*
124. *Id.*

State Regulation of Grain Warehouses

State laws regulating the operation of grain warehouses constitute the third major branch of regulation in the grain marketing industry. As discussed in the next section, the federal government has not totally occupied the area of regulation of grain storage.[125] Because of the close logistical relation between agriculture and state government, an extensive state regulatory branch has developed contemporaneously with the increase in federal regulation. Under the dual system, elevators can opt for either a federal license or a state license. That decision is often based on the relative cost and stringency of the different systems. Presently, at least twenty-nine states have enacted statutes regulating the warehousing of grain.[126] Although these statutes vary, the majority establish a comprehensive regulatory system for protecting producer interests in grain stored in state licensed warehouses. Similar to federal laws, state regulation of grain storage is based on annual licensing requirements and the provision of bonds. State regulations also use periodic physical examination of records and grain to insure compliance with the law and may restrict the issuance of warehouse receipts to protect the integrity of the system. More than two-thirds of the 10,000 elevators in the nation are state licensed. Since this represents over half of the nation's storage capacity, the state regulatory programs are significant in terms of the amount of grain involved.[127]

State law may provide extensive requirements as to the duties and obligations of warehousemen to protect grain held in storage.[128] At least a dozen states have adopted laws that go beyond regulating the storage of grain, to regulating the grain merchandising practices of elevators.[129] These laws, commonly known as grain dealer laws, regulate the dual activities of grain warehouses that also engage in grain marketing.[130] Because the federal government has not promulgated laws or regulations governing grain marketing, federally licensed grain warehouses are subject to state regulation of grain marketing activities.

The development and existence of the dual federal-state system of regulating grain warehouses has created some problems in creating a uniform and consistent program of regulation. Since participation in either system is

125. *See infra* text accompanying notes 131-56.

126. The G.A.O. REPORT, *supra* note 4, at 33-42 contains an extensive comparison of the requirements of the various state laws. In addition, the TASK FORCE REPORT, *supra* note 88, at 6-9, contains a summary of the bonding and insurance requirements of such laws.

127. It is not known exactly how many grain warehouses exist in the United States, but industry figures place the number at over 10,000. Of that number roughly 1,800 are federally licensed. Of the remainder a small percentage are located in states where licenses are not required. By necessity, the remaining number, which conservatively must be close to 7,000 would be subject to state regulation. One figure that gives an indication of the number of state licensed elevators is that 4,393 of the 6,321 elevators under contract with the C.C.C. are state licensed. *See* G.A.O. REPORT, *supra* note 1, at 3.

128. *See, e.g.*, ARK. STAT. ANN. §§ 77-1301-1342 (1981) (Public Grain Warehouse Law); IOWA CODE ANN. §§ 543.1-.39 (West Supp. 1981-82) (Bonded Warehouses for Agricultural Products).

129. G.A.O. REPORT, *supra* note 4 at 33.

130. *See, e.g.*, IOWA CODE ANN. §§ 542.1-.14 (West Supp. 1981-82) (Grain Dealers).

voluntary, for example, if one system is more costly or restrictive than the other, elevators may avoid the more restrictive one. Thus, as long as the programs are in balance, the decision regarding the system under which to operate may be one of personal choice. If, however, the federal government would propose to significantly increase the required bond amounts, many federally licensed elevators might choose to switch to state licensing. In that circumstance, not only would the new bonding level fail to provide additional protection, but the loss of a significant number of elevators could endanger the viability of the federal regulatory program. The problem of warehouses abandoning the federal system for less restrictive state systems has, in fact, been mentioned as an important consideration in the current discussion concerning improving the regulatory system. Perhaps the federal government should enact legislation that would preempt state law in order to develop a comprehensive federal system of warehouse regulation and to prevent gaps in coverage.[131] This suggestion, however, is possibly unwise since many of the current state programs are effective. An all federal program is not presently under consideration; if it were, the likelihood of adoption is limited.

In all probability, the present grain regulatory system, a dual system of federal and state regulations, will continue. These two systems must be coordinated and such coordination has been studied at the federal level. Coordination of these systems will undoubtedly be under greater scrutiny as the reform process continues. Because the coexistence of federal and state regulation is significant in addressing grain warehouse regulatory problems, it is informative to look at how this dual system has developed constitutionally.

Federal Preemption of State Agriculture Regulation

Federal preemption of state agriculture regulation derives from the broad federal powers under the commerce clause.[132] When a subject is within interstate or foreign commerce, which are defined broadly enough to cover most local activities, the subject is within the domain of federal regulation.[133] The question in each situation is what the federal government has attempted to do, i.e., "take unto itself all regulatory authority over [the matter], . . . share the task with the States, or adopt as federal policy the state scheme of regulation."[134]

The test of federal preemption, for agricultural and other matters, has been set down in *Florida Lime & Avocado Growers, Inc. v. Paul.*[135] The *Avocado Growers* test has three elements: 1) whether there is a direct irreconcil-

131. For instance, the alternative of a mandatory federal program is discussed in the TASK FORCE REPORT, *supra* note 88, at 10-15.

132. U.S. CONST. art. I, § 8; United States v. Darby, 312 U.S. 100, 114-15 (1940); Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 196 (1824).

133. Wickard v. Filburn, 317 U.S. 111, 124-25 (1942); Lemke v. Farmers' Grain Co., 258 U.S. 50, 55-59 (1922).

134. Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 229-30 (1946).

135. 373 U.S. 132 (1963).

able conflict between the two statutes; 2) whether the subject matter demands national uniformity; and 3) whether Congress exhibited a clear and manifest design to preclude state regulations.[136] All three elements must be present for the federal law to preempt the state law.[137] The question in *Avocado Growers* was the relation of a California statute setting oil content standards for avocados grown in the state and the standards of the federal Agricultural Adjustment Act. The Supreme Court ruled that the California act was not preempted by the federal regulation, because the federal act did not manifest an intent by Congress to displace state law.[138] The result was different from that reached in *Rice v. Santa Fe Elevator Corp.*[139] which held that federally licensed grain warehouses were exempt from state regulation and *Campbell v. Hussey*[140] which held that federal standards on flue-cured tobacco preempted state standards.

The rule set forth in *Avocado Growers* requires the determination of preemption by the language and intent of the federal regulation as it relates to the state law. In most areas of agricultural legislation where the federal government has acted, there is some statutory expression of the intended relation between state and federal regulatory schemes.[141] As in *Avocado Growers*, when this guidance is not available, the question of preemption requires the court to discern congressional intent.

The general rule is that the federal power under the commerce clause allows the wholesale preemption of state regulation in many areas. The traditional exercise, however, of the state police power in the regulation of agriculture and the need for and importance of such state regulation, has usually led Congress and the courts to construct a dual system of regulation and stop short of total preemption of state regulation.

