And When She Go There, the Cupboard Was Bare: The Producer's Plight in Grain Warehouse Insolvency

Part 1

by

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AND WHEN SHE GOT THERE, THE CUPBOARD WAS BARE: THE PRODUCER'S PLIGHT IN GRAIN WAREHOUSE INSOLVENCY

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I. INTRODUCTION

One hundred and six years ago, the United States Supreme Court wrote that grain warehouses stand "at the very gateway of commerce to take toll from all who pass,"[1] and that the warehouses "must submit to be controlled by the public for the common good."[2] Since those words were written, both state and federal governments have regulated the grain warehousing industry, requiring licenses and periodic inspection to prevent abuses such as conversion of stored grain by warehousemen.[3] Warehouse regulatory statutes typically provide that when preventive measures fail, storers have access not only to any remaining grain but also to a bond before they must stand in line with other unsecured creditors for the remaining warehouse assets.[4]

These regulations and bonds may have lulled producers dealing with the country's 10,000 grain warehouses[5] into the erroneous belief that grain or credit "in the bin" is as safe as money in an insured bank. However, recent well-publicized grain warehouse insolvencies have shown there is a wide gulf between the protection afforded insured bank deposits and that given grain deposits.

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1. Munn v. Illinois, 94 U.S. 113, 132 (1876).

2. *Id.* at 126.

3. Federal regulation began with the passage in 1916 of the United States Warehouse Act, 7 U.S.C. § 241 (1916). The early history of state regulation and developments in federal regulation of the grain warehousing industry are charted in Blomquist, *Warehouse Regulation Since Munn v. Illinois*, 29 CHI.-KENT L. REV. 120 (1951).

4. *See, e.g.*, 7 U.S.C. §§ 247-249 (1982); IOWA CODE ANN. §§ 543.44 (West 1983), 543.12 (West 1981); NEB. REV. STAT. §§ 88-503 to -515 (1981 & 1983 Supp.).

5. There is apparently no accurate count of grain warehouses nationwide. In 1977, the National Grain and Feed Dealers Association estimated there were 10,000 grain warehouses. *See* U.S. GENERAL ACCOUNTING OFFICE, MORE CAN BE DONE TO PROTECT DEPOSITORS AT FEDERALLY EXAMINED GRAIN WAREHOUSES 3 (1981) [hereinafter cited as GAO REPORT].

The Federal Deposit Insurance Corporation, which insures most bank accounts to $100,000, releases insured deposits from banks closed for insolvency in less than a week.[6] By contrast, the effective bond coverage on stored grain is often very low and distribution of proceeds is very slow. When a grain warehouse is closed for insolvency, too often only a small part of the grain supposedly in storage is found.[7] When claimants then check the warehouse's bond coverage, they may find $3.50 per bushel corn and $8.00 beans bonded for no more than twenty cents, and sometimes as little as five cents, a bushel.[8] A recent Nebraska grain warehouse bankruptcy saw distribution of the $32,500 bond proceeds, about six cents on the dollar of eligible claims, more than a year after the warehouse ceased business.[9] The same warehouse's grain pro-

6. *See* FEDERAL DEPOSIT INSURANCE CORPORATION, 1982 ANNUAL REPORT 2, 32-33. The FDIC closed 42 banks for financial difficulty in 1982. In 35 of these cases, the deposit liabilities were assumed by another bank.

In the seven cases where deposits were not assumed, but were paid off by the FDIC, the longest interval between closure and actual disbursement on the insured portion of deposits was four days. *Id.* at 32.

7. A U.S. Department of Agriculture Task Force recently pointed out: "In theory, a warehouse should always contain enough commodities to meet all obligations to bailors and all creditors to whom commodities . . . have been pledged as collateral. In practice, this is usually not the case when [a grain warehouse] goes bankrupt."
U.S. DEPT. OF AGRICULTURE, GRAIN ELEVATOR TASK FORCE, REPORT TO THE SECRETARY OF AGRICULTURE 4 (1981) [hereinafter cited as USDA TASK FORCE REPORT].

For example, when Prairie Grain Company of Stockport, Iowa was shut down by the Iowa Commerce Commission in 1980, the warehouse should have been holding more than a million bushels of corn and just over half a million bushels of soybeans. In fact, the warehouse contained only approximately 340,000 bushels of corn and 100,000 bushels of beans. *See Prairie Grain's Collapse*, Des Moines Reg., Feb. 17, 1980, at 5A, col. 1.

8. Under the United States Warehouse Act, 7 U.S.C. § 241 (1982), and under the warehouse regulatory statutes of most states, the amount of the bond is based on the physical storage capacity of the warehouse without regard to the market price of commodities actually accepted for storage. In Nebraska, the relevant statute, NEB. REV. STAT. § 88-503(3)(b) (1983), permits the Public Service Commission (PSC), to set the amount of the required bond. The regulations require conventional grain elevators to be bonded at the rate of 20 cents per bushel of capacity for the first 1,250,000 bushels of capacity, 15 cents on the next 1,666,666 bushels, 10 cents on the next 5,000,000 bushels and 5 cents on any additional capacity. *See* Neb. PSC Regs., Title 291, ch. 8 § 004.03.

One exception to the pattern is Kansas, which sets its bond based on market values of grain in April each year. *See* KAN. STAT. ANN. § 34-229 (1981).

If a warehouse has entered into storage contracts for more grain than it in fact has the capacity to store, the effective rate of bond coverage is even lower per bushel than the statutory rate. This same result will occur where persons other than storers, such as unpaid sellers, are held entitled to the protection of any bond based on storage capacity.

9. On March 29, 1982, the Milligan Grain Company surrendered its grain warehouse license to the Nebraska Public Service Commission and ceased operations. Subsequent investigation disclosed severe shortages of grain. The Public Service Commission issued its order on entitlement to the $32,500 bond proceeds the follow-

ceeds at this writing are still held by a federal bankruptcy court; no date has been set for their distribution.[10] In the widely reported Stockport, Iowa bankruptcy of Prairie Grain Co., distribution of grain and bond proceeds, about thirty cents on the dollar, came three years after the warehouse was shut down.[11]

The delays in grain warehouse insolvency cases are sometimes blamed on but are not necessarily due to dilatory tactics of attorneys, regulatory agencies or bankruptcy courts. Instead, much delay is caused by poor warehouse records, the result of warehouse management's fraud or incompetence. The problem of poor records is perpetuated by the lack of a requirement that grain warehouses submit to a full-fledged audit by a certified public accountant on an annual basis. Additional delay is due to unsettled questions of law and numerous questions of fact arising from the variety of transactions that may entitle a producer, lender, or grain buyer to share in the insolvent warehouse's grain and bond assets. Under these circumstances, it is not surprising that the FDIC, as to standardized transactions in regularly audited banks, can move faster than those charged with liquidating grain warehouses.

While producers storing their own grain in public warehouses have been hard hit by warehouse bankruptcies, another producer group has also suffered great losses. Grain warehouses purchase more grain directly from producers than any other buyer group,[12] and many of those purchases are on credit. Until recently, most grain warehouse regulation did not protect unpaid sellers from the risk of the buyer-warehouse's insolvency. Unpaid sellers were usually held to have no claim either to the grain remaining in the warehouse or to the warehouse's bond.[13]

Grain merchandising, that is, the purchase and resale of grain for the warehouse's own account, is potentially more profitable for a warehouse than storage for others, so merchandising volume has

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ing year, on July 26, 1983. *See* In re Fecht (Milligan Grain Co., Inc.), PSC No. 159 (July 26, 1983). However, because of challenges to the PSC decision, checks were not disbursed until late 1983. *See Payments Ok'd to Elevator Creditors*, Omaha World Herald, Dec. 8, 1983, at 10, col. 1.

10. The federal bankruptcy petition is docketed in the Bankruptcy Court of the District of Nebraska in *In re* Milligan Grain Co., BK-82-701 (Bankr. D. Neb. filed July 26, 1983). No date has been set for distribution of proceeds from the sale of grain remaining in the warehouse when operations ceased, and the matter is on appeal. In re Milligan Grain Co., BK-82-701 (Bankr. D. Neb. filed July 26, 1983), *appeal docketed*, CV-38-0-574 (D. Neb. filed ____, 198__).

11. *See Appeal May Delay Prairie Grain Checks*, Des Moines Reg., Dec. 29, 1982, at 55, col. 1.

12. *See* ECONOMIC ATLAS OF NEBRASKA 112-13 (R. Lonsdale ed. 1977).

13. *See* Part VI of this article *infra*.

been growing.[14] With this growth has come increased financial risk for warehouses. The grain a warehouse buys may be immediately resold or stored for later sale, depending on available storage space, transportation and market prices. Since the harvest season for each crop is short, but resale to and receipt of payment from their buyers is spread over the marketing year, grain warehouses are big users of credit. Some credit is extended by producers, but warehouses often must borrow large amounts from commercial or other lenders as well. Thus, the sustained high interest rates of recent years have been a big factor in warehouse failures.[15]

Another factor leading to warehouse insolvency has been losses through trading in commodity futures. Warehouses need, and lenders or regulators may require them, to hedge their grain positions against market risks.[16] It is frequently suggested that

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14. *See* USDA TASK FORCE REPORT, *supra* note 7, at 18-19.

15. *Id.* at 47.

16. Hedging is the process of using the commodity futures market to shift the risk of price fluctuations in particular commodities. A hedger (as opposed to a speculator) must have an interest in the physical commodity either as a buyer or a seller. As Professor Norman Thorson of the University of Nebraska—Lincoln has summarized:

> [A] businessman can guard against possible price increases in a commodity input to his business by purchasing futures. Assuming the cash price parallels the future, dollars lost as the physical commodity increases in cost are offset by gains on the futures contract. Similarly, futures contracts can be sold by holders of physicals who are concerned about possible price declines. Any loss incurred as a result of declining cash prices will be offset by a parallel gain in the futures market. The symmetry between cash and futures prices, of course, implies that favorable moves in the cash market will be offset by unfavorable moves in the futures market. Thus traders who spread risks on the futures market sacrifice potential gains from favorable price movements in the cash market. This can be viewed as the cost of purchasing the price insurance.

Thorson, *Commodity Futures Contracts*, in 1 AGRICULTURAL LAW 376, 389 (J. Davidson ed. 1981). *See also* Johnston, *Understanding the Dynamics of Commodity Trading: A Success Story*, 35 BUS. LAW. 705, 707-09 (1980).

Hedging, in the context of grain warehouses with deferred price contracts on their books, has been described as follows:

> In order to avoid the risk of unfavorable market fluctuations . . . the [warehouse] "hedges" its position by purchasing commodity futures contracts on the Chicago Board of Trade. Thus, when the [warehouse] acquires an obligation to pay a farmer an unknown price for grain that it has already received and sold [a "short" position], the [wareshouse] will purchase contracts for the same commodity on the Exchange, thereby taking an offsetting "long position." . . . If the price rises and the farmer elects to price out his sale contract at a higher price than that which the [warehouse] realized when it sold his grain, the [warehouse] is fully protected against the loss because it can at that time sell the offsetting commodity futures contract and realize a gain on the increased price. Similarly, if the price declines and the farmer prices his contract at . . . less than what the [warehouse] sold his grain for, the resulting gain will be offset by an accompanying loss on the Exchange when the futures contract is closed out at a price less than the original price.

many of the warehouses which fail are those which go beyond hedging into more risky futures speculation, swiftly incurring margin calls and large losses.[17] Merchandising activities make warehouses financially vulnerable in other ways. Government actions such as export embargoes and the 1983 Payment in Kind program can lead to rapid price swings. Deregulation of the rail and trucking industries may limit transportation options and increase transportation prices for smaller warehouses more than for larger, higher volume warehouses.

Although recent interest rate reductions and grain price increases, if sustained, may slow the pace of grain warehouse insolvencies, there is no reason to believe the risks will be eliminated. Between 1975 and early 1981, about two percent of this country's grain warehouses filed federal bankruptcy petitions.[18] Many others were liquidated under state law during the same period. In one recent eighteen month period, Nebraska's Public Service Commission forced the closure for insolvency of seven grain warehouses,[19] and in a blitz audit of 480 state-licensed grain warehouses, found grain shortages in fifty-four more.[20] The federal government's General Accounting Office recently analyzed financial data on grain warehouses in federal programs, and found almost five percent to be in severe financial difficulty.[21]

Grain warehouse insolvencies, and the resultant reduction in the confidence producers may have in grain warehouses, are matters for general public concern. First, the producer and other creditors of a grain warehouse are usually concentrated in a small geographic radius, so the economic impact of warehouse failure may be great on that area. Second, if producers lose confidence in the solvency of rural grain warehouses, they may turn to arguably inefficient practices, either purchasing on-farm storage equipment for grain that will not be consumed on the farm, or transporting their grain greater distances at increased cost to larger, and hopefully better financed, warehouses. On-farm storage of grain des-

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Plaintiff's Post-Trial Brief, In re Hemphill, Bk. No. 80-1671-W (Bankr. S.D. Iowa 1982) (Summary of testimony of Glenn Hemphill, former Iowa grain warehouse operator, and Wallace Dick, former head of the Iowa Commerce Commission's Grain Warehouse Division).

17. See USDA TASK FORCE REPORT, *supra* note 7, at 45-51. On the distinction between hedging and speculating, and the risks of each, see Thorson, *Commodity Futures Contracts*, in 1 AGRICULTURAL LAW 376, 390-94, 424-33 (J. Davidson ed. 1981).

