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Minnesota's Grain Elevator Legislation: Inadequate Protection for Minnesota's Grain Farmers Means Overprotection for the Country Elevator

Todd Gillingham

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**MINNESOTA'S GRAIN ELEVATOR LEGISLATION:
INADEQUATE PROTECTION FOR MINNESOTA'S
GRAIN FARMERS MEANS
OVERPROTECTION FOR THE
COUNTRY ELEVATOR**

The plight of farmers in today's economy has been well documented. In addition to the traditional difficulties, many farmers have recently been confronted with the prospect of grain elevator bankruptcies. Minnesota's present legislation has not sufficiently protected farmers from the difficulties this possibility presents. This Note describes the problems faced by farmers in this area and recommends legislative alternatives to provide relief.

INTRODUCTION	221
I. THE SOCIAL AND ECONOMIC EFFECTS OF GRAIN ELEVATOR BANKRUPTCIES	226
II. GRAIN MARKETING OPTIONS AND ACCOMPANYING PROBLEMS	227
III. MINNESOTA GRAIN ELEVATOR LEGISLATION	232
IV. <i>IN RE</i> Kern	236
V. ANALYSIS OF THE MINNESOTA LEGISLATION	239
VI. RECOMMENDATIONS	244
CONCLUSION	246

INTRODUCTION

The number of grain elevator failures has increased dramatically in Minnesota and the rest of the nation in the past fifteen years.¹ Nationally, there have been over 165 elevator bankruptcies and Minnesota currently claims twelve of these.² The magnitude of the prob-

1. See Carr, Jackson, Logsdon & Miller, *Grain Elevator Bankruptcies in the U.S.: 1974 Through 1979*, at 1 (prepared for Illinois Legislative Council, Memorandum File 9-179, March 1981); see also Casey, Conley & Ahlen, *Grain Elevator Insolvencies and Bankruptcies in Eight North Central States 1974-82*, at 1 (prepared for the Illinois Legislative Council, Memorandum File 9-391, March 1984). To date, the later study is the most comprehensive data on past insolvency losses. The study is based on 90 of 165 insolvencies reported.

2. See Casey, Conley & Ahlen, *supra* note 1, at 7. This report lists the number of grain elevator bankruptcies nationally since 1975. See also Carr, Jackson, Logsdon & Miller, *supra* note 1, at 5; MINNESOTA DEPARTMENT OF AGRICULTURE: REPORT REGARDING THE NUMBER OF STATE GRAIN ELEVATOR BANKRUPTCIES (July 1, 1984)[hereinafter MINNESOTA GRAIN ELEVATOR FAILURES]. The Minnesota failures include: Hastings Farmer's Cooperative Association, Hastings, Minn.; Herbeck's Farm Service, Green Valley, Minn.; Clara City Feed and Grain, Inc., Clara City, Minn.; Welcome Grain Co., Welcome, Minn.; Jerry Kern, d/b/a Kern Grain Co., Kenyon, Minn.;

lem is even more staggering if one considers the dollars involved when a country elevator files bankruptcy. The losses suffered by grain farmers stemming from elevator insolvencies have become enormous.³ The eight year span from 1974 to 1982 saw 5,184 grain producers across the country file bankruptcy claims totaling over fifty-eight million dollars.⁴ Recovery on these claims has been a meager forty percent.⁵ In Minnesota, grain farmers have filed claims against insolvent elevators in excess of two million dollars in the past ten years. Recovery on these claims is at thirty-three percent; somewhat higher than the national average, but still insufficient to protect

Victoria Grain Co., Victoria, Minn.; Lundberg, d/b/a Lundberg Feed and Grain, Houston, Minn.; Jensen Elevator, Inc., Lanesboro, Minn.; Freidrichs, d/b/a/Freidrichs Grain, Gibbon, Minn.; Miller Feed Elevator, Balaton, Minn.; Lakeland Bean, Inc., Lakeland, Minn.; Judson Market, Inc., Judson, Minn.

A country elevator is synonymous with a public grain warehouse. Interview with Robert Swanson, Director of Public Relations for the Minnesota Department of Agriculture, St. Paul, Minn. (November 1, 1985) [hereinafter Swanson Interview]. A grain warehouse is defined as any "elevator, flour, cereal or feed mill, malthouse or warehouse in which grain belonging to a person other than the grain warehouse operator is received for purchase or storage." MINN. STAT. § 232.21, subd. 8 (1984).

For a recent illustration of the tremendous problems that can develop because of a grain elevator bankruptcy see *James v. Cryts (In re Cox Cotton Co.)*, 24 Bankr. 930 (E.D. Ark. 1982). Wayne Cryts stored grain in a Ristine, Missouri elevator operated by the James Brothers (debtors). The bankruptcy petition was filed in the Bankruptcy Court for the Eastern District of Arkansas on August 11, 1980. The trustee appointed by the court requested authority to sell all the debtor's grain free and clear of all liens and interests. The trustee's request infuriated Cryts and other claimant-creditors. These enraged farmers barricaded entrances to the elevator, which resulted in Federal Marshals arriving on the scene. *Id.* at 932.

Cryts and several other creditors removed over 31,000 bushels of soybeans from the elevator in mid-February of 1981. The grain was removed in the presence of the marshal and several FBI agents. A convoy of 77 trucks transported the confiscated grain to a neighboring elevator in Bernie, Missouri. *Id.*

The trustee received permission to sell the grain, but found that Cryts and his accomplices had removed the soybeans from the Bernie location in the wee morning hours of July 22, 1981, and held the grain hostage at an undisclosed location. *Id.*

Civil contempt charges were filed by the trustee. At the subsequent hearing, Cryts invoked his fifth amendment privilege against self-incrimination and refused to answer any questions regarding the kidnapping of the grain. Judge Baker of the United States Bankruptcy Court for the Eastern District of Arkansas jailed Cryts for contempt. *Id.* at 933.

The United States District Court for the Eastern District of Arkansas reversed the contempt finding of the bankruptcy court, declaring that the power of civil contempt vested in a bankruptcy judgment under the 1978 Bankruptcy Code was an unconstitutional grant of judicial power. *Id.* at 956. The district court then directed the appellants to appear before that court to testify why they should not be held in civil and criminal contempt for the removal of the grain. *Id.* at 959.

3. Carr, Jackson, Logsdon & Miller, *supra* note 1, at 5-6; Casey, Conley & Ahlen, *supra* note 1, at 10.

4. Carr, Jackson, Logsdon & Miller, *supra* note 1, at 5-6.

5. *Id.*

the grain farmer.⁶

Worries of the grain farmer have traditionally included the weather, insects, uncontrollable markets, inadequate government policies, and international politics.⁷ Today, the farmer's dire financial situation and the accompanying doom of foreclosure by the Farmer's Home Administration and Production Credit Association are worries added to this already lengthy list.⁸ Grain elevator bankruptcies have also been added to this list, and can be remedied nationally and locally with adequate legislative modification.

Minnesota's first legislation regulating the relationship between grain elevators and grain farmers was enacted near the turn of the century.⁹ Recent changes in these statutes have failed to keep pace with the modernization of agriculture and its accompanying financial problems. The problem with these statutes is illustrated by the increasing number of Minnesota grain farmers who have lost substantial amounts of money in grain elevator bankruptcies. Among problems not adequately reached by the current legislation are: (1) undercapitalization; (2) poor recordkeeping and accounting practices; (3) speculation with the depositor's funds in the futures market; and (4) fraud.¹⁰

One notable example of the inadequacy of the state legislation occurred in the late 1970's near Kenyon, Minnesota. The case of *In re Kern Grain Co.*¹¹ involved a country elevator, licensed by the state, which allegedly reaped funds from forty-one grain farmers. These unsuspecting depositors claimed they were merely storing their grain with the Kern elevator.¹² The elevator, however, disregarded the farmer's intentions and sold their grain to other elevators. The elevator continued charging the farmers storage fees for grain which it no longer held.¹³ The elevator eventually became insolvent leav-

6. MINNESOTA GRAIN ELEVATOR FAILURES, *supra* note 2, at 1-4. The report found total losses due to elevator insolvency to be approximately \$1.9 million in this state since 1975. This figure does not consider the several pending cases that have yet to be decided.

7. See generally Keith, *Revolutionary Change Being Considered in Government Warehouse Programs*, GOVERNMENT & GRAIN, Oct. 15, 1981, at 2-3.

