

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

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I. INTRODUCTION

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

These regulations and bonds may have lulled producers dealing with the country's 10,000 grain warehouses⁵ into the erroneous belief that grain or credit "in the bin" is as safe as money in an insured bank. However, recent well-publicized grain warehouse insolvencies have shown there is a wide gulf between the protection afforded insured bank deposits and that given grain deposits.

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

2. *Id.* at 126.

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

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

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

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

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

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

7. A U.S. Department of Agriculture Task Force recently pointed out: "In theory, a warehouse should always contain enough commodities to meet all obligations to bailors and all creditors to whom commodities . . . have been pledged as collateral. In practice, this is usually not the case when [a grain warehouse] goes bankrupt."

U.S. DEPT. OF AGRICULTURE, GRAIN ELEVATOR TASK FORCE, REPORT TO THE SECRETARY OF AGRICULTURE 4 (1981) [hereinafter cited as USDA TASK FORCE REPORT].

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

15. *Id.* at 47.

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

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

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

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

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

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

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

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

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

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

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

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

20. *Id.*

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

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

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

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

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

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

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

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

II. OVERVIEW OF GRAIN MARKETING PATTERNS

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

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

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

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

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

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

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

25. See NEB. REV. STAT. § 88-506 (Reissue 1981) and NEB. REV. STAT. (U.C.C.) § 7-201 (Reissue 1980). The term "document of title" is defined as including a: bill of lading, dock warrant, dock receipt, warehouse receipt or order for the delivery of goods, and also any other document which in the regular course of business or financing is treated as adequately evidencing that the person in possession of it is entitled to receive, hold and dispose of the document and the goods it covers. To be a document of title, a document must purport to be issued by or addressed to a bailee and purport to cover goods in the bailee's possession which are either identified or are fungible portions of an identified mass.

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

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

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

Id. § 7-501(4).

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

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

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

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

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

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

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

28. This arrangement is often called a grain bank.

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

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

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

32. *Id.*

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

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

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

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

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

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

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

The biggest problem . . . was that the "price-later" contracts were getting grain dealers into trouble. They would . . . take [a farmer's] grain [and] give the farmer a contract which would say, in effect, "We will pay you later sometime when you decide you are ready to price out," and the grain dealer would take this grain and . . . then do whatever he wanted to do with the money.

He might buy a farm, which was probably a pretty good idea, but, then again, he might take the money and play it on the board of trade . . . which usually was not a good idea. Then, in 1 or 2 years, or in 6 months even, he might himself be in a lot of financial trouble.

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

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

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

III. OVERVIEW OF GRAIN WAREHOUSES AND GRAIN DEALER REGULATION

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

Hearings, *supra* note 35, at 41.

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

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

subject to regulation.

The federal government's regulatory activities are based on the United States Warehouse Act³⁹ (U.S.W.A.), enacted in 1916, and administered by the United States Department of Agriculture.⁴⁰ The U.S.W.A. is a permissive statute, allowing but not requiring the licensing of qualifying grain warehouses. About 1700 warehouses nationwide, and 150 in Nebraska, operate under a U.S.W.A. license.⁴¹

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

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

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

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

40. See, e.g., *id.* § 243, 244, 246.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

51. *Id.*

cies did.⁵²

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

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

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

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

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

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

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

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

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

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

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

Warehouses opting for a state license must satisfy the PSC as to their net worth and post a bond or certificate of deposit in whatever amount the PSC requires.⁶⁴ PSC regulations fix the amount based on the warehouse's physical storage capacity. The requirements begin at twenty cents per bushel and slide down to five cents per bushel with no statutory maximum.⁶⁵ The warehouse must submit financial statements, which need not be audited, to and undergo periodic inspection by the PSC.⁶⁶ The PSC is charged with inspecting the 480 state licensees⁶⁷ at least once

57. 1891 Neb. Laws 55.

58. NEB. REV. STAT. (U.C.C.) § 1-101 (Reissue 1980).

59. *Id.* §§ 88-501 to -517 (Reissue 1981).

60. *Id.* §§ 88-518 to -519.

61. *Id.* §§ 88-502, -515, -518.

62. *Id.* §§ 88-501, -516.

63. *Id.* §§ 88-502, -516.

64. *Id.* § 88-503.

65. See note 8 *supra*.

66. NEB. REV. STAT. §§ 88-502, -503(1) (Reissue 1981). Section 88-503(1) requires only that an annual financial statement be submitted which has been "compiled by" a certified public accountant. This means that a CPA will fill out the required information based on information in books and records supplied warehouse management. However, the CPA will not attempt to verify the correctness of the information supplied, so the compilation statement is much less rigorous than an audit.

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

67. See *Hearings on LB 73*, *supra* note 41, at 7-8 (Jan. 28, 1983) (testimony of Comm'r Eric Rasmussen).

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

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

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

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

IV. SOME JURISDICTIONAL PROBLEMS IN GRAIN WAREHOUSE INSOLVENCY CASES

A number of jurisdictional problems arise when either a de-

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

69. *Id.* §§ 88-517, -518.

70. *Id.*

71. *Id.*; Nebraska Public Service Commission Regulations, Title 291, Chapter 8, § 005.01B. Under current PSC regulations, the requirements for financial statements from licensed grain buyers are even less stringent than those for warehouses. The grain buyer need only submit a financial statement prepared and signed by an officer, partner or owner; no CPA review of any kind is required.

72. See text accompanying notes 206-51 *infra*.

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

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

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

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

73. 696 F.2d at 543.

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

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

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

This sometimes allows a federal licensee to continue operating without a license and without a bond. In Nebraska, for example, an Ashland warehouse lost its federal license in 1980, when it could no longer obtain the required bond. However, the operator continued to accept grain for storage and to buy and sell grain without any license or bond for about six months before creditors finally discovered the situation and forced its closure in February of 1981.⁷⁷ The Nebraska PSC allegedly was notified when the federal license was suspended and again when it was finally terminated. However, the PSC did not act to force closure, apparently because it believed it had no jurisdiction. Certainly the PSC might lack jurisdiction while the federal license was only suspended and not yet finally revoked or terminated. However, as soon as the federal license was terminated, the PSC would have had jurisdiction under Nebraska Warehouse Act, section 88-502,⁷⁸ which requires all grain warehouses in Nebraska to have a state or a federal license.

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

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

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

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

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

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

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

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

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

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

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

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

82. 647 F.2d at 771.

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

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

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

The court also held that the automatic stay under section 362 of the Bankruptcy Act applied to the Missouri Department of Agriculture’s attempts to enforce Missouri’s grain laws on distribution of the grain proceeds from the insolvent warehouses. The court said the statutory exception to the automatic stay for proceedings to enforce a state’s “police or regulatory powers” applied only to matters affecting the public health and safety and not to a state’s effort to protect the financial interests of some of its citizens.⁸⁷ Further, the court indicated that even if the state proceedings had been within the exception and thus not automatically stayed, the Bankruptcy Act preempts state insolvency proceedings. For that reason, the bankruptcy court could issue specific stays under section 105 of the Bankruptcy Act⁸⁸ as needed to protect its jurisdiction.⁸⁹

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

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

85. 647 F.2d at 774.

86. *Id.* at 772.

87. *Id.* at 775-76.

88. 11 U.S.C. § 105(a) (1982).

89. 647 F.2d at 776-77.

90. 11 U.S.C. §§ 542, 543 (1982).

91. Although the grain . . . is ‘property of the estate’ for jurisdictional purposes, its actual ownership has yet to be determined [T]hat court should carefully consider . . . the duty under the Code to protect the property interests of third parties [W]hen persons other than the debtor have an interest in the property, adequate protection must be taken ‘as will result in the realization by such entity of the indubitable equivalent of such entity’s interest in such property.’

647 F.2d at 778.

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

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

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

92. *Id.* at 779.

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

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

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

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

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

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

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

V. RIGHTS OF STORERS OF GRAIN

STORERS SHARE STORED GRAIN AS TENANTS IN COMMON

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

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

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

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

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

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

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

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

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

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

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

(1) Unless the warehouse receipt otherwise provides, a warehouseman must keep separate the goods covered by each receipt so as to permit at all times identification and delivery of those goods except that different lots of fungible goods may be commingled.

(2) Fungible goods so commingled are owned in common by the persons entitled thereto and the warehouseman is severally liable to each owner for that owner's share. Where because of overissue a mass of fungible goods is insufficient to meet all the receipts which the warehouseman has issued against it, the persons entitled include all holders to whom over-issued receipts have been duly negotiated.

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

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

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

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

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

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

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

REASONS FOR SHORTAGES IN WAREHOUSED GRAIN: OVERSELLING AND FRAUDULENT ISSUE

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

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

While sale and delivery of more grain than the warehouse

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

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

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

owns is wrongful,¹⁰⁹ the sale is nevertheless effective to convey good title to an ordinary course buyer¹¹⁰ under U.C.C. section 7-205, which provides:

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

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

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

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

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

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

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

111. *Id.* § 7-205.

112. *Id.* (Official Comment).

positors . . . as tenants in common.¹¹³

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

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

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

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

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

Id.

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

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

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

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

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

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

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

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

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

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

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

Id. (emphasis added).

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

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

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

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

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

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

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

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

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

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

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

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

122. See note 101 *supra*.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

SCALE TICKETS AS EVIDENCE OF OWNERSHIP OF STORED GRAIN

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

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

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

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

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

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

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

135. *Id.* at 19.

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

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

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

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

The recent trend of legislative and judicial decisions is to treat

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

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

138. *Id.* at 19-21.

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

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

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

FURTHER RESOURCES AVAILABLE TO SATISFY STORERS' CLAIMS

In addition to a *pro rata* share of the grain remaining in an insolvent warehouse,¹⁴⁴ the storer has an unsecured claim against the warehouse for the balance of his grain deposit,¹⁴⁵ and a claim against the warehouseman's bond under the relevant warehouse licensing act.¹⁴⁶ In Nebraska, a successful claimant under the warehouse bond may also recover attorney's fees from the surety¹⁴⁷ if the claimant must file suit on the bond or if the surety names the claimant as a defendant in a declaratory judgment or

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

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

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

144. See text at note 101 *supra*.

145. *Id.*

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

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

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

interpleader action.¹⁴⁸

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

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

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

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

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

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

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

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

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

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

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

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

In the Iowa case, *Adam v. Mount Pleasant Bank & Trust Company*, producers alleged that Prairie Grain had been insolvent for at least five years before the ICC discovered the warehouse's massive shortages in early 1980.¹⁵⁵ The plaintiffs contended that had ICC properly inspected Prairie Grain, the insolvency would have been discovered much earlier, so that plaintiffs would not have lost money on grain stored with or sold to the warehouse.