18. *See* GAO REPORT, *supra* note 5, at 14.

19. *See PSC Says 154 Elevators Had Too Little Grain*, Omaha World-Herald, June 24, 1982, at 14, col. 1.

20. *Id.*

21. *See* GAO REPORT, *supra* note 5, at 13-14.

tined for off-farm use requires an extra loading and unloading of the commodity, plus additional transportation that would be unnecessary if the grain were delivered at harvest to the warehouse which would eventually buy it. Bypassing local warehouses and trucking the grain greater distances increases transportation costs to producers and reduces revenues of the rural warehouses, making insolvency more likely.

These problems have not escaped legislative attention. In the early 1980's many states amended existing grain warehouse statutes and some extended regulation to the merchandising end of the industry. This legislation has both preventive and remedial goals. More frequent inspections, stiffer licensing and financial reporting requirements, limits on commodity speculation and reserve requirements against credit purchases of grain are intended to prevent insolvency, or at least, to identify failing firms before shortages grow large. Where prevention fails, streamlined liquidation proceedings, increased bond protection and indemnity funds aim to speed and increase distributions to grain producers.

A wide variety of legislation has been introduced at the federal level, but no major changes have been enacted as of April 1, 1984. Senator Robert Dole of Kansas has sponsored, and the Senate has several times passed a package of amendments to the Bankruptcy Reform Act dealing with grain warehouse bankruptcy. In early 1984, the House passed H.R. 5174, which omits many of Senator Dole's more controversial proposals, and differs in other details from, Senate Bill 445, the most recent such bill to pass the Senate. Hopes for an immediate resolution of the differences in conference dimmed when Congress decided on March 30, 1984 to postpone further action.[22] Since it is unclear whether and when any of the S. 445 or H.R. 5174 grain warehouse amendments will become law, this article will attempt only to point out, at the relevant places, the effect of those proposed changes which have passed both houses of Congress.

This article will examine, with emphasis on Nebraska law, the protection currently afforded storers and sellers of grain to licensed grain warehouses.[23] It will point out some steps producers

22. *Bankruptcy Courts in Limbo: Record is Disgraceful* (J. Kilpatrick), Omaha World Herald, Mar. 31, 1984, at 10, col. 3.

23. Some recent articles analyzing the grain warehouse and grain dealer laws of particular states are: Note, *Dealing With Grain Dealers: The Use of State Legislation to Avert Grain Elevator Failures*, 68 IOWA L. REV. 305 (1983); Note, *Grain Elevator Bankruptcies: How Can The Grain Producer be Better Protected?*, 31 KAN. L. REV. 158 (1982). A wide range of problems and suggested solutions are treated in Geyer, *Prompt and Full Payment for Agricultural Commodity Producers*, 4 AGRIC. L.J. 247 (1982); Looney & Byrd, *Protecting the Farmer in Grain Marketing Transac-*

could take, but usually do not, to reduce the risk of loss due to warehouse insolvency. Further, because the protection afforded storers and sellers is less than that available in some other states, and less than that which might be desirable, the article will examine some possible legislative changes which could reduce the risk of insolvency losses. Before current law and possible changes are analyzed, however, three related areas will be explored: first, typical transactions between producers and grain warehouses; second, the relevant regulatory agencies and the extent of their authority; and third, some jurisdictional problems arising when a grain warehouse is found to be insolvent.

II. OVERVIEW OF GRAIN MARKETING PATTERNS

That grain warehouses still stand at the gateway of commerce is evident from an overview of grain marketing patterns. A grain producer has three main options for turning his crop into cash: he can store the crop and use the stored grain as collateral for a loan; he can sell the crop, at harvest or later, out of storage; or he can feed the crop to his own livestock and sell them. While any of these routes can be taken without use of a public grain warehouse, all three often involve a warehouse's services.

A producer who plans to store his grain at harvest in hope of a mid-marketing year price rise does not have to deposit it in a public grain warehouse. Many Nebraska producers have on-farm grain storage equipment, and more grain is stored on farms than in warehouses in Nebraska at all times during the marketing year.[24] However, many other producers either have no on-farm storage capacity or not enough for their whole crop, so their choices are limited to use of commercial storage or sale at harvest.

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tions, 31 DRAKE L. REV. 519 (1981-82); Note, *A Survey of Current Issues and Legislation Concerning Grain Elevator Insolvencies*, 8 J. CORP. L. 111 (1982). The rights of storers of grain in bankruptcy proceedings are examined in Note, *In Re Cox Cotton Co.: Is There a Right to Reclaim Bailed Property from the Estate of a Debtor Under the Bankruptcy Code?*, 17 TULSA L.J. 728 (1982). Another useful analysis is Meyer, *Advising Market Strategies: The Farmer as a Creditor*, I Proceedings of the 1983 Ann. Meeting of the Iowa St. Bar Ass'n. at B-7 (1983).

24. On Jan. 1, 1983, a record 1,055,061,000 bushels of corn were stored in Nebraska. Almost three-quarters of the corn, or 770,340,000 bushels, were in on-farm storage. Stocks of sorghum, oats, barley, wheat, rye and soybeans on the same date totalled 379,625,000 bushels, of which 184,616,000 bushels were stored on the farm. *See* Nebraska Crop and Livestock Reporting Service, *Nebraska Agri-Facts*, issue 03-83, 2/2/83, at 3.

There are no recent surveys of total on-farm storage capacity in Nebraska. Total off-farm grain storage capacity was 666,100,000 bushels in 713 locations in January, 1983. Commercial capacity increased 22% since January, 1982, with many warehouses building new facilities. *Id.*

If a producer needs cash before he is ready to sell his grain, he may be able to use stored grain as collateral for a loan. Lenders may prefer for several reasons to loan against grain stored in a licensed warehouse rather than that stored on the farm. First, commercial warehouses are more experienced in and perhaps better equipped than most farmers for protection of grain from deterioration, theft and other casualty risks. Second, commercial warehouses can issue negotiable warehouse receipts, documents of title which are freely transferable by the lender.[25] The ability to transfer title to the grain by negotiation of the document rather than by physically moving the grain is valuable to the lender. In event of default on the loan, liquidating the collateral is easy. All that is needed for liquidation of warehouse-receipted grain is transfer of the warehouse receipts.[26] For farm-stored grain, on the other hand, removal, transportation and restorage elsewhere of the grain itself might be required before it could be sold. Even if the loan never goes into default, the negotiability of commercial warehouse receipts allows the lender more flexibility in arranging its portfolio.

Most producer-owned grain, wherever stored, will eventually be sold, and that often means sold to or through a grain warehouse. Grain warehouses purchase large quantities of grain directly from producers. For example, cooperative grain warehouses alone buy about half of all corn sold by Nebraska producers each year.[27]

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25. *See* NEB. REV. STAT. § 88-506 (Reissue 1981) and NEB. REV. STAT. (U.C.C.) § 7-201 (Reissue 1980). The term "document of title" is defined as including a:

> 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.

Id. § 1-201(15). *See also id.* § 1-201(45) (the definition of warehouse receipt is "a receipt issued by a person engaged in the business of storing goods for hire.").

26. NEB. REV. STAT. (U.C.C.) § 7-501(1) (Reissue 1980) provides that a "negotiable document of title running to the order of a named person is negotiated by his indorsement and delivery." The document is

> 'duly negotiated' when it is negotiated . . . to a holder who purchases it in good faith without notice of any defense against or claim to it . . . and for value, unless it is established that the negotiation is not in the regular course of business or financing or involves receiving the document in settlement or payment of a money obligation.

Id. § 7-501(4).

A holder "to whom a negotiable document of title has been duly negotiated acquires thereby: (a) title to the document; [and] (b) title to the goods . . . ." *Id.* § 7-502(1).

27. *See Hearings on L.B. 529 Before the Agriculture and Environmental Comm. of the Nebraska Unicameral*, 87th Leg., 1st Sess. 62 (Mar. 6, 1981) [hereinafter cited as *Hearings on L.B. 529*] (statement of Robert Guenzel).

Even when someone other than the local warehouse is the buyer, often the warehouse participates in the transaction, handling part or all of the details of the sale and delivery of grain or storage receipts to the buyer and returning the proceeds, less the warehouse's commission, to the selling producer.

When a producer intends to feed his grain to his own livestock, a warehouse's facilities may be used to process the grain into suitable feed before it is stored on the farm. If on-farm storage is lacking, the farmer may deposit grain at the warehouse at harvest time and arrange to withdraw equivalent quantities of processed feed as needed over the feeding season.[28]

Sales contracts between grain producers and grain buyers are subject to infinite variations, but there are a few identifiable categories. Most common is the cash sale. Cash sales may involve a cash forward contract, in which the producer contracts in advance of harvest to sell his crop for an agreed price, with payment and delivery due at harvest time.[29] On the other hand, a producer who has grain stored on the farm or in a warehouse may sell his grain to a warehouse in a cash transaction whenever that is mutually agreeable. "Cash sales" of course, rarely involve the exchange of legal tender; instead payment is made by the warehouse's check in exchange for grain or surrender of storage receipts. Therefore, the warehouse gets possession of and title to the grain before the producer learns whether the check is backed by sufficient funds.[30]

While the majority of grain sales by producers to warehouses are intended to be cash sales, many other sales involve lengthy extensions of credit by producers to warehouses. Two common types of credit contracts are deferred payment and deferred pricing agreements. Under a deferred payment contract, payment will not be due until several months or more after delivery.[31] This type of sale is frequently used by cash-basis producers who wish to sell their crop at harvest, but to defer recognition of income into the following tax year.[32] While this deferral of income has tax advantages for the cash-basis farmer, it also gives him the risk of his buyer's insolvency over an extended period.

Deferred pricing contracts are contracts by which the warehouse agrees to buy grain at a price that will not be determined

28. This arrangement is often called a grain bank.

29. Forward contracting of grain is described in detail in Malm, *Contracts for Future Delivery of Grain: An Overview of Common Legal Problems*, 1980-81 AGRIC. L.J. 483.

30. *See* text accompanying notes 183-95 *infra*.

31. Looney & Byrd, *supra* note 22, at 524.

32. *Id.*

until well after delivery of the grain. Usually the seller has the right to pick any day after delivery and before an eventual settlement date as the pricing day. The warehouse is then obligated to pay a designated market's price as of that day for similar grain, less some agreed discount. These contracts permit a farmer to retain the chance of profiting from a post-harvest price rise, and yet tie down a buyer at harvest so he need not find storage space.[33]

The warehouse benefits from both types of credit contracts since it gets title to the grain on delivery and can resell it whenever it is most advantageous.[34] The warehouse will often have use of the resale proceeds for weeks or months before it must pay the producer for the grain.

While credit contracts offer advantages to both parties, there are some real risks as well. The producer bears a credit risk on both types, and some down-side market risk on deferred pricing contracts. Deferred pricing contracts have proven particularly risky for warehouses and have figured as a cause in many insolvencies.[35] The warehouse, of course, does not know for an extended period what its actual liability will be or when it will be asked for payment, and it may fail to maintain adequate reserves. Even if grain prices remain stable, experience has shown that some warehouses use funds derived from the resale of deferred price grain for unwise and eventually disastrous commodity futures speculation.[36]

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33. *See* Good, *Delayed Pricing by Country Elevators* 1-2 (Sept. 1977) (Dept. of Agricultural Economics, University of Illinois, No. 77 E-22). Good indicates that while deferred pricing contracts (also known as delayed pricing and price-later agreements) have been used for many years, they became much more common in the mid-1970's, when large corn harvests resulted in shortages of storage capacity around the country. *Id.*

34. *See* text accompanying notes 183-95 *infra*.

35. *See, e.g., Bankruptcy Reform Act of 1978 (Farm Produce Storage Facility Amendments): Hearings on S. 1365 Before the Subcomm. on the Courts of the Senate Comm. on the Judiciary*, 97th Cong. 1st Sess. 61-62 (1981) (Comments of Wallace Dick, Director of the Grain Warehouse Division, Iowa Commerce Commission) [hereinafter cited as *Hearings*].

36. *See* notes 16, 18 and accompanying text *supra*. John R. Block, now Secretary of Agriculture and formerly Director of Agriculture of the State of Illinois, testified before a Senate Subcommittee on causes of grain warehouse insolvencies:

> The biggest problem . . . was that the "price-later" contracts were getting grain dealers into trouble. They would . . . take [a farmer's] grain [and] give the farmer a contract which would say, in effect, "We will pay you later sometime when you decide you are ready to price out," and the grain dealer would take this grain and . . . then do whatever he wanted to do with the money.
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> He might buy a farm, which was probably a pretty good idea, but, then again, he might take the money and play it on the board of trade . . . which usually was not a good idea. Then, in 1 or 2 years, or in 6 months even, he might himself be in a lot of financial trouble.

There are several ways in which grain warehouses could protect themselves from unfavorable price swings, especially with regard to deferred price liabilities. In addition to hedging on the futures market, the warehouse could retain grain delivered to it under deferred price contracts until the producer prices out his contract. Then the warehouse could resell at an equivalent market price. That option, of course, requires the warehouse to incur storage expense. Another possibility is for the warehouse to resell the grain on delivery on the same deferred price arrangement it has with the producer, sometimes called "back-to-back deferred pricing." In that case, when the producer prices out his grain, the warehouse does the same on the second deferred price contract.