8. See Minneapolis Star & Tribune, Nov. 1, 1985, § D, at 1, col. 1.

9. See Act of April 7, 1893, ch. 28, 1893 Minn. Laws 131 (codified as amended at MINN. STAT. §§ 232.20-.25 (1984)); see also Act of April 14, 1899, ch. 225, 1899 Minn. Laws 245 (requiring those selling farm produce on commission to give a bond to the state for benefit of their consignors).

10. See Casey, Conley & Ahlen, *supra* note 1, at 6-8; Swanson Interview, *supra* note 2. Mr. Swanson confirmed the sorry state of the Minnesota grain farmer and the inadequacy of the current grain legislation.

11. 369 N.W.2d 565 (Minn. Ct. App. 1985).

12. *In re Kern*, AGR-83-004-RL (Administrative Hearing, Sept. 24, 1984)[hereinafter Findings of Fact].

13. *Id.* The administrative findings stated the background facts as follows:

ing the farmers with an aggregate loss of over \$600,000 on an invest-

1. Kern Grain Company, which started accepting grain (corn, soybeans and wheat) from farmers for storage in 1975, grew out of the corn farming operation of Jerry and Phyliss Kern. The Company's facilities are located in Rice County, approximately eight miles west and south of Kenyon, Minnesota.

2. Jerry and Phyliss Kern, husband and wife, owned Kern Grain Company as a sole proprietorship. At all times relevant herein, Jerry Kern concentrated on the corn farming operation and Phyliss Kern ran the Kern Grain Company business.

3. During the late 1970's, the business grew significantly. Additional storage facilities were added, including a grain dryer, a scale and auxiliary buildings. The business was coordinated out of a converted house trailer on the same site as the Kern's home farm. . . . By 1981, the Company had 186,000 bushels of storage space on the Rice County site.

4. For each year running from July 1 to June 30 between July 1, 1979 and June 30, 1982, Kern Grain, as Principal, entered into a Public Local Grain Warehouseman's Bond with the Auto-Owner's Insurance Company (Surety), as required by MINN. STAT. ch. 232. . . .

5. In most cases involving storage of grain, farmers would negotiate an oral contract with Kern Grain, in person or over the telephone, to the effect that grain received by Kern was to be stored. In almost every such case, the farmer was also advised at that time as to the Company's monthly storage charges.

6. From 1979 through early 1982, Kern Grain did a large volume of business. The Company advertised extensively in local print and electronic media, claiming a large amount of storage space. This advertising campaign came at a time when farm prices generally were down and farmers in south and southeast Minnesota were producing bumper crops, causing a great demand for storage space on the part of persons who did not wish to market their crops until prices went up again.

During this period, the Company sent out a monthly newsletter reminding farmers of the availability of storage space and favorable storage terms. Frequent ads to this effect appeared in Kenyon, Faribault and Owatonna newspapers, one of which ads claimed that Kern had "leased 800,000 bushel of storage space at a facility in the Twin Cities." On at least one occasion, Phyliss Kern told a claimant that the Company had "a million" bushels of storage.

7. In fact, Kern Grain never did buy or lease any storage space beyond that on the Rice County site. Its advertising, newsletters and oral representations showing otherwise were falsehoods.

8. Most of the grain (corn and soybeans) involved in this matter never went through the Kern facility at Kenyon. Kern's trucks would pick up the grain at the Claimants' farms and transport it directly to grain storage facilities of large grain processors such as Archer-Daniels-Midland (ADM) or Continental Grain in St. Paul, South St. Paul or Red Wing. Most of the grain delivered to Kern's facility in Rice County was handled the same way, and left Kenyon for the grain terminals with [sic] a few days. While representing to the Claimants that the grain was being stored for them, Kern represented to the large grain companies that it (Kern) owned the grain, and that it was delivering it to them pursuant to earlier contractual arrangements between Kern and the large grain processors. Kern would be paid for the grain upon delivery, but never told the farmers that this grain had been sold and did not forward any of the proceeds to the farmers. In addition, Kern continued to assess storage charges against the Claimants' accounts. This was the general pattern followed by Kern in marketing grain during the fall of 1981. This scheme gave Kern Grain a large amount of cash in late 1981 and, since grain prices were still low, the farmer-Claimants were not then making demand for that cash.

10. In the fall of 1981, United States Department of Agriculture officials, who inspected Kern Grain's facility and records, informed the Company that it was in violation of applicable rules and regulations because Company books showed grain held as "Price Later" without signed contracts from farmers documenting the "Price Later" arrangements. This information was given to the Company after many of the Claimants had delivered their grain to Kern and Kern had, without the Claimants' knowledge, actually sold the grain. In carrying this grain as "Price Later" on its books, Kern was representing to the Inspectors that the farmers had already transferred title in (sold) the grain in question to Kern, with the price to be set and payment made at a later time. This representation was false.

11. The Federal inspectors informed Kern that, unless "Price Later" or "Delayed Pricing" Contracts were signed by the farmers to cover the grain represented on the Company's books, the grain would be considered as being in "open storage."

12. After the Federal inspection summarized in the two preceding findings, Kern Grain purchased Delayed Pricing Contract forms from the Kemske Paper Company and bookkeeper-accountant [sic] John Timmers mailed out the forms to each Claimant with the written request "Please sign and return." There was no explanation of the meaning or implication of the Contracts, which itemized and totaled the loads the farmers believed they had placed with the Company for storage. Many of the Claimants signed these Contracts, thinking that they were simply confirmation of storage. In fact, the Contracts purported to transfer title of grain to the Company from the farmers. Most of them were back-dated, and they quoted the agreed-to storage fees as "service charges."

13. The Claimants were not informed that, at the time the Delayed Pricing Contracts were mailed out, their grain had already been converted by Kern Grain Company which had sold it to the large grain companies at which it was purportedly "stored" in space "leased" by Kern. The contract forms contained a warranty by the seller (farmer-Claimant) that (s)he still owned the grain.

14. In the spring of 1982, farm commodity prices began to rise and the Claimants called Kern Grain, or went in to the Rice County facility to direct the Company to sell their stored grain and give them the proceeds. . . . [T]he Claimants in this proceeding were only partially paid or not at all because Kern Grain had squandered the cash received in the fall of 1981 to the point where it was unable to meet its obligations.

15. In April of 1982, Kern Grain's credit line at the various banks with which it dealt was cut off. During that month, Jerry Kern auctioned off his farm equipment in an effort to keep the Company afloat. And, on April 19 and 20, 1982, the Kerns met with several of the wealthier and more influential (as perceived by the Kerns) of their farm customers in an effort to form an investor's syndicate to re-finance the Company's operations. These efforts at re-capitalization ultimately failed, as did a proposed sale of the Company

16. Kern Grain did not cease operations until early July of 1982. Its trucks were still operating in the vicinity, picking up grain, and the Company continued to pay farmers and employees to the extent it was able. In May and June of 1982, the Company issued three newsletters, each of which told its customers that, although the Company was in financial trouble, it was taking measures to work its way out of those troubles. (citations omitted).

17. Kern Grain Company ceased operations in early July, 1982, and on July 14, 1982, the Company filed for bankruptcy under Chapter 7 (Dissolution) of the Federal Bankruptcy Code.

18. The first claim in this proceeding was made . . . on April 29, 1982. The final claims . . . were filed on November 29, 1982.

Id. at 2-5.

ment which should have been devoid of almost all risk.¹⁴

This Note will analyze how farmers sustain such heavy losses despite legislation which purports to regulate and protect the farmer's interest. This Note will also explain the social and economic effects of a grain elevator bankruptcy, and illustrate typical grain marketing options and problems accompanying these options. The inadequacy of the Minnesota legislation will be demonstrated through *Kern*. Analysis of this legislation will reveal why it actually protects the bankrupt elevator rather than the farmer. Finally, suggested statutory reforms will conclude this Note, offering better protection for the rights of grain producers should their local elevator become insolvent.

