# The Surety Relationship in the Agricultural Commodity Storage Context and Grain Indemnity Funds: A Jurisdictional Survey

## Part 1

by

Peter E. Karney & John F. Fatino

Originally published in CREIGHTON LAW REVIEW
40 CREIGHTON L. REV. 41 (2006)

# THE SURETY RELATIONSHIP IN THE AGRICULTURAL COMMODITY STORAGE CONTEXT AND GRAIN INDEMNITY FUNDS: A JURISDICTIONAL SURVEY

PETER E. KARNEY & JOHN F. FATINO†



† Peter E. Karney, member of the bar of Illinois, and John F. Fatino, member of the bars of Iowa and Minnesota. Mr. Karney is a vice-chair of the Fidelity-Surety Law Committee of the Section on Torts and Insurance Practice of the American Bar Association. Mr. Fatino is a member of Whitfield & Eddy, PLC in Des Moines, Iowa. The opinions expressed herein are solely those of the authors.

## I. INTRODUCTION

The following Article discusses the federal and subject state jurisdictions'[1] statutory schemes for the regulation of those engaged in the storage of grain and related agricultural commodities and the requirements each of the jurisdictions imposes concerning surety bonds or other types of surety arrangements for such transactions. Each of the jurisdictions treats these matters differently both in terms of applicable statutory regulations and scope/types of coverage required. Each jurisdiction's statute is somewhat unique; albeit case law from other jurisdictions can enlighten counsel and the courts when interpreting a particular statute or surety relationship in a given situation.

This Article will analyze the materials based upon an introduction and an examination of the applicable federal statutes and regulations. Finally, the subject state jurisdictions' statutes and case law will be examined.

### A. THE CASE FOR COMMENTARY

The topic is worthy of scholarly commentary as the courts, practitioners, producers, and the community alike can find themselves dealing with the ramifications of a failed agricultural storage facility. It has been estimated that at any one time at least five percent of all grain storage facilities are experiencing financial difficulties.[2] The "ripple effect" of a grain storage facility failure can easily cause related failure of other producers. As grain storage is generally deemed to be "open storage,"—i.e., the same types of grain from multiple producers are commingled in common bins—hundreds of other producers are impacted by the failure and concomitant delay when a facility fails.[3] This same causation would apply to any agricultural commodity that is stored by a party other than the producer.

While a myriad of causes exist for the failure of a grain storage facility, a discussion of each of those causes is beyond the scope of this Article. Suffice it to say, however, that the primary reason why such facilities fail is poor record keeping.[4] In the long run, poor record keeping contributes to a net shortage of grain from which a financially strapped operator cannot recover.[5] Thus, grain shortages are the "primary symptom of elevator insolvency."[6] Given the impact on the com-

1. Illinois, Indiana, Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, South Dakota, and Wisconsin.

2. Tom H. Connolly & Charles R. Beach, *Grain Elevator Insolvency: State Law and Bankruptcy Law Considerations*, 19 COLO. LAW. 635, 635 (1990).

3. Connolly & Beach, 19 COLO. LAW. at 635.

4. *Id.*

5. *Id.*

6. *Id.*

munity as a whole, it would appear that the exercise of the state's police powers would be appropriate in this arena.[7]

In addition, counsel must contemplate the actual nature of the relationship between the producer and the facility. Generally speaking, a storage facility may provide two separate services to producers. The first service is where the facility acts as a grain dealer wherein the operator engages in certain transactions such as cash or credit sales and commodity futures.[8] However, this depends upon a particular jurisdiction's regulatory scheme.

The other service involves holding the commodity for the producer as a warehouse. For instance, some state statutes contemplate that a sale has not taken place between the producer and the facility; instead, grain storage contracts are considered "true bailments . . . and the depositors are thereby considered tenants in common of the commingled grain held in open storage."[9] The same result could be reached under the case law as well.[10] The latter category of service is called a "commercial bailment agreement."[11] Those jurisdictions that regulate grain banks treat the relationship between a grain bank and a depositor as controlled by the common law of bailment.[12]

Similar problems are experienced by those who have sold grain but have not been paid before the facility shuts down. The problems are largely those of proof and lack of sufficient funds to pay all of the depositors. If the facility agreed to purchase the grain directly, the "sales 'contract' may be written or oral, and may be based upon nothing more than a telephone conversation with the depositor. When the shutdown or bankruptcy finally arrives, many depositors that sold to the elevator may be unpaid or may have been paid with checks that later are dishonored."[13]

These problems are compounded by the fact that the operator of a facility must also secure a line of operating capital. Needless to say, the commodity itself is the operator's greatest asset because, generally

7. Michael D. Love, Note, *A Survey of Current Issues and Legislation Concerning Grain Elevator Insolvencies,* 8 J. CORP. L. 111, 114 (1982) (discussing impact of grain operator insolvencies on farm communities and on financial institutions).

8. Roger Dunekacke, Note, *Grain Elevator Insolvencies and Help for the Producer: An Examination of the Bankruptcy Act of 1984,* 64 NEB. L. REV. 463, 464 (1985). This service is commonly known as "merchandising." *See also* Love, Note, 8 J. CORP. L. at 118-19.

9. Connolly & Beach, 19 COLO. LAW. at 636 (citing COLO. REV. STAT. § 12-16-207 as derived from the Uniform Commercial Code).

10. Love, Note, 8 J. CORP. L. at 117 n.66.

11. Dunekacke, Note, 64 NEB. L. REV. at 465 (discussing the commercial need for such facilities and the economic factors that encourage such facilities).

12. Duxbury v. Spex Feeds, Inc., 681 N.W.2d 380, 386 (Minn. Ct. App. 2004) (citing Torgerson v. Quinn-Shepherdson Co., 201 N.W. 615, 616 (Minn. 1925)).

13. Connolly & Beach, 19 COLO. LAW. at 637.

speaking, the operator's fixed assets would be insufficient to collateralize a loan.[14] In turn, the operator's lenders will not finance the operation without "receiving warehouse receipts covering sufficient grain to secure a loan."[15]

Accordingly, this Article will examine the federal statutory scheme for grain warehouses and operators of packing and stock yard facilities.[16] Further, this Article will examine the various jurisdictions' approaches to the imposition of a surety relationship on those entities which engage in the storage of grain and other agricultural commodities.[17]

### B. An Overview of the Rules of Sales and Warehousing

Before embarking on a case that involves a dispute concerning the storage of agricultural commodities and bonds written in connection with the endeavor, counsel will want to closely examine her state's adopted version of the Uniform Commercial Code concerning the requirement of a writing for the sale of goods.[18] Counsel should also study when title passes to goods.[19] A purchaser acquires all of the interest held by the transferor unless there was a transfer of a limited interest.[20] After all, a commodity is a good within the meaning of the Uniform Commercial Code,[21] and whether a transaction is covered by the Uniform Commercial Code is a question of law.[22]

Further, in the absence of contrary statutory language that regulates the warehousing of agricultural commodities, the Uniform Commercial Code will most likely govern the transaction under the warehousing provisions of Article Seven.[23] Needless to say, counsel will also want to examine the subject statute and any written evidence of a surety relationship.

At the same time, a short discussion concerning "warehouse law" or "documents of title" as described by the drafters of the Uniform Commercial Code is warranted. Ordinarily, a warehouse is liable for

---

14. Love, Note, 8 J. Corp. L. at 120.
15. *Id.* This may be critical because of cash needs during particular seasons. *Id.*
16. *See infra* notes 64-228 and accompanying text.
17. *See infra* notes 229-1012 and accompanying text.
18. U.C.C. § 2-201 (amended 2003). *See, e.g.,* Iowa Code Ann. § 554.2201 (West 2001).
19. U.C.C. § 2-401 (amended 2003). *See, e.g.,* Iowa Code Ann. § 554.2401 (West 2001). *See also* Connolly & Beach, 19 Colo. Law. at 638 (discussing impact under Colorado law).
20. U.C.C. § 2-403 (amended 2003).
21. U.C.C. § 2-105(1) (amended 2003). *See, e.g.,* Iowa Code Ann. § 554.2105(1) (West 2001).
22. *Duxbury*, 681 N.W.2d at 386 (citing Valley Farmers' Elevator v. Lindsay Bros., Co., 398 N.W.2d 553, 556 (Minn. 1987)).
23. *See infra* notes 26-39 and accompanying text.

damage to goods in its possession only if the warehouse fails to use ordinary care, that is, a "failure to exercise care . . . that a reasonably careful person would exercise under similar circumstances."[24] If the damages could not have been avoided even if reasonable care was used, the warehouse is not liable.[25] Also, damages may be limited under the warehouse receipt or the parties' storage agreement.[26] However, under no circumstances may the warehouse limit its liability for conversion.[27] Similarly, specifications may be placed in the warehouse receipt concerning "reasonable" provisions for the "time and manner of presenting claims and commencing actions based on the bailment . . . ."[28]

The Uniform Commercial Code also contains provisions concerning the purchase of a document of title, which represents goods held by the warehouse. The Uniform Commercial Code provides that when a document of title, other than a bill of lading, is purchased in good faith, the purchaser may recover "damages caused by the nonreceipt or misdescription of the goods" unless "the document conspicuously indicates that either the issuer does not know" the contents or the purchaser has notice of the fact.[29]

Like the provisions for the sale of goods, Article Seven of the Uniform Commercial Code contains a provision for the essential terms of a warehouse receipt.[30] However, in the case of agricultural commodities stored under a statute that requires a bond, "a receipt issued for the goods is deemed to be a warehouse receipt even if issued by a person that is the owner of the goods and is not a warehouse."[31]

Iowa's adoption of section 7-202 of the Uniform Commercial Code contains additional provisions that are noteworthy. First, if applicable, the receipt must reflect in its printed or written terms that the "receipt is issued for goods of which the warehouse operator is owner, either solely or jointly or in common with others . . . ."[32] Second, the receipt must contain a "statement of the amount of advances made and of liabilities incurred for which the warehouse operator claims a

24. U.C.C. § 7-204(a) (amended 2003); *See, e.g.,* IOWA CODE ANN. § 554.7204(1) (West 2001).

25. *Id.*

26. U.C.C. § 7-204(b); *See, e.g.,* IOWA CODE ANN. § 554.7204(2).

27. *Id.*

28. U.C.C. § 7-204(c); *See, e.g.,* IOWA CODE ANN. § 554.7204(3).

29. U.C.C. § 7-203 (amended 2003). *See, e.g.,* IOWA CODE ANN. § 554.7203 (West 2001).

30. U.C.C. § 7-202 (amended 2003). *See, e.g.,* IOWA CODE ANN. § 554.7202 (West 2001).

31. U.C.C. § 7-201(2) (amended 2003). *See, e.g.,* Iowa Code Ann. § 554.7201(2) (West 2001).

32. IOWA CODE ANN. § 554.7202(2)(h).

lien or security interest."[33] Moreover, a "warehouse operator may insert in the receipt any other terms which are not contrary to the provisions of this chapter and do not impair the warehouse operator's obligation of delivery . . . or duty of care."[34]

Furthermore, the Uniform Commercial Code addresses the negotiable nature of the warehouse receipt. According to the 2001 and prior versions of section 7-104 of the Uniform Commercial Code, "a warehouse receipt, bill of lading or other document of title is negotiable" if the goods are deliverable to the bearer or the "order of a named person" or when the instrument concerns international trade and the instrument runs to a person so named or its assign.[35] It is against this back drop that the various statutory schemes set out to change the paradigm regarding agricultural commodity storage.

### C. The Surety Relationship

At the same time, in order to be an effective counselor and advocate, counsel must have a basic knowledge of the vocabulary and legal relationships that are the foundation of a surety agreement. While a detailed analysis of a surety relationship and the myriad of settings in which the device is used are the subject of many authoritative treatises, the definitions employed and the concepts underlying the relationship are common regardless of the enterprise in which the device is used. Moreover, the legal concepts are critical to an understanding of the balance of this Article. At the same time, the relationship will be distinguished from the traditional notion of insurance.[36]

A surety relationship is a tripartite one involving a principal, an obligee, and a surety.[37] The concept is an ancient one with historical antecedents that date to 2750 B.C. when agreements were made on tablets.[38] The Bible warns against the practice.[39] The practice was

33. § 554.7202(2)(i).

34. § 554.7202(3).

35. U.C.C. § 7-104 (2001) (amended 2003). *See, e.g.,* Iowa Code Ann. § 554.7104 (West 2001). The language of section 7-104 of the Uniform Commercial Code was amended in 2003, but the commentary reflects that the section still deals with "commodity paper." *See* U.C.C. § 7-104 cmt. (amended 2003).

36. However, certain state statutes may define insurance to include the practice of suretyship, which often leads to confusion of the terminology and mixed results with respect to certain causes of action and statutory remedies. *See, e.g.,* Benjamin B. Ullem & John F. Fatino, *Defeating the Bad Faith Claim Against the Miller Act Surety*, Fidelity & Surety L. Committee Newsl. (ABA/Tort Trial and Insurance Practice Section), Summer 2003, at 10-11. *See also* William H. Woods, *Historical Development of Suretyship*, *in* The Law of Suretyship 2-37 (Edward G. Gallagher ed., 1993) (discussing the problems that have arisen from applying principles of insurance law to the surety agreement).

37. Woods, *supra* note 36, at 2-1.

38. *Id.* at 2-2.