The State of Iowa moved for summary judgment on the ground that the claim was basically one for misrepresentation, and thus specifically excepted from the state tort claims act.¹⁵⁶ However, the trial court, and on interlocutory appeal, the Iowa Supreme Court, found the misrepresentation exception inapplicable.¹⁵⁷ The Iowa Supreme Court pointed out that Iowa's tort claims act¹⁵⁸ was identical to the Federal Tort Claims Act,¹⁵⁹ and the court relied heavily on recent federal cases narrowing the misrepresentation exception.¹⁶⁰ The court held that the misrepresentation exception bars suits based solely on the government's failure to use due care in communicating information on which plaintiffs relied to their detriment. However, where the government agency breached statutory duties, such as those imposed by grain warehouse licensing

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

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

156. *Id.* at 252.

157. *Id.* at 254.

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

159. 28 U.S.C. § 1346 (1946).

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

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

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

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

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

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

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

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

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

164. *Id.* at 236-39.

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

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

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

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

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

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

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

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

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

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

172. *Id.* at 536.

173. *Id.* at 536-39.

174. *Id.* at 537.

175. *Id.* at 539.

176. *Id.* at 536-38.

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

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

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

VI. RIGHTS OF UNPAID SELLERS OF GRAIN

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

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

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

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

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

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

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

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

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

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

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

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

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

ceipt had been issued, the warehouse would get title to the grain upon surrender of the receipt.¹⁸⁴

Title to and possession of the grain under a purchase contract empowers the warehouse to encumber the grain with security interests, even if the seller has not been paid and the lender has not advanced funds in reliance on the specific grain purchase.¹⁸⁵ The warehouse also gets the power to resell and deliver the grain to a buyer, free from any claims of the unpaid producer-seller.¹⁸⁶

If the agreement between the warehouse-buyer and the producer-seller is for a cash sale,¹⁸⁷ the U.C.C. gives the seller the right to reclaim the grain from the buyer upon demand.¹⁸⁸ Credit sellers have a similar right, if they can show the warehouse was already insolvent when it took delivery of the grain under the sales

at time and place of contracting." See also *Reeves v. Pillsbury Co.*, 229 Kan. 423, — 625 P.2d 440, 446-47 (1981).

184. NEB. REV. STAT. (U.C.C.) § 2-401(3)(a) (Reissue 1980) provides, "Unless otherwise explicitly agreed where delivery is to be made without moving the goods . . . (a) if the seller is to deliver a document of title, title passes at the time when . . . he delivers such document . . ."

185. NEB. REV. STAT. (U.C.C.) § 2-403(1) (Reissue 1980) provides:

A purchaser of goods acquires all title which his transferor had or had power to transfer. . . . A person with voidable title has power to transfer good title to a good faith purchaser for value. When goods have been delivered under a transaction of purchase the purchaser has such power even though . . .

- (b) the delivery was in exchange for a check which is later dishonored, or
- (c) it was agreed that the transaction was to be a "cash sale," or
- (d) the delivery was procured through fraud. . . .

For cases holding a lender with a security interest in the buyer's inventory to be a good faith purchaser for value, see *In re Samuels & Co.*, 526 F.2d 1238, 1244 (5th Cir. 1976), cert. denied 429 U.S. 834 (1976); *In re Western Farmers Ass'n*, 6 Bankr. 432, 435-36 (W.D. Wash. 1980).

186. NEB. REV. STAT. (U.C.C.) § 2-403(1) (Reissue 1980) (text at note 185 *supra*); NEB. REV. STAT. (U.C.C.) § 7-205 (Reissue 1980) (which provides, "A buyer in the ordinary course of business of fungible goods sold and delivered by a warehouseman who is also in the business of buying and selling such goods takes free of any claim under a warehouse receipt even though it has been duly negotiated."). See also *In re Fairfield Elevator Co.*, 14 U.C.C. REP. SERV. (Callahan) 96, 108 (Bankr. S.D. Iowa 1973).

187. A "cash sale" may, but need not, involve the exchange of legal tender at time of delivery. It is enough that payment in the form of a check or other draft is demanded at the time of delivery, so that there is no voluntary extension of credit by the seller. See NEB. REV. STAT. (U.C.C.) §§ 2-507, -511 (Reissue 1980); see also *Peck v. Augustin Bros.*, 203 Neb. 574, 578, 279 N.W.2d 397, 399 (1979).

188. See NEB. REV. STAT. (U.C.C.) § 2-507(2) (Reissue 1980), which provides, "Where payment is due and demanded on the delivery to the buyer of goods or documents of title, his right as against the seller to retain or dispose of them is conditional upon his making the payment due."

Reclamation could be affected by filing a replevin action. See *Peck v. Augustin Bros.*, 203 Neb. 574, 581, 279 N.W.2d 397, 400-01 (1979).

contract.¹⁸⁹

However, reclamation rights usually prove illusory. Reclamation can be demanded only against the buyer-warehouse itself. If, before grain is successfully reclaimed, a third-party good faith purchaser's rights attach to the grain, the right to reclaim is lost or subordinated.¹⁹⁰ Good faith purchasers whose rights may intervene include secured lenders to¹⁹¹ and buyers from the warehouse.¹⁹² Even if no third-party intervenes, reclamation time limits are short. Credit sellers must demand reclamation within 10 days after delivery. The Eighth Circuit would give cash sellers more time,¹⁹³ but if a bankruptcy petition is filed, the Bankruptcy Act generally limits all unpaid sellers' reclamation rights to written demands made within ten days after delivery to the warehouse.¹⁹⁴

If the producer-seller is unable to reclaim his grain, the U.C.C.

189. See NEB. REV. STAT. (U.C.C.) § 2-702(2) (Reissue 1980), which provides, "Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt"

190. For cash sellers that limitation is derived from the phrase "as against the seller" found in *id.* § 2-507(2) (text at note 188 *supra*); see also *id.* § 2-507 Official Comment 3. For credit sellers, the limitation is expressed in U.C.C. § 2-702(3), 1A U.L.A. 349 (1976), which provides: "The seller's right to reclaim under subsection (2) is subject to the rights of a buyer in ordinary course or other good faith purchaser under this Article (Section 2-403). . . ."

191. See *In Re Samuels & Co.*, 526 F.2d 1238, 1246-48 (5th Cir. 1976); *In re Western Farmers Ass'n*, 6 Bankr. 432, 435-36 (W.D. Wash. 1980).

192. See *In re Fairfield Elevator Co.*, 14 U.C.C. REP. SERV. (Callaghan) 96, 108 (Bankr. S.D. Iowa 1973).

193. See NEB. REV. STAT. (U.C.C.) § 2-702(2) (Reissue 1980) (text at note 189 *supra*) (credit sellers); see also *id.* § 2-507 Official Comment 3 (cash sellers). The Comment states: "The provision of this Article for a ten-day limit within which the seller may reclaim goods delivered on credit to an insolvent buyer is also applicable here." Courts are divided on whether this Comment, which clearly goes beyond the text of the U.C.C., should be given effect. Compare *Burk v. Emmick*, 637 F.2d 1172 (8th Cir. 1980) (cash seller's reclamation not limited to ten days) with *Szabo v. Vinton Motors, Inc.*, 630 F.2d 1 (1st Cir. 1980) (cash sellers must reclaim within ten days).

194. 11 U.S.C. § 546(c) (1979), provides:

The rights and powers of the trustee under sections 544(a), 545, 547, and 549 of this title are subject to any statutory right or common-law right of a seller, in the ordinary course of such seller's business, of goods to the debtor to reclaim such goods if the debtor has received such goods while insolvent, but—

- (1) such a seller may not reclaim any such goods unless such seller demands in writing reclamation of such goods before ten days after receipt of such goods by the debtor; and
- (2) the court may deny reclamation . . . only if court—
 - (A) grants the claim of such a seller priority as an administrative expense; or
 - (B) secures such claim by a lien.

The seller's right to reclaim is ably examined in Wallach, *The Unpaid Seller's Right*

and the Bankruptcy Act give him only an unsecured claim against the warehouse.¹⁹⁵ Therefore, the seller should examine the state and federal statutes under which the warehouse is licensed and bonded.

RIGHTS OF SELLERS UNDER WAREHOUSE LICENSING STATUTES—IN GENERAL

Whether an unpaid seller of grain is covered by a warehouse bond depends on the statute requiring the bond. Some states, as noted earlier, extend bond coverage to sellers. In many jurisdictions, however, the bond excludes sellers. Typical statutory language says the bond secures: ". . . the faithful performance of his obligations as a warehouseman under the terms of this chapter . . . and of such additional obligations as a warehouseman as may be assumed by him under contracts with the respective depositors of agricultural products in such warehouse."¹⁹⁶

Such a statute provides bond coverage for breach of two types of warehouse duties: those imposed by statute and those undertaken by contract. In both cases, the duties are expressly qualified by the phrase "as a warehouseman." Courts faced with the "as a warehouseman" limitation generally hold that a warehouseman is one in the business of storing goods for profit, and that only those statutory or contractual duties which involve storage for profit are "obligations as a warehouseman." For example, in *Merchants Mutual Bonding Co. v. Appalachian Insurance Co.*,¹⁹⁷ unpaid sellers claimed the warehouse's grain purchase contracts were "additional obligations . . . assumed" within the meaning of an Iowa statute identical to that quoted above.¹⁹⁸ The Eighth Circuit Court of Appeals rejected that argument, stating that not every obligation of a warehouse is an obligation "as a warehouseman."¹⁹⁹

Coverage is limited to "obligations as a warehouseman,"

to Reclaim Goods: The Impact of the Uniform Commercial Code and the Bankruptcy Acts of 1898 and 1978, 36 ARK. L. REV. 252 (1980).

Both Houses of Congress have passed bills which would amend 11 U.S.C. § 546 by adding a new subsection on reclamation by grain sellers against a grain warehouse. Each bill provides, "the court may deny reclamation to such a producer with a right of reclamation that has made such a demand only if the court secures such claim by a lien." See H.R. 5174, 98th Cong., 2d Sess. § 251 (1984); S. 445, 98th Cong., 1st Sess., § 236 (1983). The effect of the bills could be to ensure a reclaiming seller's claim is treated as a secured claim rather than as a priority unsecured claim.

195. See notes 207-15 *infra*.

196. The quotation is from the United States Warehouse Act, 7 U.S.C. § 247 (1982).

197. 556 F.2d 889 (8th Cir. 1977).

198. *Id.* at 901, quoting IOWA CODE ANN. § 543.12 (West 1950).