I. THE SOCIAL AND ECONOMIC EFFECTS OF GRAIN ELEVATOR BANKRUPTCIES

The problem surrounding grain elevator failures is felt throughout the entire rural community. Grain farmers who cannot recoup their losses in a bankruptcy proceeding may have no option but to liquidate or refinance farmstead assets.¹⁵ Even if the grain farmer does recover all of his loss in the bankruptcy proceedings, the lengthy delays inherent in the bankruptcy process interfere with farm operations. Financial burdens are imposed because the funds tied up in bankruptcy are usually the only source of financing for next year's planting. The entire farm's existence may, therefore, be jeopardized by the delay created by the bankruptcy process.¹⁶

In addition, the farmer incurs increased marketing costs when the local elevator fails. After a country elevator becomes insolvent, grain farmers usually transfer their business to large commercial elevators which are thought to be in a stronger financial position than the smaller country elevator.¹⁷ Increased transportation costs result because the large commercial elevators are normally farther from the grain farmer's fields. This increase in the cost of grain merchandising results in less net income for the grain farmer.¹⁸ In addition to the increased expenses, the grain farmer's dealing with the larger elevators will eventually force the smaller elevators from competition.¹⁹ The dwindling number of country elevators will also decrease the competition for grain and, thus, will further decrease

14. *Id.*

15. Note, *Dealing with Grain Dealers: The Use of State Legislation to Avert Grain Elevator Failures*, 68 IOWA L. REV. 305, 308 (1983).

16. *Id.* at 308.

17. *Id.* at 309.

18. *See id.*

19. *Id.* *See also* Swanson Interview, *supra* note 2.

grain prices.²⁰

In addition to the grain farmers, there are many others that experience the adverse impact of a grain elevator failure.²¹ Banks and other businesses that deal with the elevator also realize losses. A country elevator is usually one of the larger employers in a rural community. Many residents may, therefore, find themselves unemployed when an elevator fails.²² Businesses also feel the impact because the money generated by the elevator is suddenly withdrawn from the community.²³ These detrimental social and economic impacts felt by grain farmers, elevator employees, local businesses, and the surrounding community demonstrate a problem requiring immediate attention.²⁴

II. GRAIN MARKETING OPTIONS AND ACCOMPANYING PROBLEMS

When harvest time arrives, grain farmers have four basic options.²⁵ The farmer can either: (1) feed the grain to the livestock; (2) store the grain on the farm; (3) sell the crop for cash in a grain-glutted market; or (4) transfer the grain to an elevator.²⁶ Among these basic decisions lie variations that are becoming commonplace in transactions between the grain farmer and the country elevator.

The first option, feeding the crop to the livestock, involves no risk since there is no sale involved. Not all farmers, however, are able to use this option. Some grain, notably soybeans, is not generally used as feed. In addition, not all farmers have adequate numbers of livestock to consume all the grain the farmer may raise.

Some grain farmers minimize their risk in marketing grain by investing in their own on-farm storage facilities. In addition to the cost of constructing such facilities, there are problems associated with maintaining the quality of the grain.²⁷ These problems make the use of grain elevators an attractive alternative that has been a beneficial service to both parties. Recent economic conditions, however, have brought difficulty to both parties of this transaction. Improved legislation is necessary to retain the partnership of the grain farmer and the elevator operator.

The cash sale is arguably the least risky option for the grain

20. Note, *supra* note 15, at 309.

21. *Id.*

22. *Id.*

23. *Id.*

24. *Id.*

25. Hamilton & Looney, *Federal and State Regulation of Grain Warehouses and Grain Warehouse Bankruptcy*, 27 S.D.L. REV. 334, 336-75 (1982).

26. *Id.*

27. *Id.*

farmer.²⁸ Payment is received upon delivery of the crop to the elevator. Two inherent problems make this safe option unfeasible in most instances. First, market prices are usually at their lowest at harvest time, making this transaction unlikely to realize any profit.²⁹ The second disadvantage of the cash sale is the potential for an elevator's check to be worthless due to insufficient funds.³⁰ Assuming that the farmer does not use the grain for feed, sell it for cash, or store it on the farm, the farmer must deal with a grain elevator. A variety of risky transactions are possible once the farmer decides to deal with an elevator.

Grain farmers sometimes agree to a forward contract with their elevator. This marketing strategy resembles an insurance policy in that it allows the farmer to guarantee an outlet for his crop at an agreed-upon price.³¹ The farmer contracts in advance with the elevator to deliver a certain quantity and quality of grain on a specified date. The primary reason for using a forward contract is to assure his market and price.³² In addition, the farmer reduces his risk because he never loses physical control of the grain until delivery to the elevator.

Nevertheless, the increasing risk of insolvency may occur between the time the parties contract and the time of delivery when the payment is due, leaving the farmer without an elevator and without the benefit of the bargain.³³ In addition to these losses, the trustee in bankruptcy has sixty days to decide if the farmer must fulfill the executory contract with the elevator. Thus, the possibility remains that the grain farmer may receive payment even lower than the market price, or no payment at all.³⁴

In addition to these marketing options, a series of contracts denoted as voluntary extension of credit contracts are available. These are agreements:

for the purchase of a specific amount of grain from a producer in which the title to the grain passes to the grain buyer upon delivery, but the price is to be determined or payment for the grain is to be made at a date later than the date of delivery of the grain to the grain buyer. Voluntary extension of credit contracts include deferred or delayed payment contracts . . . and all other contractual arrangements with the exception of cash sales and grain storage

28. See Looney & Byrd, *Protecting the Farmer in Grain Marketing Transactions*, 31 *DRAKE L. REV.* 519, 523 (1981-82).

29. *Id.*

30. *Id.*

31. See Looney & Byrd, *supra* note 28, at 523-28.

32. *Id.*

33. *Id.*

34. *Id.*

agreements evidenced by a grain warehouse receipt.³⁵

These credit contracts presume that title passes to the elevator upon delivery and provide no bond coverage.³⁶

An example of this type of agreement is the deferred payment contract. This option is often used to avoid payment of income tax.³⁷ The grain price is determined upon delivery, but payment is deferred into the future. This is an attractive marketing option because it is similar to storage of grain, but without the additional storage fee.³⁸ Since the elevator holds the grain and defers payment, potential problems arise if the elevator goes bankrupt. The Minnesota legislation presumes that title passes to the elevator upon delivery of the grain.³⁹ This presumption raises several issues when determining the grain farmer's rights as a creditor in bankruptcy.

Similar to the deferred-payment contract is the deferred-price contract, more commonly known as the price-later contract.⁴⁰ This contract was at the heart of the issue in *Kern*.⁴¹ In the price-later

35. MINN. STAT. § 223.16, subd. 16 (1984).

36. *Id.*

37. See Estes, *Congress Rescues Farmer Deferred Crop Payment Contracts from IRS Attack*, 3 AGRIC. L.J. 1 (1981); Geske, *Deferral of Income from Crop Sales Under the New Installment Sales Revision Act*, 3 AGRIC. L.J. 13 (1981).

38. See Looney & Byrd, *supra* note 28, at 524.

39. See MINN. STAT. § 223.177, subd. 6. This subdivision states that the title to grain delivered on a voluntary extension-of-credit contract transfers to the grain buyer upon delivery. See also MINN. STAT. § 232.23, subd. 3. This subdivision states that:

All grain delivered to a public grain warehouse operator shall be considered sold at the time of delivery, unless arrangements have been made with the public grain warehouse operator prior to or at the time of delivery to apply the grain on contract, for shipment or consignment or for storage.

40. See Looney & Byrd, *supra* note 28, at 524.

41. See 369 N.W.2d at 568; see also Findings of Fact *supra* note 12, at 3-4.

Kern Grain presented a variety of documents to the farmers to record transactions involving delivery of grain to it by the claimants. These documents included:

(a) *Truck Bills-of-Lading*. Bills-of lading were issued for each load picked up by truckers sent by Kern to haul grain off the claimant's (sic) farms for delivery to other terminals. Some of the bills of lading were marked "store," and some were unmarked. None were marked "Price Later" or "Delayed Pricing";

(b) *Certificates of Certified Weight*. These are Minneapolis Grain Exchange documents recording shipments received at ADM's Elevator D in St. Paul (which received the plurality of grain "stored" at outside facilities by Kern in the fall of 1981). Some were mailed to farmers, others were kept in the farmer's files at Kern Grain. None of them were marked "Price Later" or "Delayed Pricing";

(c) *Grain Inspection Certificates*. This form accompanied truck bills-of-lading or certificates of certified weight regarding individual shipments received at ADM Elevator D. The certificates state that an inspection has been made of "Grain Stored" or to be stored in Elevator D, and did not contain the terms "Price Later" or "Delayed Pricing";

