PROTECTING THE FARMER IN GRAIN MARKETING TRANSACTIONS*

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I. INTRODUCTION

The market for agricultural products is characterized by more fluctuation and is affected by more outside forces than the markets for most other products. Seasonal fluctuations, weather patterns, livestock cycles, rates of inflation, international politics, government policies, and numerous other uncertainties beyond the farmer's control all affect the market for agricultural products—sometimes dramatically.[1]

Concern is frequently expressed about the farmer's share of the food dollar—generally averaging only about 40%.[2] The farm to retail price spread or the so-called "marketing margin" reflects the processing, grading, packaging, storing, transporting, financing and risk-bearing costs of getting the product from the farm to the consumer—all vital functions of the marketing system. The farmer has no control over these processes and they have little effect on the price he receives for the farm product.

The farmer loses physical control over the product at the first step in the marketing process. For most food and feed grains, private grain handling facilities or cooperative elevators serve as the first step in the marketing process. They serve as points of assembly and conditioning of the product, and often for storage as well. In many areas, country elevators still serve the local community as centers of assembly and shipping. Shipment is made either directly to processors or to terminal elevators or exporters.

From the farmer's perspective, grain marketing basically involves two alternatives: selling or storage for later sale.[3] The sales transaction may be concluded by the terms of a forward cash contract or through a cash contract at harvest. The sales contract may also involve deferred payment or deferred pricing arrangements. Storage transactions frequently involve the commercial storage facilities of private or cooperative elevators. The amount of grain stored under such contracts is evidenced by warehouse receipts (negotiable or non-negotiable), or by scale tickets. These choices lead to many of the legal problems encountered by the farmer in the grain marketing transaction. For example, much of the litigation in the early 1970's between farmers and grain elevators involved forward cash contracts, often oral or informal in nature. Farmers' losses when elevators become insolvent may

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1. For a discussion of agricultural marketing, *see generally* J. LOONEY, BUSINESS MANAGEMENT FOR FARMERS (to be released by Doane Agric. Serv. 1982).

2. Coffey, *The U.S. Agricultural Economy in Perspective*, PRINCIPLES OF AGRICULTURAL ECONOMICS: SELECTED READINGS AND SELF-LEARNING EXERCISES (S. Batie & J. Looney eds. 1980). The farmer's share varies greatly according to food groups. For example, the farmer's share of the food dollar exceeds 65¢ for eggs but is less than 15¢ for bakery and cereal products.

3. Actually, the farmer may also choose to market grain by feeding it to livestock which are ultimately sold.

result because the farmers choose to market the product through a deferred payment arrangement so that the farmer is treated as a general, unsecured creditor in any grain elevator bankruptcy proceeding.

Not all transactions between farmers and elevators are satisfactorily concluded. First, a myriad of problems may arise from the sales contract itself. The seller may refuse to deliver either due to crop failure, or because of price fluctuations which tempt the farmer to market elsewhere in breach of the contract. Upon delivery, the buyer may claim the delivery is insufficient based on deficiencies in the product—usually weight or grade.

The buyer may refuse to accept delivery due to transportation or storage problems, or a change in prices may tempt the elevator to dishonor contractual obligations; and, the buyer may not have the ability to pay for delivery of the product. Similar problems may arise from grain storage contracts where the bailee-warehouse is unable to re-deliver (or pay for) the product upon demand due to financial difficulties resulting from poor management or wrongful conduct.

In recent months, farmers have protested what they consider to be "unfair" treatment of those who get caught in the trap of grain elevator bankruptcy.[4] Two illustrations follow. In the fall of 1978, farmers in southeast Arkansas had smaller than usual crops due to drought conditions. In order to minimize losses, farmers sought competitive offers from grain buyers. A Louisiana corporation, doing business in Arkansas as Riverport Terminal, Inc., operated a local grain terminal in Ashley County, Arkansas. Representatives of that company actively sought grain contracts from area farmers. The company offered the highest price in the area and bought over $1 million worth of soybeans in Ashley and Chicot Counties. It issued checks to the sellers which were returned to the sellers as "insufficient funds" checks. Shortly thereafter, Riverport Terminal, Inc., filed for bankruptcy relief, and, to date, the farmers have received no payments in the bankruptcy proceedings.[5]

In 1979 and 1980, northeast Arkansas and southeast Missouri farmers sold crops to or stored crops in facilities owned by the James Brothers, doing business in a number of Missouri and Arkansas locations under various partnership identities and one affiliated corporation. In August, 1980, the debtors filed proceedings in the Bankruptcy Court for the Eastern District of Arkansas under the Bankruptcy Reform Act of 1978.[6] The bankruptcy

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4. *See e.g.*, Reynolds, *Elevators—The Ristine Rumor: How the Truth Got Buried Under the Drama of Grain Trucks and Wayne Cryts*, KANSAS FARMER (1981); Schotsch, *Elevator Bankruptcies: Don't get Caught Holding the Bag*, FARM J. (1981); Van Hoozer, *Seller Beware, Big Farmer Entrepreneur* (1981).

5. *In re* Riverport Terminal, Inc., No. B79-642-M (Bankr. W.D. La., filed April 1979).

6. *In re* James, No. J080-154 (Bankr. E.D. Ark., filed Aug. 1980). *See* Missouri v. United States Bankr. Ct., 647 F.2d 768 (8th Cir. 1981) [hereinafter cited as Missouri v. U.S. Bankr. Ct.]. In note five of that case, the court noted that no adversary factual record had been made in the various *James Bros.* proceedings, and the court summarized the facts at 771-72 of the

court appointed a trustee for the purpose of operating and liquidating the various partnerships.[7] The trustee asserted authority to sell all grain held in the facilities, whether the grain was stored, purchased or contracted to be purchased in the future.[8] Farmers who had merely stored grain in the elevators objected because the amount they actually owed the debtor for storage was only a few cents per bushel.[9] The State of Missouri intervened because state laws regulating the liquidation of grain held in grain warehouses were not being followed. This chaotic state of affairs led to serious confrontations between farmers and federal marshals, and ultimately the jurisdictional questions were taken to the Eighth Circuit Court of Appeals and to the United States Supreme Court.[10]

The United States Department of Agriculture estimates that since 1975 about 175 grain elevators of an estimated 10,000 have failed.[11] These failures have received wide publicity because of the direct effect on individual farmers. According to an Illinois study, 110 bankruptcies occured from 1974 to 1979, resulting in losses to over 3000 farmers who recovered an average of only twenty-eight percent of their claims.[12] While the total dollar losses are not major (averaging only $3.6 million per year out of a storage of $15 billion at any one time) the effect on an individual farmer can be devastating because farmers typically place their entire source of annual income into one facility.[13]

Why have these losses occured? According to the Illinois study, the main causes for grain elevator and warehouse bankruptcies were losses in grain futures market trading (speculation) and general mismanagement.[14] Other reasons cited were under-capitalization, poor recordkeeping and accounting, and unwise use or misuse of funds.[15]

The remainder of this article will be devoted to a review of the typical grain marketing transaction and the problems that a farmer can encounter in the marketing system, including those resulting from the buyer's inability to pay. Suggestions for strengthening the farmer's position in the contractual relationship are included along with remedies available to the farmer caught in a bankruptcy proceeding involving an insolvent grain buyer or storage facility. Legislative and regulatory proposals for affording greater

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opinion. *Id.*

7. *In re* James, No. J080-154, 155 (Bankr. E.D. Ark., filed Aug. 1980).

8. *Id. See also* Bankruptcy Act, 11 U.S.C. § 363(f)(4) (Supp. III 1979).

9. *In re* James, No. J080-154, 155.

10. Missouri v. U.S. Bankr. Ct., 647 F.2d 768 (8th Cir. 1981), aff'd, ___ U.S. ___ (1982).

11. *United States Department of Agriculture, Keeping Harvests Safe From Failing Elevators,* FARMLINE (1981).

12. ILLINOIS LEGISLATIVE COUNCIL, GRAIN ELEVATOR BANKRUPTCIES IN THE U.S. 1974 THROUGH 1979, File 9-179 (1981).

13. *Id.* at D-1, app. D.