In addition to using one or more of these price protection methods, a warehouse should retain a cash reserve to meet maintenance margin calls and other needs for cash. However, as Wallace Dick, former Director of the Iowa Commerce Commission's Grain Warehouse Division, has remarked, in most states there is no requirement that warehouses follow these prudent practices, and most do not.[37]

In all of these common transactions, grain producers extend credit to grain warehouses, whether those credits are measured in grain under storage contracts or in dollars under sales contracts. For cash sellers, the term of the credit is normally very short, lasting until the warehouse's check is credited to the seller's account. For storers and credit sellers, the credits can be quite long-term. While the primary reliance in extending these credits must be trust in the character and capacity of the warehouseman, that trust may in part be based on the existence of regulation aimed at preventing warehouse insolvency and at cushioning the blow to producers and others when prevention fails.

III. OVERVIEW OF GRAIN WAREHOUSES AND GRAIN DEALER REGULATION

Grain warehouse operations, as has been shown, can be divided into storage of grain for others and merchandising of grain for the warehouse's own account. The federal government and about twenty-nine states regulate the storage activities of grain warehouses.[38] Merchandising, on the other hand, has been less

Hearings, supra note 35, at 41.

37. Plaintiff's Post-Trial Brief, Hemphill v. T & F Land Co., No. 80-0210, part of *In re* Hemphill, No. 80-1671-W (Bankr. S.D. Iowa 1982) (Summary of Testimony of Wallace Dick). *See also* USDA TASK FORCE REPORT, *supra* note 7, at 49-51.

38. *See* USDA TASK FORCE REPORT, *supra* note 7, at 1, 6-9.

subject to regulation.

The federal government's regulatory activities are based on the United States Warehouse Act[39] (U.S.W.A.), enacted in 1916, and administered by the United States Department of Agriculture.[40] The U.S.W.A. is a permissive statute, allowing but not requiring the licensing of qualifying grain warehouses. About 1700 warehouses nationwide, and 150 in Nebraska, operate under a U.S.W.A. license.[41]

While the federal government does not require warehouses to be licensed to store grain for others, many states do require warehouses within their borders to obtain a grain storage license.[42] However, the U.S.W.A. has been interpreted as requiring states to accept a U.S.W.A. storage license in fulfillment of any state law storage license requirement.[43] In effect, then, the U.S.W.A. gives warehouses the option, in states where storage licenses are required, of meeting that duty by obtaining either a federal or a state storage license, but not both.

Further, warehouses licensed under the U.S.W.A. are exempt from other state regulation of their storage activities.[44] This is particularly advantageous to warehouses operating in more than one state, for the federal licensee has only one set of storage rules and reporting requirements to follow, instead of multiple states' different and perhaps inconsistent regulations.

The existence of the federal licensing option, however, acts as a brake on reforms at the state level. If state regulation becomes more costly to comply with than that of the federal government,[45]

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39. United States Warehouse Act, 7 U.S.C. §§ 241 (1982).

40. *See, e.g., id.* § 243, 244, 246.

41. *See* GAO REPORT, *supra* note 5, at 3; *Hearings on L.B. 73 Before the Agricultural and Environmental Comm. of the Nebraska Unicameral*, — Leg., 1st Sess. 8 (Jan. 28, 1983) [hereinafter cited as *Hearings on L.B. 73*] (testimony of Comm'r Eric Rasmussen of the Nebraska Public Service Commission).

42. *See* GAO REPORT, *supra* note 5, at 33.

43. As originally enacted, the U.S.W.A., 39 Stat. 486, 490 (1916) provided in § 29 that "nothing in this Act shall be construed to conflict with . . . or . . . to impair or limit the effect or operation of the laws of any State relating to warehouses . . . ."

In 1931, Congress amended § 29 to provide that while the Secretary of Agriculture is "authorized to cooperate with State officials charged with the enforcement of State laws relating to warehouses . . . the power, jurisdiction and authority conferred upon the Secretary . . . under this chapter shall be exclusive with respect to all persons securing a license hereunder . . . ." 7 U.S.C. § 269, 46 Stat. 1463, 1465 (1931).

The United States Supreme Court held in Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 233-37 (1947), that the amendment relieved federal licensees from securing a state license for grain storage.

44. 331 U.S. at 233-37.

45. Warehouses applying for a federal license must have a net worth of at least $25,000 and more may be required depending on the storage capacity of the ware-

state-licensed warehouses can escape state storage regulation by switching to a federal license. State jobs, revenue and local control depend on state licensing, so state regulators and legislators are reluctant to drive state licensees into the federal fold.[46] Warehousing industry lobbyists use this threat in opposing proposed state law reforms such as increased bond coverage or requiring an annual CPA audit.

The U.S.W.A., when originally enacted, was primarily intended to facilitate the commercial acceptance of warehouses receipts,[47] by providing some assurance that the receipt was backed in fact by the appropriate quality and quantity of commodities. Producer protection in general is not the main goal of the U.S.W.A., although producers as well as lenders and other investors in stored grain benefit from the U.S.W.A. in some ways. In keeping with its limited aims, the U.S.W.A. regulates only the storage activities and

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house. 7 CFR § 102.6(d) (1983). The applicant must also post a bond for the protection of holders of storage receipts. The amount of the bond depends on the warehouse's storage capacity; it begins at 20 cents a bushel on the first 1,000,000 bushels of capacity, is 15 cents a bushel on the next 1,000,000 bushels, and is 10 cents a bushel thereafter, with a maximum bond of $500,000. *Id.* § 102.14. Once licensed under the U.S.W.A., the warehouse is subject to unannounced inspections, supposed to occur at least twice a year, although that goal is not always met. *See* GAO REPORT, *supra* note 5, at 1-2.

46. *See*, for example, the testimony of Everett Green, former Director of the Warehouse Division of the Nebraska Public Service Commission, on problems involved in increasing the warehouse bond required by state law:

> [E]ven if you did raise the state bond, a good many of these warehouses would go to a federal license so you haven't solved the problem at all, and the federal bonding requirements are smaller than the state bonding requirements. So, if you wanted to drive the warehouseman out of the state system, that would be one way to do it . . . .

Hearings on LB 529, supra note 27, at 44 (testimony of Everett Green).

See also the remarks of Nebraska State Senators Chronister and Fenger in opposition to requiring CPA compilation of a warehouse's financial statements. "Now there are 20 percent of the grain elevators in Nebraska today hold a federal license and that is compared with 12 percent just 5 years ago. If we make the restrictions tighter, the trend will be for more elevators to go to a federal license." *See* Transcript of Nebraska Unicameral Floor Debate on LB 529, at 5037 (May 13, 1981) (Senator Chronister).

"[I]f we require compilation statements prepared by CPAs, we will see the federally licensed warehouse become the rule rather than the exception." *Id.* at 5044 (Senator Fenger).

47. "The prime purpose of the Federal warehouse act is to make it possible to finance, properly, agricultural products while in storage." Rice v. Santa Fe Elevator Corp., 331 U.S. at 223 n.4. The Court also quotes from the Senate Report accompanying the 1931 amendments to § 29 of the U.S.W.A.:

> As the law now reads, for fear the Federal act may be negatived by State legislation . . . a banker is obliged to follow closely the laws of the 48 different States . . . . This is an impossible task. The suggested amendment will place the Federal act independent of State acts and should enhance the value of receipts for collateral purposes.

S. REP. NO. 1775, 71st Cong., 3d Sess. 2, *cited in* 331 U.S. at 233 n.11.

not the grain purchase and resale activities of its licensees, and the U.S.W.A. bond does not extend to unpaid sellers to the warehouse.[48]

A second federal government presence in the grain warehousing field is the Commodity Credit Corporation. The CCC performs many important functions in the federal government's agricultural price support and commodity reserve programs. One phase of price support is CCC's program of low-interest nonrecourse loans to producers, under which CCC takes a security interest in grain the producer has in storage. Later, the producer may repay the loan and reclaim the grain, and he would normally do so if the market price exceeded the loan rate. On the other hand, if market prices fall below the loan rate, the producer can elect not to reclaim the grain. In that case, CCC gets title to the grain and the producer has no obligation to repay the loan. These loan programs result in CCC holding very sizeable amounts of warehouse receipts, some of which represent CCC-owned grain and the balance representing producer-owned grain securing a CCC loan.[49]

The CCC stores grain it owns and has producers store grain in which CCC has a security interest, in federally-licensed, state-licensed, and even unlicensed warehouses, as well as in on-farm storage. In order to qualify as a storer of CCC grain, a warehouse must sign and comply with the CCC's Uniform Grain Storage Agreement. The requirements of the Uniform Grain Storage Agreement are quite similar to those of the U.S.W.A., except that the CCC does not require its warehouses to furnish bond protection.[50] The U.S. Department of Agriculture's Agricultural Marketing Service has the authority to examine CCC contract warehouses, but this responsibility is often contracted out to a state agency if the warehouse in question is state-licensed.[51] The CCC's regulations and inspection program are primarily intended to protect the CCC's own interests and not those of grain storers in general. In fact, the CCC has at least twice been severely criticized in appellate court opinions for converting grain owned by other storers to its own use, where the CCC discovered a warehouse's grain shortage before other storers and regulatory agen-

48. United States Warehouse Act, 7 U.S.C. § 247 (1982); *see also* USDA TASK FORCE REPORT, *supra* note 7, at 18; GAO REPORT, *supra* note 5, at 30 n.1.

49. For a more extensive discussion of CCC's functions, see H. Pickard, *Price and Income Adjustment Programs*, *in* 1 AGRICULTURAL LAW § 1.23 (J. Davidson ed. 1981); Frass, *Federal Assistance Programs for Farmers: An Outline for Lawyers*, 3 AGRIC. L.J. 405, 430-44 (1981).

50. GAO REPORT, *supra* note 5, at 2.

51. *Id.*

cies did.[52]

Those states which license and inspect grain warehouses have varying requirements as to net worth, bonding, and financial statements.[53] State regulatory statutes are often more extensive than the U.S.W.A., and often have goals different from or additional to those of the U.S.W.A. State regulations vary as well in the quality of enforcement. Sometimes very adequate legislation is ineffective because money is not available for enough well-trained inspectors and accountants to enforce the rules and analyze the data.

A few state warehousing laws, unlike the U.S.W.A., regulate grain merchandising activities and attempt to protect unpaid sellers, as well as storers, of grain. States have devised various ways to protect unpaid sellers of grain. One common device is to require two licenses and two bonds. One license and bond covers a warehouse's storage function, while the second license and bond relate to its grain merchandising.[54] The United States Supreme Court has held that the U.S.W.A. preempts state regulation only of the storage activities of federally-licensed warehouses, since that statute regulates only those functions.[55] Therefore, an advantage of dual-licensing is that the second license, often called a grain dealer license, can be required of all warehouses, regardless of whether the storage license is of state or federal origin. Further, the separate grain dealer license, if the legislature so intends, can be required even of non-warehousemen who buy grain from producers.

A further innovation in some states is the creation of a large fund, not tied to any particular warehouse, from which claims against an insolvent warehouse can be paid if, as is so often the case, producers' claims cannot be fully satisfied from an insolvent warehouse's grain assets and bond proceeds.[56] State laws vary on

52. *See* Preston v. United States, 696 F.2d 528, 537-38 (7th Cir. 1982); United States v. Luther, 225 F.2d 499, 503-06 (10th Cir. 1955). *See* text accompanying notes 169-76 *infra*.

53. *See* GAO REPORT, *supra* note 5, at 33-42.

54. *See, e.g.*, IOWA CODE ANN. §§ 542.1-.4 (West Supp. 1983) (requiring anyone who buys more than 500 bushels of grain a month from producers to obtain a grain dealer license and to post a bond conditioned on payment of the purchase price of grain to the producer). IOWA CODE ANN. § 543.12 (West 1950) and § 543.16 (West Supp. 1983) require a separate license for storage of bulk grain and a separate bond conditioned on performance of the warehouseman's obligations under Iowa Code Ann. chapter 543.

55. Rice v. Santa Fe Elevator Corp., 331 U.S. at 234-37.

56. Among the states which have created such a fund are Illinois, 1983 Ill. Legis. Serv. 4655 (West); Ohio, 1982 Ohio Laws HB 770; Oklahoma, OKLA. STAT. tit. 2, §§ 9-41 to -47 (Supp. 1983-84); and South Carolina, S.C. CODE ANN. § 39-21-310 (Law. Co-op. Supp. 1982).

whether sellers, or only storers, are protected by the fund, and whether all sellers, or only cash sellers may share in the fund.