(d) *Scale Memoranda*. These documents were issued for each load deliv-

contract, the farmer delivers the grain to the elevator with the price to be determined in the future. Advantages to this agreement include avoiding on-farm storage and benefiting from higher market prices.⁴²

There are, however, many disadvantages to the deferred-payment contract. First, the farmer must pay storage fees.⁴³ Second, and by far the most destructive aspect of this contract, are the misunderstandings that continually occur because of the parties' failure to recognize the consequences of a price-later agreement.⁴⁴ These problems arise because many farmers do not understand that they lose title to their crop upon delivery to the elevator in this agreement.⁴⁵ Although the Minnesota legislation requires written documentation of every transaction,⁴⁶ farmers often contract with their elevator orally, as did the farmers in *Kern*.⁴⁷ Finally, the elevator is relieved of any bond coverage for deferred-payment contracts should the elevator fail.⁴⁸

Open storage is another common marketing option available to the parties. The farmer's objective when exercising this option is to take advantage of seasonal price increases that will more than offset storage costs.⁴⁹ Unlike the voluntary extension-of-credit contracts, title does remain with the farmer if the farmer possesses a valid warehouse receipt from the elevator evidencing ownership of the crop.⁵⁰

ered to Kern's Rice County facility. Some were marked "Store." On others "P.L." was indicated. Still others were marked "Contract" or "Price Later" and many of them were not marked at all. None of the memoranda explained the meanings of the terms "Price Later" or "Delayed Pricing"; and

(e) *Kern Grain Statement*. Claimants were issued this document, which purported to show how much grain they had on deposit with the Company. Some of the statements were marked with "Store," others were marked "Price Later," but none of them contained an explanation of the term "Price Later." In most cases, the statement indicated accrued storage charges, calculated at a per bushel per month basis since the delivery date of the grain. These charges confirmed the storage prices quoted to the farmers before they placed their grain with Kern.

Id. at 3-4.

42. See Looney & Byrd, *supra* note 28, at 524.

43. See *id.*

44. Findings of Fact, *supra* note 12, at 51.

45. See MINN. STAT. § 232.23, subd. 3.

46. *Id.* §§ 223.175, 232.23, subd. 2, 4, 8.

47. Findings of Fact, *supra* note 12, at 3.

48. See Findings of Fact, *supra* note 12, at 49-52. According to these findings, the claimant-farmers did not understand the consequences of the different contractual arrangements.

49. Looney & Byrd, *supra* note 24, at 525.

50. See MINN. STAT. § 232.23, subd. 4(b). That section provides:

A grain warehouse receipt must be in duplicate, contain the name and location of the grain warehouse, and be delivered to the depositor or the depositor's agent. Grain warehouse receipts shall be consecutively numbered as prescribed by the commissioner and state the date of deposit, except where

In the open storage situation, as well as all other transactions, the elevator operator is required to issue a non-negotiable scale ticket evidencing the quality and quantity of grain, the date the grain was delivered, and whether the grain is to be stored or sold.⁵¹ This document is to be delivered to the grain farmer upon each delivery of grain, regardless of the type of transaction between the parties.⁵²

A warehouse receipt must also be issued to the grain farmer upon delivery of grain for storage.⁵³ This negotiable document must state the name and location of the warehouse and state that, pursuant to statutory provisions, the grain is insured through the date of expiration of the annual license of that particular warehouse.⁵⁴ Storage costs are to be paid by the grain farmer upon presentation of the warehouse receipt to the elevator or at the end of the storage period.⁵⁵ At that time, the same quantity and quality of grain previously deposited shall be returned to the grain farmer. The statute does provide for bond coverage for all stored grain, but only if the grain farmer can produce a valid warehouse receipt identical to the statutory direction.⁵⁶ If no warehouse receipt is produced or there is the slightest deviation in form from the statutory model, the grain farmer loses any bond coverage should the elevator become insolvent.⁵⁷ In addition, the farmer might not be able to recover his or her crop even if the elevator remains solvent.⁵⁸

the deposit of a certain lot for storage is not completed in one day. In that case, the grain warehouse receipt, when issued, shall be dated not later than Saturday of the week of delivery.

Id.; see also Interview with Jon Murphy, Special Assistant Attorney General, (October 19, 1985) [hereinafter Murphy Interview].

51. MINN. STAT. § 232.23, subd. 2. That section provides:

A public or private grain warehouse operator, upon receiving grain, shall issue a scale ticket for each load of grain received. Scale tickets shall contain the name, location and the date of each transaction and be consecutively numbered. A duplicate copy of each scale ticket shall remain in the possession of the public or private grain warehouse operator as a permanent record. The original scale ticket shall be delivered to the depositor upon receipt of each load of grain. Each scale ticket shall have printed across its face "This is a memorandum, non-negotiable, possession of which does not signify that settlement has or has not been consummated." The scale ticket shall state specifically whether the grain is received on contract, for storage, for shipment or consignment or sold. If the grain is received on contract or sold, the price shall be indicated on the scale ticket. All scale tickets shall be dated and signed by the public or private grain warehouse operator or the operator's agent or manager.

Id.

52. *Id.*

53. See *id.*; MINN. STAT. § 232.23, subd. 4 (1984).

54. *Id.*

55. *Id.* § 232.23, subd. 4(b).

56. Murphy Interview, *supra* note 50; see Findings of Fact, *supra* note 12, at 50-51.

57. See MINN. STAT. § 232.23, subd. 5; see also Swanson Interview, *supra* note 2.

58. See MINN. STAT. § 232.23, subd. 5.

One problem the Minnesota legislation failed to take into account is the farmer's customary informality in these agreements. A handshake is all that many grain farmers demand when delivering their grain.⁵⁹ They seem unaware of the hard truth that their livelihoods could quickly and easily be destroyed if the warehouse should go bankrupt. The farmer's naiveté, whether it be legitimate or not, was the major issue surrounding the *Kern* case.

III. MINNESOTA GRAIN ELEVATOR LEGISLATION

Minnesota is one of twenty-nine states that have enacted individual legislation requiring grain elevators to obtain bonds.⁶⁰ Although legislation varies considerably from state to state, the objective is the same: to provide protection and security for grain farmers to guarantee that they receive payment for their harvested crop.⁶¹

Effective state grain legislation must have both preventive and remedial provisions.⁶² Preventive provisions include licensing, minimum net worth requirements, and annual inspections. Remedial provisions establish compensation for grain farmers who experience losses when their elevator fails despite the preventive provisions. Examples of remedial provisions are those requiring indemnity funds and bonding.

In Minnesota, the vast majority of country elevators are regulated by state rather than federal legislation.⁶³ Most elevators are, there-

59. See Looney & Byrd, *supra* note 30, at 523-28; see also Findings of Fact, *supra* note 12, at 3.

60. See GENERAL ACCOUNTING OFFICE, FEDERAL INSURANCE PROGRAM FOR GRAIN WAREHOUSE DEPOSITORS-ISSUES AND INFORMATION (GAO/RCED-85-39 March 1, 1985)[hereinafter GAO REPORT]. Other states having grain elevator legislation include: Alabama, Arkansas, Colorado, Florida, Georgia, Indiana, Iowa, Illinois, Kansas, Kentucky, Louisiana, Maryland, Michigan, Mississippi, Missouri, Montana, Nebraska, New York, North Carolina, North Dakota, Oklahoma, Oregon, South Carolina, South Dakota, Texas, Washington, Wisconsin, Wyoming. *Id.* at 6. See also Murphy Interview, *supra* note 50.

61. GAO REPORT, *supra* note 60, at 3-6.

62. Note, *supra* note 15, at 311.

63. Swanson Interview, *supra* note 2. The relationship between state and federal warehouse legislation exemplifies the importance of effective state legislation. In 1916, the United States Warehouse Act was enacted to provide a uniform federal regulatory system governing warehouses that store agricultural products. The Act's major objective is to facilitate proper financing of the stored commodities. The Act does not require all of the elevators to be licensed according to its provisions, but merely offers an alternative to state regulation. Thus, an elevator operator can choose to be federally or state licensed.