The regulation of grain warehouses is an excellent example of such a dualistic approach to regulatory activity. As discussed previously,[142] the federal government and most states have cnacted statutes that regulate the activities of grain warehouses.[143] Such regulation generally occurs through the licensing of warehouses and a required showing of financial security either through surety bonds or other means.

The United States Warehouse Act provides that:

> In the discretion of the Secretary of Agriculture he is authorized to cooperate with State officials charged with the enforcement of State laws relating to warehouses, warehousemen, weighers, graders, inspec-

136. *Id.* at 141-52.
137. *Id.*
138. *Id.* at 152. The *Avocado Growers* decision has been criticized by some commentators as being inconsistent with the trend of earlier decisions in the matter. *See* Note, *Federal and State Economic Regulation—A Preemption Problem*, 17 HASTINGS L.J. 619 (1966).
139. 331 U.S. 218 (1947).
140. 368 U.S. 297 (1961).
141. *See* 7 U.S.C. § 269 (1976) (grain warehouses); 7 U.S.C. § 228c (1976) (packers and stockyards).
142. 7 U.S.C. §§ 241-273 (1976).
143. *E.g.*, IOWA CODE ANN. §§ 543.1-.39 (West Supp. 1981-82).

> tors, samplers, or classifiers; but the power, jurisdiction, and authority conferred upon the Secretary of Agriculture under this chapter shall be exclusive with respect to all persons securing a license thereunder so long as said license remains in effect.[144]

Prior to the addition of this clause in 1931, this section did not place any restriction on the state regulation of agricultural warehouses even though such regulation tended to affect interstate or foreign commerce.[145]

This rule was changed with the United States Supreme Court decision in *Rice v. Santa Fe Elevator Corp.*[146] which set forth the rule of law that still controls today. In *Rice*, an individual filed charges based on nine grounds against a federally licensed warehouse for violating the Illinois Grain Warehouse Act by charging unjust, unreasonable, and excessive rates and discriminating against certain customers in favor of the federal government.[147] As a starting point, the court stated that since warehouses storing grain for interstate and foreign commerce are in the federal domain, Congress may assume all regulatory authority over them, if it should choose to do so.[148] The question was what Congress intended to do in this area when it enacted the United States Warehouse Act. The Court felt that Congress had legislated in a field which was traditionally a subject of state regulation and therefore the exercise of the state police power would only be superceded if that was the clear and manifest purpose of Congress.[149] The Court, however, felt that the congressional intent to preempt the field was obvious from the reports concerning the adoption of the 1931 amendment.

According to the Court, the 1931 amendment meant that:

> a licensee under the Federal Act can do business "without regard to State Acts"; that the matters regulated by the Federal Act cannot be regulated by the States; that on those matters a federal licensee (so far as his interstate or foreign commerce activities are concerned) is subject to regulation by one agency and by one agency alone.[150]

In other words "warehousemen electing to come under the Federal Act need serve but one master, and that one the federal agency."[151]

The result in *Rice* was similar to an earlier decision of the South Dakota Supreme Court, *In re Farmers Cooperative Association*,[152] which addressed the same subject. In that case, the South Dakota Supreme Court

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144. 7 U.S.C. § 269 (1976).
145. *E.g.*, Merchants Exch. v. Missouri *ex rel.* Barker, 248 U.S. 365 (1919); Independent Gin & Warehouse Co. v. Dunwoody, 40 F.2d 1 (5th Cir. 1930).
146. 331 U.S. 218 (1947).
147. *Id.* at 220-21.
148. *Id.* at 229-30.
149. *Id.* at 230. *See* Munn v. Illinois, 94 U.S. 113 (1876).
150. Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 234 (1947).
151. *Id.* Another case similar to *Rice* is Campbell v. Hussey, 368 U.S. 297 (1961). In that case there was a challenge to a Georgia statute concerning the labeling of tobacco grown in the state. The Supreme Court ruled that the federal law defining types and grades of tobacco and providing for the labeling of the tobacco preempted the similar state law. The Court said, "We have then a case where the federal law excludes local regulation, even though the latter does no more than supplement the form." *Id.* at 302.
152. 69 S.D. 191, 8 N.W.2d 557 (1943).

held that although the warehouse business of the plaintiff cooperative was local in nature, such warehousing business so affects interstate commerce that it was within the reach of the federal commerce power.[153] Therefore, the federal licensing of warehouses in South Dakota totally removed those warehouses from the jurisdiction of the state.

The rule that extends from these cases, however, is not that the federal government has totally occupied the field of regulation of grain warehouses. Rather, the rule after *Rice* is that there are two systems of warehouse regulation, exclusively federal and exclusively state. If a warehouseman opts for federal licensing, the state cannot regulate the activities of his warehouses. States, however, can and do regulate those warehouses which choose to exist under state regulation. This dual system of regulation operates relatively well, but does have some problems, as discussed previously.

Many states have also passed grain dealer laws which regulate the marketing transactions of elevators in buying and selling grain.[154] Since most warehouses also conduct a grain buying business, the existence of a state grain dealer licensing requirement means that a federally licensed grain elevator must comply with both statutes, the federal grain warehousing law and the state grain dealers law. To date, the federal government has not regulated the marketing transactions of licensed warehouses. This proposal, however, has been made by the A.M.S. as one way to achieve more complete federal control over elevators.

Whether such state grain dealer laws conflict with federal grain elevator laws has not been decided by the courts. Only one reported case since *Rice* has addressed the situation where a state or local regulation was alleged to impinge on the freedom of federally licensed warehouses. In *Duluth Board of Trade v. Head*,[155] a three judge panel ruled on a Minnesota statute requiring that warehousemen stamp a certain legend on all weight certificates or receipts not issued by representatives of the state weighing department. The court ruled the statute was unconstitutional as conflicting with the federal statute requiring that federally licensed warehouses issue uniform receipts. The state law would have required the inscription, "This Certificate is Not Issued Under State Authority", in red letters one-quarter inch high on all weight certificates issued by federally licensed warehouses employing federally licensed weighers.[156] The district court rested its decision on *Rice* and the weight that the United States Supreme Court gave in that opinion to the Congressional intent that federally licensed warehouses issue uniform receipts. The district court felt the additional matter required by the Minnesota statute "stand[s] in violent and direct conflict with the congressional desire for a uniform and credible weight receipt."[157]

153. *Id.* at 199, 8 N.W.2d at 561.
154. *E.g.*, IOWA CODE ANN. §§ 542.1-.14 (West Supp. 1981-82).
155. 298 F. Supp. 678 (D.C. Minn. 1969).
156. MINN. STAT. ANN. § 233.31 (West 1972) (repealed 1974).
157. 298 F. Supp. 678, 681 (D.C. Minn. 1969). The plaintiff tried to argue that the Supreme

The Minnesota statute as applied to federal warehouses does appear to have been a punitive response to the independence of the federal warehouses in that the accuracy of the federal weights could not seriously be in question. Since state grain marketing laws deal with an area not affected by federal law, apparently they are not preempted. What effect the adoption of the A.M.S. proposal to regulate marketing transactions would have on state grain dealer laws is unclear. Since the A.M.S. proposal would relate to only federally licensed elevators, it would not affect state licensed elevators; it would, however, preempt the application of state grain dealer laws to federally licensed warehouses.