39. *Id.* at 2-3.

used in ancient Greece, was observed by Roman law, continued across the continent, was cemented in English jurisprudence, and made its way to the newly formed colonies.[40] Evidence of the release of a surety dating back to 1050 A.D. exists in Nuremberg, Germany.[41] A "surety" is a person or entity "who contracts to answer for the debt or default of another."[42] "The principal is the primary obligor, the obligee is the person to whom the principal and the surety owe a duty and the surety is the secondary obligor."[43] A contract of suretyship must be in writing.[44]

Unlike insurance, a surety essentially extends credit to its principal in that the surety will make good on any loss or failure of performance by the principal to a person or entity known as the obligee, that is, the person to whom the "obligation" of performance or other condition is owed. (The obligation, of course, depends upon the surety's undertaking - e.g., performance or payment bond, bid bond, notary bond, etc.)

Suretyship is also unlike insurance in that it is not based upon the premise that the surety will suffer a loss from an actuarial standpoint.[45] Underwriting for a surety bond is different from the underwriting used for a traditional insurance product.[46] The surety's promise is only triggered when the principal fails to perform.[47] In turn, the surety will only suffer a loss if the principal is unable to reimburse the surety.[48] As such, surety underwriting is based upon the technical competency and financial wherewithall of the principal.[49] Therefore, as the surety has access to information to validate the decision to extend such credit, evidence of any "appreciable likelihood of default" during the underwriting process will lead to a rejection of the opportunity to issue a particular bond.[50] Insurance, on the other hand, spreads the risk of loss over its customers by assuming

40. *Id.* at 2-4 to 2-23.

41. HANS THIEME, NUREMBERG CITY GUIDE 10-11 (1995). A special thank you to Simone Siegler for bringing this information to the attention of the authors.

42. Edward G. Gallagher, *Introduction*, *in* THE LAW OF SURETYSHIP, *supra* note 36, at 1-1. *See also* State v. Bi-States Constr. Co., 269 N.W.2d 455, 458 (Iowa 1978) (citation omitted) ("A contract of suretyship is usually, in general terms, defined as a contract to answer for the debt, default, or miscarriage of another").

43. Gallagher, *supra* note 42, at 1-1.

44. *Id. See, e.g.*, IOWA CODE ANN. § 622.32 (West 1999).

45. EMMETT J. VAUGHAN & THERESE M. VAUGHAN, FUNDAMENTALS OF RISK AND INSURANCE 608 (7th ed. 1996).

46. For a discussion concerning underwriting practices of surety underwriters, *see* Timothy Martin, *Using the Underwriter's File in Litigation*, FOR THE DEFENSE, Sept. 2002, at 39.

47. Gallagher, *supra* note 42, at 1-1.

48. *Id.*

49. *Id.*

50. *Id.*

that a certain number of losses will occur and charges the premiums to all of its customers accordingly. In any event, the surety's liability is limited to the penal sum of the bond.[51]

Additionally, unlike a surety, an insurer has no right to proceed against its insured in the event the insured caused a loss. This result follows because the insurer "has the primary obligation to pay and has no recourse against the insured."[52] Instead, a surety has a right to proceed against its principal and other individuals who agreed to indemnify the surety in the event the surety should incur any cost, expense, or loss. The actual scope of the duty to indemnify will be determined by the actual language employed in the surety's indemnity agreement. Generally speaking, the indemnity agreement is executed prior to issuance of any bonds by the surety on the principal's behalf. This will, of course, depend upon the actual underwriting and procedures for issuance of bonds by a given surety.

### D. Bankruptcy and the State Surety Requirements.

In order to expedite the resolution of claims arising out of the failure of commodity storage facilities, Congress enacted 11 U.S.C. § 557 as part of the federal bankruptcy code.[53] Section 557 places specific duties upon the bankruptcy trustee.[54] Other provisions of the bankruptcy code relate to agricultural storage facilities.[55]

A trustee in bankruptcy is to move swiftly once the bankruptcy court invokes the section.[56] To that end, notwithstanding the bankruptcy court's jurisdiction over a facility, there still is a role for state grain regulators to assist in the process. Some suggest that "the considerable expertise of state agricultural authorities can be of great help to the trustee during this initial phase."[57]

---

51. Lynn M. Schubert, *Modern Contract Bonds—An Overview*, *in* The Law of Suretyship, *supra* note 36, at 3-1. However, as discussed, *infra*, there are exceptions to the proposition.

52. Gallagher, *supra* note 42, at 1-1. *See also* AID Ins. Co. v. United Fire & Cas. Co., 445 N.W.2d 767, 771 (Iowa 1989) (insurer has no right of subrogation against its insured).

53. Connolly & Beach, 19 Colo. Law. at 636. *See also id.* (discussing prior case law in effect that, in part, caused Congress to adopt section 557). For an excellent discussion of case law that has developed since the farm crisis of the 1980s, see Randy Rogers, *Current Developments in Agricultural Bankruptcies and Insolvencies*, 5 Drake J. Agric. L. 137 (2000).

54. For additional commentary concerning the available procedures under section 557, see Connolly & Beach, 19 Colo. Law. at 636-37. *See also* Dunekacke, Note, 64 Neb. L. Rev. at 474-75.

55. *See* 11 U.S.C. § 546(d) (2000), *amended by* Pub. L. No. 109-8, 119 Stat. 105, 177, 182, 199 (2005) (limitation of avoiding powers of trustee); *See also id.* § 507(a)(5)(A) (priority claims).

56. Connolly & Beach, 19 Colo. Law. at 637.

57. *Id.*

In the bankruptcy context, a strong argument can be made that the penal sum of the surety bond is not property of the bankruptcy estate.[58] Such a result seems the only logical conclusion in that the penal sum of the bond is payable to the obligee (read as a given state's Department of Agriculture) only upon the default of the principal and provided that the obligee has acted in accordance with the terms of the bond.[59] In short, the penal sum of the bond never comes into possession of the debtor and is only due upon the debtor's default.

With respect to state regulatory schemes, the goal is "to protect the grain producer above all. Their prevailing objective is to distribute the assets of the insolvent elevator as quickly as possible."[60]

Nonetheless, counsel must be mindful of the interaction between state court proceedings and bankruptcy court. Findings in the state proceeding can preclude further litigation in bankruptcy court. For instance, a debtor's issuance of warehouse receipts to a creditor representing the purchase of grain and soybeans when the warehouse does not have sufficient inventory to permit the creditor to redeem the receipts may result in a finding that the debt is non-dischargeable under 11 U.S.C. § 523(a)(2)(A).[61] The state court findings will prevent the relitigation of a state court fraud finding arising out of misrepresentation of warehouse receipts because of the doctrines of collateral estoppel and *res judicata*.[62] At the same time, a bankruptcy court will not re-examine the result that arises from the invocation of the Fifth Amendment in a state court proceeding (with resultant adverse inference from the state tribunal).[63]

## II. THE FEDERAL APPROACH

### A. Federal Warehouse Provisions

#### *1. Statutes*

The federal government of the United States has established a statutory scheme for the regulation of warehouses that store agricultural commodities.[64] The Act is generally known as the United States Warehouse Act ("Warehouse Act").[65] The determination of liability

58. Rogers, 5 Drake J. Agric. L. at 141 (citing *In re* Hallmark Builders, Inc., 205 B.R. 974 (Bankr. M.D. Fla. 1996)).

59. *Bi-States Constr. Co.*, 269 N.W.2d at 458 (a bond is construed according to the law of contracts).

60. Love, Note, 8 J. Corp. L. at 115.

61. *In re* White, 315 B.R. 741, 748-49 (Bankr. D. Neb. 2004).

62. *White*, 315 B.R. at 746-48.

63. *Id.* at 747-48.

64. *See* 7 U.S.C. §§ 241–254 (2000).

65. Implementation of the United States Warehouse Act, 67 Fed. Reg. 50778 (Aug. 5, 2002).

under a federal warehouse bond is governed by federal law and not state law.[66] The Farm Service Agency of the United States Department of Agriculture maintains a website concerning the Warehouse Act.[67]

The Warehouse Act is meant to reach agricultural products that are stored for interstate or foreign commerce.[68] As used in the Warehouse Act, "'agricultural product' means an agricultural commodity . . . including a processed product of an agricultural commodity."[69] A "warehouse" is a structure or other storage facility approved by the Secretary in which agricultural products are "stored or handled for the purposes of interstate or foreign commerce."[70]

It is the prerogative of the Secretary of Agriculture to specify which types of agricultural products may be subject to warehouse licensing under the Warehouse Act.[71] Likewise, the Secretary has the authority to "prescribe the duties of a warehouse operator" licensed under the Warehouse Act.[72] This power includes the authority to conduct examinations and audits of persons that engage in the business of storing agricultural products subject to the Warehouse Act, state agencies that regulate the storage of agricultural products, and any commodity exchange.[73]

Congress specifically authorized the Secretary to issue licenses for the operation of warehouses when "the Secretary determines that the warehouse is suitable for the proper storage of the agricultural" products and, in turn, "the warehouse operator agrees, as a condition of the license, to comply with the" Warehouse Act and regulations promulgated thereunder.[74] At the same time, the Secretary has the authority to license other persons engaged in the process of storage, including those that inspect, sample, classify, and weigh such products.[75] Nonetheless, Congress has authorized the Secretary to "cooperate with officers and employees of a State who administer or enforce

66. 7 C.F.R. § 735.1 (2005).

67. FSA: Commodity Operations, http://www.fsa.usda.gov/FSA/ (follow "Commodity Operations" hyperlink; then follow "Warehouse Services" hyperlink; then follow "United States Warehouse Act" hyperlink) (last visited Nov. 21, 2006).

68. Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 229-30 (1946); *see also In re* Farmers Coop. Ass'n, 8 N.W.2d 557, 562 (S.D. 1943); *see also* Edward R. Bacon Grain Co. v. City of Chicago, 59 N.E.2d 689, 693 (Ill. App. Ct. 1945). The system does not preclude the application of local regulations provided the local regulations do not run afoul of the federal requirements.

69. 7 U.S.C. § 241(1) (2000).

70. § 241(10).

71. *Id.* § 242(b).

72. § 242(g).

73. § 242(i)(1)-(3); *see also* § 242(l).

74. § 242(j)(1)-(2).

75. § 242(k)(1)(A)-(D).

State laws relating to warehouses, warehouse operators, weighers, graders, inspectors, samplers, or classifiers" and enter cooperative arrangements with such states.[76]

As a condition of obtaining a license under the Act, the applicant must file with the "Secretary a bond, or provide such other financial assurance as the Secretary determines appropriate, to secure the person's performance of the activities so licensed or approved."[77] With respect to the "surety," the surety or other financial institution must "be subject to service of process in lawsuits or legal actions on the bond or other financial assurance in the State in which the warehouse is located."[78] In addition, the Secretary, upon a determination that a previously approved bond or other financial assurance is insufficient, may require additional bonds or other financial assurance.[79]

Congress has specifically provided for the rights of third parties against the bond.

> Any person injured by the breach of any obligation arising under this Chapter for which a bond or other financial assurance has been obtained . . . may sue with respect to the bond or other financial assurance in a district court of the United States to recover the damages that the person sustained as a result of the breach.[80]

A warehouse operator "may commingle agricultural products in a manner approved by the Secretary."[81] Yet, a warehouse operator "shall be severally liable to each depositor or holder for the care and redelivery of the share of the depositor and holder of the commingled agricultural product to the same extent and under the same circumstances as if the agricultural products had been stored separately."[82] The surety cannot avoid liability when the principal fails to comply with the Warehouse Act.[83]

A warehouse operator, when requested by the depositor, is required to issue a receipt in the form prescribed by the Secretary.[84] A receipt cannot be issued unless the product was "actually stored in the warehouse at the time of the issuance of the receipt."[85] The Secretary has the authority to require the recording of additional information on

76. § 242(m)(1)-(2).
77. *Id.* § 245(a); *see also* 7 C.F.R. § 735.14 (2006).
78. 7 C.F.R. § 735.14(e); *see also* 7 U.S.C. § 245(b).
79. 7 U.S.C. § 245(c).
80. § 245(d).
81. *Id.* § 248(a).
82. § 248(b).
83. Farmers Elevator Mut. Ins. Co. v. Jewett, 394 F.2d 896, 899-900 (10th Cir. 1968).
84. 7 U.S.C. § 250(a) (2000).
85. § 250(b).

the receipt.[86] Unless the Secretary allows otherwise by regulation, additional receipts may not be issued for the same agricultural product when there are presently outstanding and uncanceled warehouse receipts for the product,[87] nor may other duplicate documents be issued under such circumstances.[88]

The warehouse operator has a duty of prompt delivery of the agricultural product upon demand made by "the holder of the receipt" or "the person that deposited the product," if no receipt has been issued.[89] At the same time, there is an obligation that payment is to accompany demand.[90] That is, "[p]rior to delivery of the agricultural product, payment of the accrued charges associated with the storage of the agricultural product, including satisfaction of the warehouseman's lien, shall be made if requested by the warehouse operator."[91] Whether the statute has been met is a jury question.[92]

The Secretary of Agriculture is authorized, following notice and opportunity for hearing, to "suspend or revoke any license . . . for a material violation of, or failure to comply with, any provision" of the Warehouse Act or the applicable regulations.[93] This power includes the authority to suspend a license prior to hearing.[94] Judicial review of final agency action rests only in the district courts of the United States.[95] The Secretary is also empowered to issue civil monetary penalties for noncompliance with the Warehouse Act or the regulations.[96]

The Warehouse Act enumerates which information maintained by the Secretary is public[97] and further prohibits employees of the Department of Agriculture from divulging "confidential business information" obtained during warehouse examinations or obtained during other functions performed as part of their duties.[98] Yet the Warehouse Act does not define the term "confidential business information."

