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An Agricultural Law Research Article

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Originally published in SOUTH DAKOTA LAW REVIEW
30 S. D. L. REV. 326 (1985)

www.NationalAgLawCenter.org

GRAIN ELEVATOR BANKRUPTCIES

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INTRODUCTION

The agricultural community in the United States is not seeing a wave of insolvency hitting grain elevators. There is certainly no disaster confronting grain elevators like the banking disasters that occurred in this country during the Great Depression. The Kansas State Grain Inspection Department reports that normally Kansas has about 8/10ths of a grain warehouse liquidation per year.[1] There has been a recent increase, as they are reporting three liquidations in Kansas in 1983 and two in 1984.[2] They report that there have been sixteen grain warehouse liquidations in Kansas in the past nineteen years.[3] Ten of these liquidations resulted in no loss to grain claimants.[4]

Assuming that the facts in other grain producing areas are comparable, it would appear that there definitely is no epidemic of grain warehouse failures. This does not, of course, minimize the damage that can be done to any specific agricultural community that does experience a grain warehouse failure. The impact of such a failure on a specific community or specific producer was best illustrated by Wayne Cryts when he and a large number of his friends engaged in their much publicized self-helf procedure of forcefully removing soybeans claimed by Cryts from a Missouri elevator.[5] The cry from Mr. Cryts and other producers with similar distress was heard in the halls of Congress. Their concern was particularly addressed by the Bankruptcy Amendments and Federal Judgeship Act of 1984,[6] approved July 10, 1984. Title III B of this Act is entitled "Amendments Relating to Grain Storage Facility Bankruptcy."[7]

THE AMENDMENTS

Both Houses of Congress had previously adopted legislation on this subject. Their bills were generally similar. When the Conference Committee considered the bankruptcy amendments, they were very concerned about settling major differences relating to labor contracts and the well known constitutional problem over judicial appointments to the bankruptcy bench. The Conference Committee spent almost no time considering the grain elevator proposals.

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1. Special report to Grain Elevator Bankuptcy Task Force by Sam Reda, Chief Warehouse Inspector, 1985.
2. *Id.*
3. *Id.*
4. *Id.*
5. Reported in Daily Press.
6. Pub. L. No. 98-353, 98 Stat. 333 (1984).
7. *Id.* at 98 Stat. 358-61.

This resulted in very little legislative history being written on this portion of the Act.

There are seven provisions in the Grain Storage Facility Bankruptcy subtitle that will be of interest to counsel advising producers. A general knowledge of the subtitle is important to such counsel, if for no other reason than because of the deep emotion and firmly established through incorrect beliefs or fears of their clients.

First, it is now clear that unless there is a state warehouse law providing to the contrary, warehouse receipts, scale tickets or similar documents are equal in priority and show prima facie evidence of ownership of grain.[8] There had previously been some concern that the holder of a warehouse receipt might have priority over a producer or other party who did not secure a warehouse receipt for grain held in open storage. Prior case law on this subject has been divided. The Tenth Circuit held in *Farmers' Elevator Mutual Insurance Company v. Jewett*,[9] that the surety of a federally licensed warehouse was liable to depositors who were given scale tickets only, rather than warehouse receipts. There was, however, a difference of judicial opinion, even in the same court. In *In re Durand Milling Co., Inc.*,[10] the bankruptcy court for the Eastern District of Michigan treated the "scale ticket" as a "non-negotiable warehouse receipt." The court presumed that a bailment was created when grain was delivered to the warehouse and no document had been issued. After a change in judges, the same court in *In re Biniecki Brothers*,[11] held that producers who deliver grain to a warehouse and do not request a warehouse receipt have, in effect, sold their grain to the elevator operator on a "price later" basis. This would make the producer who thought he had grain on open storage merely an unsecured creditor of the warehouseman. This inconsistency has now been resolved by federal law in favor of a bailment.[12]

Second, the trustee in bankruptcy can now recover from the sale of grain stored in the bankrupt facility only the cost attributed to preserving or storing the grain.[13] The general expenses of the bankruptcy proceeding cannot be deducted from the recovery paid to grain storage patrons.[14] As a result, all of the non-grain expenses of a bankruptcy will fall on unsecured creditors.