Nebraska has regulated its public grain warehouses since 1891,[57] although the particular legislation and regulations have frequently changed. Currently, Nebraska has three relevant statutes in force, the Uniform Commercial Code (U.C.C.),[58] the Nebraska Public Grain Warehouse Act (Nebraska Warehouse Act),[59] and the Nebraska Grain Buyer's Act.[60] The last two statutes are enforced by the Nebraska Public Service Commission (the PSC).[61]

The Nebraska Warehouse Act requires all grain storage warehouses in the state to be licensed, either by the state under that act or by the federal government under the U.S.W.A.[62] If the federal option is chosen, the federal licensee is then exempt from compliance with the rest of the Nebraska Warehouse Act.[63]

Warehouses opting for a state license must satisfy the PSC as to their net worth and post a bond or certificate of deposit in whatever amount the PSC requires.[64] PSC regulations fix the amount based on the warehouse's physical storage capacity. The requirements begin at twenty cents per bushel and slide down to five cents per bushel with no statutory maximum.[65] The warehouse must submit financial statements, which need not be audited, to and undergo periodic inspection by the PSC.[66] The PSC is charged with inspecting the 480 state licensees[67] at least once

57. 1891 Neb. Laws 55.
58. NEB. REV. STAT. (U.C.C.) § 1-101 (Reissue 1980).
59. *Id.* §§ 88-501 to -517 (Reissue 1981).
60. *Id.* §§ 88-518 to -519.
61. *Id.* §§ 88-502, -515, -518.
62. *Id.* §§ 88-501, -516.
63. *Id.* §§ 88-502, -516.
64. *Id.* § 88-503.
65. *See* note 8 *supra*.
66. NEB. REV. STAT. §§ 88-502, -503(1) (Reissue 1981). Section 88-503(1) requires only that an annual financial statement be submitted which has been "*compiled by*" a certified public accountant. This means that a CPA will fill out the required information based on information in books and records supplied warehouse management. However, the CPA will not attempt to verify the correctness of the information supplied, so the compilation statement is much less rigorous than an audit.

However, most warehouses must submit to a CPA audit at some interval, even though Nebraska's Grain Warehouse Act does not so require. Cooperatively-owned warehouses undergo an annual CPA audit, and other warehouses are normally required by their corporate bonding company to undergo a CPA audit as a prerequisite to initial issuance of a bond. Once the warehouseman's bond is issued, the surety may require additional audits at intervals of three to five years. *See Floor Debate on L.B. 529 in the Nebraska Unicameral*, 87th Leg., 1st Sess. 4534-35 (May 5, 1981) [hereinafter cited as *Floor Debate on L.B. 529*] (remarks of Sen. Kahle).
67. *See Hearings on LB 73*, *supra* note 41, at 7-8 (Jan. 28, 1983) (testimony of Comm'r Eric Rasmussen).

each nine months, and it may inspect more often if it believes closer surveillance is warranted in a particular case.[68]

A second relevant statute is the Nebraska Grain Buyer's Act, which applies to all who buy grain in Nebraska for purposes of resale, with the very significant exceptions of licensed grain warehousemen, the largest class of grain buyers, and livestock feeders.[69] The Nebraska Grain Buyer's Act requires non-warehouse grain buyers to get an annual license, post a bond for the protection of unpaid sellers, and display proof of PSC licensing on any trucks they might use for transportation of grain.[70] In addition, the grain buyer must submit annual financial statements, which need not be audited, to the PSC.[71]

The Grain Buyer's Act has not been effectively enforced for a number of reasons. First, the group of buyers to which it might apply is to some extent a mobile and elusive group, whose only tangible assets other than just-purchased grain may be a fleet of grain-hauling trucks, and even those may be leased. Second, the statute does not set any minimum level of grain purchases before a license is required, and the PSC has had some difficulty in deciding which grain buyers, if less than all, should be the target group.

In any event, it is clear that Nebraska does not follow the dual-licensing pattern of some other states. A warehouse which stores grain for others must be licensed under either the U.S.W.A. or the Nebraska Warehouse Act, and the warehouse's storage activities will be regulated and bonded by the relevant licensing authority. The warehouse's trading in grain for its own account has been largely unregulated in Nebraska, however, since licensed warehouses are exempt from compliance with the Grain Buyer's Act, and the Nebraska Warehouse Act, like its federal counterpart, is for the most part limited to grain storage rather than purchase and resale.[72]

IV. SOME JURISDICTIONAL PROBLEMS IN GRAIN WAREHOUSE INSOLVENCY CASES

A number of jurisdictional problems arise when either a de-

68. NEB. REV. STAT. § 88-502 (Reissue 1981).
69. *Id.* §§ 88-517, -518.
70. *Id.*
71. *Id.*; Nebraska Public Service Commission Regulations, Title 291, Chapter 8, § 005.01B. Under current PSC regulations, the requirements for financial statements from licensed grain buyers are even less stringent than those for warehouses. The grain buyer need only submit a financial statement prepared and signed by an officer, partner or owner; no CPA review of any kind is required.
72. *See* text accompanying notes 206-51 *infra*.

positor or a regulatory agency discovers that a warehouse is insolvent or has a serious shortage of grain. The particular problems depend on the authority and energy of the relevant licensing body, and, if the warehouse ceases operation, the forum chosen to conduct its dissolution. Among the possible choices are a federal bankruptcy court, a state licensing agency with or without resort to state courts, and a creditors' committee operating informally under state law. Frequently, however, several of these groups will vie for jurisdiction over the assets.

After a warehouse is discovered to be insolvent or seriously short of grain, there is a need for some responsible third-party to take possession of and guard the remaining grain from several potential hazards. There is a danger that the warehouse operator will convert more grain, sell it to good faith purchasers and conceal the proceeds. A second problem is a possible "run on the bank." If word of a shortage gets out, the depositors who can get trucks or train cars may present their receipts at the warehouse and attempt to take delivery of the face amount of their warehouse receipts, rather than their *pro rata* share of the remaining grain in the elevator. While depositors who knowingly receive an overage might be forced to return the grain or its money value,[73] prevention is preferable.

A third hazard is deterioration of the remaining grain. While grain can be stored almost indefinitely if properly maintained, it needs constant moisture control and fumigation to remain in good condition. An insolvent warehouse may be unable or unwilling to keep the grain in good condition. State grain warehousing statutes frequently permit the licensing agency which has closed an insolvent warehouse to sell all of the remaining grain as soon as possible. The proceeds, rather than the grain itself, are then held for depositors. This procedure avoids the expense of maintaining the grain during the sometimes lengthy process of determining ownership.[74]

When the warehouse in question is federally licensed, forcing closure and surrender of the grain can require an involuntary bankruptcy petition or initiation of a state-law receivership. The U.S.W.A. allows license revocation and criminal sanctions in case of serious misconduct by the warehouse,[75] but no mechanism is

73. 696 F.2d at 543.

74. *See* NEB. REV. STAT § 88-515 (Reissue 1981), IOWA CODE ANN. § 543.1 (West Supp. 1983).

75. 7 U.S.C. §§ 246, 270 (1982); *see also* United States v. Kirby, 587 F.2d 876, 880 (7th Cir. 1978) (affirming criminal convictions of warehousemen under the U.S.W.A.).

provided for forcing the closure of the warehouse before its assets can be further dissipated. The U.S.W.A. does not authorize the Agricultural Marketing Service's Warehouse Division to take possession of and sell the grain or to secure the bond proceeds and distribute these to eligible claimants.[76]

This sometimes allows a federal licensee to continue operating without a license and without a bond. In Nebraska, for example, an Ashland warehouse lost its federal license in 1980, when it could no longer obtain the required bond. However, the operator continued to accept grain for storage and to buy and sell grain without any license or bond for about six months before creditors finally discovered the situation and forced its closure in February of 1981.[77] The Nebraska PSC allegedly was notified when the federal license was suspended and again when it was finally terminated. However, the PSC did not act to force closure, apparently because it believed it had no jurisdiction. Certainly the PSC might lack jurisdiction while the federal license was only suspended and not yet finally revoked or terminated. However, as soon as the federal license was terminated, the PSC would have had jurisdiction under Nebraska Warehouse Act, section 88-502,[78] which requires all grain warehouses in Nebraska to have a state or a federal license.

State warehouse regulatory agencies frequently have broad powers and duties for the protection of those who deal with the warehouse. The Nebraska PSC, for example, is authorized to force the closure of a warehouse, take possession of the remaining grain, sell it, deposit the proceeds in an interest-bearing account, and distribute the proceeds to "all valid owners, depositors, or storers of grain who shall be holders of evidence of ownership of grain." The PSC also has the power to commence a suit in state district court for the benefit of storers of grain, if needed, for example, to obtain

76. In the case of a federally-licensed grain warehouse whose license has been suspended:

> [s]uspension does not prevent a warehouseman from continuing operations, it means that such operations are not sanctioned as a licensed warehouseman. . . . When deficiencies are not corrected . . . and a license continues in a suspended state, there appears to be a 'void' in the regulatory process. Conditions can worsen during a period of suspension.

USDA TASK FORCE REPORT, *supra* note 7, at 24. *See also* Stevens v. Farmers Elevator Mutual Ins. Co., 415 P.2d 236 (Kan. 1966) (operation under U.S.W.A. license suspension).

77. The case in question involved the Kuhl-Reece Company of Ashland, Nebraska, managed by Dick Kuhl, who eventually pleaded no contest to a misdemeanor charge of buying grain for resale without a state license. *See PSC Urges Prosecution of Elevators*, Omaha World-Herald, Apr. 8, 1982, at 27, col. 1; *Financial Woes Strike Elevators*, Omaha World Herald, May 30, 1982, at 10-B, col. 1.

78. NEB. REV. STAT. § 88-502 (Reissue 1981).

the bond proceeds or a damage award against the warehouse operator.[79] The powers of grain regulatory authorities in other states vary. Some do not have the power to close down a warehouse on their own, but must request and obtain a court order to that effect before they can act.[80]

If a federal bankruptcy petition is filed by or against an insolvent warehouse, there is considerable potential for confusion and conflict between the bankruptcy court and the state warehouse agencies which may have already taken control of remaining grain in the warehouse. This happened, for example, in the James Brothers bankruptcies in the early 1980's. The debtors operated several warehouses in Arkansas and Missouri, and allegedly had moved much of the Arkansas grain into state-licensed Missouri warehouses to hide shortages from Missouri inspectors.[81] However, the debtors finally admitted they had a serious shortage, and Missouri's Department of Agriculture asserted its power to liquidate and distribute the grain found in the debtors' Missouri warehouses.[82] Thereafter, the debtors filed a bankruptcy petition in Arkansas. The Arkansas warehouses were left with very little grain. Not surprisingly, the trustee in bankruptcy, as well as Arkansas storage claimants who believed that "their" grain had been trucked to Missouri, argued that the bankruptcy court, rather than a Missouri state agency, was the proper forum for liquidating all the grain assets and determining who among the claimants in both Arkansas and Missouri was entitled to share in those assets.[83]

The controversy was taken to the Eighth Circuit Court of Appeals in *In re Missouri*.[84] The court held that the debtors' possession of the grain and their lien for storage charges made the grain

79. *Id.* § 88-515. *See In re* Fecht (David City Grain Co., Inc.), 216 Neb. 535, 344 N.W.2d 636 (1984).

80. *See, e.g.*, IOWA CODE ANN. § 543.3.1 (West Supp. 1983) (providing that the Iowa State Commerce Commission, following suspension or revocation of a state warehouse license, may "file a verified petition in the district court requesting that the Commission be appointed as a receiver to take custody of the commodities . . . and to provide for the disposition of those assets . . . .").

81. "[G]rain owned by Arkansas farmers stored in Arkansas has been transferred by the bankrupts to Missouri. The proof is perfectly clear that 34,382.86 bushels of soybeans, 502,110 pounds of milo and 499.83 bushels of wheat [were] transferred from Arkansas to Missouri, apparently to balance shortages prior to inspections in Missouri." Brief of Intervenor Arkansas Farmers at 2-3, *In re* Missouri, 647 F.2d 768 (8th Cir. 1981).

82. 647 F.2d at 771.

83. *Id.* at 770 n.1.

84. *Id.* at 768. *See also* Note, *In re Missouri: Federal-State Jurisdiction*, 15 CREIGHTON L. REV. 803 (1982); Note, *In re Cox Cotton Co.: Is There a Right to Reclaim Bailed Property from the Estate of a Debtor Under the Bankruptcy Code?*, 17 TULSA L.J. 728 (1982).

"property of the estate," for jurisdictional purposes at least, giving the bankruptcy court the power to decide whether the debtors in fact had any substantial ownership interest in the property.[85] Thus, the court allowed the bankruptcy court to assert preliminary jurisdiction over the grain, even though it appeared that at most two percent of it belonged to the debtors and ninety-eight percent belonged to storage claimants.[86]

The court also held that the automatic stay under section 362 of the Bankruptcy Act applied to the Missouri Department of Agriculture's attempts to enforce Missouri's grain laws on distribution of the grain proceeds from the insolvent warehouses. The court said the statutory exception to the automatic stay for proceedings to enforce a state's "police or regulatory powers" applied only to matters affecting the public health and safety and not to a state's effort to protect the financial interests of some of its citizens.[87] Further, the court indicated that even if the state proceedings had been within the exception and thus not automatically stayed, the Bankruptcy Act preempts state insolvency proceedings. For that reason, the bankruptcy court could issue specific stays under section 105 of the Bankruptcy Act[88] as needed to protect its jurisdiction.[89]

Thus, in this circuit, it is clear that once a bankruptcy petition is filed, state insolvency proceedings, whether conducted by a state regulatory agency, a receiver, an assignee for benefit of creditors, or other creditors' committee, are stayed. The grain and other assets of the warehouse would be subject to turnover orders under the Bankruptcy Act.[90] The court emphasized in *In re Missouri*, however, that the bankruptcy court had a duty to protect the interests of third parties in the grain and to offer them adequate protection under section 361 of the Bankruptcy Act.[91]

A problem with letting the bankruptcy court rather than the relevant state agency decide to whom the grain or its proceeds be-

85. 647 F.2d at 774.
86. *Id.* at 772.
87. *Id.* at 775-76.
88. 11 U.S.C. § 105(a) (1982).
89. 647 F.2d at 776-77.
90. 11 U.S.C. §§ 542, 543 (1982).
91. Although the grain . . . is 'property of the estate' for jurisdictional purposes, its actual ownership has yet to be determined . . . . [T]hat court should carefully consider . . . the duty under the Code to protect the property interests of third parties . . . . [W]hen persons other than the debtor have an interest in the property, adequate protection must be taken 'as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.'