Federal Agencies Focus on Improving Regulatory System

The *James Brothers* elevator collapse added new incentive to calls for review of the warehouse laws. As congressional concern regarding elevator insolvencies heightened, the agencies involved in the regulatory system began reviews of their programs. Two major reports by federal agencies focused on the federal grain warehousing regulatory system and recommended improvements. These reports by the General Accounting Office and the United States Department of Agriculture provide an important starting point for considering the problems of the present regulatory system and its improvements.

Grain Elevator Task Force Report

On February 26, 1981, the Secretary of the Department of Agriculture appointed a Department of Agriculture Task Force to review the current grain warehouse laws and regulations and to recommend changes to safeguard the interest of both farmers and the government when commercial grain elevators enter bankruptcy. This group, the Grain Elevator Task Force, was comprised of individuals representing the various Department of Agriculture agencies involved in the marketing and storage of grain as well as other Department of Agriculture groups involved with grain elevator insolvencies. This task force worked throughout the spring and summer of 1981, seeking the views of farm groups, warehousemen, and the grain trade industry, on what changes in federal laws could prevent grain elevator bankruptcies. The Grain Elevator Task Force issued its report on August 18,

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Court decision in *Avocado Growers* had altered the test set forth in *Rice* but the District Court disagreed. *Id.* *Cf.* Edward R. Bacon Grain Co. v. City of Chicgo, 325 Ill. App. 245, 59 N.E.2d 689 (Ill. App. Ct. 1945). In *Edward R. Bacon Grain Co.* the Illinois Appellate Court upheld a municipal ordinance regulating and preventing the storage of certain combustible and explosive materials, including grain. Under the ordinance Chicago required that elevator operators obtain an annual license from the city. The court held that the ordinance did not conflict with the Federal Warehouse Act and did not fit under the rule expressed in *In re* Farmers Cooperative Association, 69 S.D. 191, 8 N.W.2d 557 (1943), because the ordinance did not "regulate the occupation of warehousemen as such, but the place in which the grain is stored." Edward R. Bacon Grain Co. v. City of Chicago, 325 Ill. App. 245, —, 59 N.E.2d 689, 693 (Ill. App. Ct. 1945). Whether such a distinction based on the safety aspects of a state or local law would prevail today in view of *Rice* is debatable.

1981 and made seven major recommendations.[158] The Task Force Report presents a detailed analysis of the various recommendations and alternatives considered by the Task Force.[159] The following describes some of these recommendations.

First, the Task Force suggested creating a study group of federal and state regulatory agencies to coordinate federal and state efforts regarding minimum licensing or agreement requirements, establish uniform minimum net worth standards, and recommend methods of auditing warehouses on grain merchandising. The Task Force, then, recommended amending the Commodity Credit Corporation's (C.C.C.) warehouse standards of approval for grain, rice, dry edible beans, and seeds. The standards would be amended to: 1) require that warehousemen file an annual unqualified certified financial statement prepared by an independent certified public accountant; 2) increase the net worth requirements; and 3) provide for the acceptance of irrevocable letters of credit in lieu of bonds.

Additionally, the report recommended with regard to federally licensed grain elevators, that the A.M.S. continue to receive comments on the proposed grain marketing regulations published in the Federal Register on June 9, 1981, and that warehousemen file annual certified financial statements prepared by a certified public accountant. Further, the recommendations included that the Department of Agriculture take steps, including possibly requesting legislation, to protect grain claimants during the period after the Department has suspended elevator licenses but prior to bankruptcy or other action on the elevator. This recommendation includes the establishment of a special Department of Agriculture team consisting of the A.S.C.S., A.M.S., the Office of General Counsel and the Office of Inspector General, who would report directly to the Secretary of the Department with the specific purpose of dealing with warehouse problems when a suspension of a license or contract has been initiated by the Department.

The Task Force Report also supported initiating a policy that would pertain to bankrupt elevator cases where the Department of Agriculture has a vested interest in the elevator. This policy would apply in situations such as where the elevator has stored grain under the C.C.C. programs. The general counsel was given the responsibility for determining the Department policy position regarding the integrity and security of warehouse receipts. The recommendations include developing a comprehensive information package for the instruction and education of users of warehouse receipts. Such instruction would include the various types of contracts that are normally used by warehousemen and the requirements and conditions of the Department of Agriculture as to licenses and contracts with warehouses. Finally, the Task Force recommended creating an ad hoc committee composed of warehousemen directly affected by the user fee legislative mandate

158. *See* TASK FORCE REPORT, *supra* note 88.
159. *Id.* at i-ii. (summary of Task Force recommendations).

relating to the United States Warehouse Act program. This committee would study U.S.D.A. audit costs and sources as it relates to the user fee proposed by the U.S.D.A.

The Task Force Report also provided that there were three conditions that they felt inappropriate to recommend at this time. Those dealt with: 1) the implementation of an insurance or indemnity program; 2) the establishment of a new federal agency to deal with grain elevators; and 3) the creation of a clearing house for information on elevator insolvencies. The Task Force recommended alternatives that should not be adopted as C.C.C. approval standards. These were: 1) the requirement of performance bonds; and 2) the requirements that all warehouses be either licensed under the United States Warehouse Act or by a state which has laws and regulations comparable to the Act. The recommendations set forth in the Task Force Report represent the major effort made by the government concerning improvement of the grain regulatory system, and as discussed shortly, have been the basis for several proposed changes in that system.

General Accounting Office Warehouse Bankruptcy Report

On June 19, 1981, the General Accounting Office (G.A.O.) released a report entitled, "More Can Be Done to Protect Depositors at Federally Examined Grain Warehouses."[160] Based in part on a random sample of over 400 elevators, this study presented a review of the magnitude of bankruptcies at federally inspected elevators and recommended changes for strengthening current programs. Part of the motivation for the G.A.O. study was that the Department of Agriculture needed to develop a formula to predict the number of potential bankruptcies before the Department recommended major legislative changes to address the problem of grain elevator insolvencies. The G.A.O. study reviewed past elevator bankruptcies and found that only 2% of the approximately 10,000 elevators had entered bankruptcy since 1974.[161] While financial formulas had been developed in certain industries to predict bankruptcies, the G.A.O. report found that such a predictive formula had not been developed in the grain trade.