14. *Id.* at 5, C-1, app. C.

15. *Id.* at 6.

protection to the farmer are analyzed and some preventive measures are suggested.

II. Grain Marketing Transactions: Typical Arrangements and Common Problems

A. *Types of Transactions*

The farmer uses various marketing strategies as management tools in an effort to increase net returns for the product. The last decision concerning the product for the farmer is that of which marketing strategy to follow. Generally, this strategy involves a decision not only as to when the product is to be sold (i.e. title transferred), but when the farmer is to be paid. Tax planning often drives the marketing decision. Thus, the farmer may choose to sell the product for cash at harvest or by the terms of a forward cash contract, or delay receipt of the income by transferring the product to the elevator under a deferred payment or deferred pricing contract or storage agreement.

1. *Selling Grain at Harvest*

One marketing alternative available to farmers is to simply harvest the grain, deliver it to the local elevator and sell it at that time for cash. With a few exceptions, the period of harvest typically is the worst time to sell grains. Supplies are high and prices low. The exception occurs in those years when there is a heavy demand relative to supply. When grain is sold at harvest, the farmer has two choices: to sell the grain wet, often subject to moisture discounts; or to dry, condition and clean the grain to a quality necessary to meet certain grain standards. Whether it pays to raise the grain to standard by drying and conditioning before selling depends upon the amount of the moisture discount and, of course, the cost of drying and conditioning the grain.[16] Cash sales are not entirely free of risk, as illustrated by those situations such as Riverport Terminal, Inc., where checks received in payment are not honored. An unpaid seller in such circumstances is in no different position than the unpaid seller under a deferred payment or de-

16. Grain dealers and processors buy grain at a standard weight. For corn this is 56 pounds per bushel and it is discounted from the bid price to compensate for excess moisture (above 15.5% for #2 corn). For soybeans, the standard weight is 65 pounds per bushel with a discount from the bid price to compensate for excess moisture (above 13% for #1 soybeans). Discount rates vary at a given time and location, but a typical discount is to deduct 1% of the bid price for each .5% moisture above the standard.

Moisture discounts are designed to (1) adjust for the shrinkage which occurs when excess moisture is removed, (2) cover the extra cost of drying, handling and conditioning, (3) compensate for risk, and (4) discourage large amounts of high moisture grain from entering market channels. Thus, the moisture discount is made up of the value of the shrinkage and the imputed or implied handling charge.

ferred pricing contract if the facility becomes insolvent.

2. *Deferred Payment and Deferred Pricing Contracts*

Another type of contract used between farmers and elevators is the deferred pricing contract, also referred to as the "price later" contract. A typical deferred pricing contract provides that the elevator will pay the farmer a price quoted on a date elected by the farmer, minus a specific amount which is, in effect, a charge for storage. A variation also includes the deferred payment contract in which a price is determined but payment is delayed until a future time. These contracts are used for deferring income for tax or other reasons and not necessarily for "locking in" a particular price.[17]

Such arrangements are an alternative to simply leaving the grain in storage with the elevator and receiving a warehouse receipt, although many farmers may wish to store the grain and wait for a seasonal price rise. In cases of elevator bankruptcy, the farmer who has sold grain under such arrangements may be at a disadvantage compared to the farmer who has stored under a warehouse receipt.[18]

3. *Forward Contracting Through Cash Contracts*

One of the options available to the farmer as a marketing alternative is to contract in advance to deliver a specified quantity and quality of grain at some future date. This is generally referred to as a forward contract. The contract may be for specific quantities of a specific quality of a particular crop. In some cases the contract will be based on acres of crop from a certain farm or a specific producer. The price and time of payment is frequently specified, although deferred payment or deferred pricing arrangements may be included.

Most elevator operators have resorted to the use of written contracts in these situations and have come to expect strict compliance, often because they are also bound by similar contracts with processors, exporters, or with other elevators. In recent years, a number of legal actions against farmers have been brought because the sellers failed to deliver under the contract when cash prices increased substantially above the contract price.[19]

The basic reason for using a forward contract is to guarantee a market outlet. Since the contract provides for delivery of specific quantities of a product of a specific quality at a specific time and place and for an exact

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17. For a discussion of the current tax treatment of such contracts *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).

18. *See* text accompanying note 5 *supra* for a discussion of the problems arising in bankruptcy proceedings.

19. *See* text accompanying note 4 *supra*.

price (or a price to be determined by some formula), the farmer is guaranteed a market at the time when it is needed. Secondly, such arrangements limit the risk of the farmer because he has locked in a price and a market. This may have the effect of stabilizing income and affording some protection against declining prices, although it does not offer any advantage in cases of cash price increases unless coupled with a deferred pricing arrangement.

4. *Grain Storage as a Marketing Strategy*

Another marketing alternative available at harvest is to delay the sale and store the grain. A decision to store will depend in large part upon the availability of storage, the cost of storage, the current cash price, and the anticipated seasonal price rise. The objective in storing grain is to maintain the quality during the storage period in order to avoid any damage discounts, and then to time the marketing to not only take advantage of seasonal price increases but to recover storage costs as well.

On-farm storage avoids some of the problems of selling grain at a time when the price may not be favorable; it allows the avoidance of waiting lines at the elevator and loss of time during harvest; and it will permit management of income for tax purposes. At the same time, it does require extra handling, extra attention, and more careful marketing. Naturally, a certain amount of risk is involved. Additional investment is also required for the facilities. For this reason many farmers use commercial storage facilities.

Agricultural producers who store grain at elevators or other commercial facilities are issued warehouse receipts or weight (scale) tickets as evidence of the amount of grain stored. The United States Grain Warehouse Act[20] is designed to offer some protection to farmer-depositors in federally licensed grain storage facilities. In addition, warehouses that store grain under Commodity Credit Corporation (CCC) contracts must meet CCC Standards for Approval.[21] Many states have regulations covering warehouses. These state regulations generally cover grain storage facilities that are not subject to the federal law. While these regulations serve as a means of offering some reduction in the risk of insolvency, the farmer who stores grain in a commercial facility may still become embroiled in any bankruptcy proceeding involving the elevator, as illustrated by the controversy in the *James Brothers* proceeding.[22]

B. *Nature of the Contract and Typical Problems*

Many marketing transactions between farmers and grain warehousemen or grain dealers are informal in nature. Most elevators and many farmers are now aware of the dangers of operating in an informal fashion, particularly

20. 7 U.S.C. §§ 241-273 (1976).
21. 15 U.S.C. § 714 (1976 & Supp. IV 1980).
22. 6 Bankr. 619 (Bankr. E.D. Ark. 1980).

when forward contracts and deferred payment or deferred pricing contracts are used. Even so, farmers continue to become involved in litigation relating to the applicability of various Uniform Commercial Code provisions to these marketing transactions.[23]

1. *Oral Contracts*

The threshold consideration in such contracts is the question of the validity of an oral contract for the future delivery of grain. The Uniform Commercial Code governs such transactions, and by its statute of frauds provision requires a sale of goods for $500 or more to be evidenced by a writing signed by the party against whom enforcement is sought.[24] An important exception to the writing requirement is the so-called "merchants exception," which permits the enforcement of an oral contract for the sale of goods between merchants where one party sends a confirmation of the contract to the other within a reasonable time and no objection is made within ten days after the confirmation is received.[25]

Applicability of the merchants exception to grain sales transactions has raised the question of whether the farmer is a merchant. This issue has been extensively litigated, and a uniform result has not been achieved.[26] In those states that have concluded that the farmer is a merchant for purposes of the Uniform Commercial Code, oral contracts for future delivery of grain have been enforced where sufficient evidence of the contract exists and where the "merchants exception" is applicable.[27] On the other hand, in those states that have concluded that the farmer is not a merchant, oral grain sales contracts have not been enforced—at least not under the merchant's exception.[28]

Some states have relied on other grounds to find enforceability, the most notable of which is the doctrine of estoppel.[29] The doctrine of estoppel operates to prevent an unjust result in cases where action in reliance on the promise is induced on the part of the promisee.[30] Since grain dealers typically immediately contract for the resale of grain purchased on future delivery contracts, or enter futures market transaction in reliance on the

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23. For a review of the legal problems that can arise in such contracts, *see* Malm, *Contracts for Future Delivery of Grain: An Overview of Common Legal Problems*, 2 AGRIC. L.J. 483 (1981).