Federal courts have exclusive jurisdiction over any dispute under the Warehouse Act without regard to the citizenship of the parties or

86. § 250(c).
87. § 250(d)(1).
88. § 250(d)(2).
89. *Id.* § 251(a)(1)-(2); *see also* 7 C.F.R. § 735.110 (2006).
90. 7 U.S.C. § 251(b).
91. *Id.*
92. Schilling v. Book, 405 N.E.2d 824, 829 (Ill. App. Ct. 1980).
93. 7 U.S.C. § 252(a) (2000); *see also* 7 C.F.R. § 735.6 (2006).
94. 7 U.S.C. § 252(b).
95. § 252(d)(1).
96. *Id.* § 254; *see also* 7 C.F.R. at § 735.5 (2006).
97. 7 U.S.C. § 253(a)-(b) (2000).
98. § 253(b).

the amount in controversy.[99] Congress specifically articulated that nothing in the Warehouse Act was to preclude the enforceability of any arbitration agreement that would otherwise be enforceable under Title 9 of the United States Code.[100]

*2. Regulations*

The adoption of the new regulations pursuant to the Grain Standards and Warehouse Improvement Act of 2000 ("Act") has not been without controversy.[101] The regulations issued under the new Act do not state the exact language to be contained in the bond.[102] Instead, the regulations now merely require a bond or other financial assurance.[103] Nonetheless, the obligations undertaken by the entity providing financial assurance are quite clear.[104]

On the other hand, the warehouse can provide a certificate that documents "participation in, and coverage by, an indemnity or insurance fund . . . established and maintained by a State . . . which guarantees depositors of the licensed warehouse full indemnification for the breach of any obligation of the licensed warehouse operator under the terms of the Act."[105]

At the same time, the operator must comply with insurance policies for the warehouse and the products stored in the facility.[106] Also, the operator has an obligation to comply with the duty of care imposed by the relevant licensing agreement.[107]

Should the warehouse exceed its storage capacity, the warehouse is to immediately notify the Secretary of the situation.[108] Moreover, the regulations address the procedures which inspectors, samplers, classifiers, and weighers must comply with when acting in such capacities.[109]

---

99. *Id.* § 255(a).
100. § 255(b).
101. Jerry Perkins, *Iowa Targets Elevator Rule; State Officials Say Changing Regulation Puts Farmers at Risk*, DES MOINES REG., Jan. 4, 2003, at D1. In addition to Iowa, letters from other states regarding rescission of state regulation under the new federal regulations were signed by the following states: Colorado, Georgia, Idaho, Illinois, Louisiana, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio and South Dakota. Jerry Perkins, *Regulations Hamper Protection of Elevators*, DES MOINES REG., Sept. 29, 2002, at M1.
102. *Compare* 7 C.F.R. § 736.13 (2002) (stating exact language required for the bond), *with* 7 C.F.R. § 735.14 (2005) (failing to state the exact language required for the bond).
103. 7 C.F.R. § 735.14(a); *Id.* § 735.102(a).
104. § 735.102(a)(1)-(2).
105. § 735.102(a)(4).
106. *Id.* § 735.104.
107. *Id.* § 735.105.
108. *Id.* § 735.106(a).
109. *Id.* §§ 735.200-.202.

In the event the warehouse is not covered by the federal Act, the warehouse must look to section 7-202 of the U.C.C. for its form for the warehouse receipt.[110] The overwhelming number of warehouses that are subject to state rather than federal regulation reflects that state regulated elevators are much more common; yet it remains the choice of the elevator as to whether it will be federally or state licensed.[111]

*3. Practice pointers*

At least one author has described several pragmatic considerations that arise under the federal Act.[112] While the discussion focuses on an earlier edition of the Act and the regulations, the discussion remains instructive, as many of the obligations still exist.

First, under the Act, the warehouse has a duty to inspect, grade, and weigh grain before a receipt may be issued.[113] Next, the warehouse has a mandatory obligation to issue receipts, which must also comply with the applicable federal forms, for all grain stored in the warehouse.[114] Moreover, should the warehouse redeliver the grain to the depositor, the warehouse must both capture the original receipt and cancel it on its face and within the records of the warehouse.[115]

Also, the warehouse must deliver out grain in accordance with the grade of delivered grain.[116] This duty is described as follows: "In other words, if Farmer Jones deposited 10,000 bushels of No. 4 oats, the warehouseman is obligated to deliver out to Farmer Jones 10,000 bushels of No. 4 oats."[117] This is called a "quantity settlement."[118]

110. Love, Note, 8 J. CORP. L. at 120.

111. *Id.* at 121.

112. *See* Bruce Gillman, *A Primer on Handling Surety Claims under the United States Warehouse Act: A Venture into the Unknown*, SURETY CLAIMS INST. (1997). While the article discussed the predecessor statute and regulations, many of the same duties and obligations still exist. However, they have been recodified because of the Grain Standards and Warehouse Improvement Act of 2000, Pub. L. No. 106-472, 114 Stat. 2058, adopted on November 9, 2000. *See also* Implementation of the United States Warehouse Act, 67 Fed. Reg. 50,783-790 (Aug. 5, 2002) (adopting 7 C.F.R. Part 735). The old act expired on August 1, 2001. Grain Standards and Warehouse Improvement Act of 2000, Pub. L. No. 106-472, § 202(c)(2), 114 Stat. 2058.

113. Gillman, *supra* note 112, at 5 (citing former 7 U.S.C. § 256 & 7 C.F.R. § 736.19). *See* 7 C.F.R. § 735.300(b)(3) (2006).

114. Gillman, *supra* note 112, at 5-6 (citing former 7 U.S.C. §§ 259–60 & 7 C.F.R. §§ 736.30, .18, .26). *See* 7 C.F.R. § 735.300(a)(3).

115. Gillman, *supra* note 112, at 6. *See* 7 U.S.C. § 251(c)-(d) (2000). *See also* 7 C.F.R. § 735.300(b)(5), (7), (8), (9).

116. Gillman, *supra* note 112, at 7-8. The scope of the duty under the new Act is unclear, as the language has changed; yet, a duty to measure such qualities still exists. *See, e.g.*, 7 C.F.R. § 735.300(b)(3). *See also* 7 U.S.C. § 249(b) (2000) (duty to redeliver "kind, quality, and grade called for by the receipt . . .").

117. Gillman, *supra* note 112, at 8.

118. *Id.*

The reader will further note the unique obligation this places upon the warehouse.

Conversely, if the warehouse only has No. 3 oats on hand when the farmer wants the No. 4 oats, "the warehouseman can offer Farmer Jones the better oats, but if this is acceptable to Farmer Jones, he is only entitled to a lesser number of bushels sufficient to give him the dollar equivalent of ten thousand bushels of No. 4 oats."[119] This is defined as a "quality settlement."[120]

It is worth noting, however, in order for the surety to be liable, "the warehouseman must have acted in his capacity as a warehouseman–not [in] his capacity as a grain dealer."[121] In short, the "Federal Warehouse Bond does not cover the warehouseman's transactions as a licensed grain dealer under state law."[122] This result should still follow despite the adoption of the new Act and regulations; the language still exists that the bond or financial assurance only secures the person's compliance with the Act.[123]

From a practical stand point, once the surety or counsel for the surety learns of a claim, the surety should act promptly. As described by one commentator, the first task is to "get on the phone and call the warehouseman's bank and the state and federal regulators as soon as possible . . . ."[124] From a practical standpoint, given the proximity to state regulators, this should probably be the first call made.[125]

Then, the surety or its representative should examine all available records as quickly as possible.[126] Counsel should ask for "copies of all inspection reports and all other pertinent documents, including all notes from any statements they may have taken from the warehouseman's employees and from the loan officers at the warehouseman's bank."[127] In that regard, counsel will want to pay particular attention to the "daily position records, financial statements, collateral register and all storage contracts."[128] Thereafter, counsel should examine the regulators' own reports to the extent they are available.[129] Once counsel has the factual backdrop, she can easily deal with the documents submitted in support of the claim.[130]

---

119. *Id.*
120. *Id.*
121. *Id.* at 20.
122. *Id.* at 20 (citing *In re* Julien Co., 44 F.3d 426, 431 (6th Cir. 1995)).
123. 7 C.F.R. § 735.14(a) (2006).
124. Gillman, *supra* note 112, at 20.
125. *Id.* at 21.
126. *Id.* at 20.
127. *Id.* at 21.
128. *Id.*
129. *Id.*
130. *Id.*

Particularly when dealing with the claims submitted by a bank, "it is imperative for the surety's attorney to examine all bank records regarding loans to the warehouseman . . . ."[131] Then counsel will want to interview the loan officer.[132] Once those interviews have been completed, or in the case of claims submitted by parties other than the bank, counsel will then want to interview the "claimant, the warehouseman, his manager and inspector, his accountant, his loan officer, [and] the state and federal inspectors . . . ."[133]

## B. Packers and Stockyards Act

### *1. Statutes*

#### (a) General provisions

The practitioner should immediately note that the Warehouse Act does not cover livestock by its own definition.[134] Instead, Congress has established a separate statutory scheme for the regulation of the animal livestock industry.[135] Under the Packers and Stockyards Act, Congress has decreed that livestock acquired by cash sales and "all inventories of, or receivables or proceeds from meat, meat food products, or livestock products derived therefrom, shall be held by such packer *in trust* for the benefit of all unpaid cash sellers of such livestock until full payment has been received by such unpaid sellers . . . ."[136] Any packer whose average annual purchases are not in excess of $500,000 is exempt from the section.[137]

Under the Packers and Stockyards Act, the unpaid seller loses the benefit of the trust unless the seller, when unpaid, sends written notice to the packer and files the notice with the Secretary of Agricultural or, in the event of a dishonored instrument, within fifteen days of receiving notice of the dishonored payment.[138] Of course, the sales component is not the only trigger for the Act; the actual sale must be deemed "in commerce."[139]

---

131. *Id.* at 21-22.

132. *Id.* at 22.

133. *Id.*

134. 7 U.S.C. § 241 (2000).

135. *Compare* 7 U.S.C. § 241 (defining various terms such as warehouse and warehouse operator), *with* 7 U.S.C. § 182 (2000 & Supp. IV 2004) (defining various terms under the Packers and Stockyards Act including "meat food products," "livestock," "livestock products," "poultry," "poultry product," and "swine contractor").

136. 7 U.S.C. § 196(b) (2000) (emphasis added).

137. *Id.*

138. *Id.*

139. *Id.* § 183.

A similar statutory scheme exists for poultry.[140] Average annual sales in excess of $100,000 trigger the poultry statute.[141] A similar notice requirement exists for a notice of nonpayment to the Secretary of Agriculture and the live poultry dealer.[142]

The Secretary may require bonds from every market agency, every packer, except those whose average annual purchases are not in excess of $500,000, and dealers under such rules and regulations as the Secretary may issue.[143] In addition, the Secretary has the power to suspend registration if the bond requirement is not met or issue cease and desist orders if the entity is insolvent.[144]

A "market agency" is defined as "any person engaged in the business of (1) buying or selling in commerce livestock on a commission basis or (2) furnishing stock yard services . . . ."[145] In contrast, a "dealer" is "any person, not a market agency, engaged in the business of buying or selling in commerce livestock, either on his own account or as the employee or agent of the vendor or purchaser."[146]

Beyond the duty to pay for livestock acquired, Congress has imposed upon the stockyard owner the obligation to regulate the stockyard "in a just, reasonable, and nondiscriminatory manner, to prescribe rules and regulations and to require those persons engaging in . . . the purchase, sale, or solicitation of livestock . . . to conduct their operations in a manner which will foster, preserve, or insure an efficient, competitive public market."[147] If one fails to comply with this Chapter

> relating to the purchase, sale, or handling of livestock, the purchase or sale of poultry, or relating to any poultry growing arrangement or swine production contract, he shall be liable to the person or persons injured thereby for the full amount of damages sustained in consequence of such violation.[148]

The liability may be enforced in either an action brought to the Secretary or by suit in the United States District Court of competent jurisdiction.[149] The provisions of the Act are cumulative to the existing common law and statutory remedies and are not to be construed to "in any way abridge or alter the remedies now existing . . . ."[150]

140. *Id.* § 197(b).
141. *Id.*
142. § 197(d).
143. *Id.* § 204.
144. *Id.*
145. *Id.* § 201(c).
146. § 201(d).
147. *Id.* § 208(b).
148. *Id.* § 209(a).
149. § 209(b).
150. *Id.*

The Secretary has broad powers to hear complaints under the Act.[151] A complainant need not have suffered direct damage to initiate a complaint before the Secretary.[152] Persons who have prevailed before the Secretary with respect to a complaint against a defendant, if unpaid, may bring suit in the district court. The Secretary's order shall be prima facie evidence of the facts, and, if the petitioner prevails, the petitioner may recover reasonable attorney fees.[153]

The Secretary has the power to prescribe rates and practices to prevent discrimination between intrastate commerce and interstate commerce.[154] The Secretary also has the power to prevent unfair, discriminatory, or deceptive practices.[155] Pursuant to such authority, the Secretary may assess civil penalties of not more than $10,000 per violation.[156] Furthermore, failure to obey orders of the Secretary under 7 U.S.C. §§ 211, 212, or 213 shall result in a fine of $500 per offense per day.[157] Likewise, the Secretary, the Attorney General, or an injured party may apply for an injunction to enforce the Secretary's orders.[158]

Congress, in adopting the Packers and Stockyards Act, sought to foreclose any potential *respondeat superior* argument. Congress commanded that

> [w]hen construing and enforcing the . . . Chapter, the act, omission, or failure of any agent . . . acting for or employed by any packer . . . within the scope of his employment or office, shall in every case also be deemed the act, omission, or failure of such packer . . . as well as that of such agent . . . .[159]

The Secretary of Agriculture is specifically authorized to request temporary injunctions or restraining orders when the Secretary has reason to suspect that any person subject to the Act has "failed to pay . . . or has failed to remit to the person entitled thereto the net proceeds from the sale" of certain enumerated products and commodities.[160] Likewise, the Secretary has the authority to request temporary injunctions or restraining orders when a person has operated while insolvent.[161] The Secretary may also act when the person does

151. *Id.* § 210(a).
152. § 210(d).
153. § 210(f).
154. *Id.* § 212.
155. *Id.* § 213.
156. § 213(b).
157. *Id.* § 215(a).
158. *Id.* § 216.
159. *Id.* § 223.
160. *Id.* § 228a(a).
161. § 228a(b).

not have a bond.[162] Of course, the purpose of the statute is to address the responsibility of the packer to pay for the purchase of livestock. A purchaser of livestock has a statutory duty to promptly pay for the purchase of livestock.[163] "Each packer, market agency, or dealer purchasing livestock shall, before the close of the next business day following the purchase of livestock and transfer of possession thereof, deliver to the seller . . . the full amount of the purchase price . . . ."[164] Nonetheless, the parties may agree, subject to the conditions prescribed by the Secretary, to waive such requirements.[165] Delay in payment and attempts to delay payment are deemed an unfair practice under the Act.[166]

Federal law specifically provides that no state or territory of the United States may enforce any regulation "with respect to bonding of packers or prompt payment by packers for livestock . . . ."[167] However, the statute allows that the state may enforce requirements that do not conflict with the Act or its regulations.[168]

(b) Live poultry

Live poultry is subject to a similar requirement concerning prompt payment.