To estimate how many elevators might be in financial trouble, the G.A.O. conducted a random sample of 400 grain warehouses under federal jurisdiction. After reviewing the use of predictive formulas with grain elevators, the G.A.O. developed and applied three detailed criteria to determine if an elevator was in difficulty. These three criteria were based on: 1) a current ratio (current assets divided by current liabilities) of less than 1:1 for the current year, with either no improvement or a downward trend over previous years; 2) a debt to total assets percentage of more than 58% in the current year with no improvement or an upward trend; and 3) an average net

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160. *See* G.A.O. REPORT, *supra* note 1.
161. *Id.* at 7.

profit to net worth percentage of less than 11.2% for the years reviewed.[162] If an elevator meets all three criteria, it is noted as having potential financing problems. Of the 400 elevators sampled, nineteen, or 4.75%, met the criteria for being in financial trouble.[163] Based on this result, G.A.O. estimates that about 300 elevators under federal authority may be financially unsound.

In order that the Secretary of the Department of Agriculture can take advantage of predictive formula to help prevent elevator bankruptcy, the G.A.O. made several recommendations. First, elevators must submit additional financial data, particularly sales data to the A.M.S.[164] Once the Department of Agriculture requires that the elevators submit the necessary data, G.A.O. recommended that a predictive formula be developed and implemented. G.A.O. felt the implementation of this program would help the Department of Agriculture determine *what if any* changes were necessary in the grain warehouse laws. The G.A.O. also felt that the use of such a test would "red flag" elevators with possible problems. Elevators, then could be subject to closer federal scrutiny to prevent the development of insolvencies. The Department, for example, could watch elevators that were predicted as having potential problems for commodity speculation or major grain shortages. The G.A.O. also applied their three criteria to the financial data submitted to A.M.S. by the twenty-seven C.C.C. contract elevators that had entered bankruptcy since January, 1979. Of these elevators, only nine, or 33%, met the criteria. The G.A.O. criteria were more accurate, however, once factors not reflected in financial data, such as commodity speculation losses and major shortages which had played a major role in other eighteen failures, were eliminated.[165] Thus, while the criteria were not foolproof, G.A.O. believed they offered a reasonable indication of possible financial problems.

The G.A.O. study also focused on the current procedures for warehouse examinations and the issuance of warehouse receipts. The G.A.O. found two weaknesses that hamper the A.M.S.'s ability to determine if a warehouse has enough grain to meet its storage obligations. First, all federally examined warehouses do not always issue warehouse receipts for all grain placed in storage. The G.A.O. Report discussed that in the course of normal grain marketing transactions, some grain may be accepted by an elevator on open storage. In that case, a warehouseman issues a weight scale ticket, not a warehouse receipt. When a warehouse receipt or sales contract is not issued on the scale ticket, difficulties may arise in insuring that the obligations on the elevators' books or accounts match actual obligations because scale tickets are an uncontrolled document and their recordation is subject to error or manipulation. The difficulty is that the A.M.S. inspector cannot accurately verify open storage obligations to determine if inventory meets

162. *Id.* at 12-13.
163. *Id.* at 12-14.
164. *Id.* at 15.
165. *Id.* at 13.

obligations unless the records are accurate.[166] The G.A.O. report noted that this problem could be remedied in part by requiring the prompt issuance of warehouse receipts for all grain deposited. Presently, this is not required at all federally licensed warehouses or at the C.C.C. contract warehouse; 36% of these warehouses are subject *only* to state law requirements.

The G.A.O. study noted a second problem concerning the use of warehouse receipts and the federal inspectors inability to verify the accuracy of warehouse accounts. This is the lack of controls, particularly at the state level, over the printing and distribution of warehouse receipts.[167] This lack of control makes it impossible for A.M.S. inspectors to verify that all warehouse receipt obligations have been accounted for. An important part of the warehouse examination is a careful audit of the warehouse receipts to be sure that all receipts are accounted for. Without controls over access to receipts, operators can print and issue their own warehouse receipts for grain they do not own or have in storage and then use the receipts as collateral for loans. The existence of such "wild card" receipts creates a great potential for financial collapse and also drastically affects the integrity of all warehouse receipts. For these reasons, the G.A.O. recommended requiring all C.C.C. contract warehouses to use warehouse receipts that could be adequately accounted for during federal examinations. The G.A.O. noted that this could be accomplished through better state control over the printing and distribution of warehouse receipts and by requiring such adequate controls as a prerequisite to participation in the Uniform Grain Storage Agreement contracts for C.C.C. elevators. As will be seen, the proposed regulations reflect these G.A.O. recommendations.

PROPOSED FEDERAL REGULATORY CHANGES

As a result of the increased attention on problems in the regulation of the grain warehousing industry, the federal agencies in charge, the A.M.S. and the C.C.C., have proposed a number of changes in the regulations governing federally licensed or approved warehouses. The changes reflect several of the recommendations made by the Grain Elevator Task Force and the G.A.O. report. Some of the proposals have already been adopted, but several others have proven controversial and are still under consideration. The proposals relate to three major concepts: 1) strengthening the financial requirements for elevator approval and requiring a certified financial statement from federally regulated elevators; 2) requiring elevators to pay fees covering the actual costs for federal inspection services; and 3) regulating the marketing transactions of federally licensed grain warehouses in addition to regulating their storage activities. Presently five separate regulatory changes have been proposed. The content and status of each of these proposals is discussed in detail below.

166. *Id.* at 16-23.
167. *Id.* at 21.

Federally Licensed Warehouses: Fees for Services

On September 4, 1981, the Agricultural Marketing Service proposed a significant change in the operation of the Federal Warehouse Act when it published proposed rules concerning the imposition of user fees on federally licensed warehouses.[168] This development was required by the Omnibus Budget Reconcilliation Act of 1981 which was approved August 13, 1981. This Act amended the United States Warehouse Act to stipulate:

> The Secretary of Agriculture, or his designated representative, shall charge, assess, and cause to be collected a reasonable fee for (a) each examination or inspection of a warehouse (including the physical facilities and records thereof and the agricultural products therein) under this Act; (b) each license issued to any persons to classify, inspect, grade, sample, or weigh agricultural products stored or to be stored under the provisions of this Act; (c) each annual warehouse license issued to a warehouseman to conduct a warehouse under this act (sic), (d) each warehouse license amended, modified, extended, or reinstated under this Act. . . Such fees shall cover as nearly as practicable, the costs of providing such services and licenses; including the administrative and supervisory costs.[169]