24. U.C.C. § 2-201(1) (1977).

25. U.C.C. § 2-201(2) (1977).

26. *See generally* Squillante, *Is He or Isn't He a Merchant? The Farmer*, 1 AGRIC. L.J. 38 (1979), *reprinted from* 82 COM. L.J. 155, 367, 430 (1977).

27. *Id.*

28. *Id.*

29. *See* Malm, *supra* note 23 and cases cited therein. *See also* Annot., 56 A.L.R.3D 1037 (1974).

30. RESTATEMENT (SECOND) OF CONTRACTS § 217A(1) (1973). *See also* Note, *Oral Contracts for the Sale of Agricultural Products*, 22 S.D.L. REV. 619 (1977) and cases cited therein.

purchase contract, an argument could be made that the doctrine of estoppel could apply to make the initial contract, even though oral, enforceable.[31]

2. *Crop Failure*

What if the farmer suffers a crop failure after having agreed to contract for future delivery of a specified quantity and quality of grain? Unless the contract by its terms addresses this possibility, the Uniform Commercial Code provisions dealing with commercial frustration apply.[32] This provision excuses performance where it "has been made impracticable by the occurrence of a contingency the nonoccurrence of which was a basic assumption on which the contract was made."[33] If the contract specifically identifies the crops as those to be grown on designated land, performance may be excused.[34]

If the contract does not identify the crop as from particular land or does not provide for an excuse of performance in the event of a crop failure (a *force majeure* clause), the farmer may be under a duty to fulfill the contract by purchases elsewhere.[35] Performance may be excused if it is not possible to fulfill the contract by such purchases.[36]

3. *Buyer's Claims for Deficiencies*[37]

When the forward contract calls for delivery of grain of a specified quality under the Uniform Commercial Code,[38] an express warranty is made that

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31. *See,* Minnesota Farm Bureau Marketing Corp. v. North Dakota Marketing Ass'n, 563 F.2d 906 (8th Cir. 1977); C.R. Federick, Inc. v. Borg-Warner Corp., 552 F.2d 852 (9th Cir. 1977); Warder & Lee Elevator, Inc. v. Britten, 274 N.W.2d 339 (Iowa 1979). *Contra* Decatur Coops. Ass'n v. Urban, 219 Kan. 171, 547 P.2d 323 (1976); Sacred Heart Farmers Coop. Elevator v. Johnson, 305 Minn. 324, 232 N.W.2d 921 (1975); Jamestown Terminal Elevator, Inc. v. Hieb, 246 N.W.2d 736 (N.D. 1976); Dangerfield v. Markel, 222 N.W.2d 373 (N.D. 1974); Farmers Elevator Co. v. Lyle, 90 S.D. 86, 238 N.W.2d 290 (1976).

32. U.C.C. § 2-615 (1977). *See* Note, *Crop Failures and Section 2-615 of the Uniform Commercial Code,* 22 S.D.L. Rev. 529 (1977). U.C.C. sections 2-613 (where the continuing existence of the goods is presupposed by the agreement) and 2-616 (setting forth buyer's options on receipt of notification of impracticability) might apply in some situations, but U.C.C. section 2-613 was designed to protect buyers as U.C.C. section 2-616 is procedural in nature. Thus, section 2-615 is the section which deals most appropriately with crop failures from the perspective of the farmer.

33. U.C.C. § 2-615 (1977).

34. The Uniform Commercial Code section 2-615 essentially adopts the common law doctrine of impossibility. *See* Note, *supra* note 32.

35. *See* Malm, *supra* note 23.

36. *Id.* and cases cited therein. *E.g.,* Holly Hill Fruit Prods. Co. v. Bob Staton, Inc., 275 So. 2d 583 (Fla. App. 1973). *See also* Note, *supra* note 32, and cases cited therein.

37. *See* Dean, *Seller's Protection from Non-payment and From Claims of Deficiencies in Weights and Grades Under Grain Sales Contracts and Confirmations,* 1 Agric. L.J. 369 (1979).

38. U.C.C. § 2-313(1)(b) (1977).

the grain will conform to the stated grade. What if the farmer delivers grain that does not meet the specified grade? As indicated earlier, moisture discounts are generally specified in the contract. However, the contract may only call for grain of a specified grade. If so, the seller would be under an obligation to deliver grain of that grade, or claims for off-grade grain might result. Price adjustments are generally made for off-grade shipments and for deficiencies in weight. The contract between the parties could easily resolve any difficulties arising from such claims if the terms include standards for establishing claims based on deficiencies of grade or weight and a reference for making price adjustments or discounts.[39]

4. *Buyer's Inability to Accept Delivery*

The typical future delivery contract calls for delivery either on a specific date or during a period of time specified in the contract. Not infrequently, the buyer may be unable to accept delivery of the grain at the specified time due to transportation shortages or lack of storage capacity. May the seller be relieved of the responsibility to deliver if the buyer is unable or unwilling to accept delivery? Generally, the responsibility is concurrent—payment and delivery.[40] Thus, the seller may be excused from future delivery when the buyer requests delays in delivery unless the seller acquiesces in the delay.[41]

III. Grain Marketing Transactions: Problems Arising from the Buyer's Inability to Pay

The farmer who sells or contracts to sell grain assumes certain risks. The cash seller assumes the risk of nonpayment, especially if the contract involves a deferred pricing or deferred payment arrangement. The forward contract, by its nature, involves risk. The farmer not only bears the risk of nonperformance on the buyer's part, but also the risk of nonpayment following delivery. In addition, the seller may face the risk of competing claims for the grain from inventory financers of the buyer as well as from trustees in bankruptcy if the buyer becomes insolvent. In addition, there may be competing claims of purchasers of the grain who allege that they acquired title from the elevator operator.

The farmer who is so unfortunate as to sell or contract to sell grain to an elevator that goes bankrupt faces the risk of being forced to abide by contractual agreements made prior to the bankruptcy, but which call for performance at a date after the petition in bankruptcy is filed. *In re Cox Cotton Company*[42] presents the example of the pervasive force of the bank-

39. *See* Dean, *supra* note 37.
40. *See* Malm, *supra* note 23, at nn. 25-26.
41. *Id.*
42. 8 Bankr. 682 (Bankr. E.D. Ark. 1981).

ruptcy court in enforcing such contracts to sell grain. In that case, the bankruptcy trustee, appointed to operate the James Brothers elevators, sued six farmers for specific performance of contracts to sell milo which were not to be performed until a date which was after the bankruptcy petition was filed.[43] Bankruptcy Judge Charles W. Baker held that the contracts were specifically enforceable.[44] He further stated that the congessional intent and spirit of the Bankruptcy Code mandated that the court in which the petition for relief was filed should "in the interest of justice" and "for the convenience of the parties" retain jurisdiction of a case where the contracts had been entered into before the debtor entered the bankruptcy, but the grain was not deliverable until afterwards.[45]

A. *The Farmer as a Creditor in Bankruptcy*

The Bankruptcy Reform Act of 1978[46] was the first major revision of the law of bankruptcy in 40 years, and the first new act since 1898. The new Bankruptcy Act's changes in the law were, for the most part, effective October, 1979. Under the new law, the bankruptcy court, as an adjunct of the United States District Court in each judicial district, is granted pervasive authority in bankruptcy proceedings.