199. 556 F.2d at 901.

i.e., obligations incurred in "the storage of agricultural products for compensation." The obligation involved in this case, however, is the elevator's duty to pay . . . the purchase price of grain. This duty arose, not from the elevator's storage of the grain for compensation, but from its purchase of the grain for its own account. . . . [An] obligation of this kind is not within the coverage of the statutory bond.²⁰⁰

Similarly, many cases hold that sales of a producer's grain on commission by a warehouse are not covered by the bond, when the warehouse fails to remit the price. Since warehouse statutes do not require warehousemen to act as factors or selling agents and since storage plays only an incidental part in such transactions, sales on commission are not obligations as a warehouseman.²⁰¹ Another transaction sometimes excluded in the purchase of grain from a warehouse, when the claimant shows he paid the price to the warehouse but never received the grain.²⁰²

A minority of cases read similar language more broadly, arguing that bond coverage is intended not only for duties required by law but also for the normal and customary activities of the licensed businesses. A recent Minnesota case extended coverage to unpaid sellers, even though the statute in force at time of loss said the

200. *Id.* For other cases holding that sellers of grain to the warehouse are not protected by the warehouse bond, see *Thomas v. Reliance Ins. Co.*, 617 F.2d 122, 125-27 (5th Cir. 1980) (Texas law); *United States Fidelity & Guar. Co. v. Long*, 214 F. Supp. 307, 314 (D. Or. 1963) (Oregon law); *United States v. Fireman's Fund Ins. Co.*, 191 F. Supp. 317, 320 (D. Idaho 1961) (Idaho law); *Jensen v. United States Fidelity & Guar. Co.*, 78 Idaho 145, —, 298 P.2d 976, 978 (1956); *True v. Merchants Mut. Bonding Co.*, 251 N.W.2d 543, 544 (Iowa 1977) (cash seller denied bond protection under Iowa's Bonded Grain Warehouse Act, although court noted seller would have been protected under the subsequently enacted Iowa Grain Dealers Act, if his loss had not preceded its effective date); *Michael v. Merchants Mut. Bonding Co.*, 251 N.W.2d 531, 533 (Iowa 1977).

201. See *United States v. Fireman's Fund Ins. Co.*, 191 F. Supp. 317, 320 (D. Idaho 1961) (Idaho law); *Jensen v. United States Fidelity & Guar. Co.*, 78 Idaho 145, —, 298 P.2d 976, 978-79 (1956); *State ex rel. Cawrse v. American Sur. Co.*, 148 Or. 1, —, 33 P.2d 487, 491-92 (1934); *Republic Underwriters v. Tillamook Bay Fish Co.*, 133 Tex. 141, —, 126 S.W.3d 641, 642-43 (1937). *But cf.* *Indemnity Ins. Co. v. Archibald*, 299 S.W. 340, 341 (Tex. Civ. App. 1927) (distinguished in *Tillamook*).

202. For a case denying bond protection to buyers from the warehouse, see *Allied Mut. Ins. Co. v. Farmers Nat'l Co.*, 309 F. Supp. 732, 733 (N.D. Iowa 1970); *Allied Mut. Ins. Co. v. Farmers Nat'l Co.*, 303 F. Supp. 555, 557-58 (N.D. Iowa 1969). Buyers were held covered by the warehouse's storage bond in *Aetna Ins. Co. v. Junction Warehouse Co.*, 389 F.2d 464, 466-67 (5th Cir. 1968) (Texas Law) and *People v. Farmers Elevator Mut. Ins. Co.*, 74 Ill. App. 2d 1, —, 220 N.E.2d 585, 585-591 (1966).

The differences in result may be due to the different role of storage in the cases. In the Iowa cases, the buyer was to take almost immediate delivery and had not been issued scale tickets or warehouse receipts. In the Texas and Illinois cases, the warehouse had agreed to store the grain for the buyer and had issued scale tickets or warehouse receipts for the grain purchased.

bond covered only "persons storing grain in such warehouse."²⁰³ The result was heavily influenced by legislative history, with the court pointing out that Minnesota had previously required two licenses and two bonds, one for storage and one for merchandising. Later the statutes had been amended to require only one license and one bond, but merchandising activities were still regulated by the licensing statute. The court relied on this history in stating that the bond should be "coextensive with the operations licensed," and that sellers as well as storers should be covered.²⁰⁴ The court emphasized that warehouse bonds should be liberally construed to protect all who deal with public warehousemen "in normal and usual transactions," and that sellers rely on warehousemen just as storers do.²⁰⁵

UNPAID SELLERS OF GRAIN TO NEBRASKA WAREHOUSES

With that background, let us examine the Nebraska statutes which might provide bond coverage for unpaid sellers of grain. We will consider:

- (1) The United States Warehouse Act and Nebraska Grain Buyer's Act.
- (2) The Nebraska Warehouse Act if loss occurred prior to August 1983.
- (3) The Nebraska Warehouse Act if loss incurred after August 1983.

Sellers to Federally-Licensed Nebraska Warehouses

The United States, under its Warehouse Act (U.S.W.A.)²⁰⁶ does not regulate the grain buying and selling activities of warehouses. The U.S.W.A.'s bond provision²⁰⁷ is identical to the Iowa statute construed in *Merchants Mutual*.²⁰⁸ There are few reported decisions interpreting the federal act's bond coverage, but the result would probably be the same as in *Merchants Mutual*, and unpaid sellers would have no claim under the U.S.W.A. bond.²⁰⁹

While Nebraska could, as some other states do, regulate and

203. *St. Paul Ins. Cos. v. Fireman's Fund Am. Ins. Cos.*, 245 N.W.2d 209, 217 (Minn. 1976).

204. *Id.*

205. *Id.*

206. 7 U.S.C. §§ 241-273 (1982).

207. 7 U.S.C. § 247 (1982).

208. 556 F.2d 889 (8th Cir. 1977).

209. *See, e.g.*, *Farmers Elevator Mut. Ins. Co. v. Jewett*, 394 F.2d 896, 899-900 (10th Cir. 1968) (emphasizing that the grain in question had not been sold to the warehouse); *Stevens v. Farmers Elevator Mut. Ins. Co.*, 197 Kan. 74, —, 415 P.2d 236, 240-41 (1966). The U.S. Department of Agriculture in 1981 proposed regulating and

bond the nonstorage activities of federal licensees,²¹⁰ neither the Nebraska Warehouse Act²¹¹ nor the Nebraska Grain Buyer's Act²¹² do so. The Nebraska Warehouse Act specifically exempts federally licensed warehouses from all of its provisions.²¹³ The Grain Buyer's Act specifically excludes "public grain warehouses licensed as such in this state" from its coverage.²¹⁴ Since the Nebraska Warehouse Act's licensing requirement can be satisfied by obtaining either a state or federal license,²¹⁵ a federal licensee may be a warehouse "licensed as such in this state" within the meaning of the Grain Buyer's Act exclusion. If the Grain Buyer's Act were read to include federal warehouses, it would discriminate by requiring them, but not state-licensed warehouses, to obtain a dealer's license and bond. Essentially then, an unpaid seller to a federally-licensed Nebraska warehouse remains where the U.C.C. leaves him, just an unsecured creditor without bond protection.

Unpaid Sellers of Grain to State-Licensed Nebraska Warehouses—Pre-1983

Since this article will appear in 1984, it may seem unnecessary to investigate a seller's status under the pre-1983 version of the Nebraska Warehouse Act. This historical digression, however, has several purposes. First, there are claims still pending that arose before the 1983 amendments took effect. Second, the history may shed some light on the current version of the Act and on similar legislation in other states. Finally, it illustrates a common problem with statutes, that amendments are adopted without reference to prior judicial construction, creating difficult problems of interpretation.

Until a 1983 amendment,²¹⁶ the Nebraska Warehouse Act bond ran to "all persons storing grain in such warehouse" and was conditioned on "the delivery of all stored grain or payment of the value thereof upon the surrender of the warehouse receipt, and upon the faithful performance by the warehouse of all the provisions of law relating to the storage of grain by such warehouseman

bonding warehouse purchases and sales, but the proposed regulations have not been adopted. See USDA TASK FORCE REPORT, *supra* note 7, at 39-46.

210. See text at notes 53-53 *supra*. See also USDA TASK FORCE REPORT, *supra* note 7, at 18.

211. NEB. REV. STAT. §§ 88-501 to -517 (Reissue 1981).

212. *Id.* at §§ 88-518, -519.

213. *Id.* § 88-516.

214. *Id.*

215. *Id.* §§ 88-501, -516.

216. L.B. 73, 1983 Neb. Laws 289. This amendment is discussed in the text at notes 250-55 *infra*.

. . . "217

One familiar with warehouse regulation in other states might conclude that sellers are excluded under this Act just as they are under the U.S.W.A. and similar legislation. However, judicial interpretation of the Nebraska Warehouse Act has been more generous. Both the Nebraska Supreme Court and the United States District Court for the District of Nebraska held that the pre-1983 Nebraska Warehouse Act included unpaid sellers within the protected category of "storers of grain."²¹⁸ Both courts awarded unpaid sellers a portion of the warehouse bond. While neither case involved a claim to the proceeds of the grain remaining in the warehouse, the same reasoning might have been used to give sellers a share in that as well.

The state agency charged with administering the Nebraska Warehouse Act, the PSC, considered these decisions incorrect, and adhered to the view that sellers had no claim to the grain or the bond. In PSC decisions on distribution of grain and bond proceeds from insolvent warehouses, the judicial decisions were not followed.²¹⁹

The controversy hinged on the Nebraska Warehouse Act's definition of stored grain. Until 1951, what is now section 88-501 of the Act provided: "Any grain, which has been received at any . . . grain warehouse and for which the actual sale price is not fixed within ten days after the receipt of the same, is construed to be grain held in storage within the meaning of [the Act]."²²⁰

In that form, the definition established a presumption for the protection of depositors of grain. The warehouse and the surety had the burden of proving a delivery was for sale rather than storage.²²¹ Unless the warehouse could show that a contract for sale had been made and the price fixed, the grain was to be treated as stored grain, to which the depositor would retain title and on which he could demand a warehouse receipt.

In 1951, the statutory definition of stored grain was amended to read: "Any grain, which has been received at any . . . grain warehouse and for which the actual sale price is not fixed *and payment*

217. NEB. REV. STAT. § 88-503(3) (Reissue 1981) (amended 1983).

218. *Kort v. Western Sur. Co.*, No. CV 77-L-208, slip op. at 2-4 (D. Neb. Aug. 4, 1980); *Mintken v. Nebraska Sur. Co.*, 187 Neb. 215, 217, 188 N.W.2d 819, 820-21 (1971).

219. *See, e.g.*, *In re Fecht (Milligan Grain Co.)*, PSC, No. 159 (July 26, 1983); *In re Fecht (Traders Grain, Inc.)*, PSC, No. 146 (Jan. 12, 1982).