Elevators licensed under the Warehouse Act must pass certain requirements in order to be federally licensed. Mr. Swanson stated that these requirements include the funding of an acceptable bond, maintaining a minimum net worth, and paying of licensing and inspection fees. After being licensed, warehousemen are subject to unannounced periodic investigations by agents of the Department of Agriculture. In

fore, regulated by chapters 223 and 232 of the Minnesota Statutes.⁶⁴ Chapter 223, the Grain Buyers Act,⁶⁵ gives the Commissioner of Agriculture the authority to regulate grain buyers. Chapter 232, the Grain Storage Act,⁶⁶ authorizes the Commissioner to regulate the storage of grain by public grain warehouses. It is the inadequacies and the inequities in these chapters that strip the responsible grain farmer of any protection and security. These Acts better protect the financially troubled, mismanaged, or fraudulently run grain elevator.

The statutory purpose of these Acts is to give the Commissioner of Agriculture the authority to regulate grain buyers and local public warehouses. Since country grain elevators are considered public grain warehouses that buy and store grain, both chapters apply in bankruptcy. In addition to the statutory purpose, the legislation should minimize the risk in transactions between the grain farmer and the elevator. This would ensure smooth and profitable dealings.

The Grain Buyers Act and the Grain Storage Act require annual licensing of the elevator with the Commissioner of Agriculture before any grain may be purchased or stored.⁶⁷ Both Acts require distribution of the licensing fees into the grain buyers and storage fund.⁶⁸ This fund is used to offset the expenses of administering and enforcing each chapter.⁶⁹

Before either license is issued, however, the applicant must file a bond with the Commissioner as security in the event of an elevator default.⁷⁰ The applicant that seeks licensing under both Acts must purchase both a grain buyer's bond and a grain storage bond.

addition, these warehouses must distribute warehouse receipts describing detailed information about storage contracts between the parties. The warehousemen may be fined or imprisoned for failing to comply with the Act.

64. *Id.*

65. MINN. STAT. §§ 223.15-.19.

66. *Id.* §§ 232.20-.25.

67. *See id.* § 223.17, subd. 1. "An application for a grain buyer's license must be filed with the commissioner and the license issued before any grain may be purchased. The types of grain buyers' licenses are: (a) private grain warehouse operator's license; (b) public grain warehouse operator's license; and (c) independent grain buyer's license." *Id.*; *see also id.* § 232.22, subd. 1. "An application for a public grain warehouse operator's license must be filed with the commissioner and the license issued before the purchase or storage of grain may be commenced." *Id.*

68. *Compare id.* § 223.17, subd. 3, *with id.* § 232.22, subd. 3.

69. *Id.* §§ 223.17, subd. 3, 232.22, subd. 3.

70. *See id.* § 223.17, subd. 4. That section provides:

Before a grain buyer's license is issued, the applicant for the license must file with the commissioner a bond in a penal sum prescribed by the commissioner but no less than the following amounts (a) \$10,000 for grain buyers whose gross annual purchases are \$100,000 or less; (b) \$20,000 for grain buyers whose gross annual purchases are more than \$100,000 but not more than \$750,000; (c) \$30,000 for grain buyers whose gross annual purchases are more than \$750,000 but not more than \$1,500,000; (d) \$40,000 for grain buyers whose gross annual purchases are more than \$1,500,000 but not

Although the Commissioner determines the amount of each bond, there are statutory guidelines that formalize the amounts of the bond coverage.⁷¹ These guidelines range from bond minimums of \$10,000 to \$50,000 per year on each bond, depending upon the business volume of the elevator.⁷²

The grain buyer's bond provides coverage for losses that occur when a grain farmer demands payment on a cash sale but the elevator is unable to pay within the statutory period because of insufficient funds.⁷³ The grain farmer who is damaged by a breach of contract on a cash sale must file a written claim with the Commissioner within 180 days of the breach.⁷⁴ If the claim is valid, the Commissioner may immediately suspend the elevator's license.⁷⁵ If more than one claimant exists and the bond coverage is insufficient to pay the entire liability, the bond proceeds are apportioned among the bona fide claimants.⁷⁶

The grain storage bond provides coverage for losses that occur when a grain farmer tenders a valid warehouse receipt and the elevator is unable to deliver that particular quantity or quality of grain or provide payment for grain sold on a cash basis. The warehouse receipt signifies open storage of the grain in the elevator. The receipt must be in statutory form and include the name and location of the warehouse, the date of deposit, and other pertinent information evidencing the grain farmer's ownership of the stored grain.⁷⁷ If the

more than \$3,000,000 and (e) \$50,000 for grain buyers whose gross annual purchases exceed \$3,000,000. . . .

Id.; see also *id.* § 232.22, subd. 4 (grain storage bond requirements).

71. *Id.* §§ 223.17, subd. 4, 232.22 subd. 4.

72. *Id.* §§ 223.17, subd. 4, 232.22 subd. 4.

73. *Id.* § 223.17, subd. 8(a). "The bond required . . . shall provide payment of loss caused by the grain buyer's failure to pay, upon the owner's demand, the purchase price of grain sold to the grain buyer in the manner provided by subdivision 5, including loss caused by failure to pay within the time required . . ." *Id.*

74. *Id.* § 223.17, subd. 7. "A producer claiming to be damaged by a breach of a contract for the purchase of grain by a licensed grain buyer may file a written claim with the commissioner. The claim must state the facts constituting the claim." *Id.*

75. *Id.*

76. *Id.* § 223.17, subd. 8(c).

77. *Id.* § 232.23, subd. 4(b). That subdivision provides:

A grain warehouse receipt shall contain either on its face or reverse side the following specific grain warehouse and storage contract: "This grain is received, insured and stored through the date of expiration of the annual licenses of this grain warehouse and terms expressed in the body of the grain warehouse receipt shall constitute due notice to its holder of the expiration of the storage period. It is unlawful for a public grain warehouse operator to charge or collect a greater or lesser amount than the amount filed with the commissioner. All charges shall be collected by the grain warehouse operator upon the owner's presentation of the grain warehouse receipt for the sale or delivery of the grain represented by the receipt, or the termination of the storage period. Upon the presentation of this grain warehouse receipt and payment of all charges accrued up to the time of presenta-

claimant has properly filed his written claim within the 180 day period and the Commissioner finds the claim is valid, the bonding company issues payment. As with the grain buyer's bond, if the bond coverage is insufficient to pay all of the valid claims, the proceeds are apportioned on a pro rata basis among claimants.⁷⁸ In addition to the bond coverage, if an elevator defaults, then any grain owned or stored in that warehouse is sold and the combined proceeds deposited in a special fund.⁷⁹ These proceeds, in conjunction with the bond coverage, are then distributed to valid holders of warehouse receipts.⁸⁰

To determine the bond amount for each elevator, the commissioner requires that financial records be maintained and periodically delivered to the Department of Agriculture. The Grain Buyers Act requires the annual delivery of balance sheets, a statement of income, a statement of the dollar amount of grain purchased in previous fiscal years, and other records prepared by the warehouse, coincidental with a balance sheet compiled by an independent accounting firm.⁸¹

The Grain Storage Act requires the elevator to file monthly reports evidencing the net liability of all grain outstanding in warehouse receipts.⁸² These reports are also used to determine the amount of the bond.⁸³ In addition, this Act lists a number of book-keeping procedures used to determine the amount of grain on hand.⁸⁴ This amount is important when determining whether the grain farmer can recover his crop at any given point in time. This Act specifically states that the elevator "must maintain . . . at all times grain of proper grade and sufficient quantity to meet delivery obligations of all outstanding grain warehouse receipts."⁸⁵ In addition to receiving these financial records, the Commissioner reserves the right to make inspections and audits of each warehouse at the agency's discretion.⁸⁶ The purpose of these two forms of investigation is to ensure the responsible management of the elevator.

A final explanation of the legislation again involves the bonds of

tion, the above amount, kind and grade of grain will be delivered within the time prescribed by law to the depositor or the depositor's order."

Id.

78. *Id.* § 223.22, subd. 7(e).

79. *Id.* § 232.22, subd. 7(d).

80. *Id.* This could result in even further losses because grain may be sold in the fall, when the price of grain is at its lowest.

81. *Id.* § 223.17, subd. 6.

82. *Id.* § 232.22, subd. 5.

83. *Id.*

84. *Id.*

85. *Id.* § 232.22, subd. 5(d).

86. *Id.* § 232.24.

each Act and when they do not apply. The Grain Buyers Act provides that no bond coverage exists for voluntary extension-of-credit contracts.⁸⁷ These types of transactions include any agreement between a grain farmer and an elevator except the cash sale and open storage.⁸⁸ Bond coverage exists, therefore, only for these two transactions, and does not exist in any situation involving credit such as deferred-payment, price-later, or any hybrid contract. In addition, if the farmer was not given a statutorily valid warehouse receipt, there is no bond coverage.