Third, the bankruptcy trustee must now consult with the governmental unit having regulatory jurisdiction over the grain elevator.[15] This mean if it is a federally or state licensed warehouse, the trustee must consult with the appropriate warehouse department. Very likely the trustee will have little experience handling a large grain inventory. The warehouse department can certainly give him assistance in keeping the grain in condition, in marketing it

8. *Id.* at 361.
9. 394 F.2d 896 (10th Cir. 1968).
10. 9 Bankr. 669 (E.D. Mich. 1981).
11. 38 Bankr. 519 (—— 1984).
12. 98 Stat. 361 (1984).
13. 98 Stat. 361.
14. *Id.*
15. *Id.* at 360.

or in redelivering it to the proper owners. The Eighth Circuit in *Missouri v. United States Bankruptcy Court*[16] settled a jurisdictional dispute between the bankruptcy court and the Missouri Department of Agriculture, which had supervisory authority over state licensed warehouses in that state. The court held that the bankruptcy court had exclusive jurisdiction over the debtor, notwithstanding state law requiring their regulation by the Department of Agriculture. It would appear that the new Bankruptcy Act is an attempt to direct the parties to work together for the benefit of grain claimants. It would appear that the expertise available in the appropriate warehouse department would be a valuable resource to a trustee who might be knowledgeable about bankruptcy proceedings but not knowledgeable about the business end of a grain operation.

Fourth, in order to simplify handling of grain inventory, the trustee is directed to sell grain and convert it to cash if there is over 10,000 bushels of any specific type of grain.[17] Any Midwesterner knowledgeable about the grain business would realize that this is actually a very small amount of grain. It would be a very unusual grain elevator in the Midwest that would have any inventory of grain under 10,000 bushels. The cash arising from this sale would stand in place of the grain and would be payable to those who are entitled to delivery of the grain.[18] This means that a producer might be forced to have his grain sold at a time that did not conveniently fit into his own financial planning. This could create tax problems that the producer had expected to avoid. On the other hand, with the elevator in bankruptcy, the storage patron would probably be fortunate to get his money whenever he can get it, even if it has some adverse tax implications. The idea is very prevalent among grain producers that once sold, the proceeds from the grain sale would be distributed for the benefit of general creditors. That is not true.

Fifth, The 1984 Act amends the Bankruptcy Code by giving a fifth priority in the distribution of assets of the estate in bankruptcy to pay up to $2,000 on allowed unsecured claims of producers for grain.[19] This payment would be made in full before any amount is paid to the general unsecured creditors.[20] The balance due to the producer over $2,000 would be paid if funds were available on a pro rate basis with other general unsecured creditors.[21] This provision will benefit small farmers who have unpaid claims for grain or claims for conversion of bailed grain.

Sixth, the Uniform Commercial Code sets forth the applicable statutory law related to the right of an unpaid seller of goods to reclaim them from the insolvent buyer.[22] The 1984 Act contains a relatively similar provision for

16. 647 F.2d 768 (8th cir. 1981), *cert. denied*, 454 U.S. 1162 (1982).
17. 98 Stat. 361.
18. *Id.*
19. *Id.* at 358.
20. *See* 11 U.S.C. § 507(a) (1985).
21. *Id.*
22. U.C.C. § 2-702(2) (1981).

grain producers.[23] After a farmer delivers grain, he has ten days to reclaim the grain in writing if he is not paid.[24] If the bankruptcy court cannot return his grain to him, he is then entitled to be secured by a lien.[25] It is less than clear exactly what this lien would cover. It is also unclear what his priority would be in connection with conflicting liens. Apparently the ten day claim period starts to run upon receipt of the grain by the debtor. The claim period would be partially gone if the producer received a check before he realized that the check was being returned for insufficient funds. Producers will need to be educated to this right so that they can act promptly to preserve their claim.

Seventh, the most important provision of the 1984 Act for grain producers is the new Section 557 added to the Bankruptcy Code by Section 352(a) of the 1984 Act.[26] This section requires the bankruptcy court to expedite the determination of interests in grain held by a bankrupt warehouse.[27] It also requires expediting the disposition of the grain and the disposition of the proceeds.[28] The court is required to act under a timetable of not more than 120 days' duration, unless the timetable is modified by the court for cause.[29] I have personally had experience with a grain elevator bankruptcy that involved a fourteen month delay in settling with grain claimants. I am certain that the fourteen month delay was harmful to producers. During this period of time, they could not secure the return of their grain or sell it. The farmers could, of course, sell grain futures. There are many reasons why they might not want to sell grain futures. Many farmers are unfamiliar with the futures market and do not feel comfortable with what appears to them to be a speculative transaction. They also would have no knowledge of when their grain inventory might finally be released to them. This, combined with the fear of fees that might be charged on the futures transaction, would have resulted in many producers choosing not to go that way.