220. NEB. REV. STAT. § 88-201 (Reissue 1950) (current version at *id.* § 88-501 (Reissue 1981)).

221. *Cf. Farmers Elevator Mut. Ins. Co. v. Jewett*, 394 F.2d 896, 899 (10th Cir. 1968); *Hartford Accident & Indem. Co. v. State* 247 F.2d 315, 320 (10th Cir. 1957).

made therefor within ten days after the receipt of the same, is construed to be grain held in storage”²²² In 1965, the ten days was changed to thirty days,²²³ and in that form, the definition still stands. The legislative history sheds no light on the purpose of adding the phrase “and payment made therefor.”

Certainly it is possible to read section 88-501 as amended to mean that grain is stored grain, and its depositor is a storer of grain under the Act, despite a contract of sale, so long as the seller has not received final payment. The Nebraska Supreme Court so construed section 88-501 in *Mintken v. Nebraska Surety Co.*²²⁴ In that case, an unpaid seller sued the buyer-warehouse’s bonding company, claiming that he was a storer of grain protected by the bond. The bonding company argued that storers of grain were only those who had not transferred title to their grain to the warehouse. Since the seller admitted making a contract of sale and receiving part payment, the surety contended the seller could not be a storer within the meaning of the Act.²²⁵

The court, without discussing the history of section 88-501 or analyzing the Nebraska Warehouse Act as a whole, held for the seller. The court stated that even though title to the grain had passed to the warehouse, that was not relevant under the Nebraska Warehouse Act. The Act’s definition of stored grain, the court held, was controlling on the question of bond coverage. Grain sold but not paid for was stored grain under section 88-501. The seller therefore was deemed a storer of grain entitled to bond coverage under the Act.²²⁶

Nine years later, the United States District Court for the District of Nebraska followed *Mintken*. In *Kort v. Western Surety Co.*,²²⁷ the court found that unpaid cash and credit sellers were storers of grain under section 88-501 and so were covered by the warehouse bond.²²⁸

The PSC has advanced a very different construction of section 88-501. In the PSC’s view, location of title is and always has been a crucial dividing line, and section 88-501 was never intended to bring sellers, who had transferred title to their grain to the warehouse, within the protection of the Act. Instead, the PSC argues, the function of section 88-501 before and after the 1951 addition of

222. L.B. 377, § 1, 1951 Neb. Laws 1151 (emphasis added).

223. L.B. 200, ch. 584, art. II, § 1, 1965 Neb. Laws 1886.

224. 187 Neb. 215, 217, 188 N.W.2d 819, 820-21 (1971).

225. *Id.*

226. *Id.*

227. *Kort v. Western Sur. Co.*, No. CV 77-L-208 (D. Neb. Aug. 4, 1980).

228. *Id.* at 2-4.

"and payment made," is simply to determine whether a particular depositor of grain has agreed to sell and has transferred title to the warehouse. Only if there has been no transfer of title would the grain be stored grain, and its owner entitled to a warehouse receipt and bond coverage.²²⁹

In the PSC's view, grain delivered to a warehouse is not stored grain if either of two facts can be proved. First, if the depositor has entered into a contract of sale, not within the statute of frauds and not otherwise invalid, which fixes a price, then the grain is warehouse-owned rather than stored grain and the depositor is not a storer under the Act.²³⁰ A second way to remove grain from the protected category of "stored grain" is to show that at or after delivery, payment was made by the warehouse and accepted by the seller.²³¹ Since under this construction, the aim of section 88-501 is only to determine whether the parties intended a sale, it is irrelevant that the warehouse grain payment check has bounced. The fact that a check was issued to and accepted by the grain depositor would evidence a sale.²³²

Whether section 88-501 and the rest of the Nebraska Warehouse Act, prior to the 1983 amendments, were intended to treat all unpaid sellers as storers is a difficult question. In support of a broad seller-protection aim, one can point to the precise language of section 88-501: It says "and payment made" rather than "or payment made." If the purpose were only to search for evidence of a contract of sale, it would be unnecessary to prove both a contract which fixed a price *and* payment by the seller.²³³

229. See *In re Fecht* (Traders Grain, Inc.), PSC, No. 146 at 4 (Jan. 12, 1982). The Public Service Commission said:

[T]he Mintken case was incorrectly decided by the district court . . . and the error was perpetuated by the Supreme Court and further compounded by the U.S. District Court. . . .

Where contracts for sale of grain have been concerned, the Commission has held that those who delivered their grain over to the warehouseman and passed title were not storers of grain. . . .

Id.

230. *Id.* at 4-5. "The establishment of the price and the change in title have always been the deciding factors for the Commission." *Id.*

231. *Id.* at 2-3. "When the books showed that the grain was sold to the warehouse and the check register showed a concurring transaction . . . the seller was no longer considered . . . a storer of grain." *Id.*

232. *Id.* at 5. "The payment is presumed to have been completed once a check is issued and the Commission has steadfastly declined to go behind the check." *Id.*

233. Iowa formerly had a provision in its Bonded Warehouse Law quite similar to Nebraska's § 88-501. In 1964, the Iowa Attorney General issued an opinion that the "and payment made" requirement of the Iowa statute meant actual satisfaction of the debt, not just documentation of the amount owed in the warehouse records. 1.6 Op. Iowa Att'y Gen. 9 (Feb. 12, 1964).

Nevertheless the Iowa provision was interpreted in *Allied Mut. Ins. Co. v. Farm-*

Sellers could also rely on the fact that the 1951 amendment to section 88-501's definition of stored grain was followed, in the next legislative session, by enactment of the Nebraska Grain Buyer's Act.²³⁴ That statute was very clearly intended to protect grain sellers from the risk of nonpayment by the buyer,²³⁵ yet it excludes from its coverage licensed grain warehouses.²³⁶ Perhaps the reason for excluding so important a group of grain buyers was the belief that sellers to warehouses were already protected by the 1951 amendment's addition of "and payment made" to the Nebraska Warehouse Act.

On balance, however, the arguments in favor of a narrower role for section 88-501 seem stronger. When the Nebraska Warehouse Act is read as a whole, other sections place importance on whether title to the grain has passed to the warehouse or has been retained by the depositor. For example, section 88-501, giving the PSC power to close a warehouse and liquidate its grain, provides that the PSC holds the grain or its proceeds for "distribution . . . to all valid owners, depositors, or storers of grain who shall be holders of evidence of ownership of grain."²³⁷ Thus, only persons holding documents of title, i.e. evidence of ownership, may share in the remaining grain.

Although the language includes persons other than owners, the non-owner depositors and storers referred to need not be unpaid sellers. There are cases in which non-owners deposit grain in a warehouse without the warehouse graining title to the grain. For example, a lender might hold documents of title to grain owned by its debtor, a producer. A warehouse filled to capacity might move

ers Nat'l Co., 303 F. Supp. 555, 559 (N.D. Iowa 1969), as not extending bond coverage to grain not under warehouse receipt. See *Michael v. Merchants Mut. Bonding Co.*, 251 N.W.2d 531, 532-33 (Iowa 1977) denying bond coverage for grain sold but not paid for.

Later, Iowa amended its provision to provide: "Any grain which has been received at any licensed warehouse for which the actual sale price is not fixed *and proper documentation made or payment made* shall be construed to be grain held for storage within the meaning of this chapter." IOWA CODE ANN. § 543.17.1 (West Supp. 1983-84) (emphasis added). With these changes, Iowa's statute would permit grain sold to the warehouse but for which final payment had not been made to become company-owned rather than stored grain if the price were fixed and there was proper documentation in a warehouse records.

234. L.B. 585, § 1, 1953 Neb. Laws 1151.

235. NEB. REV. STAT. § 88-518 (Reissue 1981). The grain buyer's bond is "conditioned that the applicant will pay the purchase price of such grain upon demand of the owner or seller . . ." *Id.*

236. *Id.* The statute begins with the words "Any person, firm, cooperative, or corporation, *other than a public grain warehouseman licensed as such in this state*, who shall purchase grain . . . for . . . resale . . ." *Id.* (emphasis added).

237. *Id.* § 88-515(3)(a).

grain owned by its storage customers to a second warehouse. In these cases, the grain is stored grain in the usual sense of the word, and the warehouse in possession does not have title.

Similarly, the statutory condition of the bond, before a 1983 amendment, was "the delivery of all stored grain or payment of the value thereof upon the surrender of the warehouse receipt" ²³⁸ The section presupposes that the bond claimant holds a document of title to the grain, yet unpaid sellers, unless they had initially stored their grain in the warehouse, would not have a warehouse receipt.

Another consideration is that the amount of the Nebraska Warehouse Bond has not been determined with reference to the warehouse's probable liability to unpaid sellers. The PSC bases the amount on the physical storage capacity of the warehouse. ²³⁹ By contrast, the amounts of the Nebraska Grain Buyer's Bond and similar seller protection bonds in other states are usually measured by a percentage of the buyer's aggregate grain purchases in prior years. ²⁴⁰ The fact that potential liability to sellers has played no part in setting the amount of the bond indicates the bond was not intended to cover unpaid sellers.

A seller's argument that warehouses were excluded from the Grain Buyer's Act only because unpaid sellers to warehouses already had bond protection could be countered by pointing out that there were in 1953, and still are, good reasons for affording Nebraska producers more protection from non-warehouse buyers than from warehouse grain buyers. The 1953 Grain Buyer's Act was originally entitled the "Itinerant Grain Buyer's Act."²⁴¹ Apparently it was aimed a particularly predatory group—truckers who pick up a seller's grain at his farm, cheat him by understating the amount of grain,²⁴² then quickly resell the grain and perhaps leave the state before the payment check bounces.²⁴³ Licensed

238. *Id.* § 88-513 (amended 1983). See note 216 *supra*.

239. See note 8 *supra*.

240. NEB. REV. STAT. § 88-518 (Reissue 1981). Iowa's Bonded Grain Dealer's Law requires a \$50,000 bond for dealers whose grain purchases *from producers* exceeded \$250,000 in the previous fiscal year. IOWA CODE ANN. § 542.3.4a (West Supp. 1983-1984) (emphasis added).

241. L.B. 585, § 1, 1953 Neb. Laws 1151. L.B. 585 carried the title "Requiring Licensing of Itinerant Grain Buyers." *Id.*

242. See *Hearings on L.B. 529, supra* note 27, at 42, 84.

243. No legislative history is available on the Grain Buyer's Act. L.B. 585 (1953) was placed directly on the General File, which means there was no public hearing before a legislative committee. Floor debates of the Nebraska Unicameral were not recorded before 1961. See Letter from Patrick J. O'Donnell, Clerk of the Legislature, Nebraska Unicameral to Marianne Culhane (Mar. 7, 1984) (on file with CREIGHTON L. REVIEW).

grain warehouses, by contrast, have an established place of business, some minimum net worth, regularly inspected scales, and an expectation of repeat business with particular sellers. Warehouses arguably present less of a danger to sellers, since even if sellers are not protected by the warehouse bond, the warehouse has assets from which debts might be collectable.