> Each live poultry dealer obtaining live poultry . . . in a cash sale shall, before the close of the next business day following the purchase of poultry, and each live poultry dealer obtaining live poultry . . . shall, before the close of the fifteenth day following the week in which the poultry is slaughtered, deliver . . . the full amount due to such cash seller or poultry grower on account of such poultry.[169]

Delays and attempts to delay the payment of funds are deemed an unfair practice under the Act.[170] Under the Act, "a cash sale means a sale in which the seller does not expressly extend credit to the buyer."[171]

Similarly, the Secretary of Agriculture is authorized, whenever the Secretary believes a violation of sections 197 or 228b-1 has occurred or is ongoing, to conduct a hearing, issue cease and desist or-

162. § 228a(c).
163. *Id.* § 228b.
164. § 228b(a).
165. § 228b(b).
166. § 228b(c).
167. *Id.* § 228c.
168. *Id.*
169. *Id.* § 228b-1(a).
170. § 228b-1(b).
171. § 228b-1(c).

ders, and impose civil penalties.[172] Judicial review of the order lies in the United States Court of Appeals for the circuit in which the live poultry dealer has its principle place of business.[173] The Court of Appeal's jurisdiction is exclusive.[174] Violations of a final order are separate offenses, for each day on which the violation occurs, with additional fines.[175]

*2. Regulations*

The Department of Agriculture set out the Packers and Stockyards Act regulations at 9 C.F.R. Part 201.

(a) General bonding provisions

The surety on these bonds must be a surety company approved by the Treasury Department of the United States "for bonds executed to the United States; and which has not failed or refused to satisfy its legal obligations under bonds issued under said regulations."[176] Any entity required to maintain a surety bond may execute either a bond or a bond equivalent.[177] The bond equivalent may be a trust fund agreement in fully negotiable instruments of the United States, a federally insured deposit, or an account which is readily convertible to currency.[178] The equivalent may also be a trust agreement under an irrevocable standby letter of credit.[179] Further, the bond and trust fund agreements must be filed on forms approved by the Department.[180]

(b) Market agency, dealer, and packer bonds

The regulations also require specific bonds for market agencies, packers, and dealers. "Every market agency, packer, and dealer . . . except packer buyers registered as dealers to purchase livestock for slaughter only, shall execute and maintain a reasonable bond on forms approved by the Administrator . . . ."[181] The bond must contain the "condition clauses."[182] Moreover, the bond must be "applicable to the activity or activities in which the person or persons propose to engage, to secure the performance of obligations incurred by such mar-

172. *Id.* § 228b-2(a)-(b). This section concerns poultry.
173. *Id.* § 228b-3(a).
174. § 228b-3(h).
175. *Id.* § 228b-4.
176. 9 C.F.R. § 201.27(a) (2006).
177. § 201.27(b).
178. § 201.27(b)(1).
179. § 201.27(b)(2).
180. § 201.27(d).
181. *Id.* § 201.29(a).
182. *Id. See infra* notes 192-98 and accompanying text.

ket agency, packer or dealer."[183] Operations shall not be conducted unless there is a bond on file and in effect.[184]

However, a person who works both as a market agency and as a dealer may be covered by one bond.[185] Yet, a "person operating as a market agency selling on a commission basis and as a market agency buying on a commission basis or as a dealer shall file and maintain separate bonds . . . ."[186] "Each market agency and dealer whose buying operations are cleared by another market agency shall be named as clearee in the bond filed and maintained by the market agency registered to provide clearing services."[187]

In addition, a packer that purchases livestock directly or through "an affiliate or an employee or a wholly-owned subsidiary . . . shall file and maintain a reasonable bond."[188] A packer that maintains a wholly-owned subsidiary or an affiliate to buy livestock shall separately register as a packer buyer apart from the parent packing firm, but "the required bond shall be maintained by the parent packer firm."[189]

Bond coverage turns on the status of the entity, which may include a market agency selling, a market agency buying, a market agency acting as a clearing agency, or a packer.[190] The required amount of bond coverage is determined by a regulatory formula.[191]

The regulations define the condition clauses of the bond.[192] Condition number one requires that "[w]hen the principal sells livestock for the accounts of others," the principal shall pay the amount due to the person less any lawful charges.[193] Condition number two applies "[w]hen the principal buys livestock for his own account or for the accounts of others."[194] Under this condition, the principal must pay the purchase price for all livestock and keep such funds safe and properly disburse funds which come into the principal's hands.[195] Condition clause number three governs when the principal "clears other registrants buying livestock" and is responsible for the obligations of other registrants.[196]

183. 9 C.F.R. § 201.29(a).
184. *Id.*
185. § 201.29(b).
186. *Id.*
187. § 201.29(c).
188. § 201.29(d).
189. *Id.*
190. *Id.* § 201.30.
191. *Id.*
192. *Id.* § 201.31.
193. § 201.31(a).
194. § 201.31(b).
195. *Id.*
196. § 201.31(c).

Condition clause number four governs when the principal buys livestock on his own behalf while acting as a packer.[197] Under that scenario, the "principal shall pay when due to the person or persons entitled thereto the purchase price of all livestock purchased by said principal for his own account."[198]

Also, each bond or bond equivalent must contain a provision that any person damaged by the "failure of the principal to comply with any condition clause" may bring suit to recover, even if the party bringing the suit is "not a party named in the bond or bond equivalent."[199]

Any claim for recovery on the bond or the equivalent must be filed in writing with the surety, trustee, or the Administrator.[200] Upon receipt of a claim, whichever party receives the claim is to notify the others.[201] The regulations provide that the surety or the trustee shall not be liable on any claim if it is not filed in writing within sixty days from the date of the transaction at issue and a suit thereon is "commenced less than 120 days or more than 547 days from the date" on which the transaction was based.[202] The bond or bond equivalents may not be used to pay for the legal expenses, salaries or fees "for legal representation of the surety or the principal."[203] The regulations specify the means by which market agency, dealer, and packer bonds may be terminated.[204]

(c) Proceeds of sale

The regulations also define the means and manner of calculation of payments to consignors and shippers.[205] The regulations sharply prohibit the payment of net proceeds to persons other than the consignors and shippers unless certain conditions are met.[206]

The regulations further define payment for livestock as being "trust funds" and place the concomitant obligation upon the regulated entities to establish custodial accounts.[207] "Each payment that a livestock buyer makes to a market agency selling on commission is a trust

197. § 201.31(d).
198. *Id.*
199. *Id.* § 201.33(a).
200. § 201.33(b).
201. *Id.*
202. § 201.33(d).
203. § 201.33(e).
204. *Id.* § 201.34.
205. *Id.* § 201.39.
206. § 201.39(a).
207. *Id.* § 201.42.

fund. Funds deposited in custodial accounts are also trust funds."[208] The regulations specify the requirements for custodial accounts.[209]

At the same time, the regulations define the means and manner by which payment and accounting for livestock and live poultry must be made.[210] Similar regulations exist for market agencies.[211]

(d) General practices

The requirements for scale tickets and the weighing of feed are established in the agency's rules.[212] In addition, the regulations establish standards for scales, accurate weights, and the operation of weighing livestock.[213] Finally, prohibitions regarding a number of trade practices exist.[214]

The regulations provide for the inspection of brands.[215] When an association or agency is granted the authority to inspect brands, it must register as a market agency, but it is exempt from the bonding requirements.[216]

(e) Access by the Secretary

The regulations require that each stockyard owner, market agency, dealer, packer, and live poultry dealer shall, "upon proper request," allow the Secretary or the Secretary's designee to examine records pertaining to the business that is subject to the Act.[217] However, no employee or agent of the United States shall make facts known that were obtained as a result of the inspection without the consent of the regulated entity except to other employees or agents of the United States or by a court of competent jurisdiction.[218]

(f) Records regarding live poultry

Specific provisions address the record keeping obligations of live poultry growers and sellers.[219] These include instructions for the weighing of live poultry.[220]

208. § 201.42(a).
209. § 201.42(b)-(g).
210. *Id.* § 201.43.
211. *Id.* §§ 201.44-.45.
212. *Id.* § 201.49.
213. *Id.* §§ 201.71-.82.
214. *Id.* §§ 201.53-.61, .67-.70.
215. *Id.* § 201.86.
216. § 201.86(b).
217. *Id.* §§ 201.94-.95.
218. *Id.* § 201.96.
219. *Id.* § 201.100.
220. *Id.* § 201.108-1.

(g) Credit terms

The regulations set out the exact requirements for the sale of livestock to a packer on credit, including the requirements for a written acknowledgement.[221] This can be excepted based on the lack of sales volume.[222]

(h) Rules of practice

Part 202 of Title 9 of the Code of Federal Regulations governs the rules of practice under the Act. The rules address rate proceedings and reparation proceedings.

(i) General policy statements

The Secretary has specifically set out a document retention policy for packers, live poultry, stockyard owners, market agencies and dealers under the Packers and Stockyards Act.[223] The outside length of time for retention of records appears to be two years unless the party receives notice in writing from the Administrator that specified records shall be retained for a longer period of time.[224]

Another general policy statement addresses insolvency. The test for insolvency under the Packers and Stockyards Act is "whether a person's current liabilities exceed his current assets."[225] The general policy statement further defines the term and its discrete subparts.[226]

Finally, the general policy statement addresses the mailing of checks for livestock purchases for slaughter.[227] The statement is designed to provide the terms for notification of the purchaser when an individual is not present at the time of the sale and would instead prefer payment by the mailing of a check.[228]

## III. THE JURISDICTIONS

The National Association of State Departments of Agriculture has prepared tables comparing various licensing, bonding and audit requirements under grain and commodity related programs for a number of jurisdictions.[229] The document can be of assistance when

221. *Id.* § 201.200.
222. *Id.*
223. *Id.* § 203.4.
224. § 203.4(a)-(c).
225. *Id.* § 203.10(a).
226. § 203.10(b)-(e).
227. *Id.* § 203.16.
228. *Id.*
229. National Association of State Departments of Agriculture, Survey of States: Grain and Commodity Related Laws and Programs, http://www.nasda.org/nasda/nasda/legislative_regulatory/warehousetaskforce/Chart.pdf (last visited Jun. 12, 2005).

comparing various state programs (including those not analyzed in this Article) on specific issues.

## A. ILLINOIS

### *1. Statutes*

The Illinois Department of Agriculture has broad control of "surety" and trust funds. Specifically, Illinois Compiled Statute section 205/205-410(b) provides:

> The Department has the power to control surety bonds and trust funds and to establish trust accounts and bank accounts in adequately protected financial institutions, to hold monies received by the Director of Agriculture when acting as trustee, to protect the assets of licensees for the benefit of claimants, to accept security from licensees to collateralize licensees' financial deficiencies (and that security shall be secondary to surety bonds in the collection process), to accept collateral and security in lieu of or in addition to a commercial surety bond, and to collect and disburse the proceeds of those bonds and trust funds when acting as trustee on behalf of claimants without responsibility for the management and operation of discontinued or insolvent businesses, those funds, or additions to those funds in which the State of Illinois has no right, title, or interest.[230]

Moreover, the Department is statutorily authorized to hold hearings, to identify and verify claimants and claim amounts, and to collect the proceeds of surety bonds and other moneys.[231] A "claimant" is any person "who is unable to secure satisfaction of financial obligations due from a person subject to regulation by the Department, in accordance with the applicable statute or regulation and the time limits provided for in that statute or regulation, if any . . . ."[232] The Illinois statute is not merely limited to "grain" but instead includes the following:

> the Illinois Egg and Egg Products Act;
> the Personal Property Storage Act;
> the Livestock Auction Market Law;
> the Illinois Pesticide Act;
> the Weights and Measures Act;
> the Illinois Livestock Dealer Licensing Act;
> the Slaughter Livestock Buyers Act; and
> the Illinois Feeder Swine Dealer Licensing Act.[233]

230. 20 ILL. COMP. STAT. ANN. 205/205-410(b) (West 2001).
231. 205/205-410(c).
232. 205/205-410(a).
233. *Id.*

Likewise, the Act specifically enumerates what constitutes a failure.