1. *The Bankruptcy Proceeding*

An example of the pervasive authority of the bankruptcy court is found in *Missouri v. United States Bankruptcy Court*.[47] A bankruptcy action was commenced by the James Brothers partnerships that operated grain storage facilities and brought and stored grain in both Arkansas and Missouri. The Eighth Circuit Court of Appeals stated that the bankruptcy court acquired "exclusive jurisdiction of all the property, wherever located, of the debtor,"[48] as of commencement of the bankruptcy action.[49] The court then noted that section 541 of the Code establishes that the filing of a bankruptcy petition creates an estate and defines which property comprises the estate.[50] Section 541 goes further than prior bankruptcy law and includes everything that possibly could be property of the debtor, even that property needed for a fresh start.[51] The historical and revisionary notes to section 541 explain

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43. *Id.*
44. *Id.* at 683.
45. *Id.* at 684.
46. Pub. L. No. 95-598, 92 Stat. 2549 (1978) (current version at 11 U.S.C. § 363 (Supp. III 1979)).
47. 647 F.2d 768 (8th Cir. 1981).
48. *Id.* at 774.
49. Bankruptcy Act, 11 U.S.C. § 301 (Supp. III 1979).
50. *Id.* § 541.
51. *See* Lockwood v. Exchange Bank, 190 U.S. 294 (1903). Under prior law, property needed for a fresh start was not included as property of the estate, but paragraph (1) of 11

that:

> [u]nder paragraph (1) of the subsection (a), the estate is comprised of all legal or equitable interests of the debtor in property, wherever located, as of the commencement of the case. The scope of this paragraph is broad. It includes all kinds of property, including tangible or intangible property, causes of action, and all forms of property. . . . The debtor's interest in property also includes "title" to property, which is an interest, just as are a possessory interest, or leasehold interest for example.[52]

Herein lies a problem for farmers who have delivered grain to elevators that file for bankruptcy relief. Even slight interests appear to be sufficient to confer preliminary jurisdiction over the property in the bankruptcy court.[53] For example, on the record before the court, the debtor's (James Brothers') interest in the Missouri grain consisted of possession and a minute ownership interest, consisting of minimal charges for storage of the grain, or perhaps the right of the bankrupt grain facility to sue for future delivery of grain purchased based on the definition of property under section 541 of the Code.[54] Thus, when a farmer dumps grain at an elevator, the burden is on him from that point forward to show that he has a superior interest in the grain, regardless of the arrangement with the grain storage facility.

The court in *Missouri v. United States Bankruptcy Court*,[55] did hold that even though the bankruptcy court had preliminary jurisdiction over the property, it must administer the debtor's limited interest consistent with the ownership rights of holders of documents of title under Missouri law, or in the case of Arkansas grain, under Arkansas law.[56]

It is clear that when persons other than the debtor have an interest in the property, as the farmers in the James Brothers situation clearly did, adequate protection must be taken "as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property."[57] The Eighth Circuit Court of Appeals added that "[t]he bankruptcy court should particularly examine its authority to order the sale (of the grain) if title documents indicate that the estate possesses no substantial ownership rights to the grain and that any bona fide dispute over the prop-

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U.S.C. § 541 overrules that case. Now all property comes into the estate, then the debtor is permitted to exempt certain property under 11 U.S.C. § 522.

52. Bankruptcy Act, 11 U.S.C. § 541 (Supp. III 1979). *See also* 11 U.S.C.A. § 541, historical and revision notes at 686 (1979).

53. 4 COLLIER BANKR. CAS. 2d ¶ 541.08(2) (MB 1981). *See In re* Farmers Grain Exch., Inc., 1 Bankr. 1621 (Bankr. W.D. Wis. 1975).

54. Missouri v. U.S. Bankr. Ct., 647 F.2d at 770.

55. 647 F.2d 768 (8th Cir. 1981).

56. *See* MO. REV. STAT. §§ 400.7-207 (1978); ARK. STAT. ANN. §§ 85-7-207, 85-7-403 (1961). *See also In re* Clemens, 472 F.2d 939, 942 (6th Cir. 1972); *In re* Farmers Grain Exch., Inc., 1 Bankr. 1621 (Bankr. W.D. Wis. 1975).

57. Bankruptcy Act, 11 U.S.C. § 361(3) (Supp. III 1979).

erty exists only between third parties."[58] The broad coverage of section 541 property of the estate, coupled with the authority of the bankruptcy court to allow the sale of the property free and clear of any interest in such property,[59] illustrates the difficult task that farmers face when trying to salvage their crops or the proceeds therefrom out of bankruptcy.

Another blockage in the farmer's road to recovery is section 362 of the Bankruptcy Code.[60] Section 362 provides that upon the filing of a bankruptcy petition, all judicial and other proceedings are automatically stayed.[61] According to the historical and revisionary notes to section 362, the stay is a fundamental debtor protection because it gives the debtor a breathing spell by stopping all collection efforts, harrassment, and foreclosure actions. "It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressure that drove him into bankruptcy."[62] This automatic stay, in effect, ties the hands of those trying to make collection efforts, and re-routes all attempts to relief through the bankruptcy court.[63] Each step of the creditor's post-bankruptcy collection efforts are closely scrutinized by the bankruptcy court. The policy behind automatic stay is sound: that is, to stop the harrassment by creditors. The problem is, however, that while the creditor-farmer is stopped from pursuing any collection efforts, the debtor in possession may be steadily conveying away the farmer's grain stored in the elevator, thereby decreasing chances of meaningful collection efforts. It is important to note that the farmer is not totally without a remedy at this stage of bankruptcy. He may request adequate protection[64] or a protective order.[65] The potential hazard, however, is that the adequate protection or protective order may be too little, too late.

These specific obstacles encountered by farmers in the James Brothers elevator bankruptcies are illustrative of the problems faced by farmers and state agencies when bankruptcy proceedings are initiated by insolvent grain storage facilities. Testimony before the Senate Committee on the Judiciary, Subcommittee on the Courts, was summarized in the Senate Report as establishing the following problems:

> (1) delay in abandonment of crop assets owned by parties who have delivered such assets to the debtor upon a contract of bailment, with delays in excess of two years not uncommon;
> (2) conflicts in jurisdiction between the bankruptcy courts and state agencies charged with the responsibility of supervising the liquidation of insolvent storage facilities;

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58. Missouri v. U.S. Bankr. Ct., 647 F.2d 768, 778 (8th Cir. 1981).
59. Bankruptcy Act, 11 U.S.C. § 363(b) (Supp. III 1979).
60. *Id.* § 362.
61. *Id.*
62. *Id. See also* 11 U.S.C.A. § 362, historical and revisionary notes at 419 (1979).
63. 11 U.S.C. § 362(d) (Supp. III 1979).
64. *Id.* § 361.
65. *Id.* § 105.

> (3) the requirements of present law which mandates that owners of crop assets held by the debtor solely on the basis of his status as a bailee must share grain assets held by the trustee in bankruptcy on a pro rata basis with any creditor holding a security interest in assets of a similar type which are owned by the debtor, such that the bailors of such storage contract crop assets have the value of their property diminished for the benefit of such creditors when there is a shortage of produce on hand;
> (4) the unprotected status, as unsecured creditors in bankruptcy, of farmers who have sold crops to a farm produce storage facility but have not received payment for that crop;
> (5) the reluctance of some courts to accept warehouse receipts and scale tickets, the principal documents used in warehouse business to establish record of ownership of crop assets stored in warehouse facilities on bailment contracts, as evidence of ownership in bankruptcy abandonment proceedings; and
> (6) the tendency of certain bankruptcy courts to attach bailed property for the payment of trustees fees and expenses incurred in performing services unrelated to that bailed property.[66]

While a number of the problems outlined relate specifically to bailment situations, it is evident that for a farmer-creditor to effectively assert his interest in any elevator bankruptcy proceeding is not an easy task. He must assert his legal rights quickly, or he runs the risk of being permanently barred from recovery, or at least faces significant delays in receipt of the crops or the proceeds from the crops.