A further argument that grain sellers were not intended to be protected arises from the method of calculating the warehouseman's obligation, that is, the amount of grain which the warehouse is required to have on hand.²⁴⁴ If one treated all grain received under purchase contracts but not finally paid for as stored grain, that would impose a 100 percent reserve requirement for grain delivered under purchase contracts, as well as for that under straight storage contracts. The warehouse could not rightfully resell or re-ship the purchased but unpaid grain. Such treatment of grain under purchase contract is not consistent with usual warehouse operational and regulatory patterns. Other states which have recently adopted statutes clearly intended to protect unpaid sellers do not require a 100 percent reserve against unpaid grain.²⁴⁵

The PSC's interpretation of "and payment made" as referring merely to issuance and acceptance of a check, rather than to final payment, is consistent with the U.C.C.'s Article Two statute of frauds. U.C.C. section 2-201(3)(c) takes an oral contract out of the statute of frauds with respect to goods for which "payment has been made and accepted . . ." ²⁴⁶ An insufficient funds check does not discharge the underlying debt, but its issue and acceptance constitute "payment" within the meaning of the statute of frauds.²⁴⁷ Since U.C.C. § 2-201 was not available in 1951 to help de-

244. Neither the Nebraska Grain Warehouse Act nor the Public Service Commission's published regulations defines the warehouseman's obligation, although Title 291, chapter 8, section 004.17 of the PSC regulations mentions the concept when referring to "the total storage obligations" of the warehouse.

Iowa's Bonded Warehouse Law differentiates between "grain of depositors" and "company-owned grain"; and then states "At no time may a warehouseman have less grain . . . in the warehouse than the obligations to depositors . . ." IOWA CODE ANN. § 543.1.15 (West Supp. 1983-1984).

245. For example, Iowa's Bonded Grain Dealers Law requires a grain dealer [to] "maintain current assets equal to at least ninety percent of current liabilities or provide bond . . ." IOWA CODE ANN. § 542.3.4.c (West Supp. 1983-1984). The grain dealer thus can satisfy this requirement with assets other than grain in the warehouse. See also MICH. COMP. LAWS ANN. § 285.67A (West Supp. 1983-1984).

246. See NEB. REV. STAT. (U.C.C.) § 2-201(3)(c) (Reissue 1980).

247. See *Lea Indus. Inc. v. Raelyn Int'l, Inc.*, 363 So. 2d 49, 52 (Fla. Dist. Ct. App. 1978); cf. *Kaufman v. Solomon*, 524 F.2d 501, 502-03 (3d Cir. 1975); *Presti v. Wilson*, 348 F. Supp. 543, 546 (E.D.N.Y. 1972).

cide whether a sales contract had been made,²⁴⁸ it seems reasonable to presume that the "and payment made" language of section 88-501 was added for that narrow purpose, and not to add all unpaid sellers to the category of storers of grain.

Whatever the merits of this controversy, it probably has been settled for the future by a 1983 amendment to the Nebraska Warehouse Act.

Unpaid Sellers to Nebraska State-Licensed Warehouse—Post-1983.

Apparently, few sellers were aware of the judicial interpretation of the pre-1983 Nebraska Warehouse Act. Instead of challenging the PSC and the bonding companies in court, unpaid sellers took their disappointments to the legislature. The legislature responded in 1983 by amending the Nebraska Warehouse Act's bond provision to include one narrow class of sellers. This amendment seems to reject the prior broad judicial construction, although nothing in the legislative history indicates the legislature was aware of the prior case law.²⁴⁹

The 1983 amendments to the Nebraska Warehouse Act were embodied in L.B. 73.²⁵⁰ That bill added to the class of persons entitled to share in the warehouse bond "persons holding checks for the purchase of grain which were issued by the warehouseman not more than five business days prior to the cutoff date of operations for the warehouse"²⁵¹ The legislative history shows the five-day rule was a delicate compromise. In response to producer pressure, the bill's proponents attempted to protect some unpaid sellers without requiring big increases in the cost of the warehouseman's bond and without unduly diluting bond protec-

248. L.B. 49, 1963 Neb. Laws 1693. Nebraska adopted the Uniform Commercial Code in 1963.

249. See *Hearings on L.B. 73, supra* note 41, at 31-32. For example, Robert Andersen, Executive Secretary of the Nebraska Cooperative Council, testified "[T]he transactions of the price—later contracts [and] deferred payment contracts . . . are not included within the warehouseman's bond The warehouseman's bond applies to grain that is brought into a local elevator . . . and is being stored for that individual farmer . . . he retains title to that grain." *Id.*

In floor debate on the bill, Sen. Chronister opposed adding seller protection to the warehouse bond, stating: "[W]e can't guard . . . against everything . . . so the powers that be in past decided [to] . . . protect grain in storage . . . and that has been the historical purpose of the bond." See *Floor Debate on L.B. 73 in the Nebraska Unicameral*, 88th Leg., 1st Sess. — (Mar. 29, 1983) [hereinafter cited as *Floor Debate on L.B. 73*].

250. See L.B. 73, § 3, 1983 Neb. Laws 291.

251. *Id.* § 4.

tion for storers of grain.²⁵²

While the arbitrary five-day rule may be easy to apply, the amendment may not fulfill its sponsors' hopes. The apparent intent was to include only cash sellers, those who had never agreed to extend credit to the warehouse but instead demand and receive a check when they deliver grain. Those unfortunate cash sellers who deliver grain and receive checks within the warehouse's last five days of operation would not, it was argued, have a reasonable time to get the check cleared before the warehouse's bank account was frozen.²⁵³ So small an extension of bond coverage, it was thought, would not require much of an increase in the cost of the bond.²⁵⁴

However, the amendment as drafted is not so limited; it could be read to cover credit sellers as well. The text of the statute refers only to the date the check was issued, and not to the relationship of that date to the contract date and the delivery date. A check issued within the warehouse's last five days might well be one due under a deferred payment or deferred pricing contract for grain delivered months earlier.

The lack of an express limitation to cash sales opens the provision to possible manipulation. A warehouseman who knew he was in trouble, perhaps because some checks had already bounced, might be able to predict PSC action within a few days. He could protect his friends to some extent by issuing checks to cover their outstanding credit sale contracts, thus guaranteeing bond protection, if the checks were not paid. Further, a credit seller could pressure a warehouseman into issuing a check if he heard rumors of complaints to the PSC. While producers selling grain on credit may deserve bond coverage, including them without increasing the amount of the bond could greatly dilute protection of other claimants.

Non-producer sellers are another group apparently outside the amendment's intended scope but within its language. Warehouses

252. *Floor Debate on L.B. 73, supra* note 249, at —. Several senators opposed extending bond coverage to holders of checks because they believed this additional exposure would increase bond premiums beyond the warehouses' ability to pay. *Id.* (remarks of Senators De Camp, Jacobson and Chronister). A proponent countered with the question "[H]ow much grain could be bought in five days time[?] We are moving with the five day margin here and this cannot [add] that much to the cost of the bond." *Id.* (remarks of Sen. Eret).

253. *Floor Debate on L.B. 73, supra* note 249, at —. The bill's sponsor remarked during floor debate, "What happens if I deliver a thousand bushels of corn to the elevator today, get a check and tomorrow I find out the elevator is bankrupt? Very frankly, I was not covered." *Id.* (remarks of Senator Schmit).

254. *See* note 252 *supra*.

sometimes buy large quantities of grain for resale from other warehouses and other non-producer sellers in cash or credit transactions. Non-producer sellers are perhaps less deserving of the limited bond coverage the statute affords. Normally they are professional grain merchants better able to assess the buyer's financial status and to take other measures to reduce insolvency risks than are many producers. Since transactions with non-producer sellers tend to be large, the inclusion of their claims under the bond could substantially reduce the resources available to the bond's intended beneficiaries.

Not only is Nebraska's new seller-protection provision over-inclusive as indicated, it is under-inclusive in important ways. The legislature seems to have assumed, in adopting the five-day cutoff, that the only reason warehouse checks bounce is that sellers fail to present the checks for payment before the warehouse ceases operation. Frequently, however, warehouses in financial trouble write some bad checks well before they are shut down.²⁵⁵ Suppose a producer gets a check when he delivers his grain to XYZ warehouse, promptly deposits the check in his bank and the check is returned for insufficient funds several days later. Suppose further that our seller promptly calls the warehouse and when he gets no satisfactory response, call the PSC to report that XYZ warehouse has issued a bad check in a cash sale of grain. Unless the PSC can investigate and shut the warehouse down in the one or two remaining days of the statutory five, that cash seller who acted with all possible diligence will be cut out of the bond's protection.

It appears that the only bond protection for unpaid sellers of grain to Nebraska warehouses is that afforded under the 1983 amendments to the Nebraska Warehouse Act, in favor of sellers holding checks issued within five days before the warehouse ceased operations. This is less protection than sellers enjoy in several nearby states, such as Iowa, Michigan and Illinois, which all offer bonds for unpaid sellers.²⁵⁶ Denying bond protection to sellers puts Nebraska producers at a financial disadvantage. It may also slow settlements to storers, as alleged sellers will contest that

255. See *State Maintains Grain in Storage is Farmers'*, Des Moines Reg., Feb. 19, 1980 at 3A, col. 1. For example, the Iowa Commerce Commission's January 1980 inspection of Prairie Grain Company in Stockport, Iowa was triggered by a tip, allegedly from a competitor, that Prairie Grain had issued a number of bad checks. The firm's checks began bouncing in the fall of 1979, but the recipients did not report the problem promptly to the I.C.C. *Id.*

256. See IOWA CODE ANN. § 542.4 (West Supp. 1983); ILL. ANN. STAT. ch. 111, ¶ 303 (Smith-Hurd Supp. 1983-84); MICH. COMP. LAWS ANN. § 285.67a (West Supp. 1983).

classification and try to bring themselves within the protected category of storer of grain.

How To Tell the Storers From the Sellers

Any depositor of grain runs some risk, in event of warehouse insolvency, that he will be classed as a seller rather than a storer. Sellers, of course, do not share in grain proceeds and usually get little or no bond protection, while storers get a *pro rata* share of grain and bond proceeds. Sometimes these funds are too small in relation to total claims to justify any contest by the alleged seller. Where the proceeds are more ample, however, the alleged seller may seek to escape that category and to be treated as a storer. To do this, he may rely on the U.C.C. statute of frauds or additional documentation requirements of warehouse licensing statutes. He may show that he never agreed to sell his grain. Alternatively, he may contend his sales contract is avoidable on some ground such as fraud.