> "Failure" under the Acts cited in the definition of "claimant" contained in this Section means any of the following:
> (1) An inability to financially satisfy claimants in accordance with the applicable statute or regulation and the time limits provided for in that statute or regulation, if any.
> (2) A public declaration of insolvency.
> (3) A revocation of a license and the leaving of an outstanding indebtedness to claimants.
> (4) A failure to pay claimants in the ordinary course of business and when a bona fide dispute does not exist between the licensee and the customer.
> (5) A failure to apply for renewal of a license.
> (6) A denial of a request for renewal of a license.
> (7) A voluntary surrendering of a license.[234]

The Department's trust account is what drives the system. It is from the trust account that the Department takes funds to disburse to claimants.[235] As discussed, *infra*, surety bonds are no longer a critical part of the Illinois process.[236] Instead, Illinois places an assessment on licensees, applicants, first sellers of grain to grain dealers, and lenders.[237] Yet, the Illinois process is instructive.

With the specific reference to grain, Illinois has created a Grain Indemnity Trust Account under the auspices of the Director of the Illinois Department of Agriculture.[238] "[A] person may not engage in the business of buying of grain from producers, or storing of grain for compensation, in the State of Illinois without a license issued by the Department" or the federal government.[239]

With respect to specific storage issues, Illinois defines classes of warehousemen.[240] A "'Class I warehouseman' means a warehouseman who is authorized to issue negotiable and non-negotiable warehouse receipts."[241] A "'Class II warehouseman' means a warehouseman who is authorized to issue only non-negotiable warehouse receipts."[242] Grain dealers, on the other hand, buy grain from producers.[243] Licensing is governed by Article 5 of the Grain Code.[244]

234. *Id.*
235. 205/205-410(d).
236. *See infra* notes 267-72 and accompanying text.
237. *See* 240 ILL. COMP. STAT. ANN. 40/5-30 (West 2005).
238. *Id.* 40/1-10.
239. *Id.* 40/5-5(a).
240. 40/1-10.
241. *Id.*
242. *Id.*
243. *Id.*
244. *See id.* §§ 40/5-5 to -35.

For purposes of the statute, a "claimant" includes parties that have written evidence of a storage obligation or that possess evidence of a sale at an Illinois location and remain unpaid.[245] Entities that have loaned money to a warehouse that was to receive a warehouse receipt as collateral fall within the definition of claimant if the conditions of the statute are met.[246]

"When grain is delivered to a warehouseman at a location where grain is also purchased, the licensee shall give written evidence of . . . " the delivery of grain that shall indicate "whether the grain is delivered for storage or for sale."[247] In the absence of acceptable evidence of a sale, the grain will be considered in storage.[248]

Illinois has, by statute, set out the requirements for the warehouse receipt.[249] In turn, the warehouse may require a bond of the depositor in the event of a lost or destroyed warehouse receipt.[250] Also, the Illinois statute requires that a warehouse receipt issued for collateral purposes by a warehouse first be issued by the warehouse to itself.[251]

Upon a licensee's failure, the Department will process the claims.[252] The Illinois statute contemplates published notice along with notice by mail to each potential claimant.[253] The notice must contain the statutorily required information.[254] Claims must be filed by the "claim date," which is ninety days after the "failure of the licensee" or "[seven] days from the date notice was mailed to the claimant if the date notice was mailed to that claimant is on or before the claim date."[255] Also, the statute requires that the first date of publication be within thirty days of the date of the failure.[256] Likewise, the mailed notice must be sent within sixty days of the failure.[257]

In theory, claimants are entitled to 100% reimbursement unless insufficient assets exist, in which case the claim is paid on a pro rata

245. 40/1-10; *see also id.* 40/30-5.
246. 40/1-10.
247. *Id.* 40/10-25(a).
248. *Id.*
249. 40/10-25(d)(1)-(5).
250. 40/10-25(k).
251. 40/10-25(l).
252. *Id.* 40/25-5. *See id.* 40/1-10 (defining "failure"); *see also* 20 ILL. COMP. STAT. ANN. 205/205-410(a) (West 2001) (defining "failure" in a similar fashion, except that failure under the Warehouses Act, Chapter 240, does not include the test of financial inability to "satisfy claimants in accordance with the applicable statute or regulation . . . .").
253. 240 ILL. COMP. STAT. ANN. 40/25-5(a).
254. 40/25-5(a)(1)-(4).
255. 40/25-5(a)(4)(A)-(B).
256. 40/25-5(b)(1).
257. 40/25-5(b)(3).

basis "out of the net proceeds of the liquidation of grain assets . . ." subject to a statutory cap.[258] However, if delivery and pricing were not completed 160 days before the failure, the claimant is entitled to 85% of the valid claim up to a statutory maximum.[259] In the case of a price-later contract, the latter date of execution of the contract or the date of delivery will govern, and this must not have occurred more than 365 days "before the date of the failure" in order to receive compensation.[260] Producers who sold on a price-later contract that was not final by the time of the failure are to be paid 85% of the claim, up to statutory maximum, if either the delivery or execution of the agreement occurred no more than 365 days prior to the failure.[261]

On the other hand, the statute bars certain types of claims. Claims filed by producers who completed pricing of their grain in excess of 160 days before the date of the failure are barred.[262] Secondly, the statute bars claims filed by producers for grain sold on price-later contracts if the latter date of execution of the contract or the date of the delivery of the grain took place more than 365 days prior to the date of the failure.[263]

Furthermore, claims are allowed to be filed under the Illinois statute by secured parties of the producer and are deemed to be claims filed by a producer under the statute.[264] The statute sets a maximum payout of one million dollars per claimant.[265]

*2. Case law*

As discussed, *infra*, the statutory scheme has changed with respect to the use of a surety in Illinois. This statute is intended to only reimburse at the eighty-five percent level claimants whose claims are not supported by warehouse receipts or who are grain merchandisers.[266] In essence, the new Illinois Act dispenses with the requirement of surety bonds or certificates of deposit because under that system claimants were not being paid late; they were not being paid at all.[267] Thus, there is no reason to interpret the Act in the manner

258. *Id.* 40/25-10(a).
259. 40/25-10(d).
260. 40/25-10(e).
261. *Id.*
262. 40/25-10(g)(1).
263. 40/25-10(g)(2).
264. 40/25-10(i).
265. 40/25-10(j).
266. Adams Farm v. Doyle, 727 N.E.2d 638, 643 (Ill. App. Ct. 2000).
267. *Adams Farm*, 727 N.E.2d at 642 (discussing the argument advanced by the Director of Agriculture that under prior law that required dealers to keep surety bonds or certificates of deposit, merchandising claimants received only 13% of their loss, while warehouse claimants recovered just 19% of the loss).

that would lift merchandising claimants' recovery above eighty-five percent.[268] Those claims that are subject to the eighty-five percent cap include price-later contracts wherein the title passes to the dealer, but the price is not fixed until some later time.[269] Indeed, the Department of Agriculture argued that the speculation inherent in price-later contracts had "been the primary reason for elevator failures."[270] Accordingly, the Illinois "legislature rationally chose to limit coverage under the Act on these price-later contracts."[271] "With the adoption of the Act in 1983, surety bonds were no longer used for the protection of grain producers, who instead were afforded protection from the Insurance Fund, maintained by assessments on grain dealers."[272]

## B. INDIANA

### *1. Statutes*

Indiana's Code requires that once the Indiana Grain Buyers and Warehouse Licensing Agency has determined that a grain buyer or warehouse has defaulted on payments or otherwise failed, the Board of the Indiana Grain Indemnity Corporation is to determine the value of the claims, authorize payment of money from the fund to compensate claimants, collect money through subrogated claims against any surety bonds, and borrow money in the event there is insufficient money to cover valid claims.[273] In the event that the fund is insufficient to pay all valid claims, the Board is authorized to grant priority of payment of all of the claims in the order the claims were approved "as valid" by the Board.[274]

In order to obtain a grain bank license or a warehouse license, an individual shall either post a bond, letter of credit, or cash deposit.[275] The statute also sets out a requirement for minimum positive net worth for grain banks, warehouses, grain buyers, and buyer-warehouses.[276] Indiana segregates between grain bank license/warehouse licenses, grain buyers' licenses, and buyer warehouse licenses.[277] A person applying for two or more licenses on the basis of two or more facilities in Indiana "may give a single bond, letter of credit, or cash

268. *Id.* at 643.
269. *Id.*
270. *Id.* (citation omitted).
271. *Id.*
272. *Id.* at 644.
273. IND. CODE § 26-4-6-8(1)-(4) (West 1999); *see id.* § 26-4-1-3 (defining "Agency"); *see also id.* § 26-4-1-4 (defining "Board").
274. § 26-4-6-8(6) (emphasis added).
275. *Id.* § 26-3-7-10(a).
276. *Id.* § 26-3-7-16(a)(1)-(5).
277. § 26-3-7-10(a)(1)-(3).

deposit to satisfy the requirements of this chapter . . . ."[278] Further, an applicant for a license must demonstrate proof of insurance on all grain that might be in the licensee's facilities for "full market value against loss by fire, internal explosion, lightning, and windstorm."[279]

Any deficiency in the minimum positive net worth may be corrected "by adding to the amount of the bond, letter of credit, or cash deposit."[280] Similarly, the Director is authorized to accept, instead of a letter of credit, single cash deposit, or bond, an amount that consists of a combination of any of the three.[281] The Director has the authority to request an additional bond or cash.[282]

The licensee cannot cancel an approved bond until the Director has provided prior written approval for cancellation and has received a substituted security.[283] Likewise, the surety may cancel a bond only after ninety days from the day the surety mailed the notice of the intent to cancel by either certified or registered mail to the Director.[284] A licensee may be subject to automatic suspension for failure to "file a new bond, letter of credit, or cash deposit within the ninety day period."[285]

Also, a licensee may be subject to revocation in the event that the bond or cash deposit is not maintained.[286] "The suspension shall continue until the licensee complies with the bonding and insurance requirements."[287]

Indiana has specifically defined by statute how liens against the assets of the licensee arise.[288] The statute divides the lien holders into two classes: lenders and claimants.[289] The lien attaches, in the case of a claimant, when the grain is delivered for sale, storage, or bailment.[290] The lien will also attach at the beginning of the storage obligation.[291] In the case of a lender, the lien attaches when the funds are advanced by a lender.[292] A lien granted by this section terminates upon the licensee discharging the lien.[293]

278. § 26-3-7-10(f).
279. *Id.* § 26-3-7-12(a).
280. § 26-3-7-10(i)-(j).
281. § 26-3-7-10(l).
282. § 26-3-7-10(k), (m).
283. *Id.* § 26-3-7-14(a).
284. *Id.*
285. § 26-3-7-14(b)(1).
286. § 26-3-7-14(b)(3).
287. § 26-3-7-14(b).
288. *Id.* § 26-3-7-16.8.
289. § 26-3-7-16.8(a)(1)-(4).
290. § 26-3-7-16.8(b)(1).
291. § 26-3-7-16.8(b)(2).
292. § 26-3-7-16.8(b)(3).
293. § 26-3-7-16.8(c).

Upon the failure of a licensee, the lien granted by the section is assigned to the agency.[294] Consequently, the Director has the exclusive authority to "allocate and prorate the proceeds of the grain assets."[295] However, the Director can assign the lien.[296] The statute has its own priority scheme.[297] Suffice it to say that a lender or a claimant with a receipt for grain owned or stored by the licensee has priority over other claimants.[298]

*2. Case law*

Under Indiana case law, the doctrine of laches is available as a defense when a party fails to give timely notice of its claim.[299]

C. Iowa

*1. Statutes*

(a) Grain dealers

Iowa regulates "grain dealers," which as part of the definition must meet the threshold of purchases of more than one thousand bushels or more of grain from a producer in a calendar month.[300] There are a number of exceptions to the definition.[301]

Under Iowa law, a grain dealer must have a license.[302] Iowa also requires that in order to obtain a grain dealer license, a person post a surety bond, which varies based upon the type of license.[303] Under certain circumstances, the condition can be met by maintaining current assets equal to 100% of current liabilities.[304] An irrevocable letter of credit may be used in lieu of a bond.[305]

Upon termination, revocation, or cancellation of the grain dealer's license, any claims against the grain dealer must be made in writing and filed with the grain dealer and the issuer of the bond or irrevocable letter of credit and the Department of Agriculture and Land Stewardship within 120 days after the termination, revocation, or cancellation.[306] Failure to timely make the claim constitutes waiver

294. § 26-3-7-16.8(d).
295. § 26-3-7-16.8(e).
296. § 26-3-7-16.8(g).
297. § 26-3-7-16.8(f).
298. § 26-3-7-16.8(f)(1)-(3).
299. Stiefel v. Farmers' State Bank, 168 N.E. 30, 33 (Ind. Ct. App. 1929).
300. Iowa Code Ann. § 203.12 (West 2000); Iowa Code Ann. § 203.1(10) (West Supp. 2006).
301. *See* § 203.1(10)(a)-(j).
302. *Id.* § 203.3.
303. § 203.3(4)-(5), (7).
304. § 203.3(4)(c), (5)(c).
305. § 203.3(4)-(5), (7), (8). *See also* § 203.1(1).
306. *Id.* § 203.12.

of the claim against the issuer, grain depositors, and the Sellers Indemnity Fund, but based upon the plain language of the statute, failure to make a timely claim does not relieve the grain dealer from liability to the claimant.[307]

The Iowa statute expressly provides for the creation and perfection of liens on grain dealer assets when the seller has not received full payment for the grain.[308] The lien arises when the "warehouse receipts or other written evidence of ownership" are surrendered and terminates "when the liability of the grain dealer to the seller has been discharged."[309]

Upon application of the Department, the district court may appoint the Department as the receiver if the grain dealer's license has been revoked or suspended or if the grain dealer has engaged in or is presently engaging in business without obtaining a license.[310] The Department may make plans for disposition of the grain dealer assets, continue the operation of the business on a temporary basis, or take any other course of action that would serve the interest of interested sellers.[311] Such receivership actions are not deemed contested cases under the Iowa Administrative Procedures Act.[312] The statute requires that the issuer of either the bond or the letter of credit be joined as a party in the receivership proceeding.[313]

If the district court approves the sale of the grain, the Department shall appoint a merchandiser.[314] The sale of grain "shall proceed in the same manner" as grain liquidated under a receivership for an agricultural warehouse.[315] The Department is entitled to reimbursement from the grain dealer's assets "for costs directly attributable to the receivership."[316] If the plan involves distribution of cash proceeds, the district court must approve the distribution.[317]

Likewise, under Iowa law, a grain dealer may not purchase grain on a credit-sale contract basis except as allowed by the Iowa Code.[318] The Iowa Code sets out the required contents of a credit-sale contract.[319]

---

307. *Id.*
308. *Id.* § 203.12A.
309. § 203.12A(3).
310. *Id.* § 203.12B(2)(a).
311. § 203.12B(2)(b).
312. § 203.12B(5).
313. § 203.12B(6).
314. § 203.12B(7).
315. § 203.12B(8) (citing IOWA CODE § 203C.4).
316. *Id.*
317. *Id.*
318. *Id.* § 203.15(1).
319. § 203.15(2)(a)-(f).