Associated with the preceding provision of no bond coverage for voluntary extension-of-credit contracts is the statutory presumption that the title to the grain passes upon delivery to the elevator.⁸⁹ This presumption applies in a voluntary extension-of-credit and could occur in an open storage situation if the farmer does not tender a valid warehouse receipt.

An elevator that fails to comply with either Act is guilty of a misdemeanor.⁹⁰ The Department of Agriculture may suspend or revoke the license, depending upon the agency's findings.⁹¹

IV. *IN RE KERN*

In the late 1970's, the Kern elevator, located in Kenyon, Minnesota began advertising that it had access to additional storage space.⁹² The solicitation came at a time when most other grain facilities were full. The Kern elevator, licensed under both state Acts was similar to many other warehouses in Minnesota. The facility would store and buy grain from farmers to be sold when prices rose.

In the spring of 1982, some depositors at the elevator demanded their grain or the proceeds from the grain sale.⁹³ Kern was unable to satisfy these requests and subsequently filed for bankruptcy on July 14, 1982. Prior to the elevator's bankruptcy filing, the Commissioner received forty-one claims from the depositors. Claims continued to be submitted through November 29, 1982, seven months after the first claim was filed.⁹⁴

The Commissioner investigated the situation and determined that Kern did not have the additional 800,000 bushel storage capacity

87. *Id.* § 223.16, subd. 16.

88. *Id.*

89. *Id.* § 223.177, subd. 6. The statute states that the title to grain delivered on a voluntary extension-of-credit contract transfers to the grain buyer upon delivery.

90. *Id.* §§ 223.18, 232.25.

91. *Id.* § 223.18.

92. Findings of Fact, *supra* note 12, at 3.

93. *Id.* at 5.

94. *Id.*

that they had advertised.⁹⁵ Rather, the elevator had only a 200,000 bushel capacity. The remaining grain that Kern solicited was transported to commercial elevators in the Twin Cities.⁹⁶ Kern warranted to these larger facilities that the country elevator held title to the grain.⁹⁷ Kern, however, continued to charge storage costs for the depositor's grain to which neither party held title. The administrative law judge found that no depositor had knowledge of the sale and that the questionable sale violated the Grain Storage Act.⁹⁸

The first of three issues decided by the court of appeals concerned the nature of the agreement between the parties.⁹⁹ The bonding company, arguing for Kern, stated that the agreement between the parties was for a price-later contract, thus transferring title and negating any bond coverage for the forty-one claimants.¹⁰⁰

The claimants argued that it was their intention to store the grain with Kern pursuant to the Grain Storage Act, thus retaining title and affording them bond coverage.¹⁰¹ The bonding company answered this argument by pointing out that not one depositor had a warehouse receipt to evidence an open storage contract.¹⁰² Therefore, Kern had the right to do whatever it desired with the grain that belonged to it.

The court of appeals held that the "factual findings of an agency are entitled to a presumption of correctness."¹⁰³ In this case, the court did "not even find the existence of conflicting evidence."¹⁰⁴ The Commissioner's findings supported the claimants' position that they did intend open storage instead of any voluntary extension-of-credit contract.¹⁰⁵ The opinion did not address the statutory presumption of title passing upon delivery if no warehouse receipt is tendered.¹⁰⁶ The court may have ignored this statutory provision because the elevator did not always distribute warehouse receipts in

95. *See id.* at 3.

96. *See id.*

97. *Id.*

98. *See id.* at 5. MINN. STAT. § 232.23, subd. 13 states: "No warehouse operator may sell or dispose of or deliver out of storage any grain stored without the express authority of the depositor and the return of the grain warehouse receipt." *Id.*

99. *Kern*, 369 N.W.2d at 569.

100. *Id.* at 570-71.

101. *Id.* at 571.

102. *Id.*

103. *Id.*

104. *Id.*

105. *See, e.g., Findings of Fact, supra* note 12, at 7. The intent of the claimant, Earl Peter, was for Kern to store his grain. Peter's son, however, received a delayed pricing contract. The senior Peter did not know what a delayed pricing contract was and asked for an explanation from Phylliss Kern. Ms. Kern stated that a delayed pricing contract was the same as open storage.

106. *Kern*, 369 N.W.2d at 569-70.

these open storage agreements, as required by the legislation.¹⁰⁷ Thus, the claimants could not possibly prove that they intended to hold title to the grain, except by oral evidence.

The second issue addressed by the court was whether the forty-one depositors properly filed their claims within the six month statutory period.¹⁰⁸ The first claim was filed on April 26, 1982, but the majority of the claims were filed seven months later on November 26, 1982.¹⁰⁹ According to the statutory language, "[a]ny person claiming to be damaged by a breach of the conditions of a bond . . . may enter complaint thereof . . . to the department [of public service] within six months from the breach of the conditions of the bond."¹¹⁰ Thus, the critical issue is: when was the contract breached? The bonding company argued that the six month period began running when the first claim was filed on April 26.¹¹¹ This argument would disallow bond coverage for most of the claimants since they did not file until seven months later.¹¹²

The claimants, on the other hand, interpreted this ambiguous section of the statute as allowing each depositor "6 months from the time the conditions of the bond were breached *as to that claimant* to file his claim."¹¹³ This would give each depositor six months from the time each learned of the breach to file a claim with the Commissioner.

The court held that the six month period commences upon the filing of bankruptcy by the elevator which occurred on July 14, 1982.¹¹⁴ This event should leave no question as to whether a breach has occurred between the warehouse and the depositors. The result of this decision allowed every claimant coverage under the bonds.¹¹⁵

The third and final issue discussed by the court involved the bond years upon which recovery could be based.¹¹⁶ The court based its opinion on the premise of the Commission that "the wrong [the conversion] which led to the breach took place whenever the grain was delivered to [Kern]. Grain belonging to the claimants was delivered

107. *Id.* at 571; *see also* Findings of Fact, *supra* note 12, at 8. Kern trucks removed five loads of soybeans from storage bins on the farm of Wayne Trahms with the acquiescence of Trahm's father who lived on the farm. Kern neither obtained the permission of Trahms, nor furnished a receipt. *See id.*

108. 369 N.W.2d at 569-70.

109. *Id.* at 568.

110. MINN. STAT. § 232.13 (1980). As the *Kern* court noted, the notice period is now 180 days rather than 6 months. *Kern*, 369 N.W.2d at 570.

111. *Kern*, 369 N.W.2d at 570.

112. *Id.*

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.* at 571.

to Kern as early as 1979-80.”¹¹⁷ Since the purpose of bonds under the then applicable statute was to protect against malfeasance by the warehouse,¹¹⁸ the court held that “[w]hen such malfeasance occur[s] during the time period covered by the bond, recovery may be had against the bond.”¹¹⁹

The bonding company argued that this language disallowing the stacking, or recovery against several years of bonds, is unambiguous.¹²⁰ Recovery should, therefore, only be allowed on the 1981-82 bond, because Kern’s failure took place during “the coverage dates of that bond.”¹²¹

The court again agreed with the Commissioner’s finding and ignored the statute in finding for the claimants. The administrative law judge found that recovery should be on the 1979-80, 1980-81, and 1981-82 bonds.¹²² This stacking of the bonds was allowed because Kern was converting the grain unbeknownst to the depositors during this three year period.¹²³ “While the breach of the conditions of the bond did not actually occur until spring or summer of 1982 when Kern could not give [the] claimants their money, the wrong [the conversion] which led to the breach took place whenever the grain was delivered to them.”¹²⁴ The court agreed with the Commissioner’s finding that the bonds are required by statute to protect against malfeasance by the elevator. When such malfeasance occurs during the period of bond coverage, as in this situation, recovery is allowed under all applicable bonds.¹²⁵ This ruling ignores the statutory provisions prohibiting stacking, to obtain what appears to be a guarantee of an equitable recovery of at least part of the losses incurred by the forty-one claimants.

V. ANALYSIS OF THE MINNESOTA LEGISLATION

Theoretically, the marketing option between the grain farmer and the warehouse should be relatively risk-free. This is the general intent of the legislation.¹²⁶ As *Kern* illustrated, however, only by ignoring the existing legislation could the court provide some level of recovery for the claimants. This avoidance of the Acts in conjunction with the increasing number of grain elevator bankruptcies and the

117. *Id.*

118. MINN. STAT. § 232.13 (1980).

119. *Kern*, 369 N.W.2d at 571.