2. *The Farmer-Creditor's Rights and Remedies*

The seller of grain, however, is not utterly without any rights or remedies once a petition for bankruptcy relief is filed. Sellers of grain fall into two groups—credit sellers or cash sellers. Unpaid credit or cash sellers are aided by the Uniform Commercial Code (UCC) which speaks directly to their rights to reclaim goods.[67] Before the adoption of the UCC, the rights of unpaid credit or cash sellers to rescind the contract and reclaim goods were governed by common law. The common law reasoned that a seller of goods on credit could reclaim goods if the buyer purchased the goods on credit while knowingly insolvent, because such a buyer attempted to perpetrate a fraud on the seller.[68] According to the common law, an insolvent buyer acquired only a voidable title, and the unpaid seller was entitled to reclaim his goods if the seller could establish such fraud.[69] On the other hand, a cash

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66. S. Rep. No. 97-168, 97th Cong., 1st Sess. 5 (1980).

67. U.C.C. § 2-702 (1977) (credit sellers); U.C.C. §§ 2-507, 2-511 (1977) (cash sellers). For a complete discussion of the unpaid seller's right to reclaim, *see* Wallach, *The Unpaid Seller's Right to Reclaim Goods: The Impact of the Uniform Commercial Code and the Bankruptcy Acts of 1898 and 1978*, 34 ARK. L. REV. 252 (1979).

68. *See generally* Wallach, *supra* note 67.

69. *Id.*

seller had a right to reclaim goods from the buyer by showing only that the buyer had failed to pay the purchase price.[70] Under the early common law, a buyer of goods for cash who failed to pay once the goods were delivered, or paid with a check which later was dishonored was said to have acquired no title.[71] The Uniform Commercial Code, however, changes the buyer's title from "void" to "voidable," making it possible for the buyer to transfer good title to a good faith purchaser for value.[72] This increases the difficulty of reclaiming goods sold on a cash basis.

For either credit or cash sellers to reclaim goods in bankruptcy, however, the reclamation rights must survive the avoiding powers of the trustee; and the Bankruptcy Reform Act of 1978 insures that the sellers' reclamation rights survive most of the trustees' avoiding powers.[73]

The important point here is that a farmer's attorney, who acts quickly, may be able to "void" the title to goods received by a credit or cash buyer and reclaim the farmer's grain. Both the credit seller and cash seller must make a demand for their goods within ten days after they are delivered in order to be able to reclaim.[74] Often, grain sold to an elevator will be passing through the hands of the buyer rapidly. Therefore, if the farmer is to have a meaningful opportunity to reclaim, he must act quickly. Practically speaking, the ten-day time frame may be no real obstacle for the farmer. The ten-day period runs from the date of *delivery* of the goods. The reclamation right expressly covers only sellers. Therefore, one who stores grain in an elevator will have ten days from the date upon which he sells the grain to the buyer to make a demand for reclamation. The ten-day period does not begin to run from the date of delivery into storage.

One important point is in order. Under the Uniform Commercial Code, the unpaid credit seller may not be bound by the ten-day limitation if the buyer has made a written misrepresentation of solvency in the three months preceding delivery.[75] This potential waiver provision was not recognized in the Bankruptcy Act in which a *written* demand for reclamation within ten days of receipt of the goods is necessary.[76] While the exact limits on the seller's right to reclaim may be uncertain,[77] it is apparent that since the Bankruptcy Reform Act of 1978 specifically preserved these rights in many

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70. *Id.*

71. *Id.*

72. U.C.C. § 2-403 (1977).

73. Bankruptcy Act, 11 U.S.C. § 546(c) (Supp. III 1979). Professor Wallach thoroughly discusses the different ways in which courts perceive the U.C.C. § 2-702 right to reclaim. Wallach, *supra* note 67, at 264-70 and cases cited therein.

74. U.C.C. § 2-702(2) (1977). No time limit is specifically established for the cash seller in U.C.C. § 2-507 or in U.C.C. § 2-511, but U.C.C. § 2-507, comment 3 states that the ten-day period applies.

75. U.C.C. § 2-702 (1977).

76. Bankruptcy Act, 11 U.S.C. § 546(c) (Supp. III 1979).

77. Wallach, *supra* note 67.

circumstances, this potential remedy could be useful to the farmer in the proper situation.

The Fifth Circuit Court of Appeals, in *In re Samuels & Co.*,[78] made an interesting observation that might offer a preventative measure to aid farmers in securing payment for their crops. In that case, the sellers sold cattle to Samuels and Company and received checks in payment that were subsequently dishonored because of insufficient funds.[79] Samuels immediately filed for bankruptcy relief.[80] The sellers attempted reclamation under the Uniform Commercial Code and failed because of the superior rights of an inventory financier.[81] The court noted that the sellers could have protected themselves by taking a security interest in the cattle.[82] Under the Uniform Commercial Code, a supplier of inventory may be able to assert priority over an inventory financier by perfecting a purchase money security interest in the goods.[83] The court suggested the possibility of a security interest for the farmer in goods sold to buyers to guarantee payment of the purchase price.[84] This would have the effect not only of securing payment from the buyer, but would strengthen the position of the farmer who gets caught in an elevator bankruptcy by making him a secured creditor.

There are practical problems in this approach when applied to transactions between the farmer and the grain elevator. First, the farmer probably does not possess the expertise to deal with security agreements and file and perfect them properly. He may, however, hire an attorney to help him, but would likely encounter resistance on the part of the elevator. Second, those who supply funds to finance grain elevators, banks and credit associations, would object to such transactions because their preferred status would be affected. A final problem relates to subsequent sale of the collateral by the elevator. Since the collateral may no longer be located in the facility because it is continuously moved along the chain of distribution, the farmer might find himself in the position of a secured creditor, but with no collateral remaining.

Admittedly, the foregoing suggested methods of protection for the farmer are weak because all are basically attempts to retrieve the grain in the possession of the buyer (a debtor in bankruptcy). In elevator bankruptcy situations there is usually not enough grain left in the bankrupt elevator to cover all claims. Thus, if any post-bankruptcy relief is to be had by the farmer, it must come in close proximity to the time of filing for bankruptcy

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78. 510 F.2d 139 (5th Cir. 1975).

79. *Id.* at 144.

80. *Id.*

81. *Id.* The inventory financier was a "good faith producer" under U.C.C. § 2-403. The reclaiming seller's rights are subject to those of such a good faith purchaser under U.C.C. § 2-702(3).

82. *In re* Samuels & Co., 510 F.2d at 147.

83. U.C.C. § 9-312(3) (1977).

84. *In re* Samuels & Co., 510 F.2d at 149.

relief. The suggested method of recovery do provide some chance of minimizing losses for the farmer if they are pursued quickly.

B. *Competing Claims of Third Parties*

When dealing with the insolvent buyer, the farmer may face additional competing claims—those from third-party financiers of the buyer and those of third-party buyers of the grain from the grain dealer. The case of *In re Samuels & Co.* illustrates the conflict between cash sellers and inventory financiers. There, the livestock sellers found themselves in the position of unsecured creditors in bankruptcy as opposed to the claims of inventory financiers of the livestock purchasers who were secured.[85] This situation and other similar bankruptcies by meat processors gave Congress the initiative to modify provisions of the Packers and Stockyards Act[86] to assist sellers of such products by requiring reasonable bonds of marketing agencies, dealers and packers. Further, the Act includes "prompt payment" provisions requiring a check for the full purchase price to be issued before the close of the next business day following the purchase of livestock.[87] In addition, a statutory trust is established for the benefit of unpaid cash sellers.[88] Legislation has not yet been enacted to offer similar protection to sellers of grain.[89]

Conflicts may also arise between the unpaid seller and buyers of the grain. Such buyers, if good faith purchasers for value, can obtain good title to grain purchased,[90] thus making it difficult for the unpaid sellers to exercise any rights to reclaim.[91]

IV. Grain Storage Contracts

Much of the dissatisfaction with the treatment of a farmer's grain during a bankruptcy proceeding has involved situations where the grain was not sold to the elevator, but merely stored under warehouse receipts or scale tickets. It is in these situations that farmers have experienced frustration when the warehouse receipts, issued at the time the grain was stored, were not immediately honored once a bankruptcy petition was filed.[92] Much of

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85. U.C.C. § 9-301(1), 9-312(5) (1977).