Title to all grains sold on a credit-sale basis "is in the purchasing dealer as of the time the contract is executed," unless the parties agree otherwise.[320] In the event of a "revocation, termination, or cancellation of the grain dealer's license, the payment date for all credit-sale contracts" is advanced to a date not later than thirty days after the effective date of the revocation, termination, or cancellation.[321] Unpriced grain shall be priced as of the effective date of the revocation, termination, or cancellation.[322] In the event of the sale of the grain dealer's business to another licensed dealer, credit-sale contracts may be assigned to the new purchaser.[323]

According to Iowa law, "a grain dealer shall not purchase grain on credit-sale contract during any time period in which the grain dealer fails to maintain fifty cents of net worth for each outstanding bushel of grain purchased under credit."[324] Under those circumstances, the dealer "may maintain a deficiency bond or an irrevocable letter of credit in the amount of two thousand dollars for each one thousand dollars or fraction thereof of deficiency in net worth."[325] A dealer that holds a federal or state warehouse license and "does not have a sufficient quantity or quality of grain to satisfy the warehouse operator's obligations" shall not buy grain through credit-sale contracts to correct the shortfall.[326]

Moreover, in order to engage in credit-sale contracts, the grain dealer must meet at least one additional condition: submission of the last financial statement submitted to the Department "accompanied by an unqualified opinion based upon an audit performed by a certified public accountant" or, in the alternative, the grain dealer engaging in credit-sales contracts must file "a bond with the Department in the amount of one hundred thousand dollars payable to the Department."[327] The bond is to be used to indemnify sellers for losses resulting from breach of credit-sale contracts.[328] This bond is in addition to any other bonds required by Chapter 203.[329]

The bond required by this section may not be canceled by the issuer unless ninety days have passed following notice to the Department and the principal by certified mail.[330] This procedure may be

320. § 203.15(3).
321. *Id.*
322. *Id.*
323. *Id.*
324. § 203.15(4)(a).
325. *Id.*
326. § 203.15(4)(b).
327. § 203.15(4)(c)(1)-(2).
328. § 203.15(4)(c)(2).
329. *Id.*
330. § 203.15(4)(c).

modified if an adequate replacement bond is procured.[331] If a replacement bond has not been procured within sixty days following notice, the Department shall automatically suspend the dealer's license.[332] Failure to file a replacement bond within thirty days after the suspension shall result in revocation of the grain dealer's license.[333] The Department may suspend the right of a grain dealer to purchase grain on a credit-sale basis based upon the failure to meet other enumerated conditions.[334] Finally, a licensed grain dealer that purchases grain on a credit-sale contract basis must obtain from the seller a signed acknowledgment, on forms prescribed by the Department, "stating that the seller has received notice that grain purchased by credit-sale contract is not protected by the grain depositors and sellers indemnity fund."[335]

(b) Bargaining agents

Iowa used to separately regulate "bargaining agents" who are individuals or entities "who bargain with buyers for the sale of grain for agricultural producers," but the statute was repealed.[336]

(c) Warehouses

Iowa also maintains a statutory scheme for the regulation of warehouses for agricultural products.[337] This statute also provides for oversight by the Department and for the appointment of the Department as a receiver.[338] Likewise, this statute also requires bonds or letters of credit for issuance of a license.[339] The statute also defines when liens arise on the warehouse operator's assets.[340]

At the end of the day, both grain dealers regulated under Chapter 203 and warehouses regulated under Chapter 203C are participants in the Grain Depositors and Sellers Indemnity Fund established under Chapter 203D.[341] The fund arises from a per-bushel fee on purchased grain from licensed warehouses and grain dealers.[342] A statutory lien may be enforced against the assets of a licensee.[343]

---

331. *Id.*
332. *Id.*
333. *Id.*
334. § 203.15(5)(a)-(g).
335. § 203.15(6).
336. IOWA CODE ANN. § 203A.1 (West 2000), *repealed by* 2003 Iowa Acts 135.
337. *See generally* IOWA CODE ANN. §§ 203C.1–203C.40 (West 2000 & Supp. 2006).
338. §§ 203C.2–203C.3.
339. § 203C.6.
340. § 203C.12A.
341. *Id.* §§ 203.4, 203C.12.
342. *Id.* § 203D.3.
343. *Id.* § 203D.5A.

The board of the fund reviews and makes a determination as to the validity of claims filed.[344] The statute defines how claims are made, determined, and paid.[345] Nonetheless, nothing in Chapters 203, 203C, or 203D creates any guarantee or obligation on behalf of the State of Iowa.[346]

*2. Case law*

(a) The common law and issues peculiar to the Iowa statutes

As the Iowa Supreme Court observed in *Avoca State Bank v. Merchants Mutual Bonding Co.*,[347] a grain elevator operates under one of two basic roles.[348] Either the elevator buys and sells grain, making it a grain dealer, or it acts as a storer of grain, making it a warehouse.[349] Nonetheless, in either role the operator "can work considerable financial harm upon the public, and the legislature has endeavored to provide the public a measure of protection."[350] In *Avoca State Bank*, the court examined the issue of whether a bank could recover on a warehouse's bond for issuance of invalid warehouse receipts.[351] The Iowa Supreme Court rejected the argument that the bond required by the Code covers only a conversion of existing grain by a warehouse.[352] Instead, the Iowa Supreme Court declared that it was not willing to isolate coverage of the bonds to a "conversion-type situation."[353] An elevator acting as a warehouse is liable for the non-receipt of the goods when a warehouse receipt is issued.[354] The court thus held that, "if a warehouseman issues a warehouse receipt for grain which he does not have, he breaches his duty of faithful performance as a warehouseman, and his bond covers."[355] Applying the prevailing case law to the grain situation, the bond covers when the elevator:

> did not have the grain on which [it] issued receipts that [it] pledged to the bank. If [it] had the grain and disposed of it without the receipts, the bond covers. If [it] did not have the

344. *Id.* § 203D.4(2).
345. *Id.* § 203D.6.
346. *Id.* §§ 203.14, 203C.38, 203D.7.
347. 251 N.W.2d 533 (Iowa 1977).
348. Avoca State Bank v. Merchs. Mut. Bonding Co., 251 N.W.2d 533, 538 (Iowa 1977).
349. *Avoca State Bank*, 251 N.W.2d at 538.
350. *Id.*
351. *Id.* at 535. A warehouse bond was required under the then existing Iowa Code Chapter 543, which was later codified into Chapter 203C.
352. *Id.* at 539.
353. *Id.*
354. *Id.*
355. *Id.* (citations omitted).

grain and issued the receipts and pledged them to the bank without notice, the bond covers.[356]

The next issue the Iowa Supreme Court addressed in *Avoca State Bank* was the requirement of a formal demand upon the warehouse. Iowa law does not require a demand be made upon the warehouse for grain stored pursuant to the receipts when no grain exists to fill the receipts.[357]

In the same case, the Iowa Supreme Court also addressed the issue of the rule at common law concerning a bank's ability to recover against the bond when the surety alleges that the bank knew there was insufficient grain but nonetheless took the documents as security.[358] The issue is one of fact.[359] Based upon the record in the case, the bank's argument went further. The bank maintained that nothing was recoverable under the receipts but instead looked to the bond because the receipts themselves were wrongfully issued and were invalid.[360] Under that scenario, the bank could recover under the bond.[361]

However, if the bank knew the title documents were invalid when they were received, a different result would follow. As announced by the Georgia Supreme Court, "if the transaction was a mere scheme by which the warehouse . . . undertook to obtain from the bank funds for its own use . . . and if the bank knew the character of the transaction at the time . . . the surety . . . of the warehouse . . . would not be liable to the bank . . . ."[362]

On the same day *Avoca State Bank* was decided, the Iowa Supreme Court held in two related cases that the warehouse's bond under then-existing Chapter 543 did not cover a cash sale of grain.[363]

(b) Procedural issues

The limitations period for filing of claims starts upon the date the order is affirmed by the agency and not the date upon which the administrative law judge's proposed order should issue.[364] Payment of

356. *Id.* at 540 (citations omitted).
357. *Id.* (citations omitted).
358. *Id.* at 541-42.
359. *Id.* at 541.
360. *Id.*
361. *Id.* (citations omitted).
362. *Id.* at 541-42 (citing Nat'l Bank of Wilkes v. Md. Cas. Co., 146 S.E. 739, 749 (1929)); *Cf.* Farmers Coop. Elevator, Inc. v. State Bank, 236 N.W.2d 674 (Iowa 1975) (bank may offset checking account balance of elevator against outstanding matured notes without liability for tortious interference with prospective business advantage in absence of evidence showing that bank acted to destroy or injure elevator).
363. True v. Merchs. Mut. Bonding Co., 251 N.W.2d 543, 544 (Iowa 1977); Michael v. Merchs. Mut. Bonding Co., 251 N.W.2d 531, 533 (Iowa 1977).
364. Vennerberg Farms, Inc. v. IGF Ins. Co., 405 N.W.2d 810, 811 (Iowa 1987).

the full amount of the bond to the state discharges the surety even if there may be other potential claimants.[365]

(c) Surety law in jury instructions

In *Avoca State Bank*, the surety complained on appeal that the district court erred in not cautioning the jury that it was not a surety, guarantor, or insurer of the owner's notes to the bank.[366] In the high court's view, there was no need for a cautionary instruction because the district court "narrowed the case to one major issue . . . and focused the jurors' attention on that issue."[367] Therefore, based on the discretion a trial court has to submit cautionary instructions, there was no error in light of the fact that such an instruction would interject confusion concerning an unrelated issue.[368]

Nonetheless, one can question whether the Iowa Supreme Court would reach the same conclusion today. The decision predates the adoption of the Iowa Rules of Evidence.[369] Since the rules have been adopted, counsel could certainly argue that Iowa Rule of Evidence 5.411 provides a basis to exclude evidence of a surety.[370] At the very least, the decision sends a strong signal to attorneys who represent surety companies to take a hard look at the decision whether to bifurcate the proceeding.[371]

(d) Damages

*Avoca State Bank* also addresses the measure of damages. The value of pledged grain is "the highest price between the time of the wrong and the commencement of the suit."[372]

(e) Interest

Likewise, interest earned on the sale of grain proceeds is distributed to the claimants rather than used as an offset against the

365. Iowa State Commerce Comm'n v. IGF Ins. Co., 309 N.W.2d 445, 447-48 (Iowa 1981).

366. *Avoca State Bank*, 251 N.W.2d at 541.

367. *Id.*

368. *Id.* (citation omitted).

369. IOWA R. EVID. (Official Comment – 1983). The Iowa Rules of Evidence took effect on July 1, 1983.

370. *See* IOWA R. EVID. 5.411; *see also* FED. R. EVID. 411. At least one federal circuit court has held that the federal rule would preclude evidence of a fidelity bond under Federal Rule of Evidence 411. Garnac Grain Co. v. Blackley, 932 F.2d 1563, 1570 (8th Cir. 1991).

371. Benjamin B. Ullem & John F. Fatino, *Evidence of a Surety Found to be Inadmissible Under Fed. R. Evid. 411 and Recent Successful Attempts to Bifurcate Proceedings Involving Sureties*, THE CRITICAL PATH (The Defense Research Institute, Inc., Construction Law Committee), Fall 1997, at 4-6.

372. *Avoca State Bank*, 251 N.W.2d at 541 (citations omitted).

surety's liability.[373] In the event a supersedeas bond is filed by the surety on appeal, interest may be recoverable under the supersedeas bond from the date of the trial court's judgment.[374]

(f) Preservation of error and appellate practice

Harmless error analysis will be applied in actions involving a surety. When the trial court incorrectly instructs the jury, a new trial will not be granted if the jury verdict is not a result of the mistaken instruction.[375]

From a procedural standpoint, when the surety asserts error on appeal, it must, like any other litigant, demonstrate to the appellate court that it assigned error on the point before the district court.[376] Failure to do so leaves the appellate court nothing to review.[377]

D. KANSAS

*1. Statutes*

Kansas, by statute, gives the Secretary of Agriculture authority to regulate security requirements for licensed warehouses.[378] This power includes the ability to require a bond to cover any shortage in commodities by a licensed warehouse for "outstanding receipts and scale tickets" after notice to require the warehouse to do any of the following: "(1) [c]over any existing shortage; (2) give additional bond or letter of credit; (3) submit to any further examination the Secretary may require."[379] The Secretary may impose any or all of the requirements.[380] Failure to comply may result in the issuance of a court order authorizing the Department of Agriculture to take "immediate possession of and maintain the commodities, records, and property" of the warehouse.[381]

373. Iowa State Commerce Comm'n v. Manilla Grain Terminal, Inc., 362 N.W.2d 562, 564-65 (Iowa 1985).

374. *Iowa State Commerce Comm'n v. IGF Ins. Co.*, 309 N.W.2d at 449.