120. *Id.*

121. *Id.*

122. Findings of Fact, *supra* note 12, at 66 and Appendix A.

123. *Kern*, 369 N.W.2d at 571.

124. *Id.*

125. *Id.*

126. See Murphy Interview, *supra* note 50; see also GAO REPORT, *supra* note 60, at 1-8.

subsequent losses to the grain farmers caused by a troubled agricultural economy illustrates the pressing need for a major overhaul to chapters 223 and 232.

A major problem with the Grain Buyers and Grain Storage Acts involves the statutory presumption that title to the grain passes to the elevator upon delivery.¹²⁷ Both Acts allow an exception to this presumption if the agreement between the parties is for open storage.¹²⁸ This exception is in agreement with Minnesota's common law, that views an open storage agreement as a bailment situation where title remains with the farmer.¹²⁹ To assure that the arrangement is interpreted as open storage, however, the farmer must produce a warehouse receipt which conforms to statutory requirements.

The problem appears when the farmer attempts to reclaim his stored crop from his elevator, but has no warehouse receipt, as was the case in *Kern*, or has an invalid warehouse receipt. Pursuant to the statutory presumption, the elevator operator now has title to the grain, and has actually held title since delivery, because the agreement between the parties is not considered a voluntary extension-of-credit agreement.¹³⁰ Therefore, if the farmer has a warehouse receipt that differs in any way from the provisions in the statute or has no warehouse receipt at all, title passes to the elevator, and the burden falls upon the farmer to prove his intention for open storage.¹³¹

Since the legislation presumes that a voluntary extension-of-credit situation was intended if there is no valid warehouse receipt, the farmer can seek no relief from the bonding because these credit agreements are exempt from coverage.¹³² The distraught farmer may believe that a court action can provide relief. The statute, however, again fails to protect the persons it was designed to protect. The legislation allows only a valid, statutorily conforming warehouse receipt to be admissible into evidence and further dictates that "no slip or other memorandum or other form of receipt is admissible as evidence in any civil action."¹³³ Thus, the farmer who intended an

127. MINN. STAT. §§ 223.17, subd. 7, 232.22, subd. 6.

128. *Id.*

129. *Hall v. Pillsbury*, 43 Minn. 33, 44 N.W. 673 (Minn. 1890). A deposit of grain for storage is a bailment. The title remains with the depositor. He is deemed to be the owner of grain in the warehouse to the amount of his deposit. Although the identical grain he deposited has been removed, other grain of like kind and quality is substituted in its stead. The holders of receipts for grain of the same kind and quality so deposited are tenants in common in the mass of grain of that kind and quality in the warehouse. The interest of each is limited to the amount called for by his receipt.
Id.

130. MINN. STAT. § 223.16, subd. 16.

131. *Id.* § 232.23, subd. 5.

132. *Id.*

133. *Id.*

open storage agreement, but was not given a valid warehouse receipt, has no recourse. Fortunately for the claimants in *Kern*, the court circumvented the legislation by allowing oral testimony as to the existence of open storage contracts.¹³⁴

The existing legislation should be modified to allow the use of any reasonable evidence to aid the grain farmer in reacquiring his grain. The model Illinois legislation eases this problem by allowing any "evidence of ownership" to be admitted to establish a claim.¹³⁵ This expansion of the allowable documentation would better protect the grain farmer, as is intended by both Acts.

The Acts do require careful documentation of all financial records to determine the amount of grain in storage and to assure compliance by the warehouse with the Commissioner's regulation set forth in the statutes.¹³⁶ This requirement creates an increased need for stepped-up inspection of each country elevator. This would guarantee the financial responsibility of the warehouse and avoid conversion of grain similar to that in *Kern*.

The 180 day limitation period for filing a claim with the Commissioner is inadequate and presents a third problem in both Acts.¹³⁷ First, as *Kern* illustrated, both Acts make no mention of when the limitation period should commence. The second inadequacy is that 180 days is a relatively short span of time to a grain farmer. Many grain farmers leave their deposits with the elevator for years before deciding to sell. In these situations, the grain farmer has no reason to suspect that an elevator is experiencing financial problems or even converting his crop. A compromising time limit of perhaps twelve to eighteen months would afford better protection for the grain farmer.

A fourth problem with the legislation involves the grain buyers bond and the corresponding grain storage bond.¹³⁸ There are numerous subproblems within this troubled area. The first bond problem concerns the inadequate bonding coverage in both Acts. The statutes provide guidelines for the Commissioner that range from \$10,000 to \$50,000 per year dependent upon the volume of business

134. *Kern*, 369 N.W.2d at 565.

135. See GAO REPORT, *supra* note 60, at 13-19. Basically, depositors, sellers, and lenders with "evidence of ownership" are covered by the fund. *Id.* at 13. To finance this fund, warehouses pay \$7.50 for each \$1,000 of bond formerly required by the state, up to \$10,000 of bond coverage. The rate drops to \$5 per \$1,000 for the next \$15,000 of bond and \$3 per \$1,000 for bond amounts over \$25,000. Dealers pay \$10 for each \$1,000 of bond formerly required. *Id.* at 17.

As for actual coverage, 100% of valid claims is covered for grain stored under warehouse receipts. For other grain delivered to the dealer, 85% of a claim, with a maximum payment of \$100,000 per claim is allowed. *Id.* at 19.

136. MINN. STAT. §§ 223.17, subd. 8, 232.24.

137. *Id.* §§ 223.17, subd. 7, 232.22, subd. 6.

138. *Id.* §§ 223.17, subd. 4, 232.22, subd. 4.

conducted by the elevator.¹³⁹ This maximum limit is the lowest compared to the twenty-eight other states that regulate their grain elevators. Ten of these states have no upper limit, while the remaining states have an average maximum limit of \$535,000.¹⁴⁰

The coverage on 1981-82 bonds in *Kern* totalled \$200,000.¹⁴¹ Total claims by the depositors, however, were nearly \$600,000.¹⁴² If the court would have followed the provisions disallowing stacking of bonds in the legislation, the claimants' potential recovery would have been significantly less. By granting stacking of the bonds over the four year period, the court created an equitable solution that allowed the depositors to receive almost thirty-three cents on the dollar for their crops.¹⁴³ This wide disparity illustrates the inadequacy of the bonding amounts.

A fifth problem with the bonding arises when an elevator fails and there is insufficient grain on hand to satisfy the depositors. Section 232.22, subdivision 7(d) of the Grain Storage Act states that when a bankruptcy occurs, all of the remaining grain in the warehouse is sold and the proceeds are put into a special fund for the depositor in addition to the bond disbursement for holders of valid warehouse receipts.¹⁴⁴ This fund, in conjunction with the bond coverage, is disbursed to claimants holding valid warehouse receipts.¹⁴⁵ As was illustrated in *Kern*, the amount was still insufficient to cover all claims.¹⁴⁶

139. Murphy Interview, *supra* note 50.

140. See GAO REPORT, *supra* note 60, at 9-10. Minnesota has the dubious distinction of being tied with Florida for the lowest maximum bond limit. Neighboring grain producing states have the following maximum limits: Missouri, \$1,000,000; Michigan, \$400,000. North Dakota, South Dakota, Wisconsin, and Iowa have no maximum bond limit.

141. Findings of Fact, *supra* note 12, at 8; see also MINN. STAT. § 232.22, subd. 4. This section of the Grain Storage Act states that before a licence is issued the applicant for a public grain warehouse operator's license shall file with the Commissioner a bond in a penal sum prescribed by the Commissioner. The penal sum on a condition one bond shall be established by rule by the Commissioner pursuant to the requirements of chapter 14 of Minnesota Statutes for all grain outstanding on grain warehouse receipts. The penal sum on a condition two bond shall not be less than \$10,000 for each location up to a maximum of five locations.

Pursuant to administrative rule, the elevator need only have 50% of the grain stored covered by the storage bond. Under the federal act the bonding must be to the entire storage capacity. The elevator has the choice of either selecting the state requirements or the more demanding federal requirements. Most elevators in Minnesota naturally choose the state requirements. Murphy Interview, *supra* note 50.