In some states, statutes raise a presumption of storage or sale. The Nebraska Warehouse Act, as already discussed, presumes grain delivered to a warehouse is stored grain unless a contract of sale is adequately documented.²⁵⁷ Minnesota, on the contrary, treats all deliveries as sales unless the depositor proves a storage contract.²⁵⁸ In warehouse insolvency cases, it seems more reasonable to put the burden on the warehouse, its surety and the liquidators to prove that a particular delivery was for sale rather than storage. After all, the warehouse is in the business of storing grain, it should have good records of its transactions, and it will normally have drafted any writings involved.

Categorizing a depositor can be difficult, since practices in the grain warehousing industry muddy distinctions between sales of grain and deliveries for storage. In either case, the agreement is often oral, and the only writing at the time of delivery is a scale ticket signed only by a warehouse employee.²⁵⁹ Further, it apparently is common for grain to be delivered to the warehouse without any express agreement on storage or sale, because producers and warehousemen are so busy at harvest that they postpone any deci-

257. NEB. REV. STAT. § 88-501 (Reissue 1981).

258. See MINN. STAT. ANN. § 232.23 subd. 3 (West Supp. 1984). The statute provides "All grain delivered to a public grain warehouse operator shall be considered sold at the time of delivery, unless arrangements have been made . . . prior to or at the time of delivery to apply the grain on contract, for shipment or consignment or for storage." *Id.*

259. See text at notes 135-43 *supra*.

sion on the matter.²⁶⁰ Finally, most grain delivered to a warehouse for storage will be sold to the same warehouse during the ensuing marketing year or later. These factors make it difficult to determine which, if any, agreement the parties had at the relevant time.

A producer who wants to be considered a storer might turn to the U.C.C.'s section 2-201 statute of frauds. Section 2-201 provides that a contract for sale of goods for a price of \$500 or more is not enforceable by way of action or defense unless there is a writing, signed by the party against whom enforcement is sought (the producer, in our context), sufficient to indicate that a contract for sale has been made and containing a quantity term.²⁶¹

Even if the producer has not signed any writing, however, his statute of frauds defense may be lost under the partial performance exception found in section 2-201(3)(c):

- (3) A contract which does not satisfy the requirements of subsection (1) [for a writing] but which is valid in other respects is enforceable . . .

. . . .
(c) with respect to goods . . . which have been received and accepted . . .²⁶²

The justification for this exception is, of course, that the acts of the parties indicate that a contract was made and thus fulfill the corroboration function of a signed writing.

Goods are "received" by the buyer when they are delivered to him and he has physical possession of them.²⁶³ That requirement, of course, is fulfilled when a producer deposits grain at the warehouse, regardless of the sale or storage arrangement intended. Goods are "accepted" by the buyer when he indicates he will "take or retain" them or does some act inconsistent with the seller's ownership.²⁶⁴ The "acceptance" facet of the partial performance exception is troublesome in our context. The warehouse, of course, would take or retain the goods even if storage rather than sale were the purpose of the delivery, and combining the grain with other similar grain in the warehouse is not inconsistent with the depositor's ownership. Retention of the grain and issuance of an unpriced scale ticket are equally consistent with storage and sale. Thus, while delivery of grain to and its retention by the warehouse are evidence that some contract was made between the parties, those acts do not indicate the type of contract.

260. See, e.g., *In re Fecht (Traders Grain, Inc.)*, PSC, No. 146, at 4 (Jan. 12, 1982).

261. NEB. REV. STAT. (U.C.C.) § 2-201(1) (Reissue 1980).

262. *Id.* § 2-201(3)(c).

263. *Id.* § 2-103(c).

264. *Id.* § 2-606.

The Official Comments to the U.C.C. suggest, however, that evidence of "a contract" is enough to take the contract out of the statute of frauds, even if the partial performance in question is "not . . . inconsistent with a different transaction such as a consignment for resale. . . ." ²⁶⁵ The Comments have been followed in several cases which emphasize that the partial performance need not be "exclusively referable" to the type of oral contract alleged.

In a Wisconsin case, ²⁶⁶ a producer delivered 10,000 bushels of grain to a buyer. The buyer alleged the delivery fulfilled an oral forward contract made early in the year when prices were low. The seller claimed the delivery should not take the oral contract out of the statute of frauds because the transaction might just as well have been a spot sale, that is, a sale at time of delivery for the then-current (and much higher) market price. ²⁶⁷ The court agreed the conduct was equivocal, but held in reliance on the Comments that the statute of frauds had been satisfied. ²⁶⁸

A similar result obtained in North Dakota when an uncle furnished his nephew with cattle feed, use of milking machines, and pasture space after a fire destroyed the nephew's barn. The uncle later sued the nephew for the price of the feed. The nephew relied on section 2-201, and said his receipt and use of the feed were not the types of partial performance envisioned by section 2-201(3)(c). ²⁶⁹ Given the family relationship and temporary emergency created by the fire, he argued, it was equally reasonable to believe the feed was intended as a gift. The court held that regardless of any ambiguity in the conduct, there was receipt and acceptance sufficient to remove the bar of the statute. ²⁷⁰

One might distinguish these cases on the grounds that the conduct, under any interpretation, indicated an intention to transfer title. After all, in the Wisconsin grain sale, the seller had accepted a check, so the real dispute concerned the price. In the cattle feed case, the feed had been consumed by the nephew's cattle, an act clearly inconsistent with the uncle's continued ownership. Here too, the real issue was the price. ²⁷¹

In the sale versus storage of grain situation, however, one might argue that only partial performance which shows intent to

265. *Id.* § 2-201 Official Comment 2.

266. *Gerner v. Vasby*, 75 Wis. 2d 660, —, 250 N.W.2d 319, 321 (1977).

267. *Id.* at —, 250 N.W.2d at 323.

268. *Id.* at —, 250 N.W.2d at 324-25.

269. *Hofmann v. Stoller*, 320 N.W.2d 786, 790-91 (N.D. 1982).

270. *Id.* at 791.

271. *See also West Cent. Packing Inc. v. A.F. Murch Co.*, 109 Mich. App. 493, —, 311 N.W.2d 404, 409 (1981).

transfer title should take a contract out of the statute of frauds. Delivery to the warehouse plus pretention and commingling of the grain into the common mass would not show any such intent, for they are consistent with the depositor's ownership. An argument along these lines was presented in a recent Nebraska case, *Johnson v. Holdrege Cooperative Equity Exchange*,²⁷² although the positions of the parties were reversed. The Co-op claimed Johnson delivered his wheat for storage, which Johnson claimed the delivery was for sale under an oral contract market price plus a premium for his wheat's particularly high protein content. The Co-op relied on the Section 2-201 statute of frauds when Johnson sued for the price. The trial court granted summary judgment to the Co-op, holding that the delivery of wheat to the defendant Co-op was not the type of part performance contemplated by section 2-201(3)(c).

The Nebraska Supreme Court reversed, however, and remanded to determine whether the Co-op's acts were inconsistent with the seller's ownership within the meaning of U.C.C. sections 2-201(3)(c) and 2-606. The court suggested, without deciding that two acts "may . . . [be] inconsistent with the seller's ownership." The acts were: (1) protein testing the wheat and charging test costs to the producer, and (2) combining Johnson's wheat with other lower-protein wheat, so that he could not recover the identical wheat he delivered, or even wheat of equal protein content.²⁷³

The Supreme Court's decision to remand on this issue, rather than simply to hold that delivery of the wheat satisfies the statute of frauds as a matter of law, is inconsistent with the Comments to section 2-201, but is perhaps truer to the statute. After all, section 2-201(1) is looking for evidence of a "contract of sale," not just of any contract, and section 2-206's definition of acceptance has a similar aim, some indication of an intent in the recipient to claim title to the goods. *Johnson* may mean that the partial performance relied on must indicate intent to transfer title, and that mere transfer of the goods is not enough in a context where a bailment is a realistic alternative possibility.²⁷⁴ It is unclear, however, whether the court intended so restrictive a reading of section 2-201(3)(c) in *Johnson*, since the decision was at least a partial victory for the litigant relying on an oral contract.

If delivery to the warehouse does not remove the bar of the statute of frauds, some of the other exceptions to the statute must

272. 206 Neb. 568, 293 N.W.2d 863 (1980).

273. *Id.* at 572, 293 N.W.2d at 865.

274. *Cf.* West Cent. Packing Inc. v. A.F. Murch Co., 109 Mich. App. 493, —, 311 N.W.2d 404, 408-09 (1981).

be considered. For example, the contract may still be proven if the producer admits in the course of litigation that a contract for sale was made or if he has received and accepted a check in payment for the grain.²⁷⁵

Suppose, however, that the producer denies making a sales contract, and that he has received only a scale ticket at time of delivery and no check then or since. In that case, the scale ticket is arguably a "writing in confirmation of the contract" within the meaning of subsection (2) of U.C.C. 2-201, which provides:

Between merchants if within a reasonable time a writing in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, it satisfies the requirement of subsection (1) against such party unless written notice of objection to its contents is given within 10 days after it is received.²⁷⁶

However, a scale ticket may not satisfy that provision. First, a scale ticket would be issued at time of delivery, whether the parties agreed on storage or sale or had not yet made any definite agreement. Therefore, a scale ticket might not "satisfy the requirements of subsection (1)" because it would not be "sufficient to indicate that a contract for sale had been made." On the other hand, if a scale ticket contained a warehouse's notation of a price or other indicia of sale, such as the words that the grain was "sold by" the named producer, it would indicate sale within the meaning of subsection (2).

Attention must also be paid to subsection 2's words "between merchants . . ." Except in Nebraska, a confirmation signed by the buyer may be used to satisfy the statute against the seller only if both parties are merchants.²⁷⁷ Whether a farmer can be merchant as a matter of law, and whether a particular farmer is a merchant as a matter of fact, are frequently litigated questions.²⁷⁸

275. See NEB. REV. STAT. (U.C.C.) § 2-201(3) (Reissue 1980).

276. See U.C.C. § 2-201(2), 1 U.L.A. 146 (1976). As will be explained in the text at notes 280-82 *infra*, Nebraska has adopted a non-uniform version of U.C.C. § 2-201(2).

277. *Id.* The U.C.C. defines a merchant as:

a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.

Id. § 2-104(1), at 120.