375. *Avoca State Bank*, 251 N.W.2d at 541. The trial court incorrectly instructed the jury that the verdict could have been $52,000, the amount of the bond, or less when actual loss exceeded the penal sum of the bond and "[u]nder the record, a finding that the beans and corn were worth less than $52,000 could not stand." *Id.* Since the jury returned a verdict of $52,000, no reversible error occurred. *Id.*

376. *Michael*, 251 N.W.2d at 533.

377. *Id. See also Iowa State Commerce Comm'n v. Manilla Grain Terminal, Inc.*, 362 N.W.2d at 564 (noting the surety failed to preserve error on appeal when objection at trial court was to the number of hours involved in a staff attorney fee claim but the surety asserted on appeal that recovery of any staff time was an improper receivership expense and court did not have authority to order reimbursement from surety).

378. KAN. STAT. ANN. § 34-2,104(a) (2000). *See also id.* § 34-223(n).

379. § 34-2,104(a)(1)-(3).

380. § 34-2,104(a).

381. *Id.*

From a procedural standpoint, the Department of Agriculture's petition must be verified.[382] The defendant may answer within ten days, and a hearing is to be set within fifteen days.[383]

Once in possession, the Secretary is to give notice of the proceeding to the surety or issuer of the letter of credit on behalf of the warehouse and holders of all receipts and scale tickets.[384] If the audit or investigation reveals a shortage of the commodity, the Secretary is to notify the warehouse, the surety or financial institution, and depositors of the approximate amount of the shortage.[385]

On the other hand, if the warehouse is insolvent or cannot pay all claims, then the Department may liquidate the business or request appointment of a receiver.[386] The statute specifically addresses the powers and temporal limitations placed on the receiver.[387]

Kansas has also declared that receipt provisions that provide grain receipts are not negotiable and void.[388] Warehouse receipts are to be issued only upon actual delivery of grain, and no receipt may be issued for a quantity greater than that which was received.[389]

New receipts are to be issued when part of the grain covered by an existing receipt is delivered; such new receipt must state that it represents the balance of the original receipts, the old receipt shall be canceled, and reflect the specified statutory data.[390] In any event, once grain has been delivered in its entirety, the receipt shall be marked as "canceled" and include the date and name of the individual who canceled the same.[391]

A public warehouse has an obligation to insure stored grain with a "reliable insurance company" and failure to do so triggers liability on the bond.[392]

### 2. *Case law*

There is at least one Kansas case of note, and its teaching is instructive. In *Appalachian Insurance Co. v. Betts*,[393] Appalachian Insurance Company of Providence sued Betts and his surety arising out

382. *Id. See also* § 34-223(o).
383. § 34-2,104(b).
384. § 34-2,104(c).
385. *Id.*
386. § 34-2,104(d).
387. § 34-2,104(d)-(g).
388. *Id.* § 34-244.
389. *Id.* § 34-246(a).
390. § 34-246(b)-(c).
391. § 34-246(c).
392. *Id.* § 34-236(a).
393. 518 P.2d 385 (Kan. 1973).

of a shortage of grain.[394] Appalachian alleged that Commodity Credit Corporation had entered into grain storage agreements with Betts.[395] Ultimately, upon withdrawal of the grain, a shortfall was discovered and demand was made upon Betts for the value of the shortage.[396] Commodity Credit Corporation then made demand upon Appalachian for payment of the loss pursuant to an insurance policy that Appalachian had issued to cover certain risks in connection with the storage of grain.[397] Appalachian paid the claim and then became subrogated to the rights of Commodity Credit Corporation against Betts and its surety.[398]

The defendants moved to dismiss on the basis that federal courts have exclusive jurisdiction over the claim because of 15 U.S.C. § 714b(c).[399] The statute essentially provided that Commodity Credit Corporation could only sue and be sued in federal court. The district court agreed with Appalachian.[400] The district court's rationale rested on the fact that the statute provided that the Commodity Credit Corporation may sue or be sued in federal court; thus, "exclusive original jurisdiction" rested in those courts.[401] The district court further reasoned that if the Commodity Credit Corporation was limited to federal court, so was the subrogee.[402]

The Kansas Supreme Court reversed the district court's decision.[403] The court reasoned that as Commodity Credit Corporation had been compensated for its entire loss, Commodity Credit Corporation no longer had any financial interest in the case and was no longer the real party in interest.[404] Moreover, the court did not construe section 714b(c) as narrowly as the district court in light of the fact that federal courts are courts of limited jurisdiction and state courts, under the United States Constitution, are not so limited unless otherwise restricted by Congress.[405] Yet, in federal diversity cases, the subrogee may stand on its own citizenship.[406] It follows therefore, that the subrogee is not limited to the same forum to which its subrogor may have been limited.[407] Consequently, the Kansas Supreme Court held Ap-

394. Appalachian Ins. Co. v. Betts, 518 P.2d 385, 386 (Kan. 1973).
395. *Appalachian Ins. Co.*, 518 P.2d at 386.
396. *Id.*
397. *Id.*
398. *Id.*
399. *Id.* (citing 15 U.S.C. § 714b(c)).
400. *Id.* at 386-88.
401. *Id.* at 386-87.
402. *Id.* at 387.
403. *Id.* at 388.
404. *Id.* at 387.
405. *Id.* at 387-88 (citations omitted).
406. *Id.* at 388 (citations omitted).
407. *Id.* (citations omitted).

palachian could maintain an action in state court even if its subrogor could not.[408]

Previously, the Kansas Supreme Court held that a growing immature wheat crop is not such personal property as can be disposed of on attachment or execution.[409] On another occasion, the Kansas Supreme Court determined that directors of a defunct elevator cannot be sued in their individual capacities by a creditor.[410] Consequently, claims by a creditor of retention of an employee who is "unworthy of trust" by a creditor fail to state a cause of action.[411]

The United States Court of Appeals for the Tenth Circuit has held that the Kansas statute and the bond will not protect persons who enter into transactions that do not involve the actual delivery of grain.[412] Thus, when based upon record evidence that demonstrated unregistered receipts had been issued for grain that was not in the warehouse, no judgment could be had on the bond.[413]

Finally, the Kansas Supreme Court has held that statutory terms shall be read into a bond; conditions that are not required by the statute are stricken as surplusage.[414]

## E. MINNESOTA

### *1. Statutes*

#### (a) Grain buyers

Minnesota requires that the application for a grain buyer's license must be filed with the Commissioner of Agriculture and licenses issued before any grain is purchased.[415] Minnesota provides for three categories of grain buyer's licenses: "private grain warehouse operator's license," "public grain warehouse operator's license," and "independent grain buyer's license."[416] Buying grain without a license is a misdemeanor.[417] Also, the applicant must identify "all grain buying locations owned or controlled" by the buyer and all vehicles the buyer uses to transport purchased grain.[418]

---

408. *Id.*
409. Blattler v. Westerman, 286 P. 217, 218 (Kan. 1930) (citations omitted).
410. Speer v. Dighton Grain, Inc., 624 P.2d 952, 961 (Kan. 1981).
411. *Speer*, 624 P.2d at 961.
412. Cent. States Corp. v. Trinity Universal Ins. Co., 237 F.2d 875, 877-79 (10th Cir. 1956).
413. *Cent. States Corp.*, 237 F.2d at 879.
414. Stevens v. Farmers Elevator Mut. Ins. Co., 415 P.2d 236, 240 (Kan. 1966) (citations omitted).
415. MINN. STAT. ANN. § 223.17(1) (West 2003 & Supp. 2006); *see also id.* § 223.16(3) (defining "Commissioner").
416. § 223.17(1)(a)-(c).
417. *Id.* § 223.18.
418. § 223.17(1).

Licenses must be renewed annually.[419] The Commissioner is required to set fees for inspections at the necessary levels to pay the expense of enforcing and administering the program.[420] The Minnesota legislature thereby created the Grain Buyers and Storage Account in the Agricultural Fund.[421] Money collected pursuant to sections 223.15-.19 is to be paid to the state treasury, then credited to the Grain Buyers and Storage Account, where it will be reappropriated by the Commissioner for administration and enforcement of sections 223.15-.22.[422] The Commissioner may adopt rules to carry out the statutes.[423]

At the same time, the Minnesota legislature has determined that prior to a grain buyer's license being issued, the applicant "must file with the commissioner a bond in a penal sum" to be prescribed by the Commissioner in an amount not less than required by the statutory formula.[424] The statute is determined by the gross annual purchases and ranges in penal sums from $10,000 to $150,000.[425] Nonetheless, first-time applicants for a grain buyer's licenses shall file $50,000 bonds which are to remain in effect for the first year of the licenses, and thereafter the bonds may be adjusted as set out in the statute.[426] The bonds must be in favor of the State of Minnesota as the obligee.[427]

The statute specifically contemplates that an applicant may, in lieu of a bond, deposit with the commissioner:

> cash, a certified check, a cashier's check, a postal, bank, or express money order, assignable bonds or notes of the United States, or an assignment of a bank savings account or investment certificate, or an irrevocable bank letter of credit . . . in the same amount as would be required for a bond.[428]

With respect to a cash sale, which is part of a multiple shipment sale, the "buyer shall tender payment to the seller . . . not later than 10 days after the sale of that shipment . . . ."[429] However, "when the entire sale is completed, payment shall be tendered not later than the close of business on the next day, or within 48 hours, whichever is later."[430] For other cash sales of grain, the buyer shall tender pay-

419. § 223.17(2).
420. § 223.17(3).
421. *Id.*
422. *Id.*
423. *Id.* § 223.19.
424. § 223.17(4).
425. § 223.17(4)(a)-(h).
426. § 223.17(4).
427. *Id.* § 223.16(2).
428. § 223.17(4).
429. § 223.17(5).
430. *Id.*

ment to the seller in cash, check, or wire or mail "funds to the seller's account in an amount of at least 80% percent of the value of the grain at the time of delivery."[431] A grain buyer is statutorily required to "complete final settlement as rapidly as possible through ordinary diligence."[432]

According to Minnesota law, "no grain buyer may refuse to purchase grain from a producer solely because the producer is not bonded or is not licensed by the Commissioner . . . ."[433] However, "any producer who buys grain from other producers shall be licensed and bonded as required by [Chapter 223]."[434]

In order to facilitate the Commissioner's determination of the correct amount of the bond, a licensee must submit to the Commissioner annual financial statements that are prepared in accordance with generally accepted accounting principles.[435] The financial statement must include at least all of the following: a balance sheet; a statement of profit and loss; a statement of retained earnings; a statement of change in financial position; and a "statement of the dollar amount of grain purchased in the previous fiscal year . . . ."[436] At the same time, the financial statement must be accompanied by a "compilation report . . . that is prepared . . . in accordance with standards established by the American Institute of Certified Public Accountants."[437] Finally, the financial statement must be accompanied by a certification, under penalty of perjury, of the chief executive officer or a designee that the financial statement accurately depicts the financial condition for the period of time the statement is intended to cover.[438] In the event the assets of the licensee exceed $500,000,000, a financial statement need not be filed, but the licensee must still provide the Commissioner with a certified net worth statement.[439] The financial statements are considered "private or nonpublic data."[440]

If an applicant fails to furnish financial statements, the Commissioner may refuse to issue the license.[441] If a licensee fails to furnish

431. *Id.*
432. *Id.*
433. § 223.17(5a).
434. *Id.*
435. § 223.17(6).
436. § 223.17(6)(a)(1)-(5).
437. § 223.17(6)(b).
438. § 223.17(6)(c).
439. § 223.17(6).
440. *Id. See* John F. Fatino, *Public Employers and E-Mail: A Primer for the Practitioner and the Public Professional*, 23 N. ILL. U. L. REV. 131, 140-43 (2003) (discussing the Minnesota public records statute).
441. § 223.17(6a)(a).

the financial statements, the Commissioner can either refuse to renew the license or suspend the license.[442]

The statute authorizes the Commissioner to refuse to issue a license or renew it when the Commissioner, based on the financial statement or other financial information, determines that the licensee or applicant is not financially able to operate the business.[443] The entity may, in turn, request an administrative hearing within fifteen days of the Commissioner's decision.[444]

Minnesota also provides a statutory process for resolution of bond and contract claims.[445] A producer who claims to be damaged by a breach of contract for the purchase of grain is to file a claim with the Commissioner.[446] The claim must be filed within 180 days of the purported breach.[447] If the Commissioner determines the claim is valid, the Commissioner may immediately suspend the license.[448] The licensee must request an administrative hearing within fifteen days; otherwise the Commissioner is directed to revoke the license.[449]

The bond required by this section shall provide for payment of any loss caused by the failure of the grain buyer to pay "upon the owner's demand, the purchase price of grain sold to the grain buyer . . . including loss caused by failure to pay within the time required."[450] The legislature has determined that the bond "shall be conditioned upon the grain buyer being duly licensed" as set out in Chapter 223.[451] The Commissioner is to determine whether the claim as filed is valid and notify the claimant of that decision.[452] The aggrieved party is allowed to appeal the Commissioner's determination.[453] When a contested case proceeding is not filed, or following the issuance by the Commissioner of a final order, "the surety company shall issue payment promptly to those claimants entitled to payment."[454] The Commissioner can apply to the district court to appoint a trustee and manage the operations of the defaulting grain buyer.[455] If the grain buyer is liable to multiple producers and the amount of the bond is insufficient to pay the claims of all of the producers, the bond proceeds "shall be