The proposal that federally inspected grain warehousemen now pay users fees for A.M.S. inspections was a break from past policy. In the past, the only fees imposed on the warehouseman was a fee for the original inspection when initially receiving a license and, then, a nominal license fee. The original proposal included requiring: 1) a $50 fee for each original warehouseman's license and a fee of $50 for each amended, modified, extended, or reinstated, or duplicate warehouseman's license; and 2) for each original examination or inspection, or reexamination or reinspection of a warehouse under the Act a sliding fee at the rate of $10 for each 10,000 bushels of storage capacity or fraction thereof. In no case can this fee be less than $100 or more than $1,000. As for annual warehouse licenses issued or continued, an annual fee for inspection is to be applied. This schedule begins with a minimum fee of $600 for elevators with 200,000 bushels capacity or less and moves upward to a fee of $6,000 for elevators with a 20,000,000 bushel capacity or more. As originally proposed, the warehouse inspection fee determined under this formula was to be reduced by 25% if the warehouseman provided the Secretary of the Department of Agriculture with an annual financial statement that had been audited by a certified public accountant in accordance with general accepted auditing standards. In no case, however, was the annual inspection fee to be less than $600. The proposal required that before granting any license or conducting an original examination, inspection, reexamination, or reinspection, the applicant and licensee have to deposit with the A.M.S. the amount of the fee prescribed by the regulation.

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168. 46 Fed. Reg. 44,680 (1981) (to be codified at 7 C.F.R. §§ 101.50-111.60).
169. *Id.*

The Omnibus Act required that the new fee structure go into effect by October 1, 1981. This, however, was not the case. After publication in September, the next action taken on this proposal occurred on December 30, 1981, when the A.M.S. published its final rules for service fees for federally licensed warehouses.[170] The final rules contain several changes from the original proposal, in part in response to comments and criticisms that had been received from the public. Over 115 comments were received by the Department of Agriculture during the comment period on this proposal; ninety-nine of these came from the grain industry.[171] While these comments related several concerns, the major concern, shared by the Department of Agriculture Grain Elevator Task Force Report, was that the Commodity Credit Corporation (C.C.C.) was a prime beneficiary of the licensing and inspection program and thus should have to bear a share of the cost. These reports concluded that the C.C.C. was a major beneficiary because: 1) the C.C.C. has a significant interest in loaned or owned grain that is stored in federally licensed warehouses and subject to federal examinations; 2) the C.C.C. currently pays the A.M.S. and a number of cooperating states for examining nonfederally licensed warehouses that have entered into the Uniform Grain Storage Agreement with the C.C.C.; and 3) federally licensed warehouses might consider terminating the federal license because the user fee would be higher than that which they would be subject to under a state licensing law or if they opted to not be licensed, if the C.C.C. would continue to pay for examinations under these alternative licensing methods. In the past the C.C.C. had never paid the A.M.S. for its inspection of federally licensed elevators, because the program was paid for through appropriations and no beneficiary was required to pay for user fees of the A.M.S. system. The C.C.C., however, had paid for examinations of nonlicensed or state licensed facilities.

After considering the comments, the Department of Agriculture recognized the validity of the position that the C.C.C. was a direct identifiable beneficiary of a user fee system and changed the final rule. Under the final rule, the warehouse inspection fee scale was changed with regard to annual fees. Accordingly, for elevators under the Uniform Grain Storage Agreement, the schedule runs from an annual fee of $250 for elevators with a license capacity of a 150,000 bushels or less up to a maximum of $1250 for elevators with a capacity of over 5,001,000 bushels. For elevators that do not participate in the Uniform Grain Storage Agreement program, the schedule of fees is doubled. The final rule contains the same schedule for license fees and for original examination or inspection fees as was first proposed. Additionally, the requirement that a licensee must provide an advance deposit to cover the fees was maintained. One other change was made in the final rules. This concerned the proposed price break for elevators that provided

170. 46 Fed. Reg. 63,198 (1981).

171. For a discussion of these proposals from the industry viewpoint, see *Fate of Voluntary U.S. Warehouse Act Program Hinges on User Faces*, 33 GOV'T AND GRAIN No. 15, Sept 3, 1981.

an annual financial statement audited by a certified public accountant. While this proposal was subject to critical comments, the reason that it was removed was that the C.C.C. had by December 30, proposed a rule making this requirement mandatory for approval under the Uniform Grain Storage Agreement. Therefore, the over 1,750 of the 1,832 federally licensed grain warehouses currently holding Uniform Grain Storage Agreements,[172] would need to comply with that requirement anyway. Further, a similar requirement had been proposed that covered warehouses licensed under the United States Warehouse Act.

The proposal to charge user fees for federally licensed warehouses became final upon publication on December 30, 1981. The recognition in the final rule of the benefit to the C.C.C. and the corresponding reduction in the levels of fees should help to remove some of the industry concern relating to this proposal. The grain warehousing industry's reception of the user fee proposal, however, was at best skeptical. One of the major concerns of the industry, and one reflected in the Department of Agriculture Grain Warehouse Task Force Report, was that a shift to full user fees at the federal level, without a corresponding shift in state programs, could possibly result in a shift of elevators from federal to state licenses or to no licenses. This concern reflects the problem of the gap between federal and state licensing programs discussed earlier.

Commodity Credit Corporation Warehouses: Fees for Services

Although it is too early to tell whether the federal user fee requirement is having a discernable effect on the number of federally licensed warehouses, one other rule change proposed by the federal government should help to remove the possible price differential between federally and state licensed facilities. This is the proposal made by the C.C.C. on December 30, 1981, that would: 1) require warehousemen wishing to continue their approval under a Uniform Grain Storage Agreement to pay contract fees to the C.C.C. in advance of the annual renewal date to partially defray the costs of warehouse examinations and administrative costs incurred by the C.C.C. in administering the agreement; and 2) require warehousemen requesting initial warehouse approval under the Uniform Grain Storage Agreement to pay contract fees to the C.C.C. to partially defray the cost of examining and approving the facility.[173] Under the proposal concerning user fees for federally licensed warehouses, the C.C.C. and the warehousemen agreed to jointly pay the cost of the A.M.S. services as mandated by the Omnibus Budget Reconcilation Act. The C.C.C., however, for its own protection, also requires periodic examination of warehouses not licensed under the federal act. The C.C.C. has been contracting with the A.M.S. and pay-

172. *See* 46 Fed. Reg. 30,620 (1981) (to be codified at 7 C.F.R. pt. 102) (statistics regarding licensed grain warehouses).
173. 46 Fed. Reg. 63,075 (1981).

ing all of the examination costs for those warehouses that had uniform grain storage agreements but which were not federally licensed or licensed in states having federal or state cooperative agreements. The different assessment of user fees between these groups stemmed from requiring that federally licensed warehouses pay fees in association with the C.C.C. while not requiring state or unlicensed warehouses to pay fees. The C.C.C. was concerned this could lead to warehouses withdrawing from participation in the United States Warehouse Act program, without any attendent affect on their ability to remain on the list of the C.C.C. approved warehouses. Therefore, the C.C.C. proposed to change its program so that effective July 1, 1982, the C.C.C. pays only a portion of the total cost of the examination under the Uniform Grain Storage Agreement for these other nonfederally licensed warehouses. The remaining costs of examining the warehouses would be obtained from the collection of contract fees from the warehousemen. These fees were to be based on the same formula as that used to assess fees for federally licensed warehouses. The contract fee schedule reflects the fee schedule for federally inspected warehouses operating under a Uniform Grain Storage Agreement. The C.C.C. proposal has not become final, and was open to comment until February 28, 1982. It is probable that it will become finalized.