86. 7 U.S.C. § 204 (Supp. III 1979).

87. *Id.*

88. *Id.*

89. Actually, the current U.S. Grain Warehouse Act, 7 U.S.C. §§ 241-273 (Supp. III 1979), requires bonding, but the prompt payment and statutory trust concepts are not included. Proposals for warehouse regulatory reform are reviewed in Section V *infra.*

90. U.C.C. § 2-403 (1977).

91. *See* Wallach, *supra* note 67.

92. During Hearings on S. 839 before the Committee on the Judiciary, Rep. Bill Emerson quoted one farmer as saying:

> Suppose you left your car in a public garage and received a parking receipt. Later, you came back and hand the man a receipt and ask for your car. Could he tell me,

the frustration stems from the delay inherent in the bankruptcy proceeding, especially if disputes regarding ownership must be resolved. An important consideration here is that from the point the petition for bankruptcy relief is filed by the debtor, all actions must go through the bankruptcy court.[93]

A. *Potential Remedies for the Farmer—Bailor*

A number of options are available to the farmer-bailor who has stored grain in an elevator which files a petition in bankruptcy. First, in a chapter 7 liquidation proceeding the farmer may petiton the bankruptcy court for an order compelling the trustee to release grain held in storage by the elevator.[94] After the commencement of a liquidation proceeding under chapter 7, but prior to final distribution, and upon order of the court, "the trustee shall dispose of any property in which an entity other than the estate has an interest, such as a lien, and that has not been disposed of under another section of this title."[95] Under state law a warehouse receipt would constitute an interest recognizible in a bankruptcy proceeding. If the farmer can successfully argue that the grain should be released, he may still be liable for the charges incurred in loading, handling and storage. If the grain recovered is less than the amount originally placed in storage, the farmer will have a claim against the estate for the balance as a general creditor. In such cases, he may be able to set off such charges.[96]

Abandonment provisions of section 554 would be potentially available to farmers in all bankruptcy proceedings.[97] According to section 554(a), "[a]fter notice and hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value to the estate."[98] Given the trustee's position as protector of the unsecured creditors, it is doubtful that the trustee will, of his own volition, petition the court for abandonment of property. But under section 554(b) "[o]n request of a party in interest and after notice and hearing, the court may order the trustee to abandon any property of the estate that is burdensome . . . or that is of inconsequential value . . . ."[99] This section would allow the farmer

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> "You can't have your car back because the owner filed for bankruptcy and the bankruptcy judge appointed a trustee who will decide if you get your car back. If the trustee decides to sell your car you might have to sue to collect whatever you can after the trustees and the lawyers are paid their fees.

Hearings on S. 839 Before the Subcomm. on Courts of the Senate Comm. on the Judiciary, 97th Cong., 1st Sess. 33 (April 6 and May 18, 1981).

93. Bankruptcy Act, 11 U.S.C. § 362(d) (Supp. III 1979). Certain exceptions to discharge may be filed in state court, none of which are applicable in these situations.

94. *Id.* § 725.

95. *Id.*

96. *Id.* § 553.

97. *Id.* § 554. Chapters 1, 3 and 5 apply to all bankruptcy proceedings.

98. *Id.* § 554(a).

99. *Id.* § 554(b).

to take the initiative and request abandonment. The request should be persuasive when the debtor has only a tenuous interest, such as for storage charges, in the creditor's property. By way of imaginative lawyering, one might be able to argue that section 554(b) could be coupled with redemption[100] in chapter 7 liquidation proceedings involving individual debtors. The farmer could tender into the registry of the bankruptcy court the charges against the stored grain, thereby relieving the trustee's fear of loss of value to the estate, and strengthening the argument for abandonment.

One might also seek relief from the stay[101] and go to state court for a determination of title to the grain. If in the state court action title is found to be in the farmer, the trustee would have only the possessory interest upon which to hold the grain.[102] The trustee would then be faced with the choice of either having to turn the grain over under court order or providing the farmer with aequate protection.[103] In either case, the farmer has gained some leverage in the proceeding and negated the trustee's power[104] to sell the property because the dispute over ownership has been settled.

Interrelated to the foregoing discussion is the question of title to the grain itself. State law concerning title controls questions of ownership.[105] Article 2, part 4 of the Uniform Commercial Code, entitled *Title, Creditors and Good Faith Purchases*, purports to deal with title; but according to the clear language of section 2-401(1) it applies only to a contract for sale involving a buyer and a seller.[106] Therefore, while the scope of article 2 includes "transactions" in goods, the specific sections dealing with title in article 2 contemplate a sale of goods. Thus, when questions of title in grain storage contracts arise, the parties must look to other sections of the Uniform Commercial Code or to other state statutes for resolution of such questions.

Because of the confusion that has developed over the concept of title to grain, some state legislatures have set out to clarify matters. For example, article 11 of the Arkansas Public Grain Warehouse Law[107] was amended in 1981 to set forth the state of title to stored grain:

> Ownership of grain shall not change by reason of an owner delivering grain to a public grain warehouseman, and no public grain warehouseman shall sell or encumber any grain within his possession unless the owner of the grain has, by written document, transferred title of the grain to the warehouseman. Notwithstanding any provision of the Uni-

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100. *Id.* § 722.
101. *Id.* § 362(d).
102. In *Missouri v. United States Bankruptcy Court*, 647 F.2d 768 (8th Cir. 1981), the possessory interest was enough to confer preliminary jurisdiction.
103. Bankruptcy Act, 11 U.S.C. § 361(3) (Supp. III 1979).
104. *Id.* § 361(f).
105. Missouri v. U.S. Bankr. Ct., 647 F.2d at 774.
106. U.C.C. § 2-401(1) (1977).
107. ARK. STAT. ANN. §§ 77-1339 to -1342 (repealed 1981).

> form Commercial Code (Act 185 of the 1961 [§§85-1-101 et seq.], as amended) to the contrary, or any other law to the contrary, all sales and encumberaces of grain by public grain warehousemen are void and convey no title unless such sales and encumbrances are supported by a written document executed by the owner specifically conveying title to the grain to the public grain warehouseman.[108]

The legislature has also established the relationship between the Arkansas Public Grain Warehouse Law and the Uniform Commercial Code in the following terms:

> The provisions and definitions of the Uniform Commercial Code [§85-1-101 to 9-507] relating to warehouse receipts to the extent not inconsistent with this Act shall govern warehouse receipts issued by public grain warehousemen, and the other provisions of the Uniform Commercial Code shall also be applicable to the provisions of this Act to the extent not inconsistent with this act.[109]

The applicable Uniform Commercial Code provisions dealing with warehouse receipts and documents of title are in chapter 7.[110]

Prior to 1981, a buyer in the ordinary course of business of all fungible goods from a warehouseman who was also in the business of buying and selling goods took free of any claim under a warehouse receipt.[111] The Arkansas legislature in 1981 made certain changes to insure correlation with the Arkansas Public Grain Warehouse Law:

> A buyer in the ordinary course of business of fungible goods, except the grains listed below, sold and delivered by a warehouseman who is also in the business of buying and selling such goods takes free of any claim under a warehouse receipt even though it has been duly negotiated. This section shall not apply to rice, soybeans, wheat, rye, oats, barley, flaxseed, sorghum, mixed grain, nor other food grains or oilseeds.[112]

The legislature was acting to relieve the problems regarding title when warehousemen sell or encumber crops in storage, without authorization to do so. This legislation reflects a strong public policy in favor of protecting the farmers from failing elevators.