442. *Id.*
443. § 223.17(6a)(b).
444. § 223.17(6a)(c).
445. § 223.17(7).
446. *Id.*
447. *Id.*
448. *Id.*
449. *Id.*
450. § 223.17(8)(a).
451. *Id.*
452. § 223.17(8)(b).
453. *Id.*
454. *Id.*
455. *Id.*

apportioned among the bona fide claimants."[456] In any event, the bond is not cumulative from one licensing period to the next, and under no circumstances, shall the liability on the bond exceed its face value.[457]

(b) Warehouse operators

Minnesota has also established a similar statutory scheme for the licensing of grain warehouse operators.[458] An application for a grain warehouse operator's license shall be filed with the Commissioner prior to the purchase or storage of grain.[459] The license must be renewed annually.[460] The fees for inspections, certifications, and licenses shall be set at levels necessary to pay the costs of administering and enforcing the program.[461] Such proceeds shall be deposited into the Grain Buyers and Storage Account that, in turn, shall be appropriated to the Commissioner for administration and enforcement.[462] Like a grain dealer, an applicant for a public grain warehouse license shall file a bond in the penal sum prescribed by the Commissioner by administrative rule and shall be based upon all grain outstanding on grain warehouse receipts.[463]

Grain storage warehouses must report to the Commissioner. By the tenth day of each month, the public grain warehouse operator must file with the Commissioner "a report showing the net liability of all grain outstanding on grain warehouse receipts as of the close of business on the last day of the preceding month."[464] The report is used to determine the penal sum of the bond.[465] Should a grain warehouse operator willfully neglect or refuse to file the report for two consecutive months, the Commissioner may suspend the license subject to an administrative hearing upon the operator's request.[466]

The Minnesota legislature has determined that there is a duty on behalf of a grain warehouse operator to safely store records.[467] The statute provides that every "public grain warehouse operator shall keep in a place of safety, complete and accurate records and accounts

456. § 223.17(8)(c).
457. § 223.17(8)(d).
458. *Id.* § 232.22.
459. § 232.22(1).
460. § 232.22(2).
461. § 232.22(3).
462. *Id.*
463. § 232.22(4).
464. § 232.22(5)(a).
465. *Id.*
466. § 232.22(5)(b).
467. *See* § 232.22(5)(c).

relating to any grain warehouse operated."[468] The statute identifies the exact information the grain warehouse operator is to keep. The statute enumerates what the record shall reflect:

> each commodity received and shipped daily, the balance remaining in the grain warehouse at the close of each business day, a listing of all unissued grain warehouse receipts in the operator's possession, a record of all grain warehouse receipts issued which remain outstanding and a record of all grain warehouse receipts which have been returned for cancellation.[469]

Furthermore, the operator is to retain "receipts or other documents evidencing ownership of grain" for the duration of the liability or for at least a minimum of three years.[470] At the same time, the operator must have in the warehouse "at all times" grain of a proper grade and "quantity to meet delivery obligations on all outstanding grain warehouse receipts."[471]

A person claiming damage from the breach of a condition of a bond by a licensed warehouse operator must file a claim with the Commissioner setting forth the allegations.[472] The claim must be filed within 180 days of the breach of the bond and, if the Commissioner believes the claim has validity, the Commissioner may immediately suspend the license of the operator, but the licensee may request an administrative hearing.[473]

Minnesota further divides the bonds into "condition bonds."[474] The first bond is defined as a "condition one bond."[475] The bond is conditioned upon the liability of the operator who issued a grain warehouse receipt to the "depositor for the delivery of the kind, grade and net quantity of grain called for by the receipt."[476]

The condition two bond is to provide for payment of losses caused by the grain buyer's failure to pay the purchase price of grain sold to the grain buyer once demanded by the owner.[477] The bond is "conditioned upon the buyer being duly licensed."[478] At the same time, the bond does not cover "any transaction which constitutes a voluntary extension of credit."[479]

---

468. § 232.22(5)(c).
469. *Id.*
470. *Id.*
471. § 232.22(5)(d).
472. § 232.22(6).
473. *Id.*
474. *See* § 232.22(7).
475. § 232.22(7)(a).
476. *Id.*
477. § 232.22(7)(b).
478. *Id.*
479. *Id.*

Upon receiving notification of default, the Commissioner is to determine the validity of the claims and notify those parties that have filed claims.[480] An aggrieved party may appeal the Commissioner's determination by commencing a contested case proceeding.[481] In the absence of a contested case proceeding being initiated, or following the issuance of an order in a contested case proceeding, "the surety company shall issue payment to those claimants entitled to payment."[482]

To determine the amount of the liability on a condition one bond, "all grain owned or stored in the public grain warehouse shall be sold and the combined proceeds deposited in a special fund."[483] Should liability exceed the special fund, the proceeds of the bond and the special fund are to be "apportioned among the valid claimants on a pro rata basis."[484] Yet, the "bond is not cumulative from one licensing period to the next" and, in no event, shall the maximum liability of the bond exceed its face value for the licensing period.[485]

*2. Case law*

(a) Statutory interpretation and the common law

Generally speaking, the "Statute of Frauds" as adopted by various jurisdictions in the United States requires that all contracts of indemnity and suretyship be in writing.[486] In cases involving a surety, the requirement of a writing can be critical to the outcome of the case. In *Fidelity & Casualty Co. v. Lawlor*,[487] the Cargill Elevator Company employed Lawlor as its agent for receipt of grain in Kindred, North Dakota, and Fidelity & Casualty Company of New York gave a bond to the Cargill Elevator Company against all acts of dishonesty or fraud committed by Lawlor.[488]

At the end of the one-year period of the bond for which Cargill had paid, Lawlor then requested that Fidelity & Casualty Company renew its bond for Lawlor acting in its capacity as an agent at Clifford, North Dakota.[489] The company consented by letter to this arrangement.[490] Although the factual dispute that erupted is not clear from the context of the Minnesota Supreme Court's decision, the court stated that when the bond was sued upon, the bond was a continuous one and

480. § 232.22(7)(c).
481. *Id.*
482. *Id.*
483. § 232.22(7)(d).
484. § 232.22(7)(e).
485. § 232.22(7)(f).
486. *See* § I(C), *supra*.
487. 66 N.W. 143 (Minn. 1896).
488. Fid. & Cas. Co. v. Lawlor, 66 N.W. 143, 147 (Minn. 1896).
489. *Fid. & Cas. Co.*, 66 N.W. at 147.
490. *Id.*

"bound the defendants to indemnify plaintiff against any loss by reason of its guarantee to the elevator company of Lawlor's fidelity" including any renewal or extension thereof.[491] The Minnesota Supreme Court further held that Lawlor's promise to indemnify Fidelity & Casualty Company was not within the statute of frauds.[492] The court stated "as the defendants consented to continue on the counter bond after Lawlor's transfer . . . it constituted a waiver of any rights they might otherwise have had to claim that they were released by reason of the change . . . ."[493]

The Minnesota Supreme Court has also determined in *Eagle Roller-Mill Co. v. Dillman*,[494] that it is not a defense to the surety that the scales and weights used for the measure of grain were never proved and sealed by the sealer of weights and measures as required by the Minnesota statutes.[495]

In *McBrady v. Monarch Elevator Co.*,[496] the court decided "a payment induced by the fraud of the payee may be recovered."[497] However, the proposition is one for the jury to resolve.[498] In *Central Metropolitan Bank v. Fidelity & Casualty Co.*,[499] the court stated whether a party had actual or constructive notice of a particular fact bearing on particular acts, which may or may not constitute a claim, a jury question is engendered.[500]

Yet a bank, in the ordinary course as a lender, which receives bills of lading as collateral, will not be charged with active supervision of the grain company.[501] Instead, the obligation falls to the surety: "It is the business of the surety rather than the obligee to see that the principal performs the duty which the surety has guaranteed."[502] Thus, as long as the bank acts in good faith, a bank is under "no active duty to ascertain whether a loss was probable or to prevent the continuance of the default . . . ."[503]

According to the court's opinion in *Torgerson v. Quinn-Sheperdson Co.*,[504] a demand and wrongful refusal to deliver constituted con-

491. *Id.*
492. *Id.* (citations omitted).
493. *Id.*
494. 69 N.W. 910 (Minn. 1897).
495. Eagle Roller-Mill Co. v. Dillman, 69 N.W. 910, 911 (Minn. 1897).
496. 129 N.W. 163 (Minn. 1910).
497. McBrady v. Monarch Elevator Co., 129 N.W. 163, 165 (Minn. 1910) (citation omitted).
498. *McBrady*, 129 N.W. at 165.
499. 198 N.W. 137 (Minn. 1924).
500. Cent. Metro. Bank v. Fid. & Cas. Co., 198 N.W. 137, 139 (Minn. 1924).
501. *Cent. Metro. Bank*, 198 N.W. at 139.
502. *Id.*
503. *Id.* (citation omitted).
504. 201 N.W. 615 (Minn. 1925).

version.[505] In the event of actual conversion, a demand for return of the property is not necessary.[506]

As observed by the Minnesota Supreme Court, Minnesota, by adoption of its statutes, changed the common law rule regarding the intermingling of grain: "The storage of the oats with an agreement to return an equal amount in kind though not the identical oats deposited constitutes a bailment" and not a sale.[507] As a result, the surety did not succeed on its argument that the elevator was not a warehouse because of the failure to give a bond and that therefore a sale was created (rather than a bailment as required by statute).[508]

Likewise, under the proclamations of the Minnesota Supreme Court, a surety may not assert the defense that the warehouse failed to issue the prescribed storage ticket; the surety made itself responsible for the performance by the warehouse of all duties imposed upon it by statute.[509]

Minnesota courts construe the bond, together with the statute requiring it, as the contract of the parties.[510] The failure of the principal to comply with the statute would not be a defense as to the surety because the surety bond requires that the surety make good on the obligation of the principal to faithfully perform its duties and "in all respects, observe and comply with the laws of the state."[511]

In addition, Minnesota case law reflects that parties have had their share of disputes wherein an action was brought to recover the value of certain grain and the defendant had undertaken conversion.[512] Under Minnesota law, one who raises and harvests a crop of grain while in peaceful possession (even if wrongfully in possession) at the time of harvest has long been recognized as the owner of the grain.[513] As a result, a tenant who harvested crop soon after the expiration of the right of redemption was the owner of the grain.[514] It follows, therefore, that the landlord may maintain a cause of action for conversion of the landlord's share due from the tenant but held by another.[515]

505. Torgerson v. Quinn-Sheperdson Co., 201 N.W. 615, 616 (Minn. 1925) (citations omitted).

506. *Torgerson*, 201 N.W. at 616.

507. *Id.*

508. *Id.* at 617.

509. Anderson v. Krueger, 212 N.W. 198, 199 (Minn. 1927).

510. Kramer Equity Elevator v. Indem. Ins. Co., 226 N.W. 396, 397 (Minn. 1929).

511. *Kramer Equity Elevator*, 226 N.W. at 398.

512. *See, e.g.*, Schuchard v. St. Anthony & Dakota Elevator Co., 222 N.W. 292 (Minn. 1928).

513. *Schuchard*, 222 N.W. at 294.

514. *Id.*

515. *Id.* at 295.

(b) The successive bonding dilemma

The following discussion concerns one of the greatest dilemmas facing the courts, sureties, and claimants. The case is instructive even though the result has been changed by the legislature.[516] In one case, St. Paul Fire and Marine Insurance Company commenced an interpleader action "to determine its liability under three public local grain warehouseman's bonds issued to Lafayette Farm Services, Inc."[517] Following an audit by the Agricultural Marketing Service of the United States Department of Agriculture, Lafayette was found to have insufficient grain in storage to satisfy outstanding delivery obligations; Lafayette closed and the entity was placed into receivership.[518] Ultimately, claims were served against St. Paul by various holders of storage receipts.[519] The trial court found St. Paul liable under three bonds issued by St. Paul between 1967 and 1970.[520]

One of the issues on appeal was whether St. Paul, as surety, was "liable under previous bonds which were in effect at the times Lafayette was in default."[521] The record reflected that Lafayette had in fact been in a "short position" during previous bonding periods because it had concealed certain storage receipts that had been issued.[522] As framed by the Minnesota Supreme Court, the issue of whether St. Paul's liability exceeded $140,000.00 (the penal sum of the bond in place during the year in which the default was discovered) depended upon whether the warehouseman's bonds that were renewed each year were to be viewed as a single continuing contract or as a separate contract.[523] The court discussed the issue as follows:

> If viewed as a continuing contract which is kept in force by the payment of annual premiums, then the surety's liability under the entire contract is limited to its specified amount regardless of when the default occurred. On the other hand, if the bonds are viewed as a series of separate contracts, then the surety is liable on each bond up to its stated limit for defaults which occur during the period each is in force, regardless of when the loss is actually discovered.[524]

---

516. *See* § III(E)(1)(b), *supra*.

517. St. Paul Ins. Co. v. Fireman's Fund Am. Ins. Co., 245 N.W.2d 209, 211 (Minn. 1976).

518. *St. Paul Ins. Co.*, 245 N.W.2d at 211-12.

519. *Id.* at 212.

520. *Id.* at 211, 213.

521. *Id.* at 213.

522. *Id.* at 212.

523. *Id.* at 215.

524. *Id.*