278. See, e.g., *Sierens v. Clausen*, 60 Ill. 2d 585, —, 328 N.E.2d 559, 561 (1975); *Sand Seed Serv., Inc. v. Poeckes*, 249 N.W.2d 663, 666 (Iowa 1977); *Decatur Coop. Ass'n v. Urban*, 219 Kan. 171, —, 547 P.2d 323, 328 (1976); *Lish v. Compton*, 547 P.2d 223, 226

The Nebraska Supreme Court has not decided whether farmers can be merchants.²⁷⁹ In 1983, the legislature sought to remedy this uncertainty with a non-uniform amendment to Article Two's statute of frauds. LB 188 added a new subsection (2)(b) to section 2-201, which provides that a contract of sale otherwise within the statute may be enforced:

Between a merchant and a buyer or seller of grain not a merchant, if (i) the contract is an oral contract for the sale of grain, (ii) within a reasonable time a writing in confirmation of the contract and sufficient against the sender is received, (iii) the party receiving it has reason to know its contents, (iv) it contains a statement of the kind of grain, quantity of grain, per unit price, date of contract, and delivery date of the grain, and (v) notice appears on the face of the written confirmation stating that the contract will be enforceable according to the terms contained in the confirmation unless written notice of objection is given within ten days, the writing satisfies the requirements of subsection (1) of this section against the party receiving it unless written notice of objection to its contents is given within ten days after it is received.²⁸⁰

The amendment applies only to oral contracts for the sale of grain. It denies the defense of the statute to a party who has signed nothing, if he receives a writing with the required details, has reason to know its contents, and does not promptly object in writing. Scale tickets could and probably will be printed to include this information, so Nebraska producers can lose their statute of frauds defense if they fail to examine the tickets and object within ten days. Of course, warehouses could achieve the same result with a form confirmation mailed to the seller soon after delivery of the grain.

Even if the U.C.C. statute of frauds is satisfied, warehouse regulatory statutes may impose additional documentation requirements before a depositor can be classified as a seller. For example, an Oregon statute required grain to be treated as "grain in storage" even though its depositor agreed to sell it to the warehouse, until

(Utah 1976); *Continental Grain Co. v. Brown*, 19 U.C.C. REP. SERV. (Callahan) 52, 57 (W.D. Wis. 1976).

279. The question was presented in *Kimball County Grain Coop. v. Yung*, 200 Neb. 233, 237-38, 263 N.W.2d 818, 820-21 (1978). However, because the confirmation relied upon was sent six months after the alleged oral contract was made, the Nebraska Supreme Court found it had not been sent within a reasonable time as required by U.C.C. § 2-201(2). Therefore, a majority of the court held it was unnecessary to decide whether the farmer was a merchant for purposes of that section. *Id.*

280. L.B. 188, 1983 Neb. Laws 504.

the warehouse obtained "adequate definite written instructions . . . given . . . by the owner of the grain . . . directed to a licensed warehouseman . . ." ²⁸¹ In a case arising under the Oregon statute, sellers of grain had received part payment, had obtained judgments against the warehouse for the unpaid balance of the purchase price, and had taken security interests in warehouse property to secure payment of the judgments. Nevertheless, the sellers filed claims against the warehouse's bond. The court held that since the warehouse did not obtain written instructions to sell within the meaning of the statute, the sellers were to be treated as storers for purposes of the bond. ²⁸²

Of somewhat similar effect is section 88-501 of the Nebraska Warehouse Act, which defines as stored grain any grain "for which the actual sale price is not fixed . . ." ²⁸³ Arguably, this requirement is satisfied if the parties agree either on an absolute dollar figure or on a price determination mechanism (as in deferred price contracts).

This latter matter is subject to some dispute. The United States District Court for the District of Nebraska held that deferred price contracts, at least prior to the seller's choice of a pricing day, did not fix a price within the meaning of section 88-501. Since no price was fixed, the court held that grain delivered under deferred price contracts was stored grain and its depositors were entitled to the protection of the warehouse bond. ²⁸⁴ The court's holding may accord with the actual expectations of many producers, especially if they are paying service charges equal to the warehouse's per bushel storage charge. However, the decision probably misinterprets the Nebraska Warehouse Act, for deferred price contracting is an established practice and it provides an ade-

281. See OR. REV. STAT. § 586.425 (1957), construed in *United States Fidelity & Guar. Co. v. Long*, 214 F. Supp. 307, 313 n.6 (D. Or. 1963).

282. *United States Fidelity & Guar. Co. v. Long*, 214 F. Supp. 307, 315-16 (D. Or. 1963).

283. NEB. REV. STAT. § 88-501 (Reissue 1981).

284. *Kort v. Western Sur. Co.*, No. CV77-L-208, slip op. at 3 (D. Neb. Aug. 4, 1980). On some of the deferred price contracts involved in *Kort*, "storage" charges were to accrue until the seller priced his grain. See *id.* at 13.

Service charges are commonly paid by the seller on delayed price grain. As one expert explains:

For delayed price grain which is placed in storage and not moved until priced by the seller, the service charge is actually a charge for storage and is often identical to the storage rate. For delayed price grain which is sold by the elevator and replaced with futures, the service charge reflects the anticipated narrowing of the basis between the time the elevator sells the grain and the time the seller prices it.

Good, *Delayed Pricing By Country Elevators* 6 (Sept. 1977) (Dept. of Agricultural Economics, University of Illinois, No. 77 E-22).

quate method to determine the warehouse's liability. In any event, however, the Nebraska Warehouse Act treats as stored grain any grain for which a price is not shown to have been fixed by agreement.

Of course, satisfaction of the documentation requirements by evidence indicating that a contract of sale was made does not end the matter. It is still necessary to prove by a preponderance of the evidence that a contract of sale was in fact made.²⁸⁵

In order for an agreement regarding grain to constitute a sale, the parties must intend that the buyer will get not only possession of the goods, but also title to them, in exchange for a price.²⁸⁶ Contracts for sale can be made quite informally, and if the court believes the parties intended to be bound, the contract is not invalid under the U.C.C. merely because some terms are not expressly agreed upon.²⁸⁷ However, the more terms that are left open, the more likely a court is to conclude the parties did not intend to be bound.²⁸⁸

Sometimes what looks like evidence of a contract to sell grain is also consistent with storage. Consider the similarities between a deferred price contract and storage with an offer to buy. Under the deferred price contract, a producer sells his grain and passes title to the buyer at the later of the date of the contract or the date of delivery of the grain or warehouse receipts. The price will be set later, whenever the seller notifies the warehouse that he is "pricing out" his grain. Under the contract, the warehouse is obligated to pay a designated market's closing price as of the pricing day, less an agreed discount. An agreement of that type leaves the depositor only the choice of the pricing day. He has already agreed to sell the grain, and he has no right, absent a breach by the warehouse, to reclaim the grain in kind. Thus, the deferred pricing contract is a present sale with the price to be determined in the future.²⁸⁹

A very similar arrangement in fact, but quite different in legal effect, is the common practice of warehouses to tell depositors that they may store their grain at the usual storage charge, but that the warehouse will be happy to buy the grain at any future date the

285. *Tipton v. Woodbury*, 616 F.2d 170, 170 (5th Cir. 1980); see *McCubbin Seed Farm, Inc. v. Tri-Mor. Sales, Inc.*, 257 N.W.2d 55, 58-59 (Iowa 1977).

286. See NEB. REV. STAT. (U.C.C.) § 2-106(1) (Reissue 1980).

287. See *id.* §§ 2-204, -305, -308 to -310.

288. See *id.* § 2-204 Official Comment.

289. See *id.* s§ 2-106(1), -204(3), -305; *Nytco Serv. Inc. v. Wilson*, 351 So. 2d 875, 879 (Ala. 1977).

depositor chooses.²⁹⁰ The price might be, as in a deferred pricing contract, that of a designated market less some discount on the chosen day. In this case, however, the depositor retains the right to demand redelivery of the grain in kind. When the depositor retains the right to redelivery of grain, the transaction is a bailment or storage transaction; it is not yet a sale.²⁹¹

Where the agreements are oral, and the only writings are scale tickets, it is difficult to distinguish these two transactions. Even payment of monthly fees equal to the warehouse's posted storage charges may not be decisive, since it is common for deferred price sellers to be charged a service charge equal to the warehouse's storage fee, especially if the contract is made soon after harvest.²⁹²

Courts and administrative agencies faced with deciding whether particular deliveries were sales or bailments have understandably had difficulty in these cases. They have relied on all available evidence of the parties' intent, such as prior course of dealing, discussions at the time of delivery, the documentation of the transaction in the warehouse's own records, and the contents of any writings delivered to the depositor. For example, a recent Alabama case held soybeans were stored rather than sold even though the scale tickets given depositors contained the preprinted words "bought of" followed by the depositing producer's name, because the warehouse's agent admitted she told the producers they could "store" their grain in the warehouse, and the scale tickets had the word "hold" handwritten on them.²⁹³

On the other hand, an Iowa case held beans were sold rather than stored, despite the depositor's testimony that he asked the grain warehouse to "take that grain and keep it there until I got ready to sell it." The court relied in part on the warehouse's internal records, which said the beans in question were "bought of" the depositor. There also was evidence that the producer knew the warehouse had resold the same beans and that the producer's trucker delivered the beans directly to the warehouse's resale buyer.²⁹⁴

Sometimes an alleged seller has signed a written sales con-

290. See, e.g., *Kramer v. Northwestern Elevator Co.*, 91 Minn. 346, 347-48, 98 N.W. 96, 97 (1904).

291. See *Nytco Serv. Inc. v. Wilson*, 351 So. 2d 875, 879 (Ala. 1977); *Rotterman v. General Mills*, 245 Iowa 229, 232-35, 61 N.W.2d 718, 719-21 (1953); *Kramer v. Northwestern Elevator Co.*, 91 Minn. 346, 348-49, 98 N.W. 96, 97 (1904).

292. See note 284 *supra*.

293. See *Nytco Services, Inc. v. Wilson*, 351 So. 2d 875, 877-79 (Ala. 1977).

294. See *Rotterman v. General Mills, Inc.*, 245 Iowa, 229, 229-39, 61 N.W.2d 718, 719-21 (1953).

tract clearly fulfilling all the documentation requirements of the U.C.C. and of warehouse licensing statutes. The grain covered by the writing may still be classified as stored grain, and the "seller" as a storer, if the agreement can be avoided under general contract law. For example, in a recent Nebraska case, some producers had signed written contracts providing for sale to the warehouse of grain already in storage there. Allegedly, warehouse employees eager to cover a shortage sought out the producers at their farms and requested their signatures on the form contracts. The employees allegedly told the producers the writing merely permitted their stored grain to be moved from one warehouse to another to make room for the incoming harvest. The PSC held that contracts signed in reliance on this misrepresentation could be avoided. The signers were then treated as storers of grain entitled to the protection of the Nebraska Warehouse Bond.²⁹⁵

These complexities cause many of the delays in warehouse insolvency cases. Both Houses of Congress have passed bills which would amend the Bankruptcy Act to expedite distribution of grain or grain proceeds.²⁹⁶ However, the variety and informality of the transactions involved make it difficult to speed a decision without sacrificing the truth. Standardization of the transactions and greatly increased documentation will be necessary before delays can be much reduced.