Farmers or holders of warehouse receipts are in a much preferred position if the warehouse receipts are negotiable rather than non-negotiable. A warehouse recept is negotiable if by its terms the goods are to be delivered to the bearer of the receipt or to the order of a named person.[113] The question then becomes: What does the holder of the negotiable warehouse re-

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108. 1981 Ark. Acts 401; ARK. STAT. ANN. § 77-1340 (repealed 1981).
109. ARK. STAT. ANN. § 77-1303 (repealed 1981).
110. ARK. STAT. ANN. § 85-7-101 to -603 (1966).
111. ARK. STAT. ANN. § 85-7-205 (repealed 1981).
112. ARK. STAT. ANN. § 85-7-205, *as amended* (repealed 1981).
113. U.C.C. § 7-104 (1977).

ceipt get in case of an elevator bankruptcy? Fungible goods commingled are owned by the persons holding warehouse receipts as tenants in common.[114] The warehouseman is severally liable to each owner for that owner's share.[115] The holder of negotiable warehouse receipts should, therefore, be able to assert a superior interest to the stored grain over that of the bankruptcy trustee. If there is grain in storage, the warehouse receipt holder, even if the receipt has been transferred to a new holder, shares in common with farmers pro rata in whatever grain is there.[116]

Duties of warehouses vary from state to state, but generally they are held to a high standard of care in handling other person's goods.[117] Courts have generally held that title to grain does not pass on mere storage of grain in an elevator.[118] It is interesting to note the extent to which some states have gone to protect their farmers under warehousing laws. A good example is the State of Kansas, which before enactment of the Uniform Commercial Code held that the scale tickets given to farmers showing the amount of grain stored in elevators were as good as warehouse receipts for proof of title to grain.[119]

In 1981, the Kansas legislature enacted a provision relating to title of stored grain, specifically stating that the owner, under open storage or with a warehouse receipt, has a prior right against any other person subject only to storage charges and valid liens on the grain until it is removed from storage by the owner or sold by the owner.[120]

States have been diligent in enacting laws to secure safe storage of crops in public warehouses. The problem, however, seems to be a practical one of how to enforce the laws. While the regulatory agencies have the statutory authority to oversee the facilities, there is often a shortage of available manpower and funds to properly control the elevators.[121]

V. Legislative and Regulatory Proposals

Both state and federal lawmakers have reacted to the plight of farmers who have dealt with grain storage facilities that file for bankruptcy relief. State legislatures have responded by changing certain Uniform Commercial Code provisions or by tightening state regulatory authority over grain storage facilities and grain dealers. At the federal level, significant proposals for reform of the Bankruptcy Code and the United States Warehouse Act have

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114. *See, e.g.*, Ark. Stat. Ann. § 85-7-207(2) (1966).
115. *Id.*
116. Missouri v. U.S. Bankr. Ct., 647 F.2d at 774.
117. *See* Merchants Mut. Bonding Co. v. Appalachian Ins. Co., 556 F.2d 899 (8th Cir. 1977).
118. United States v. Luther, 225 F.2d 499 (10th Cir. 1955).
119. Hartford Acc. & Indem. Co. v. Kansas, 247 F.2d 315 (10th Cir. 1957).
120. Kan. Stat. Ann. § 34-2,107 (Supp. 1981).
121. *See, e.g., In re* Prairie Grain Co., No. 80-212C (Bankr. S.D. Iowa, filed Feb. 1980).

been introduced in both houses of Congress, and the Secretary of Agriculture appointed a task force to review grain elevator bankruptcies and to make recommendations.[122] The General Accounting Office has also issued a report with recommendations for reform.[123]

A. *State Reform Proposals*

One example of legislative reaction at the state level is the change in the Uniform Commercial Code provision relating to the transfer of title to fungible goods by a warehouseman who is also in the business of buying and selling such goods. As indicated earlier,[124] the Arkansas legislature changed section 7-205 to provide that even a buyer in the ordinary course of business who buys certain grains from such a warehouseman does not take free of any claim under a warehouse receipt.

An example of reform in the regulatory function of the state regarding grain storage facilities is the authority granted the Missouri Department of Agriculture in 1977 Missouri legislation.[125] Under this legislation, revised somewhat in 1980, the Missouri Department of Agriculture has the duty to make examinations, audits, inspections and investigations of state licensed warehouses.[126] Procedures are outlined for inventory checks and for handling inventory shortages. In addition, the Missouri law requires bonding and insurance. One of the most significant changes in the Missouri law occurred in 1977 when the legislature passed a provision requiring that when grain is delivered to a warehouse or elevator, the scale ticket must indicate whether it is grain delivered for storage, for sale or some other purpose.[127] The depositor may sign an agreement for deferred payment or pricing, but such an agreement results in a transfer of title.[128] The impact of Missouri's specific requirement is to minimize confusion regarding storage and fees and the nature of the contract between the parties. It should have some value during bankruptcy proceedings to more readily identify the rights of the parties.[129]

Arkansas likewise made substantial revisions in its Public Grain Warehouse Law effective July 1, 1979.[130] These requirements call for bonding and insurance and provide for inspection and investigation by the State Plant

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122. *See* text accompanying note 144 *infra*.

123. *See* text accompanying note 145 *infra*.

124. *See* note 112 *supra*.

125. Mo. Rev. Stat. §§ 411.070-765 (1979 & Supp. 1982).

126. 1980 Mo. Laws 430, § 1 (1979).

127. Mo. Rev. Stat. § 411.325(1) (1979).

128. *Id.*

129. *See* Matthews, *Recent Developments in Missouri Agricultural Law*, 49 U.M.K.C. L. Rev. 405 (1981).

130. Ark. Stat. Ann. § 77-1301-38 (repealed 1981).

Board.[131] The Arkansas act requires the issuance of a warehouse receipt upon request of the depositor, and the depositor must have such a receipt in order to proceed against the bond of the warehouse.[132]

These examples of the strengthening of grain warehouse laws do not address all the problems encountered during a bankruptcy proceeding, nor do they address the issues of the proper distribution of grain located in storage facilities, especially when shortages are uncovered. For this reason, some states have established indemnity funds to cover depositor's losses from the elevator insolvency.[133] Oklahoma established such a fund in 1980 and increased the size in 1981 to $10 million, with funding to come from a per-bushel assessment of two-tenths of a cent.[134] Maryland also established a fund in 1981 of $5 million through a levy of one-half cent per bushel.[135] South Carolina approved a $3 million fund financed through a voluntary assessment of one cent a bushel on soybeans and one-half cent on all other grains.[136]

B. *Federal Reform Proposals*

1. *Legislative Proposals*

Senator Robert Dole introduced S. 839 on March 31, 1981, which was designed to amend the Bankruptcy Act and the United States Warehouse Act regarding farm produce storage facilities.[137] After hearings on the bill were completed, a substitute bill, S. 1365, was introduced on June 15, 1981.[138] A similar bill was introduced in the House of Representatives by Representative Dan Glicksman as H. 4179.[139] The Senate passed S. 1365 on September 17, 1981, as a part of the Agriculture and Food Act of 1981,[140] and separately on September 22, 1981.[141] The House has taken no action on the bill, and the provisions were not included in the final version of the 1981 farm bill.[142]

The objectives of the proposed legislation were set out in the Senate Report:

> (1) Create a procedure which would require expedited abandonment of

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131. *Id.*
132. ARK. STAT. ANN. § 77-1331 (repealed 1981).
133. A similar proposal at the federal level was introduced in 1981 by Congressman David Albosta as H.R. 2523 but has not been enacted.
134. OKLA. STAT. tit. 2, §§ 9-41 to -47 (Supp. 1981).
135. MD. AGRIC. CODE ANN. §§ 13-101 to -108 (Supp. 1981).
136. S.C. CODE ANN. § 39-21-310 (Law Co-op. Supp. 1981).
137. 127 CONG. REC. S. 3059 (daily ed. March 31, 1981).
138. 127 CONG. REC. S. 6211 (daily ed. June 15, 1981).
139. 127 CONG. REC. H. 4499 (daily ed. July 16, 1981).
140. 127 CONG. REC. S. 9828-34 (daily ed. Sept. 17, 1981).
141. 127 CONG. REC. S. 10,228-235 (daily ed. Sept. 17, 1981).
142. Agriculture and Food Act of 1981, Pub. L. No. 97-98, 95 Stat. 1213 (1981).