The two regulatory changes concerning fee assessment implement two basic ideas. The first, is that they carry out the mandate of the Omnibus Budget Reconcilation Act, which requires users of federal services to pay fees that would cover the actual cost of that service. Secondly, the two proposals work in common to identify the actual beneficiaries of the service and apportion the costs in an equitable manner. The effect of the two proposals is to prevent a gap from developing between the federal and nonfederal licensed warehouses so that no incentive is provided for warehousemen to drop out of the federally licensed program, but yet maintain eligibility for C.C.C. Uniform Storage Agreement coverage.

Financial Statement Requirements

One recommendation made by the Grain Elevator Task Force concerned how to provide added assurance concerning the financial ability of the warehouse operation. The Task Force felt that the existing regulations under the United States Warehouse Act deal adequately with the warehousemen's obligations and duties as *storer* of grain. As previously noted, however, part of the problem comes from the fact that licensed warehousemen often operate a grain marketing business in which they buy grain directly from producers, through the same facilities that are used to store grain. This combination of storing and marketing grain often means that funds available to the total business from both aspects of the business cannot be segregated. The situation also often creates continuous, dual and often times, uncertain financial obligations. The Department of Agriculture Task Force reported that one way to reduce the risks to producers who sell depos-

ited grain as well as to producers who store such grain with warehouses would be to provide for some independent source of periodic review of the warehousemen's financial condition. The recommendation of the Task Force was that the A.M.S. require from its federally licensed warehouses and that the C.C.C. require from its elevators participating in the Uniform Grain Storage Agreement, some type of recent statement by an independent financial auditor as to the financial capability of the warehouse.[174] This recommendation has generally come to be regarded as the requirement of an annual financial statement from a certified public accountant.

Agricultural Marketing Service Proposal for Federally Licensed Facilities

In December, 1981, the Agricultural Marketing Service published proposed rules that would require that each warehouseman, conducting a licensed warehouse or for which application for license has been made pursuant to the warehouse act, be required to submit "an annual financial statement that has been audited by a certified public accountant in accordance with generally accepted auditing standards."[175] When this rule was first published on December 7, 1981, the comment period was open until December 31, 1981. On January 6, 1982, the Agricultural Marketing Service extended the comment period on this ruling until January 15, 1982.[176] Apparently, within the industry this is considered a very controversial proposal. This was one reason given for extending the comment period, so as to give sufficient time to alert interested parties and allow such parties to consider the impact of such a requirement before commenting. Although the comment period is now closed, the final summary of the comments or further proposed rule has not been published.[177]

Commodity Credit Corporation Audit Requirement and Changes in Standards of Approval

In October, 1981, the Commodity Credit Corporation proposed a rule that would alter the standards of approval for warehouses participating in C.C.C. storage programs.[178] This proposal was pursuant to a recommendation by the Grain Elevator Task Force, and would amend the regulations to require that a warehouseman furnish to the C.C.C. an annual financial statement which had been examined by an independent certified public accountant. This statement had to be accompanied by a copy of the accountant's audit report, prepared in accordance with the generally accepted auditing standards, of the financial statement of the warehouseman. The statement was to show the financial condition of the warehouseman at a date not ear-

174. *See* TASK FORCE REPORT, *supra* note 88, at iv.
175. 46 Fed. Reg. 59,930 (1981) (to be codified at 7 C.F.R. pt. 102).
176. Extension of Comment Period, 47 Fed. Reg. 631 (1982).
177. For a discussion of the CPA audit idea from the industry view, see *Elevator Task Force Hangs Hat on CPA Audit*, 33 GOV'T AND GRAIN No. 16, Sept. 16, 1981.
178. 46 Fed. Reg. 50,378 (1981) (to be codified at 7 C.F.R. pt. 1421).

lier than ninety days prior to the date of the warehouseman's application for approval under the C.C.C. program. This recommendation is similar to that which was proposed by the Agricultural Marketing Service for all federally licensed warehouses on December 7, 1981.[179]

In addition to the recommendation concerning certified audits, the C.C.C. also proposed several other changes in their standards for approval. First, it was proposed to remove the provision that a warehouseman need not have a net worth exceeding $250,000.[180] This change would mean that regardless of the size of an elevator its net worth requirement would continue to increase in relation to its storage capacity. A second proposed change would increase the rate used to calculate the net worth required for a grain warehouseman; the rate would increase from 10¢ a bushel to 20¢ a bushel, based upon the maximum licensed storage capacity of the warehouse for grain.[181] These two proposals in combination would afford the C.C.C. and other depositors greater protection from warehouse failures due to the more than doubling of the net worth requirements for participation in the C.C.C. programs. Another proposed change would allow warehousemen to furnish the C.C.C. with an irrevocable letter of credit in order to meet their net worth requirements.[182] Currently the C.C.C. accepts cash, negotiable securities, or a legal liability insurance policy, in lieu of the amount of bond coverage. Bonds are the basic way in which net worth requirements are satisfied. The proposed rule allowing the use of an irrevocable letter of credit as substitute security, provides more flexibility for warehousemen and permits a lower cost means of meeting their bonding requirements. Currently, a warehouseman is required to have a net worth greater than $25,000 based upon storage capability. If the calculated net worth requirement is greater than $25,000 the warehouseman may satisfy the deficiency between that amount and the $25,000 minimum by furnishing bonds or acceptable substitute securities. The new rule would allow an irrevocable letter of credit as such a substitute security. The C.C.C. estimates a warehouseman's costs to furnish an irrevocable letter of credit to satisfy any net worth requirement would be approximately one-tenth or one-twentieth of the present cost of furnishing bonds.

The C.C.C. proposal concerning changing the standards for approval for Uniform Grain Storage Agreement participation was made on October 13, 1981. The comment period for that rule was to run until November 16, 1981. On November 18, 1981, the C.C.C. extended the comment period on that proposed rule until December 16, 1981.[183] The reasons for that extension were that the comments received to that date were extreme and varied and the C.C.C. felt that the comment period should be extended so that

179. 46 Fed. Reg. 59,930 (1981) (to be codified at 7 C.F.R. pt. 102).
180. 46 Fed. Reg. 50,378 (1981) (to be codified at 7 C.F.R. pt. 1421).
181. *Id.*
182. *Id.*
183. Extension of Comment Period, 46 Fed. Reg. 56,624 (1981).

maximum information could be obtained. No subsequent published action has been taken by the C.C.C. on these proposals.