In summary, it would appear that Congress has passed a bill that is as fair as possible to everyone. Nothing can take the pain out of bankruptcy. Many producers may feel that the 1984 Bankruptcy Act did not go far enough in solving the problems of grain claimants. Likewise, there may be others, particularly those financing or transacting other business with operators of warehouse facilities, who may feel the Act has gone too far. Certainly, the 120-day timetable will not delight persons appointed to serve as trustees of bankrupt grain facilities.

It can be anticipated that there will continue to be a variety of legislative proposals at the state and federal level seeking to improve the position of grain claimants. Such legislation would probably address the following areas:

23. 98 Stat. 358-59.
24. *Id.* at 359.
25. *Id.*
26. *Id.* at 359-61.
27. *Id.* at 359-60.
28. *Id.*
29. *Id.* at 360.

(1) Strengthening the State or Federal Grain Inspection Department by requiring more frequent warehouse examinations, increasing their staff and correspondingly increasing the cost of licensing to the warehouse operators.

(2) Requiring better audit reports complying with generally accepted accounting principles to be filed with the governmental licensing authority.

(3) A review of bonding requirements. The bonding requirements from state to state and from state to federal warehouse laws vary considerably. Even the largest requirement does not provide for bonds that would cover foreseeable losses. Many people do not understand the nature of a bond. An insurance policy is issued to cover a defined risk. A bond, on the other hand, is not intended to cover any risk. If the company issuing the bond has done its background work satisfactorily, it would issue bonds only to solvent companies with good operations where there is no possibility of any bond claims. Traditionally, bond premiums have not been priced to cover substantial risk. Warehouse bonds in the future will probably become far more expensive for the warehouseman. This will particularly be true if the legislative bodies were to require additional bonds.

(4) There has been considerable interest in an "FDIC type" indemnity fund for grain warehouses. This proposal is generally opposed by the stronger grain warehousemen. They anticipate that they and their customers might be required to contribute to this fund which would, in the end, encourage their customers to deal with the more speculative and less solvent competitors of the warehouseman. The state of Oklahoma adopted such a fund several years ago.[30] It assessed a charge against each producer when grain was first delivered to a warehouse.[31] This assessment was to be accumulated until a reserve was established to indemnify producers against insolvent warehouses.[32] The first warehouse thereafter to go bankrupt in the state resulted in claims far exceeding the amount of the funds that would arise under this program for a number of years.[33]

(5) Increased penalties for criminal activity associated with grain warehouse failures. The grain industry does not feel that local prosecutors are interested in white collar crimes committed by persons believed formerly to be outstanding pillars in their community. Therefore, increasing criminal penalties, while it

30. OKLA. STAT. ANN. tit. 2, § 9-42 et. seq. (1980).
31. *Id.* at tit. 2, § 9-44.
32. *Id.* at tit. 2, § 9-45.
33. In re Boise City Farmers Cooperative, pending case in Western District of Oklahoma.

may appeal to grain producers, probably would result in very little change or additional protection to them.

(6) Requiring licensing and bonding for dealers in grain who do not have warehouse facilities. This is currently required in a number of states.[34] It is not, however, required federally or in a number of other states. In the past year, the state of Kansas has seen the bankruptcy of four such grain dealers with claims in excess of $7 million. The losses in this area exceed the losses arising from the bankruptcy of grain warehousemen for this period. Surely any future legislation will address this problem.

In conclusion, the best advice that can be given to any grain producer would be to deliver his grain for storage to a solvent, well-managed and well-financed storage facility. If the storage facility is a cooperative, the member delivering grain should have free access to its financial statements. If the warehouse is privately operated, a producer would be well advised to discuss the solvency of the facility with the governmental licensing authority.

34. Such a proposal is being considered in Kansas. See S.B. 336 of the 1985 Kansas Senate.