> farm produce required to be abandoned under provisions of the bankruptcy code which is held by a debtor in bankruptcy who is engaged in the business of operating a farm produce storage facility;
> (2) Create a procedure to govern distribution of abandoned farm produce which protects the ownership interests of parties who have delivered such farm produce over to a debtor engaged in the business of operating a farm produce storage facility upon a contract of bailment;
> (3) Create a statutory lein in favor of farm producers who have delivered farm produce to a storage facility upon a contract of sale but have not received payment therefor, for a maximum period of sixty days from the date of the execution of the contract of sale, such lien to attach to any farm produce then owned by the debtor;
> (4) Create a priority position, in the distribution of assets to general unsecured creditors in bankruptcy, in favor of farm producers with respect to debts arising out of the sale or conversion of farm produce to or a debtor in bankruptcy engaged in the business of operating a farm produce storage facility;
> (5) Prohibit the scheduling of business debts of a person engaged in the business of operating a farm produce storage facility in wage-earner proceedings under Chapter 13 of the bankruptcy code; and
> (6) Prohibit the involuntary bailment of farm produce owned by third parties to a debtor who, being engaged in the business of operating a farm produce storage facility, seeks reorganization of such business under the provisions of Chapter 11 of the bankruptcy code.[143]

Even though this proposed legislation has not yet been adopted, the strong support for the changes in the Senate indicates that similar legislation may yet evolve.

2. *Regulatory Proposals*

It is clear that the legislative proposals are not designed to prevent grain elevator bankruptcies, but rather to provide additional protection to the farmer-depositor trapped in the web of a bankruptcy proceeding. A Grain Elevator Task Force Report to the Secretary of Agriculture[144] and a General Accounting Office Report[145] both emphasized the need for protection prior to bankruptcy.

Under the United States Warehouse Act,[146] the Agricultural Marketing Service (AMS) of the United States Department of Agriculture (USDA) administers the licensing and examination program for warehouses storing agricultural commodities. The program is voluntary in that it applies only to

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143. S. Rep. No. 168, 97th Cong., 1st Sess. 1-2 (1981).

144. U.S. Department of Agriculture, Grain Elevator Task Force Report to the Secretary of Agriculture (August 18, 1981) [hereinafter cited as USDA Report].

145. U.S. General Accounting Office Report, *More Can be Done to Protect Depositors at Federally Examined Grain Warehouses* (June 19, 1981) [hereinafter cited as GAO Report].

146. U.S. Grain Warehouse Act, 7 U.S.C. §§ 241-73 (Supp. III 1979).

warehouses that apply for a federal license and are found to be eligible. In addition, the Commodity Credit Corporation (CCC), through the Agricultural Stabilization and Conservation Service (ASCS) of the USDA, contracts with public warehouses for grain storage. ASCS sets standards for contract warehouses. Through these two programs a large number of public warehouses are subject to federal regulation.[147]

The General Accounting Office Report concluded that current procedures would be adequate if warehouses were required to issue warehouse receipts for all stored grain and if the distribution of warehouse receipts was controlled. The Report recommended that the Secretary of Agriculture require that all federally licensed and CCC contract grain warehouses give depositors warehouse receipts for all storage grain. The report suggested several alternatives that might be considered in revising the current federal program. These included:

> (1) Expand the U.S. Warehouse Act program to cover grain merchandising activities.
> (2) Increase bonding requirements to provide greater protection against financial losses when bankruptcies occur.
> (3) Establish a federal insurance program to cover producer financial losses resulting from grain warehouse bankruptcies.
> (4) Encourage depositors to obtain private insurance on their own.
> (5) Amend the bankruptcy laws to give grain depositors expedited or preferential treatment in bankruptcy proceedings.[148]

The Grain Elevator Task Force of the USDA recommended that immediate efforts be initiated to coordinate federal-state licensing efforts. The task force further recommended that CCC Standards for Approval be amended to (1) require an unqualified certified statement prepared by an independent certified public accountant, (2) to increase net worth requirements (to be consistent with the United State Warehouse Act), and (3) to provide for the acceptance of an irrevocable letter of credit in lieu of bonds.[149] In addition, the task force suggested that the net worth requirements of the United States Warehouse Act be increased and that annual unqualified financial statements be required.[150]

The AMS has given notice of proposed changes in the warehouse regulations for the storage of grain. These proposed changes generally relate to an increase in the net worth requirements, an increase in bond, and audited financial statements.[151] The CCC has likewise issued notices of proposed

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147. *See* GAO Report, *supra* note 145, which sets the number at 6,398 or about 64% of all warehouses.

148. GAO Report, *supra* note 145, at 30-32.

149. USDA Report, *supra* note 144.

150. *Id.*

151. *See* 46 Fed. Reg. 30,620 (1981); 46 Fed. Reg. 42,486 (1981); 46 Fed. Reg. 59,930 (1981); 47 Fed. Reg. 631 (1982).

changes in the rules for CCC contract warehouses which would require the warehouseman to furnish an annual financial statement[152] as recommended by the task force.

While none of these rules have been finally adopted, they are designed to offer greater protection to depositors of grain in federally regulated warehouses. They may afford more information regarding the warehouse and perhaps offer more confidence to depositors that such warehouses are less likely to move to bankruptcy.

VI. Conclusion

A. *Preventative Measures for Farmers*

As evidenced by the preceding sections, post-bankruptcy relief for farmers who are caught in elevator bankruptcy is limited. The best protection for the farmer is foresight and adequate investigation prior to the sale or storage of the crops.

The ways in which a farmer may investigate vary, but they basically can be accomplished with minimal effort. A farmer may check a grain handling facility to see if it is licensed under the United States Warehouse Act or if it meets the Commodity Credit Corporation's Standards for Approval by merely asking elevator officers for proof of compliance or a copy of the license. Compliance by grain storage facilities with the federal regulations is not mandatory. The USDA cannot regulate grain storage facilities and warehouses unless they are licensed under the act or contract with the CCC. The farmer might therefore ask to see proof of compliance with applicable state licensing requirements or ask to see an audited financial statement regarding the financial condition of the elevator or a letter of credit from a financial institution with which the elevator deals. Inquiry may be made as to when the company's inventory was last audited or when other state or federal inspections were completed.

Close attention to the particular operational activities of the elevator with which the farmer deals can be revealing. If the elevator has a difficult time keeping bookkeepers or accountants, there may be improper bookkeeping procedures within the company. The general physical appearance of the facility itself should reveal well-maintained and reasonably clean premises. Poor maintenance, untidy grounds and a rundown condition in general are indications that the facility is not adequately capitalized or else is not well managed.

A farmer should always beware of the elevator that is paying a price which is higher than the quoted commodity exchange prices. Buyers who are offering extremely high prices may be trying to pull grain in by using "greed" factors to cover losses they have sustained in speculative transac-

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152. *See* 46 Fed. Reg. 50,378 (1981); 46 Fed. Reg. 56,624 (1981).

tions. The grain facilities manager should offer an explanation as to why the company is offering higher than fair market price on a particular day.

Inquiries should always be made concerning the policy of the elevator on futures market speculation. If the company is engaged in speculation in the market, it may be better to stay away from that company.

After all these inquiries are made, a farmer who wants to be extra cautious may wish to demand payment upon delivery. This would entail a check for each truckload or carload lot of grain brought in, or settlement on a daily basis. Any facility buying and selling grain should have sufficient working capital or cash flow to pay for shipments of grain as they are received.

B. *Need for a Special Policy for Farmers*

Agricultural product markets are those most directly affected by the forces of supply and demand. Individually, the farmer cannot control the price he gets for his product. He never has the luxury of adjusting the price of his crops upward to cover increased costs of production or yearly losses.

The fact that farmers have no control over prices they receive makes them particularly vulnerable to financial ruin when entangled in a situation where another business receives their crops and, through bankruptcy, is relieved of the obligation to pay for the commodities. It is for this reason that special policies favoring farmers should be implemented through appropriate state and federal legislation or regulations. Without such protection, many farmers who have otherwise managed their farm business in an efficient and productive manner may be deprived of their very livelihood, and may find themselves in a bankruptcy proceeding as debtors.