Agriculture Marketing Services Proposed Rules for Marketing Transactions

On June 9, 1981, the A.M.S. proposed federal regulations that would regulate the marketing activities of all federally licensed warehouses.[184] The proposed regulations apply to warehousemen "who receive grain for storage, or who sell, handle, ship or otherwise market"[185] grain deposited in facilities that are licensed under the United States Warehouse Act. The proposed regulations mark the first time in the sixty-five year history of federal regulation of the grain warehousing industry that the A.M.S. has proposed regulations that would apply to the marketing transactions of federally licensed warehouses. The proposed regulations set forth a three-prong proposal for federal regulations. The proposals would require: 1) the examination of certain financial records as well as storage obligations; 2) the establishment of bonding requirements to cover grain marketing activities; and 3) the increase in existing bonding and net asset requirements for all federally licensed facilities.[186] The proposed regulations resulted from the concern on the part of the A.M.S. because most grain warehouses also carry on grain marketing transactions. This dual role has created unique risks for those individuals storing grain with these facilities. A.M.S views the business of storing and marketing grain as inseparable and likewise the funds that are available to the total business often cannot be segregated. As a result, this situation can create continuous, dual and at times, uncertain obligations. According to the A.M.S., many problems of elevator insolvency have stemmed in part from the grain merchandising practices of the elevators.

In particular, the growing use of marketing transactions such as price later or deferred pricing or delayed price grain which can create financial obligations on the part of the elevators that are difficult to audit added to the A.M.S.'s concerns. The A.M.S. view is that it is consistent with the objectives of the United States Warehouse Act to define various marketing transactions of licensed grain warehousemen which are a regulatory concern of the Secretary. The A.M.S. proposals were under consideration for at least two and one-half years prior to their publication.

As to specific requirements of the proposals, the first recommendation concerning the examination of marketing records, is that licensed warehouses that contract with producers to buy, sell, handle, ship, or otherwise market grain must maintain accurate records of certain unspecified types of transactions. The regulations require warehouses to issue warehouse receipts, or other documentation, that indicate delivery for all grain deposited in the warehouse and maintain records of the weights, kinds, and grades of

184. 46 Fed. Reg. 30,620 (1981) (to be codified at 7 C.F.R. pt. 102).
185. *Id.*
186. *Id.*

all lots of nonstorage grain, for instance, delayed price grain, received by or delivered from the warehouse.[187] The warehouses must maintain these records and records for grain moved by the warehousemen directly from the producer to another delivery point, for one year after the year in which the nonstorage grain was delivered.[188] The proposed regulations do not specify the actual records that the A.M.S. examiners would request to investigate warehousemen's marketing transactions. They only state that such records would generally "conform to situations which already exist, and it is contemplated that any new procedures and requirements as approved by the Secretary shall only be for those (records) already recognized as good business practices."[189]

The second proposed change concerns creating a bonding requirement to cover grain marketing transactions. The proposed regulations would require a bond of 10¢ a bushel for the license warehouse capacity, with a $25,000 minimum and a $250,000 maximum bond requirement.[190] The proposed rule requires that warehousemen engaging in marketing activity have to notify the Secretary of the Department of Agriculture and post their additional bond in advance of such activity. Failure to do so could be considered grounds for suspension of a warehouse license. The proceeds of the bond covering market activities benefit producers who sell their deposited grain or contract with the warehousemen to be their agent to market their deposited grain and who do not receive full payment for the grain in accordance with such sales agreement or contract. The rule distinguishes between persons who store grain and persons who market grain with respect to the accessibility of bonds.[191] Individuals who store grain with the warehousemen have access to the bond required for licensing; whereas, producers who sell deposited grain or contract with the warehousemen to handle their grain have access only to the additional 10¢ per bushel bond required under the new proposal. Claims against either type of bond are to be honored on a pro rata basis. The regulations define a "producer" as a grain depositor who is also the "landowner, landlord, or tenant involved in the production" of the deposited grain.[192]

The third proposal relates to increases in the bonding and net asset requirements for all federally licensed elevators. These requirements apply to the storage obligations rather than to the marketing transactions of federal warehouses. The new proposal increases the minimum net assets requirement for federally licensed warehouses from $25,000 from the current $10,000.[193] Any deficiency in the net assets required above the $25,000 minimum can be supplied through a deficiency bond. The proposal raises bond-

187. 46 Fed. Reg. 30,621 (1981) (to be codified at 7 C.F.R. § 102.30).
188. *Id.*
189. *Id.* at 30,620 (to be codified at 7 C.F.R. pt. 102).
190. *Id.* at 30,621 (to be codified at 7 C.F.R. § 102.14).
191. *Id.*
192. *Id.* (to be codified at 7 C.F.R. § 102.2).
193. *Id.* (to be codified at 7 C.F.R. § 102.14).

ing requirements to 20¢ per bushel of licensed capacity with a $25,000 minimum.[194] Currently bonding is computed on a graduated scale of 20¢ per bushel for the first million bushels of licensed capacity, 15¢ per bushel for the next million bushels and 10¢ for any licensed capacity exceeding 2,000,000 bushels.

When first proposed, the comment period on the marketing transaction rules was to extend to August 10, 1981. On August 21, 1981, the A.M.S. extended the comment period on the proposal until August 28, 1981.[195] During that comment period the proposed change was subject to a good deal of debate within the grain marketing industry.[196] Arguments supporting the A.M.S. proposal state that the regulations to cover grain marketing activities would give the A.M.S. greater authority to investigate and determine financial capacity of grain elevator operations. Accordingly, A.M.S. could help protect the reputation and integrity of the federal licensing program and the warehouse receipts issued thereunder. Additionally, since the proposed rules were nonspecific, they would permit maximum flexibility to adopt regulations to cover the wide variety of grain merchandising practices. Further, by adopting the new regulations, federally licensed elevator operators, located in states with mandatory licensing and regulations, would be relieved from the dual regulatory burden because they need to comply only with the federal law.