647 F.2d at 778.

longs is that the relevant state agencies generally are more experienced at unravelling complex warehouse records and dealing with the various documents than bankruptcy trustees. The state regulators may be less expensive as well. With these concerns in mind, the Eighth Circuit in *In re Missouri* suggested that even though the bankruptcy court must have overall control, the bankruptcy court should invite and utilize the expertise of warehouse regulators in determining ownership of the grain and the appropriate distribution of grain proceeds.[92]

Even if grain stored under warehouse receipts is property of the estate for jurisdictional purposes in bankruptcy proceedings, that would not necessarily be true of the warehouse's bond. In Nebraska, for example, the bond is an obligation of the surety running to the State of Nebraska for the benefit of eligible claimants.[93] The debtor warehouse has no right to its proceeds. On the assumption that the bond is not subject to the bankruptcy court's exclusive jurisdiction, the Nebraska Public Service Commission has, in at least one post-*In re Missouri* case, held its own hearings and distributed the bond proceeds,[94] in advance of the bankruptcy court's decision on and distribution of proceeds from property of the estate including grain.[95] While the PSC procedure may get some money into the hands of eligible claimants faster than will the bankruptcy court, claimants are then faced with proceedings in two different forums to determine the extent of their claims against an insolvent warehouse.

This assumed insulation of a corporate surety bond from the bankruptcy court's jurisdiction may not extend to certificates of

92. *Id.* at 779.

93. NEB. REV. STAT. § 88-503(3) (Reissue 1981).

94. The PSC is not authorized to order payment by the surety to grain depositors. It may, if necessary, commence a suit in district court for that purpose, so that all parties, including the indemnitors on the bond, can be protected. *In re* Fecht (David City Grain Co., Inc.), 216 Neb. 535, 344 N.W.2d 636 (1984).

95. The PSC closed the Milligan Grain Company on March 29, 1982, and a federal bankruptcy petition was filed (*In re* Milligan Grain Co., No. BK-82-701 (Bankr. D. Neb. 1982)). The grain remaining was sold and the $158,000 proceeds were turned over to the bankruptcy court.

On April 14 and 15, 1983, the PSC held hearings to determine the ownership of the grain, upon which depended entitlement to share in the warehouse bond proceeds of $32,500. *See* In re Fecht (Milligan Grain Co.), PSC No. 159 (July 26, 1983). In December of 1983, the PSC authorized checks to be mailed to the 83 claimants the PSC determined were entitled to share in the bond proceeds. They will receive approximately 5½ cents on the dollar on their claims. *See Payments OK'd to Elevator Creditors*, Omaha World Herald, Dec. 8, 1983, at 10, col. 1-2.

The bankruptcy court, however, apparently will make its own independent determination of ownership of the grain. *See* Farmers & Merchants Bank v. Valentino (*In re* Milligan Grain Co.), No. BK-82-701 (Bankr. D. Neb. filed July 26, 1983), *appeal docketed*, No. CV-38-0-574 (D. Neb.) filed —.—, 198__).

deposit. A 1983 amendment to the Nebraska Warehouse Act allows a warehouse to file with the PSC either a corporate surety bond or a certificate of deposit to fulfill licensing requirements.[96] Presumably the deposit backing the certificate would be the warehouse's own, and then the estate would have a claim to any amount not needed to satisfy eligible claimants. This would seem sufficient to bring the certificate within the jurisdiction of the bankruptcy court.

With this general background, let us now examine the rights and remedies of storers in and sellers of grain to licensed warehouses in Nebraska.

V. RIGHTS OF STORERS OF GRAIN

STORERS SHARE STORED GRAIN AS TENANTS IN COMMON

The term storage contract, in grain warehousing, typically means an agreement giving a warehouse possession of and a lien on grain to secure payment of storage and other warehousing charges.[97] The depositor retains title to the grain under a storage contract, however, and has the right to redelivery of it.[98] By contrast, under a sales contract, the warehouse would get title to the grain and the seller would have a dollar claim instead of a right to redelivery of the grain itself.[99]

The rights and remedies of producers under grain storage contracts in Nebraska depend on the terms of the contracts, the Nebraska U.C.C., and the statute, either the United States or Nebraska Warehouse Act, under which the relevant warehouse is licensed. Although the U.C.C. is state law, its provisions would seem to govern even in transactions with federally licensed grain warehouses.[100]

The U.C.C. permits warehouses to commingle the similar grains of various owners, and to commingle grain the warehouse itself owns ("company-owned" grain) with grain held in storage for

96. *See* NEB. REV. STAT. § 8-503(3)(b) (Supp. 1983).

97. The warehouseman's lien is covered by NEB. REV. STAT. (U.C.C.) § 7-209 (Reissue 1980).

98. *See* NEB. REV. STAT. (U.C.C.) §§ 1-201(2) (defining holder), 7-502, -504 (Reissue 1980) (rights of holders of negotiable documents of title and of persons in possession of nonnegotiable documents of title).

99. *See* text accompanying notes 183-95 *infra*.

100. In the grain warehousing context, the Supreme Court has held that the U.S. Warehouse Act preempts state regulation of the *storage* activities of warehouses licensed under the federal act. Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 225 (1947). However, *Rice* does not mean state law cannot be used to interpret the meaning of contracts these warehouses would enter, or otherwise to define the rights of the parties on points on which the U.S.W.A. is silent.

others.[101] One who deposits grain for storage is supposed to receive a document of title, that is, either a negotiable or non-negotiable warehouse receipt, at or soon after delivery of grain to the warehouse.[102]

Receipt holders then become tenants in common of the commingled mass of the relevant types of grain, to the face amount of their receipts.[103] If the warehouse has less grain on hand than the sum of outstanding warehouse receipts, a situation the U.C.C. calls "overissue," the holders of the warehouse receipts have a right to share *pro rata* in whatever grain remains.[104] They also have a claim against the warehouse for damages for non-delivery or conversion of the shortfall between this *pro rata* share and the face amount of the receipts.[105] When the PSC closes a state-licensed warehouse, it determines each storer's total grain claim and *pro rata* share. First, price quotes are obtained from other nearby grain dealers to set a value for each type of grain stored in the in-

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101. *See* NEB. REV. STAT. (U.C.C.) § 7-207 (Reissue 1980) which provides:

> (1) Unless the warehouse receipt otherwise provides, a warehouseman must keep separate the goods covered by each receipt so as to permit at all times identification and delivery of those goods except that different lots of fungible goods may be commingled.
>
> (2) Fungible goods so commingled are owned in common by the persons entitled thereto and the warehouseman is severally liable to each owner for that owner's share. Where because of overissue a mass of fungible goods is insufficient to meet all the receipts which the warehouseman has issued against it, the persons entitled include all holders to whom overissued receipts have been duly negotiated.

Under the U.C.C., "warehouseman" is defined simply as a person "in the business of storing goods for hire," *id.* § 7-102(h); and a warehouse receipt may be issued by any warehouseman, *id.* § 7-201(1). Warehouse receipts, under 7-202(2)(h), are supposed to disclose, "if the receipt is issued for goods of which the warehouseman is owner, either solely or jointly or in common with others, the fact of such ownership . . . ." These sections have been interpreted to authorize a warehouseman to issue receipts covering goods owned by the warehouse and otherwise to treat those goods as it would the stored goods of others. *See* Bascom, *Articles 7 and 9 of the Uniform Commercial Code—Security Interests in the Warehouseman's Own Receipts Covering Fungibles*, 19 WASH. U.L.Q. 105, 108 (1969).

Further, both the U.S. and Nebraska Warehouse Acts authorize licensed grain warehouses to issue and negotiate warehouse receipts covering the warehouse's own grain. *See* 7 U.S.C. § 260(h) (1983); NEB. REV. STAT. § 88-506 (Reissue 1981). The latter provides "[a]ny public warehouseman may issue a receipt to himself as the owner of grain stored in his own warehouse . . . ." This has long been the Nebraska rule. *See* First Nat'l Bank v. Lincoln Grain Co., 116 Neb. 809, 815, 219 N.W. 192, 195 (1928). *See also* Maryland Casualty Co. v. Washington Loan & Banking Co., 145 S.E. 761, 764 (Ga. 1928) (arising under the U.S. Warehouse Act).

102. *See* 7 U.S.C. § 259 (1983); NEB. REV. STAT. §§ 88-505, 506 (Reissue 1981).

103. *See* NEB. REV. STAT. (U.C.C.) § 7-207(2) (Reissue 1980), quoted in note 101 *supra*. *See also* Preston v United States, 696 F.2d at 535-37.

104. NEB. REV. STAT. (U.C.C.) § 7-207(2) (Reissue 1980), quoted in note 101 *supra*; *see also* NEB. REV. STAT. § 88-515(3)(a) (Reissue 1981).

105. NEB. REV. STAT. (U.C.C.) § 7-207(2) (Reissue 1980), quoted in note 101 *supra*.

solvent warehouse. Then the PSC uses warehouse records, warehouse receipts and scale tickets to determine the type and quantity of grain owed each claimant. The total value of each claim is computed by multiplying the quantity of grain by the relevant grain's unit price, and then deducting any unpaid storage charges. The *pro rata* share of grain proceeds, and of bond proceeds as well, if these have been surrendered to the PSC, is determined by totaling all the claims and then determining what percentage each claim is of the total.[106] The difference between a claimants' *pro rata* share and his total claim is an unsecured claim against the warehouse.[107]

Reasons for Shortages in Warehoused Grain: Overselling and Fraudulent Issue

Some of the reasons a warehouse might be seriously short of the grain needed to meet third-party storage claims are overselling, that is, wrongful sale of stored grain, issuance of storage receipts when no grain was in fact received, misdelivery of stored grain, allowing grain to go out of condition, and casualty and theft losses. Overselling and issuance of receipts for nonexistent grain account for most of the shortages in insolvency cases, so this discussion will concentrate on these factors.

In the overselling situation, the warehouse sells and delivers to a buyer storage grain which the warehouse neither owns nor has permission to sell. For example, in 1983, AGRI Industries of Des Moines and three of its officers were convicted of selling grain AGRI was storing for Commodity Credit Corporation. AGRI had entered into an export sales contract which reportedly provided for $6,000 per day to be assessed against AGRI for delays in delivery of the contracted grain. AGRI's company-owned grain stocks were insufficient to fulfill the contract on time, so AGRI used forty railcar loads of CCC-owned grain to meet the contract.[108]

While sale and delivery of more grain than the warehouse

106. *See e.g., In re Fecht* (York Milling and Elevator Co., Inc.) No. 154, at 1-3 (PSC July 20, 1982).

107. Both Houses of Congress would give such claims of individual grain producers priority status in bankruptcy, under bills passed in early 1984. The Senate bill provides fifth priority under 11 U.S.C. § 507 for up to $2000 if the claim arises from the sale or conversion of grain to or by a warehouse. S. 445, 98th Cong., 1st Sess. § 235 (1983). The House bill provides for seventh priority to $2000, for unsecured claims "for grain or proceeds of grain." This language may be intended to exclude unpaid sellers. H.R. 5174, 98th Cong. 2d Sess. § 250 (1984).

108. *See Guilty Verdict in Grain Theft*, Omaha World-Herald, Oct. 19, 1983, at 1, col. 5; *Grain Co-op, Six Officers Indicted by Grand Jury*, Omaha World-Herald, July 21, 1983, at 50, col. 1.

owns is wrongful,[109] the sale is nevertheless effective to convey good title to an ordinary course buyer[110] under U.C.C. section 7-205, which provides:

> A buyer in the ordinary course of business of fungible goods sold and delivered by a warehouseman who is also in the business of buying and selling such goods takes free of any claim under a warehouse receipt even though it has been duly negotiated.[111]

The comments to section 7-205 make it clear that this section's typical application is in grain warehouse insolvency cases, when holders of storage receipts might try to trace and recover in kind or in value grain oversold and delivered to buyers by the warehouse. Under pre-UCC case law, the section 7-205 comments indicate, such recapture was permitted in theory, but rarely successful in fact, due to tracing problems and the eagerness of courts to protect good faith purchasers by estoppel.[112] Several pre-UCC cases forced buyers who apparently took delivery without knowledge of shortages of grain to return grain or its value to an insolvent warehouse so it could be shared by storage claimants. For example, in 1954, the Tenth Circuit ordered a buyer to return oversold grain, stating:

> [T]he right of the warehouseman to sell or make other disposition from the common mass is limited to the excess thereof over and above the quantity necessary to redeem the receipts . . . to the depositors. . . . [T]he bankrupt delivered to [the buyer] [876,191 bushels of milo] when it did not have in the common mass any excess over and above the amount required to discharge . . . obligations to the depositors of milo. Therefore, the delivery to the [buyer] . . . amounted to a transfer from the common mass which did not belong to the bankrupt but to the de-

109. *See, e.g.*, 7 U.S.C. § 207(g), (h) (1983) (providing criminal penalties for conversion of stored grain); NEB. REV. STAT. § 88-513 (Reissue 1981) (providing presumption that shortage of grain is caused by a warehouse's wrongful removal of grain and imposing criminal liability).