142. *Id.*

143. *Id.*

144. MINN. STAT. § 232.22, subd. 7(d).

145. *Id.*

146. Recovery from the 1979-80 and 1980-81 bonds in addition to the 1981-82 bonds increased the recovery per claimant by sixty-six percent. However, the forty-

One problem with grain pooling is that the statute makes no provision for the proceeds and its distribution.¹⁴⁷ Even if this question is answered, the statute's non-differentiation of the various commodity prices between, for example, corn and soybeans creates further problems. Due to this non-differentiation, a soybean farmer may receive a lower disbursement amount when this commodity's price is significantly higher than other grains.¹⁴⁸

Distribution of the proceeds is the sixth problem existing under the present Grain Storage Act. The Grain Storage Act specifically states that disbursement will be made to holders of warehouse receipts.¹⁴⁹ If there are no warehouse receipt holders, as was the case in *Kern*, who is entitled to the proceeds? Here is yet another unanswered question that the legislation ignores.

Finally, a problem arises concerning bond coverage. The Acts allow coverage only for cash sales under the Grain Buyers Act and for open storage under the Grain Storage Act.¹⁵⁰ Coverage is excluded for any voluntary extension-of-credit contract.¹⁵¹ Of the twenty-nine states with grain elevator legislation, only three (including Minnesota) have this exclusion.¹⁵²

There are no clear policy reasons for the coverage exclusion in credit situations. What is clear, however, is that elevators have an unfair advantage when dealing with a depositor who does not know the consequences of failing to secure a valid warehouse receipt in an open storage setting. *Kern* illustrated the fact that farmers and grain elevator operators alike conduct much of their business orally, and seal their contracts with a handshake. The legislation does not take into account these informal business practices and, therefore, the grain farmer is severely disadvantaged.¹⁵³

Coverage for every transaction between the parties would create an easy solution to the problem of bond coverage. This would better protect the farmer as intended by the statutes, and would not impair

one claimants have yet to see any of their losses recouped. Murphy Interview, *supra* note 50. Mr. Murphy stated that the Kern elevator's insurance company has yet to distribute any bond coverage to any of the claimants. *Id.*

147. MINN. STAT. § 232.22, subd. 7(d).

148. Interview with Dale Dahl, Professor of Agricultural Economics at the University of Minnesota, St. Paul, Minn. (November 14, 1985) [hereinafter Dahl Interview].

149. MINN. STAT. § 232.22, subd. 7(d).

150. *Id.* § 223.17, subd. 5.

151. *Id.* § 232.22, subd. 7(b).

152. See Looney & Byrd, *supra* note 28, at 523-28; see also GAO REPORT, *supra* note 60, at 6-7. Michigan and North Dakota are the only other states that prohibit bond coverage on credit transactions in which the farmer transfers title of the grain to the operator, but agrees to defer payment.

153. GAO REPORT, *supra* note 60, at 6-7. This study analogized the grain farmer's problems involving country elevators with those of a weary traveler on a return flight home, finding his parked car has been sold to another.

the elevator's operation since it must obtain bonding anyway. The bonding companies may balk as such a suggestion, fearing that it is too risky. Such fears of the surety may be eased by analyzing the steps taken by other states to curtail the problems with warehouse legislation.

VI. RECOMMENDATIONS

As mentioned previously, the Illinois grain warehouse legislation is currently the model regarding problems inherent in bankruptcy.¹⁵⁴ The statutory modifications of Minnesota's legislation already discussed should be analyzed with this model in mind.

The Illinois legislature enacted a new priority scheme in 1982 that allows recovery from an indemnity fund by anyone with evidence of either a storage or sale contract with their warehouse.¹⁵⁵ The fund is financed by an operator's fee equivalent to the amount formerly paid for a surety bond.¹⁵⁶

Specifically, claimants of first priority are those with a warehouse receipt or written evidence showing a storage contract. Second in priority include those who have written evidence documenting a sale and have completed the delivery and pricing within thirty days prior to the elevator failure. Any remaining grain or proceeds are distributed to others with contracts for sale that have not been paid.¹⁵⁷

Generally, this model legislation eases the requirements needed to recover from the fund and expands the number of claimants who can obtain coverage. The indemnity fund has a maximum limit of \$3,000,000 with provision to borrow if the need should arise.¹⁵⁸ Since its inception in Illinois, the legislation has been accepted by all concerned parties and has worked well.¹⁵⁹

In addition to the Illinois indemnity fund, requiring the grain farmers to insure their own grain sales is another potential remedy to this problem. The dealings between producers and warehouses create the kind of risk found in any insurable business venture. Currently, there is one private insurance company that offers such protection.¹⁶⁰ The policy covers grain produced in Minnesota and grain in the Payment-in-Kind (PIK) Program which is stored at li-

154. ILLINOIS GRAIN INSURANCE ACT, ILL. REV. STAT. ch. 114, § 701-102 (1983). The Grain Insurance Act provides a system to compensate grain producers who have incurred a financial loss due to a failure of a grain dealer or warehouseman.

155. *Id.*

156. *Id.* See Comment, *Grain Elevator Bankruptcy—Has Illinois Successfully Provided Security to Farmers*, 1983 S. ILL. U. L.J. 337, 339-40 (1983).

157. See Comment, *supra* note 156, at 342, 348-55.

158. *Id.*

159. *Id.* See GAO REPORT, *supra* note 60, at 13-19.

160. See GAO REPORT, *supra* note 60, at 23-24.

censed warehouses or sold to licensed grain dealers on price-later or deferred-payment contracts.¹⁶¹ The warehouse or dealer must be in Minnesota or within seventy-five miles of the state's border. Coverage can be purchased in increments of \$50,000, up to a total of \$200,000.¹⁶² The policy covers eighty percent of losses on grain stored under warehouse receipts. Open storage contracts with invalid warehouse receipts and grain sold under either price-later or deferred-payment contracts are covered for eighty percent of losses occurring within ninety days after delivery. Coverage decreases by one percent for each week beyond ninety days after delivery, with minimum coverage being sixty percent of the loss.¹⁶³ As of January 1986, the premium was \$35 for the first \$50,000 of coverage plus \$15 for each additional increment of \$50,000.¹⁶⁴

This would seem to be an easy solution to the grain farmer's dilemma. Sales of this policy have, however, been below expectations. It seems that farmers do not think they need such insurance because they have confidence in their local elevators.¹⁶⁵ This confidence may not last long if losses from elevator failures continue. The surety in *Kern*, for example, has yet to reimburse any of the forty-one claimants for their losses.¹⁶⁶

The United States House of Representatives' Committee of Agriculture is currently studying the feasibility of a federal deposit insurance program for grain warehouses similar to those programs available to banks through the Federal Deposit Insurance Corporation (FDIC).¹⁶⁷ The FDIC insures each bank depositor up to \$100,000. This system was established in 1933 during a period of bank failures not unlike the current problems involving grain elevators.

There seems, however, to be limited support for a grain deposit insurance program. Issues of concern for such a program include its potentially high cost, the expansion of current regulatory and examination activities, methods of finance, and the possibility that such a program may encourage unsound warehouse management.¹⁶⁸ Recommendations have yet to be made by the legislative committee regarding the possibility of establishing such a program.

161. *Id.*

162. *Id.*

163. *Id.*

164. *Id.*

165. *Id.*

166. Murphy Interview, *supra* note 50.

167. GAO REPORT, *supra* note 60, at 1-22.

168. *Id.* at 7.

CONCLUSION

The desperate financial situation of the farmer across the nation demands immediate attention by the federal and state governments. Minnesota's grain farmers are not excluded from this increasing problem. Every year, thousands of this state's grain farmers unwittingly engage in risky marketing transactions. These transactions have taken millions of dollars from the grain farmer. The Grain Buyers and Grain Storage Acts provide little, if any, protection for grain farmers. Instead, they give the warehouse a protective shield in bankruptcy proceedings.

One potential remedy lies with the model Illinois warehouse legislation, which has created a new priority scheme in bankruptcy settings. Another potential solution is the purchase of private insurance to guarantee a quick recovery of any losses due to warehouse insolvency. It is unlikely, however, that the federal government will establish a federal warehouse insurance system similar to the FDIC to compensate insolvency victims. Thus, the most obvious remedy is for the Minnesota Legislature to amend the present Acts, keeping in mind the practical aspects of grain farming and the economics of the various grain marketing transactions. Modification of this legislation would remedy a needless burden placed upon today's already over-burdened grain farmer.

Todd Gillingham