Critics of the proposal contend that the nonspecific nature of the regulation provides the A.M.S. excessive flexibility and thereby, could permit the government to extend its control over grain merchandising activities of elevator operators. Participants in the private grain storage industry are skeptical of this latitude of government regulations. Apparently, the proposed federal regulations, when compared to state regulations, are weaker and thereby could possibly damage the grain marketing regulatory coverage offered in certain states. Further, the new federal merchandising regulations could be seen as usurping a state's authority to control grain marketing transactions. If federal merchandising regulations would exempt or preempt federally licensed warehouses from all state regulations, which they probably would, state governments would have no authority to inspect or verify the integrity of federally licensed grain operations within state boundaries. Under the preemption doctrine,[197] states currently have no authority to inspect the warehousing aspects of federally licensed warehouses within their boundaries. Consequently, preemption of the marketing activities of these same elevators is not without precedent. The issue is whether the marketing transaction proposals can be justified as authorized under the United States Warehousing Act. Due to the relationship between the storage activities and

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194. *Id.*

195. Reopen Comment Period, 46 Fed. Reg. 42,486 (1981).

196. For a discussion of the A.M.S. marketing transaction proposal from the industry view, see *AMS Proposes First Federal Warehouse Marketing Rules*, GOV'T AND GRAIN No. 12, June 18, 1981.

197. *See supra* text accompanying notes 131-56.

the marketing activities of an elevator and the significant effect the latter can have on the former, arguably the federal regulations governing marketing transactions are rationally related to the proposals of the United States Warehouse Act.

The grain marketing transaction proposals by the A.M.S. have not been acted upon since their proposal. Presently the A.M.S. is holding the proposed rules in abeyance and no decision has been reached on taking further action. The subject has been referred to the Department of Agriculture Grain Elevator Task Force which is considering the proposals. Possibly the proposal concerning increasing the net worth and bonding requirement for all federally licensed warehouses could be separated from the proposal and issued as a separate regulation. The comments that have been received on the proposal have been summarized and have been passed on to the Department of Agriculture Grain Elevator Task Force.

Although the Grain Elevator Task Force considered this idea when preparing its report, it did not make any recommendations on the proposal. Since the proposal concerning grain marketing transactions is a distinct break from previous A.M.S. regulatory activities, which have focused solely on storage activities of grain elevators, it is understandable that the proposal is the subject of some controversy and concern both within the industry and within federal and state agencies. That aside, the development of a well-designed system of grain marketing transaction regulation at the federal level could serve to complement the present federal regulation of storage activities and certainly would buttress the integrity of that system. This is especially true since most warehouses also conduct the dual function of marketing transactions. In that regard, the federal proposal is just a recognition of the reality of the economics of the grain storage and marketing industry. Also, this development would remove the federally licensed elevators, located in states with mandatory licensing requirements, from the present requirement of complying with both federal and state laws and provide a uniform system. The development of the federal regulations for grain transactions will be one of the more significant subjects in the area of grain elevator regulation. It may offer the potential to regulate the use of marketing practices such as delayed-pricing, and deferred-pricing which are apparently implicated in a great number of elevator insolvencies. If such a causal link can be made between certain marketing transactions and insolvencies, federal regulations should recognize the fact and place reasonable regulations on those transactions to protect the integrity of the federal grain regulatory system.

Other Possible Federal Reforms: A Grain Insurance Fund

In addition to the proposals to amend the bankruptcy laws and to alter the A.M.S. and C.C.C. regulations, Congress may consider other proposals to reform the federal grain warehouse regulatory system. One such proposal

would create a national grain insurance program "to protect persons storing grain in a public warehouse against losses that may be caused by insolvency. . . ."[198] This bill would establish a $25,000,000 national grain insurance fund within the Department of Treasury "to insure the grain deposits of all insured public warehouses."[199] This fund, known as the Public Warehouse Fund, would be used to pay insurance claims within thirty days of the closing of an "insured public warehouse because of inability to meet the demands of the depositors," and to pay the cost of administering the program.[200]

There is some confusion as to how the fund would be financed. The bill states that the premiums charged under the bill would be "paid by the owner or operator of an insured public warehouse."[201] A sponsor of the bill states that the fund will be financed by farmers who would pay a maximum fee of one-fourth of a cent per bushel for grain deposited in a public warehouse. Under the proposal grain is to be insured at its fair market value to a maximum fee of $100,000 per depositor. The bill is not clear as to whether participation in the program is voluntary or mandatory and as to which agency within the Department of Agriculture will administer the program.

The federal grain deposit insurance proposal, which is based on the Federal Deposit Insurance Corporation, has been a subject of discussion for several years. Presently three states, i.e., Oklahoma, Maryland, and South Carolina have established a form of grain insurance fund. In Oklahoma, a $4,000,000 fund was created in 1980 to be financed by a one-tenth of a cent per bushel assessment on grain delivered to a warehouse.[202] After a bankruptcy in 1981, the Oklahoma fund was increased to $10,000,000 and the assessment was increased to two-tenths of a cent per bushel. The Maryland fund, established in the spring of 1981 at $5,000,000, is financed with a one-half cent per bushel levy on producers.[203] South Carolina approved a $6,000,000 fund in 1981 to be financed through a voluntary assessment of 1¢ a bushel for soybeans and a one-half cent a bushel for other grains.[204] The creation of these funds raises many questions, such as how to assess the fee, what amount to charge, whether the program should be mandatory or voluntary and who should administer it.

The proposal for a federal program is still under consideration by the Congress. The House of Representatives Agriculture Committee's Subcommittee on Wheat, Soybeans and Feed Grains conducted hearings on the proposal in December of 1981. The proposal has been criticized by the grain

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198. *See* H.R. 2523, 97th Cong. 1st Sess. (sponsored by Rep. Donald Albosta (D-Mich)).
199. *Id.*
200. *Id.*
201. *Id.*
202. OKLA. STAT. ANN. tit. 2 §§ 9-41 to -47 (West Supp. 1981-82).
203. MD. AGRIC. CODE ANN. §§ 13-101 to -108 (Supp. 1981).
204. S.C. CODE ANN. §§ 46-41-200 to -240 (Law. Co-op. Supp. 1981).

industry as costly to administer and poorly designed.[205] These proposals, creating insurance funds, however, will be the subject of more attention at the federal level.

CONCLUSION

The *James Brothers* case exemplifies the plight of farmers who are unable to immediately recover either the grain or payment for the grain stored in an elevator undergoing bankruptcy. The publicity generated by this and similar cases has focused national attention on this problem. As a result, the United States Department of Agriculture has modified rules regulating federally licensed warehouses and warehouses storing grain under contract with the Commodity Credit Corporation. Various additional proposals have also been suggested. The General Accounting Office's proposed solutions led to tightened regulation of these warehouses. Further, Congress has considered legislative proposals to alter bankruptcy law related to grain elevator bankruptcy and is still considering a proposal to create a national grain insurance fund. Although numerous questions remain unanswered, several of the problems involved could be solved by reducing grain elevator bankruptcies through more stringent regulations or by providing a remedy for farmers through a grain insurance fund.

205. For a discussion of the federal grain deposit insurance proposal from the industry viewpoint; see *Federal Grain Deposit Insurance*, GOV'T AND GRAIN No. 25, Dec. 3, 1981.