110. The term "Buyer in Ordinary Course of Business" is defined as:

> [A] person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind . . . . "Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

NEB. REV. STAT. (U.C.C.) § 1-201(9) (Reissue 1980).

111. *Id.* § 7-205.

112. *Id.* (Official Comment).

positors . . . as tenants in common.[113]

The effect of U.C.C. section 7-205, and of a similar section added in 1955 to the Commodity Credit Corporation Act,[114] is to prevent recapture of the grain or its value from the ordinary course buyer who has given value and taken physical delivery of grain oversold by a warehouseman. Section 7-205 does not change the fact that overselling is conversion of stored grain giving rise to a claim against the warehouse and its surety, but the section does limit storers to those defendants unless the buyer did not act in the ordinary course of business.[115]

Section 7-205 is very similar to other U.C.C. good faith purchaser protection provisions. For example, section 9-307(1) allows an ordinary-course buyer to take free of security interests in goods held as inventory by his seller,[116] and section 2-403(2) (Official Text) provides that one who delivers goods for any purpose to a dealer in goods of that kind does so at the deliverer's risk. The dealer or merchant has the power, though not the right, to transfer all rights of the "entruster" (the one who left the goods with the merchant) to a buyer in the ordinary course of business.[117] The

113. Central States v. Luther, 215 F.2d 38, 45-46 (10th Cir. 1954), *cert. denied*, 348 U.S. 951 (1955). *See also* Hall v. Pillsbury, 44 N.W. 673, 674 (Minn. 1890). For a pre-Code case protecting the innocent buyer, see Rotterman v. General Mills, Inc., 61 N.W.2d 718, 723-24 (Iowa 1953) (alternate holding).

114. The Commodity Credit Corporation Charter Act, 15 U.S.C. § 714 (1948), was amended in 1955 to protect buyers from warehousemen who oversold CCC-owned grain. The 1955 amendment, codified as 15 U.S.C. § 714p, is entitled "Release of innocent purchasers of converted goods." It provides:

> A buyer in the ordinary course of business of fungible goods sold and physically delivered by a warehouseman or other dealer who was regularly engaged in the business of buying and selling such goods shall take or be deemed to have taken such goods free of any claim . . . by Commodity Credit Corporation, based on the want of authority in the seller to sell such goods, provided the buyer purchased such goods for value in good faith and did not know or have reason to know of any defect in the seller's authority to sell such goods. To be entitled to relief under this section a buyer must assert as an affirmative defense and establish by a preponderance of the evidence the facts necessary to entitle him to such relief.

Id.

115. *See* R. RIEGERT & R. BRAUCHER, DOCUMENTS OF TITLE § 5.2.2 (3d ed. 1978).

116. NEB. REV. STAT. (U.C.C.) § 9-307(1) (Reissue 1980) provides: "A buyer in ordinary course of business . . . other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence."

117. U.C.C. § 2-403(2) (1959) provides: "Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business." U.C.C. § 2-403(3) (1959) defines entrusting as including:

> any delivery and any acquiescence in retention of possession regardless of any condition expressed between the parties to the delivery or acquiescence and regardless of whether the procurement of the entrusting or the

general thrust of all these sections which protect buyers where a middleman has converted the goods is that the owner or secured party was probably better able to investigate the character and financial capacity of the merchant to whom he turns over his goods than is the ordinary course buyer from inventory, and that all will benefit from the higher prices buyers will pay for goods if buyers need not search title or insure against personal property title defects.[118]

It is noteworthy, however, that Nebraska did not enact the official version of the entrusting provision. Instead, Nebraska's nonuniform section 2-403(2) protects the buyer against the true owner's claims only if the owner entrusted the goods to the merchant "for purposes of sale."[119] Section 7-205, by contrast, gives the buyer clear title even when the grain was held by the warehouse for storage only, with no agreement by the owner to sell to or through the warehouse.

It is likely that grain producers as well as grain buyers benefit to some degree from section 7-205, since the buyer-protection rule would tend to enhance grain prices. However, other justifications advanced for section 7-205 are more questionable. The Official Comments argue that protecting the buyer at the owner's expense is justifiable because recapture is so difficult that it adds little to storer protection, but its impact, when successful, is harsh indeed on the buyer, reducing "him completely to the status of general creditor in a situation where there was very little he could do to guard against the loss."[120] The drafters seem to assume that the typical purchaser from the warehouse, and hence the recapture

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possessor's disposition of the goods have been such as to be larcenous under the criminal law.

118. *See, e.g.*, NEB. REV. STAT. (U.C.C.) § 7-501 (Comment 1) (Reissue 1980) which points out that good faith purchase rules "makes possible the speedy handling of that great run of commercial transactions which are patently usual and normal." Comment 2 to U.C.C. § 2-403 (1959) indicates that consignors of and lenders against inventory "have no reason to complain" when their rights in goods sold are cut off in favor of the buyer, "since the very purpose of goods in inventory is to be turned into cash by sale." *See also* Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 YALE L.J. 1057 (1954). It is interesting that Professor Gilmore later lost faith in the good faith purchase concept as embodied in the U.C.C. which he helped to draft. *See* Gilmore, *The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of Repentant Draftsman*, 15 GA. L. REV. 605, 612-15 (1981).

119. NEB. REV. STAT. (U.C.C.) § 2-403(2) (Reissue 1980).

> (2) Any entrusting of possession of goods to a merchant *for purposes of sale* who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business.

Id. (emphasis added).

120. NEB. REV. STAT. (U.C.C.) § 7-205 (Official Comment) (Reissue 1980).

target, is a farmer buying feed or seed in relatively small quantities for on-farm use. If that were true, then tracing the grain would be costly, and such buyers probably could have done little to guard against loss. Grain warehouses do sell seed and feed grain to farmers and feedlot operators. However, the more important sales are to larger grain warehouses, processors like milling operations, and to multi-national grain dealers, all of which might buy in quantities great enough to make recapture survive cost-benefit analysis.

Further, regular buyers of large quantities of grain may not truly be in the fix posited by section 7-205's drafters. Quantity buyers who expect to do business over time with a warehouse are probably in a better position than individual producers storing grain in that warehouse to demand and to analyze financial statements on a regular basis. Such volume buyers could probably insure against recapture losses more economically than individual producers could insure against warehouse insolvency losses. If the rule were changed to allow recapture, it would seem appropriate to limit the vulnerability of the buyer to a relatively short period, such as three to six months, and to apply the rule only to purchasers of some minimum quantity, perhaps 100,000 bushels or more within some fixed period of time.

Such a change might speed up collection and distribution of an insolvent warehouse's grain assets by eliminating troublesome questions of fact and law. At present, if recapture is attempted, the parties must litigate the complex fact question of whether the buyer acted in good faith and the legal question of what is meant by good faith, that is, whether anything short of actual knowledge of the shortage will negate good faith.[121] These would seem to be much harder to determine than such objective facts as what quantity was purchased and when it was delivered.

Unless and until such a change is made, the ordinary course buyer from the warehouse who has taken physical delivery of grain takes title to it free from any claims of holders of storage receipts issued by the selling warehouse. The receipt holders are limited to claims against the warehouse and its bond, or to attacking the good faith of the buyer in question.

A second frequent cause of shortages is issuance of storage receipts, by mistake or design, for grain that was never delivered to the warehouse. Since receipt holders share *pro rata*, overissue reduces each prior party's share in the total mass of grain. In ef-

121. *See, e.g.*, United States v. United Mktg. Assoc., 220 F. Supp. 299, 305 (N.D. Iowa 1963) (good faith under Commodity Credit Corporation Act, 15 U.S.C. § 714p (1982)).

fect, more slices are cut from the same pie where additional receipts are issued but no additional grain is deposited in the warehouse.

Deliberate issuance of storage receipts against nonexistent grain frequently occurs when a warehouse needs to raise cash quickly, perhaps to meet a margin call. Warehouses are permitted to issue warehouse receipts covering company-owned grain, and to negotiate those to third parties in sale or security interest transactions.[122] Even if there is in fact no company-owned grain to support the receipt at the time of either issuance or negotiation, that warehouse receipt apparently gives the holder by due negotiation, whether buyer or lender, the same status he would have had if he had himself delivered grain to the warehouse in exchange for the receipt. So long as the lender or buyer of the storage receipt takes by due negotiation, in good faith, and gives value without knowledge that the warehouse does not own enough grain to cover the receipt, the holder becomes entitled to a *pro rata* share in whatever grain is in the warehouse, as well as the protection of the bond.[123]

The conclusion that warehouse receipts purporting to cover grain which did not exist at time of issuance or negotiation give a holder a share in grain which rightfully belongs to other storers is based on U.C.C. section 7-207. Subsection (1) of section 7-207 permits warehousemen to commingle fungible goods, and then subsection (2) determines the effect of such commingling:

> Fungible goods so commingled are owned in common. . . . Where because of overissue a mass of fungible goods is insufficient to meet all the receipts which the warehouseman has issued against it, the persons entitled include all holders to whom overissued receipts have been duly negotiated.[124]

It has often been argued and some pre-UCC cases hold that if the warehouse in fact owns no grain over and above that needed to satisfy storage obligations, but the warehouse nevertheless issues and negotiates receipts covering nonexistent company-owned grain, such receipts confer no rights in grain on the holder. The unfortunate holder, under this argument, is left with only an unsecured claim against the warehouse and perhaps a share in the

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122. *See* note 101 *supra*.

123. An excellent critical analysis of U.C.C. § 7-207's overissue rule is found in Bascom, *Article 7 and 9 of the Uniform Commercial Code—Security Interests in the Warehouseman's Own Receipts Covering Fungibles*, 19 WASH. U.L.Q. 105 (1969).

124. NEB. REV. STAT. (U.C.C.) § 7-207(2) (Reissue 1980).

bond.[125] For example, an early Nebraska grain case stated that "it is necessary to the validity of warehouse receipts that the warehouseman issuing the same have possession of the goods covered by them."[126]

To so limit the rights of a holder who acquired the receipts as security for a loan to the warehouse would be consistent with the secured party's status as to other types of collateral. Under U.C.C. Article 9, for example, if a debtor has no rights in the collateral he offers a lender, the lender's security interest never attaches to the collateral and is not enforceable against the property in question.[127] Even under Article 7, when dealing with non-fungible goods, original owners who deliver goods for storage are protected against claims by holders of subsequently issued fraudulent receipts, under U.C.C. section 7-402 which provides:

> Neither a duplicate nor any other document of title purporting to cover goods already represented by an outstanding document of the same issuer confers any right in the goods. . . .[128]

Nevertheless, U.C.C. section 7-207(2) was probably intended to mean that whether or not there was company-owned grain to support a receipt at the time of issuance or negotiation, a holder by due negotiation acquires a *pro rata* share in whatever grain is stored in the warehouse.[129] Frequently, the largest single claim against the grain remaining in an insolvent warehouse is that of the warehouse's financing bank, which never delivered any grain into storage but instead relied on the warehouse's false claims of ownership of grain. Other claimants attempt to protect themselves by contesting the lender's good faith, and hence, its status as a holder by due negotiation. These contests are sometimes successful, but always time-consuming and expensive.[130]

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125. *See, e.g., In re* Harbor Stores Corp., 29 F. Supp. 749 (S.D.N.Y. 1939); First Nat'l Bank v. Lincoln Grain Co., 116 Neb. 809, 219 N.W. 192 (1928); *see also* St. Paul Ins. Co. v. Fireman's Fund Ann. Ins. Co., 309 Minn. 505, —, 245 N.W.2d 209, 212 n.2 (1976).

126. First Nat'l Bank v. Lincoln Grain Co., 116 Neb. 809, 816, 219 N.W. 192, 195 (1928).

127. *See* NEB. REV. STAT. (U.C.C.) § 9-203 (Reissue 1980).

128. *Id.* § 7-402. *See also* Bascom, *supra* note 123, at 114.

129. Bascom, *supra* note 123, at 118-21.

130. *See, e.g., In re* Fairfield Elevator Co., 14 U.C.C. REP. SERV. (Callaghan) 96, 111 (Bankr. S.D. Iowa 1973); *aff'd sub nom.* United States v. Merchants Mut. Bonding Co., 242 F.Supp. 465 (N.D. Iowa 1975), *aff'd in part and reversed in part*, 556 F.2d 899 (8th Cir. 1977); Branch Banking & Trust Co. v. Gill, 286 N.C. 342, 211 S.E.2d 327 (1975), *rev'd on rehearing*, 293 N.C. 164, 237 S.E.2d 21 (1977); *cf.* St. Paul Ins. Co. v. Fireman's Fund Am. Ins. Co., 309 Minn. 505, —, 245 N.W.2d 209, 212 n.2 (1976).

Where the warehouse receipts issued to a warehouse's lender are non-negotiable, then the lender of course does not take by due negotiation and is a mere trans-

Certainly, one might question whether it is desirable to give lenders to warehouses an automatic ownership interest in grain held by their borrowers only as bailee. The rule of section 7-207(2) certainly enhances the negotiability of warehouse receipts purporting to cover a warehouse's own grain. However, it might be argued that prospective lenders to warehouses are considerably more able to protect themselves against overissue than are producers who have already stored grain in a warehouse. Lenders are better able than producers to investigate whether a would-be borrower warehouse actually has purchased and taken delivery of grain to back up its warehouse receipts. Lenders can require whatever financial statements or even physical audits they believe are necessary to insure that the warehouse receipts they receive are in fact backed by warehouse-owned grain. Producer-storers, on the other hand, would not usually have the leverage to get much information at the time they brought their grain in, let alone after it was already in storage. Further, the lender is more able to assess the risk and to distribute loss if it occurs than is an individual producer who has stored most or all of a year's crop in a particular warehouse.[131]

There is some movement to change this rule. The United States Senate has several times passed provisions, sponsored by

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feree rather than a holder. In that case, U.C.C. § 7-402(2) does not benefit the lender, and the lender's rights are no greater than those of its transferor, the warehouse. If the warehouse did not in fact have enough grain to meet the claims of those who actually deposited grain for storage, then the transferee of non-negotiable warehouse receipts purporting to cover company-owned grain would not share in the commingled grain regardless of the transferee's good faith. *See, e.g.*, Citizen's Bank & Trust Co. v. SLT Warehouse Co., 368 F. Supp. 1042 (M.D. Ga. 1974); *In re* Farmers Grain Exch., Inc., 20 U.C.C. REP. SERV. (Callaghan) 1054 (Bankr. W.D. Wis. 1976). *See also* U.C.C. § 7-504(1) (1959); Dolan, *Good Faith Purchase and Warehouse Receipts: Thoughts on the Interplay of Articles 2, 7 and 9 of the U.C.C.*, 30 HASTINGS L.J. 1, 21-26 (1978).

131. The lender's position seems analogous to the financing assignee of accounts receivable. The late Professor Grant Gilmore in 1981 questioned the protection U.C.C. rules give such lenders, in words that seem equally applicable to the lender financing grain warehousing:

> The basic flaw in our analysis was our failure to perceive that the twentieth-century financing assignee was not in the least like the stranger who, one hundred and fifty years earlier, had bought goods, commercial paper, and other property in an open market without being able to find out about the prior history of whatever he bought. The financing assignee . . . is not an ignorant stranger. He is in a position to find out—and, before putting up his money, does find out—all there is to know about the operations of his borrowers. He has a close and continuing relationship with them. He can, if he chooses, require the strictest accounting from them . . . . Because he can investigate, supervise, and control, he should be encouraged to do so and penalized if he has not done so.

Gilmore, *The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of a Repentant Draftsman*, 15 GA. L. REV. 605, 626-27 (1981).

Senator Dole of Kansas, which would relegate to a secondary status warehouse receipts held as loan collateral by lenders to the warehouse. Warehouse financiers would not share in the grain unless and until producers who actually deposited grain for storage were first fully satisfied.[132] On the state law front, Arkansas recently enacted a statute which voids any attempt by a warehouseman to encumber or sell grain where the warehouseman cannot show a prior written contract for sale to the warehouse of the appropriate quantity of grain.[133]

SCALE TICKETS AS EVIDENCE OF OWNERSHIP OF STORED GRAIN

Shortages sometimes go undetected until they become very large, because warehouses do not always keep very good records, and regulatory agencies' accounting practices do not always mesh well with practices in the trade.[134] In theory, all storage grain should be covered by formal warehouse receipts held by the storers or lenders. Further, warehouse receipt forms should be issued by the regulatory agency under careful control, be consecutively numbered, and the warehouse should have to account to its regulators for each form used. That way, it would be relatively easy to determine how much grain owned by or pledged to others the warehouse was supposed to contain.

However, practice often diverges from this ideal. When a producer delivers grain to a warehouse, he usually receives not a formal warehouse receipt but instead a simple scale or weight ticket for each load of grain delivered, whether the delivery is for storage or for sale to the warehouse.[135] Therefore, possession of a scale ticket does not necessarily indicate that the holder is a storer rather than a seller of grain to the warehouse.

If grain is delivered for storage, the grain owner is entitled to

132. S. 1365, 97th Cong., 1st Sess. § — (1981); S. 445, 98th Cong., 1st Sess. § 237 (1982). However, no similar provision was included in the amendments to the Bankruptcy Act which passed the House of Representatives in March, 1984. *See* H.R. 5174, 98th Cong., 2d Sess., (1984).

133. *See* ARK. STAT. ANN. § 77-1340 (1981), which provides:

> Ownership of grain shall not change by reason of an owner delivering grain to a public grain warehouseman, and no public grain warehouseman shall sell or encumber any grain within his possession unless the owner of the grain has by written document transferred title of the grain to the warehouseman. Notwithstanding any provision of the Uniform Commercial Code to the contrary . . . all sales and encumbrances of grain by public grain warehousemen are void and convey no title unless such sales and encumbrances are supported by a written document executed by the owner specifically conveying title to the grain to the public grain warehouseman.

134. GAO REPORT, *supra* note 5, at 19-22.

135. *Id.* at 19.

have a more formal document of title, a warehouse receipt, issued to him upon demand.[136] However, unless a producer intends to use his grain as collateral for a loan, and his lender requests a formal warehouse receipt, such a receipt is not usually demanded or issued. The producer simply retains his scale ticket, trusting the ticket and the warehouse's own records to prove his claim. Grain stored under scale tickets rather than warehouse receipts is often called open storage.[137]

While scale tickets can represent additional storage obligations of the warehouse, issuance of scale tickets has not always been rigorously controlled. When a warehouse is inspected by its licensing agency, the inspector may seriously underestimate the warehouse's storage obligation if he counts only warehouse-receipted grain and omits part or all of the open storage claims. The General Accounting Office, for example, recently pointed out the lack of control of open storage accounting as a serious problem under the U.S. Warehouse Act.[138] Iowa officials blamed faulty open storage records for preventing earlier discovery of Prairie Grain's massive shortages.[139]

Until recently, the "complicity" of producers in the open storage problem, that is, their failure to insist on formal warehouse receipts for all storage grain, was punished harshly. Scale ticket holders, even if they could establish that their delivery of grain was for storage rather than sale, were often considered a second-priority group. Open storage claimants, for example, under the Nebraska Public Service Commission's pre-1981 regulations, were not entitled to share in an insolvent warehouse's grain or bond proceeds unless and until the claims of traditional warehouse-receipt holders were first fully satisfied.[140]

Producers storing grain with a warehouse would generally be well advised to demand a formal warehouse receipt, even if it is a little more difficult to deal with than a simple scale ticket. However, all is not lost for those depositors who neglect to obtain a formal warehouse receipt.

The recent trend of legislative and judicial decisions is to treat

136. *See, e.g.*, IOWA CODE ANN. § 543.18 (West 1946); NEB. REV. STAT. § 88-506 (Reissue 1981).

137. GAO REPORT, *supra* note 5, at 19.

138. *Id.* at 19-21.

139. *State Studying ICC Elevator Audits*, Des Moines Trib., Feb. 22, 1980, at 2A, col. 3.

140. 1972 Rules and Regulations of The Nebraska State Railway Commission, Warehouses, art. VI, § 15.2 at 33. (The Nebraska Railway Commission is the former name of the Nebraska Public Service Commission).

scale tickets as one type of non-negotiable warehouse receipt. Scale ticket holders can then share in an insolvent warehouse's remaining grain and its storage bond,[141] unless it is shown that the scale ticket represents a sale of grain rather than a delivery for storage in a particular case.[142] For state-licensed Nebraska grain warehouses, this result obtains due to a 1981 amendment to the Nebraska Warehouse Act which provides that scale tickets are *prima facie* evidence of the holder's claim of title to the grain describe therein.[143]

FURTHER RESOURCES AVAILABLE TO SATISFY STORERS' CLAIMS

In addition to a *pro rata* share of the grain remaining in an insolvent warehouse,[144] the storer has an unsecured claim against the warehouse for the balance of his grain deposit,[145] and a claim against the warehouseman's bond under the relevant warehouse licensing act.[146] In Nebraska, a successful claimant under the warehouse bond may also recover attorney's fees from the surety[147] if the claimant must file suit on the bond or if the surety names the claimant as a defendant in a declaratory judgment or

141. *See* Thomas v. Reliance Ins. Co., 617 F.2d 122, 127-28 (5th Cir. 1980); Hartford Accident & Indem. Co. v. Kansas, 247 F.2d 315, 319 (10th Cir. 1957); United States Fidelity & Guar. Co. v. Long, 214 F. Supp. 307, 313 (D. Or. 1963); Kansas *ex rel.* Crawford v. Centerville Grain Co., 5 Kan. App. 2d 451, —, 618 P.2d 1206, 1212 (1980); Stevens v. Farmers Elevator Mut. Ins. Co., 197 Kan. 74, —, 415 P.2d 236, 244 (1966); Kramer v. Northwestern Elevator Co., 98 N.W. 96 (Minn. 1904). *Cf. In re* Durand Milling Co., 9 Bankr. 669, 672 (E.D. Mich. 1981). *But see* Farmers Elevator Mut. Ins. Co. v. Jewett, 394 F.2d 896, 900 (10th Cir. 1968) (Scale ticket holders are allowed to share pro rata with holders of formal warehouse receipts. However, the court reserves the question of whether warehouse receipt holders should take first if, as was not the case here, total claims exceeded both the grain proceeds and the bond).

142. *See* text accompanying notes 257-95 *infra*.

143. NEB. REV. STAT. § 88.505.01 (Reissue 1981).

144. *See* text at note 101 *supra*.

145. *Id.*

146. *See* text at notes 48, 64, 65 *supra*.

147. NEB. REV. STAT. § 44-359 (Reissue 1978) provides:

> Policies; actions; attorney's fees. In all cases where the beneficiary, or other person entitled thereto, brings an action upon any type of insurance policy except workmen's compensation insurance, or upon any certificate issued by a fraternal beneficiary association, against any company, person or association doing business in this state, the court, upon rendering judgment against such company, person or association, shall allow the plaintiff a reasonable sum as an attorney's fee in addition to the amount of his recovery, to be taxed as part of the costs. If such cause is appealed, the appellate court shall likewise allow a reasonable sum as an attorney's fee for the appellate proceedings; *Provided*, that if the plaintiff shall fail to obtain judgment for more than may have been offered by such company, person or association in accordance with section 25-901, then the plaintiff shall not recover the attorney's fee provided by this section.

interpleader action.[148]

A storer's cause of action against the warehouse for undelivered grain may be based on the intentional tort of conversion,[149] as well as breach of contract. Conversion has two advantages over breach of contract in this context. First, conversion is an intentional tort for which punitive damages may be added to compensatory damages,[150] at least in jurisdictions other than Nebraska.[151] Also, liability for conversion may be nondischargeable in bankruptcy, if the warehouseman-converter is an individual and the circumstances are blatant enough to be termed "wilful and malicious" under section 523(a)(6) of the Bankruptcy Reform Act.[152]

Sometimes liability can be imposed on persons other than the warehouse itself. For example, employees of an incorporated warehouse who directly and knowingly participate in conversion of stored grain are personally liable for their own torts, so there is no need to pierce the corporate veil to impose liability on them.[153] In appropriate cases, the corporate veil may be pierced to hold stock-

148. A good discussion of the use of *id.* § 44-359 is found in Kort v. Western Sur. Co., No. CV 77-L-208, at 19-22 (D. Neb. Aug. 4, 1980). *See also* State Farm Mut. Ins. Co. v. Selders, 189 Neb. 334, 335-36, 202 N.W.2d 625, 626 (1972); State *ex rel.* School Dist. v. Ellis, 160 Neb. 400, 409, 70 N.W.2d 320, 325 (1955).

149. *See, e.g.*, American Triticale, Inc. v. Nytco Serv. Inc., 664 F.2d 1136, 1146 (9th Cir. 1981); *In re* Covington Grain Co., 638 F.2d 1357, 1359 (5th Cir. 1981); General Ins. Co. v. Commodity Corp., 430 F.2d 916, 918 (10th Cir. 1970); *In re* Durand Milling Co., 9 Bankr. 669, 674 (E.D. Mich. 1981); Nytco Serv. Inc. v. Wilson, 351 So. 2d 875, 878 (Ala. 1977); Schilling v. Book, 84 Ill. App. 3d 972, —, 405 N.E.2d 824, 826 (1980); Avoca State Bank v. Merchants Mut. Bonding Co., 251 N.W.2d 533, 540 (Iowa 1977); Associated Bean Growers v. Chester B. Brown Co., 198 Neb. 775, 783, 255 N.W.2d 425, 431 (1977).

In some cases, unpaid *sellers*, as opposed to storers of grain, have successfully based a suit on conversion theory. *See* Reeves v. Pillsbury Co., 229 Kan. 423, —, 625 P.2d 440, 442 (1981); *cf.* Nytco Serv. Inc. v. Wilson, 351 So. 2d at 881. *See also* Preston v. United States, 596 F.2d 232, 239-40 (7th Cir. 1979), *cert. denied*, 444 U.S. 915 (1979).

150. *See, e.g.*, Nytco Serv., Inc. v. Wilson, 351 So. 2d at 883.

151. The Nebraska Supreme Court has for many years interpreted article VII, section 5, of the Nebraska Constitution as prohibiting awards of punitive damages. "It has been a fundamental rule of law in this state that punitive, vindictive, or exemplary damages will not be allowed . . . ." Abel v. Conover, 170 Neb. 926, 929, 104 N.W.2d 684, 688 (1960) (citing Boyer v. Barr, 8 Neb. 68, 30 Am. Rep. 814 (1878)).

152. Section 523(a) of the Bankruptcy Reform Act of 1978, 11 U.S.C. §§ 101-151104 (1978) provides: "A discharge under section 727, 1141, or 1328(b) of this title does not discharge an individual debtor from any debt . . . (6) for wilful and malicious injury by the debtor to another entity or to the property of another entity . . . ."

In a grain warehouse insolvency case arising under the Bankruptcy Act of 1898, 30 Stat. 544 (1898) conversion liability of individuals was held nondischargeable. *In re* Durand Milling Co., 9 Bankr. at 674-75.

153. *See In re* Durand Milling Co., Inc., 9 Bankr. at 672-74 (imposing liability on the officers and employees of a grain warehouse who had directly participated in conversion of stored grain). *Cf.* American Triticale, Inc. v. Nytco Serv., Inc., 664 F.2d at 1146.

holders personally liable for the debts of an insolvent warehouse corporation. In 1979, the Minnesota Supreme Court affirmed a trial court's finding that a husband and wife, stockholder-operators of a grain warehouse, had commingled personal and corporate assets and misrepresented the personal assets as belonging to the corporation. The court held the stockholders personally liable for warehouse debts.[154]

Producers have had some success with tort claims against the government agencies charged with inspecting insolvent grain warehouses. Two recent examples involved allegations of negligent inspection by the Iowa Commerce Commission (ICC) in the Prairie Grain case, and of negligence and conversion by the Commodity Credit Corporation with regard to a Wisconsin warehouse.

In the Iowa case, *Adam v. Mount Pleasant Bank & Trust Company*, producers alleged that Prairie Grain had been insolvent for at least five years before the ICC discovered the warehouse's massive shortages in early 1980.[155] The plaintiffs contended that had ICC properly inspected Prairie Grain, the insolvency would have been discovered much earlier, so that plaintiffs would not have lost money on grain stored with or sold to the warehouse.

The State of Iowa moved for summary judgment on the ground that the claim was basically one for misrepresentation, and thus specifically excepted from the state tort claims act.[156] However, the trial court, and on interlocutory appeal, the Iowa Supreme Court, found the misrepresentation exception inapplicable.[157] The Iowa Supreme Court pointed out that Iowa's tort claims act[158] was identical to the Federal Tort Claims Act,[159] and the court relied heavily on recent federal cases narrowing the misrepresentation exception.[160] The court held that the misrepresentation exception bars suits based solely on the government's failure to use due care in communicating information on which plaintiffs relied to their detriment. However, where the government agency breached statutory duties, such as those imposed by grain warehouse licensing

154. Victoria Elevator Co. v. Meriden Grain Co., 283 N.W.2d 509, 512-13 (Minn. 1979). *See also* Adam v. Mt. Pleasant Bank & Trust Co., No. 69291 (Iowa Ct. App. filed Mar. 20, 1984).

155. Adam v. Mount Pleasant Bank & Trust Co., 340 N.W.2d 251 (Iowa 1983). There were several defendants other than the Iowa Commerce Commission.

156. *Id.* at 252.

157. *Id.* at 254.

158. IOWA CODE ANN. §§ 25A.1-.22 (West 1981).

159. 28 U.S.C. § 1346 (1946).

160. The Iowa Supreme Court relied in *Adam*, 340 N.W.2d at 252-54, on Block v. Neal, 103 S. Ct. 1089 (1983); United States v. Neustadt, 366 U.S. 696 (1961); J.W. Mechanical Corp. v. United States, 716 F.2d 190 (3d Cir. 1983); Cross Bros. Meat Packers v. United States, 705 F.2d 682 (3d Cir. 1983).

statutes, and those lapses injured the tort claimant, then the misrepresentation exception does not apply.[161]

In *Adam*, the Iowa Supreme Court discussed the somewhat similar case of *Preston v. United States*.[162] *Preston* involved a federal tort claim by Wisconsin producers alleging negligence by the Commodity Credit Corporation in inspecting a warehouse that stored both producer-owned and CCC-owned grain.[163] In *Preston*, the Seventh Circuit Court of Appeals had affirmed dismissal of the negligent inspection claim under the misrepresentation exception to the Federal Tort Claims Act.[164] The Iowa Supreme Court in *Adam*, however, held *Preston* was not controlling, because the CCC's statutory duties were less pervasive than those of the Iowa Commerce Commission, and also because *Preston* was decided before recent decisions narrowed the misrepresentation exception.[165]

The Iowa Supreme Court did not reach the merits in *Adam*,[166] nor did the court consider the effect of two provisions in Iowa's grain statutes which might insulate the state from negligent inspection liability. Both Iowa's Grain Dealer's Act and its Bonded Grain Warehouse Act include the following:

> *No obligation of state*. Nothing in this chapter shall be construed to imply any guarantee or obligation on the part of the state of Iowa, or any of its agencies, employees or officials, either elective or appointive, in respect to any agreement or undertaking to which the provisions of this chapter relate.[167]

So far, Nebraska grain warehouse insolvencies have not resulted in any reported decisions under the Nebraska Tort Claims Act. However, the Nebraska Act contains a misrepresentation ex-

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161. Adam v. Mount Pleasant Bank & Trust Co., 340 N.W.2d at 254.

162. Preston v. United States, 596 F.2d 232 (7th Cir. 1979), *cert. denied*, 444 U.S. 915 (1979). See also a second appeal in the same proceeding, Preston v. United States, 696 F.2d 528 (7th Cir. 1982).

163. 590 F.2d at 234-36.

164. *Id.* at 236-39.

165. Adam v. Mount Pleasant Bank & Trust Co., 340 N.W.2d at 252-54.

166. *Adam* was an interlocutory appeal from denial of the State of Iowa's motion for summary judgment. The only issue considered was whether the suit was barred by the misrepresentation exception to the Iowa Tort Claims Act, IOWA CODE ANN. §§ 25A.1-.22 (West 1981). Adam v. Mount Pleasant Bank & Trust Co., 340 N.W.2d at 252.

167. *See* IOWA CODE ANN. §§ 542.14, 543.38 (West 1981) (Section 542.14 reads, "in respect *of* any agreement or undertaking . . . ." (Emphasis added). The State of Iowa had raised these sections of the Iowa Code in a motion to dismiss which the trial court overruled. The State apparently did not preserve that point for appeal, so the Iowa Supreme Court refused to consider it. Adam v. Mount Pleasant Bank & Trust Co., 340 N.W.2d at 254.

ception like that considered in *Adam*.[168] The Nebraska grain warehousing statutes do not contain any exculpatory provisions similar to Iowa's.

Successful tort claims cases have not been limited to negligence; the *Preston* litigation just mentioned also included a conversion claim and on this, the producers prevailed.[169] In *Preston*, the conversion claim was based on Commodity Credit Corporation's actions after its inspectors finally discovered the grain warehouse's shortages and insolvency. The Wisconsin producer-plaintiffs alleged that after CCC learned of the shortages, it did not promptly notify other grain storers or the state licensing agency. Instead, CCC took advantage of its superior knowledge and converted the grain of other storers by ordering out and taking delivery of the full amount of grain represented by CCC's warehouse receipts, instead of CCC's much smaller *pro rata* share of the remaining grain.[170]

The Wisconsin producers prevailed on this theory.[171] The Seventh Circuit Court of Appeals relied on U.C.C. section 7-207(2)[172] and prior case law to hold that CCC was a tenant in common with other storers of grain. As such, CCC was entitled only to a *pro rata* share in event of a shortage of stored grain.[173] Under the Seventh Circuit view, however, liability for conversion in this context depends on knowledge of a shortage before taking delivery of more than a *pro rata* share. The court said that tenants in common owed each other a duty to deal "in good faith and not intentionally assail the other's interest."[174] The court indicated in *Preston* that a storer commits no wrong if he takes delivery of more than his *pro rata* share without knowledge of a shortage in the warehouse.[175] On the other hand, where one storer with superior access to financial information and inspection reports learns of a shortage, he converts others' grain if he uses that information to his own advantage and knowingly takes more than his *pro rata* share.[176] This conversion theory, of course, is not limited to governmental defendants; various other holders of warehouse receipts might have

168. The Tort Claims Act is codified as NEB. REV. STAT. §§ 81-8209 to -8239 (Reissue 1981). Section 81-8219(1)(d) excepts from its operation "[a]ny claim arising out of . . . misrepresentation . . . ."

169. Preston v. United States, 596 F.2d at 240; 696 F.2d at 540-41.

170. 596 F.2d at 239-40; 696 F.2d at 531-34.

171. 696 F.2d at 535-40.

172. *Id.* at 536.

173. *Id.* at 536-39.

174. *Id.* at 537.

175. *Id.* at 539.

176. *Id.* at 536-38.

inside information of a shortage and attempt to take unfair advantage of it.

Yet another third party potentially liable in warehouse insolvency cases is the warehouse's financing bank. In the *Adam* suit arising out of Iowa's Prairie Grain bankruptcy, producers also alleged and a jury found that a bank had conspired with Prairie Grain's owner in a scheme to defraud farmers. The jury found the bank allowed the warehouse owner to engage in a check-kiting scheme, and continued to loan the warehouse money when bank officers knew that the warehouse was no longer creditworthy. Farmers suing on this theory won a $2.1 million judgment in one suit.[177] A second group of farmers sued on a similar theory and was awarded $2.2 million.[178]

However, collection of these particular judgments is doubtful, since the defendant bank was closed by the Federal Deposit Insurance Company (FDIC), on August 6, 1982, in part due to losses the bank itself sustained on its loans to Prairie Grain.[179] In an effort to collect the farmers' judgments, suit was filed against the FDIC, alleging that the FDIC did not adequately protect the interests of the bank and its creditors when the FDIC handled the closing of the bank. Specifically, the suit charges that actions of officers of the failed bank contributed to its collapse and that the FDIC should have tried to collect damages from bank officials.[180] Those damages would have become bank assets available for distribution to the bank's creditors, including the farmers who had obtained the judgments against the bank.

VI. RIGHTS OF UNPAID SELLERS OF GRAIN

So far, this article has examined the remedies of producers who deliver grain for storage to a public warehouse which later becomes insolvent. Depositors for storage purposes normally have a

177. Cochran, *Jury finds Mount Pleasant Bank conspired to defraud farmers*, Des Moines Reg. at 1, 1982 at 5S, col. 4.

178. Hawkins, *Judge reaffirms liability of bank in Stockport fraud*, Des Moines Reg., Dec. 1, 1982, at 8S, col. 5; *2.2 million Stockport fraud judgment made*, Des Moines Reg., Dec. 9, 1982, at 5S, col. 3; *Farmers sue in Prairie Grain Case*, Des Moines Reg., Apr. 12, 1982, at 5S, col. 4.

179. *See* FDIC, ANNUAL REPORT at 5-6 (1982). The bank's deposit liabilities were assumed on August 6, 1982, by Hawkeye Bank and Trust, a new subsidiary of Hawkeye Bancorporation of Des Moines, Iowa. The FDIC was named receiver of the defendant bank. *Id. See also Individual losses may run $500,000 in bank failure*, Des Moines Tribune, Aug. 6, 1982, at 1, col. 5-6; *Order To Close Bank Shocks Mt. Pleasant*, Des Moines Reg., Aug. 7, 1982, at 1, col. 1.

180. *See Farmers sue in Prairie Grain case*, Des Moines Reg. Apr. 12, 1982, at 5S, col. 4.

pro rata share in the grain remaining in the warehouse and an unsecured claim against the warehouse. If those resources are exhausted, storers have a claim against the warehouse bond for the remainder of their loss.[181]

Now, this article will turn to the problems of unpaid sellers. Producers who deliver grain for sale and never receive payment have less protection than storers. In most cases, the unpaid seller has no ownership interest in any grain remaining in the warehouse. Further, he is excluded from bond coverage under the United States Warehouse Act (U.S.W.A.)[182] and the warehouse acts of many states. Too often, he is just one more unsecured warehouse creditor, unlikely to recover much, if any, of his claim.

Whether producer-sellers should get so much less protection than producer-storers is debatable. The category, storer or seller, in which a producer falls when the warehouse's insolvency is discovered is mainly a matter of chance. Almost all the grain that producers store in a warehouse will eventually be sold to or through the same warehouse. The timing of a sales agreement is dictated by local custom, the financial positions of the warehouse and the producer, and tax considerations. The producer may not understand that a sales contract can pass title before final payment and forfeit bond protection.

In any event, if a producer has delivered grain to an insolvent warehouse, and his claim is or is alleged to be based on a contract to sell that grain to the warehouse, he has three options: first, to try reclaiming the grain under the U.C.C.; second, to argue that the relevant statutes extend bond protection to sellers; and third, to contend that he should be treated as a storer rather than a seller, because the alleged sales contract was never made or is unenforceable.

A contract for sale of goods, of course, is an agreement to transfer possession of and title to goods in exchange for a price. If the producer agrees to sell and the warehouse to buy grain, the warehouse would get title to the seller's grain at the later of several dates: the date of delivery or the date the sales contract was made.[183] If the grain was already in storage and a warehouse re-

181. See text accompanying notes 48, 53-72 *supra*.

182. 7 U.S.C. §§ 241-273 (1982). *See* text at notes 207-15 *infra*.

183. NEB. REV. STAT. (U.C.C.) § 2-401(2) (Reissue 1980) provides: "Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods . . . ." *Id.* § 2-401(3)(b) provides, "Unless otherwise explicitly agreed where delivery is to be made without moving the goods . . . (b) if the goods are at the time of contracting already identified and no documents are to be delivered, title passes