VII. PRODUCER SELF-DEFENSE

Since producers doing business with grain warehouses risk loss due to warehouse insolvency, it may be useful to review some measures individual producers could take to reduce their risk. Some of these suggestions are obvious, other more innovative. None requires legislative change.

The first suggestion, of course, is to learn as much as possible about the warehouse with which a producer might deal. Before contracting with or delivering grain to a warehouse, ask others about its general reputation. Ask whether its debts are paid as they fall due. Ask whether sellers in recent transactions have received warehouse checks without delay from the warehouseman, and of course, whether those checks have cleared the bank. Ask whether the warehouse gives storers warehouse receipts on demand, or only excuses, such as "we're all out of receipts."²⁹⁷ Other

295. See *In re Fecht* (Milligan Grain Co.), PSC, No. 159, at 2-3 (July 26, 1983).

296. See, e.g., S. 445, 98th Cong., 1st Sess. § 237 (1983); H.R. 5174, 98th Cong., 2d Sess. § 252 (1984).

297. See *Prairie Grain's Collapse—Some Miss the Man More Than Their Money*,

matters for inquiry are the rate of employee turnover at the warehouse, and the relationship of the warehouse's bid price for grain to that of its regional competition. High turnover may indicate that some employees have learned of and are unwilling to participate in wrongful activities such as conversion of stored grain. Unusually high prices offered for grain may indicate a warehouseman's need to cover a shortage by drawing in more distant sellers.²⁹⁸

If these inquiries produce satisfactory results, then storers and sellers can go ahead, cautiously. A storer should request warehouse receipts rather than relying on scale tickets.

The *Farm Journal* recently advised cash sellers to protect themselves by spreading out the delivery dates under cash forward contracts, and by requesting payment daily rather than waiting until all the grain is harvested and hauled to the warehouse. Of course, those daily checks must be promptly presented for payment, and finally paid before more grain is delivered, for this method to help.²⁹⁹

If a seller plans instead to sell on credit (and perhaps he ought to think twice about that decision), he might investigate obtaining a letter of credit or insurance against losses due to the warehouse insolvency. Professor Keith Meyer suggests credit sellers can protect themselves with stand-by letters of credit, under which a seller gets a bank's commitment to pay the purchase price if the buyer defaults.³⁰⁰ These bank obligations are widely used in other sales of goods to protect sellers.

The transaction is structured as follows: the seller, as a condi-

Des Moines Reg., Feb. 17, 1980, at 5A, col. 1-2. The information often is available. For example, although Prairie Grain in Stockport, Iowa continued to do business until January 7, 1980,

[t]he community had hints that its finances were teetering. Checks issued by the elevator bounced as early as [the fall of 1979] and . . . word got out that Keller [the owner] wasn't paying some of his personal bills.

Farmers scrambled to protect themselves, and many requested warehouse receipts in exchange for their scale tickets. . . . Keller turned back many of them, saying he was temporarily out of receipts.

Id.

298. Again, Prairie Grain serves as an example. For a long time, the warehouse outbid others in the area, and it also had a dual-pricing system, under which sellers from 90 to 100 miles away were paid more for their grain than Prairie would pay to local sellers. Wallace Dick, then Chief of the Iowa Commerce Commission's Warehouse Division, commented that the firm could not have made any profit on these distant purchases. Since it was not making immediate payment for the grain, however, it could sell the grain and use the proceeds for commodities trading. See *Dealer's Last Note Mentions Revenge*, Des Moines Trib., Feb. 18, 1980, at 1A, col. 5.

299. See Braun, *More Grain Elevators Belly-Up in Bankruptcy*, 106 Farm Journal 17, 17 (June-July 1982).

300. See Meyer, *Advising Market Strategies: The Farmer as a Creditor*, 1 Annual Meeting of the Iowa State Bar Association 1, B4-B5 (1983).

tion of his extension of credit to the buyer-warehouse, requires the warehouse to obtain a stand-by letter of credit from the warehouse's bank, naming the seller as beneficiary. The bank, when issuing the letter, undertakes an irrevocable obligation to pay the amount of the letter to the seller-beneficiary, if the warehouse fails to make payment when due. In exchange for this bank guarantee, the bank charges a front-end fee and takes a security interest in warehouse property, most likely the grain itself. The bank does not advance any money, however, unless and until the warehouse defaults and the seller notifies the bank of the default.³⁰¹

Use of a stand-by letter of credit will not disrupt the tax advantages producers seek from deferred payment contracts. Under current Treasury Regulations, recognition of income occurs only when payment is actually received. Income need not be recognized when the stand-by letter is issued by the bank to the beneficiary.³⁰²

Although stand-by letters of credit are attractive in theory, individual producers may lack the bargaining power to get them. Each grain producer sells a fungible commodity available from many others, and supply often exceeds demand. In such a buyer's market, the warehouse might view a letter of credit as an unnecessary complication and an unwise allocation of the limited bank credit available.

Even if the warehouse and its bank were willing, the bank might be unable to issue the letter. Some warehouses are already heavy users of bank credit, so the bank's lending limit could pose a problem.³⁰³ Under bank regulations, the face amount of the letter of credit is counted against the lending limit as soon as the letter is issued, rather than later, when and if the credit is drawn upon.³⁰⁴ Therefore, if many sellers wanted stand-by letters, or a few large letters were demanded, a single bank might not be able to issue the letters and a participation arrangement would be needed.

A further problem is that the letter might not be promptly paid if the warehouse filed bankruptcy. One Florida bankruptcy court enjoined a bank from honoring a stand-by letter on the ground that payment to the beneficiary is a preference.³⁰⁵ At least one court

301. *Id.*

302. *Id.* at B10-B11.

303. The general lending limit on loans and extensions of credit to one person was increased to 15% of unimpaired capital and surplus in 1983. It had previously been 10%. See Banks and Banking, 12 C.F.R. § 32.3 (1983).

304. 12 C.F.R. § 337.2 (1983).

305. See *Twist Cap, Inc. v. Southeast Bank*, 1 Bankr. 284-85 (D. Fla. 1979).

has refused to follow that decision,³⁰⁶ and commentators generally uphold the letter against preference attack.³⁰⁷ However, there is still some possibility of litigation and resulting delay in payment.

Another possible self-defense technique is individual insurance coverage. Both storers and sellers may be able to insure against losses due to warehouse insolvencies. In September 1983, one insurer obtained approval to market such policies in Nebraska,³⁰⁸ and a few insurers have been offering the coverage in other states. Generally though, insurers have not been rushing in to fill this void. Some may have decided the policies would not sell in states where indemnity funds promise to cover most losses, and others may be waiting to see whether the Federal Crop Insurance Corporation will be authorized to sell the coverage.³⁰⁹

Farm Bureau offers this type of insurance to its Iowa and Minnesota members for grain stored in or sold to warehouses. Under the Farm Bureau policy, the warehouse in question need not be informed, at least prior to the filing of a claim, that a producer has obtained the coverage. Thus, the producer need not fear offending his local warehouseman by showing doubt of his solvency. The cost for one year ranges from \$35.00 for \$50,000 coverage up to \$80.00 for \$200,000 limits. Farm Bureau would pay up to 80% of the loss. Claims are payable in two stages. Within a month after proof of loss was filed, an advance payment of 50% of the insurer's 80% share of the producer's estimated ultimate loss would be made. When a final determination has been made, the balance of the claim if any, would be due.³¹⁰ This type of coverage is very new, so there is little experience of possible problems with it. However, it does offer an option to producers which does not require the cooperation of the warehouse or its banker.

Hopefully, using these techniques will minimize losses due to warehouse insolvency. Another way to minimize these losses may be legislative change, to which we now turn.

306. See, e.g., *Westinghouse Credit Corp. v. Page*, 18 B.R. 713 (Bankr. D.D.C. 1982).

307. See Baird, *Standby Letters of Credit in Bankruptcy*, 49 U. CHI. L. REV. 130, 147-51 (1982); Chaitman & Sovern, *Enjoining Payment on a Letter of Credit in Bankruptcy: A Tempest in a Twist Cap*, 38 BUS. LAW. 21, 26-27 (1982); McLaughlin, *Letters of Credit as Preferential Transfers in Bankruptcy*, 50 FORDHAM L. REV. 1033, 1069-70 (1982).

308. First Financial Insurance Company of Springfield, Illinois received Nebraska Department of Insurance approval in late 1983 to market these policies.

309. H.R. 4284, 98th Cong., 1st Sess. (1983). Representative Dan Glickman of Kansas introduced the bill. *Id.* The bill would direct the Federal Crop Insurance Corporation to offer such insurance to producers and to "promote the issuance of similar insurance by private insurers." *Id.* § 2(a).

310. See Iowa Farm Bureau, *THE GRAIN PROTECTOR POLICY* (1983).

VIII. PROPOSED LEGISLATIVE CHANGES

For the most part, this article has been concerned with explaining the plight of producers in grain warehouse insolvencies under current law. It is not surprising that numerous legislative and administrative proposals have been made, at the state and federal level, aimed at reducing losses from grain warehouse insolvencies. The choices range from a full federal takeover of all grain warehouse regulation to the ever present option of maintaining the status quo.³¹¹ It would be the subject of several more articles to examine all these proposals in depth; that cannot be done here.

The federal government, in the current political climate, seems unlikely to commit itself to creation of a new federal agency preempting current state regulatory programs. Therefore, it might be useful to consider some changes in state law which could reduce losses to Nebraska producers. Measures aimed at preventing warehouse insolvency or at least at alerting regulators to a warehouse's financial problems before shortages grow large, include more stringent financial reporting requirements and limits, such as reserve requirements, on credit purchases of grain. Where prevention fails, remedial measures such as increased storage bonding, merchandising bonds to cover unpaid sellers, and indemnity funds or some other form of deposit insurance might cushion the blow to storers and sellers of grain.

One preventive option is to require state-licensed warehouses to submit to an annual CPA audit, and to make an unqualified CPA opinion a prerequisite to licensing. The Nebraska Grain Warehouse Act requires applicants for new or renewal licenses to submit financial statements to the PSC for use in calculating net worth and bonding requirements.³¹² The PSC also uses this data to identify warehouses in financial difficulty, so that it can force changes in the troubled firm before shortages develop.³¹³ The accuracy of these determinations of course depends on the reliability of the financial statements themselves.

Currently, the Nebraska Warehouse Act requires these annual financial statements to be "compiled by" a CPA,³¹⁴ but this is a much less rigorous standard than a certified audit. The CPA's only function with regard to a compilation statement is to compile a balance sheet based on the books and records the warehouse gives

311. See, e.g., USDA TASK FORCE REPORT, *supra* note 7, at 10-17.

312. See NEB. REV. STAT. § 88-503(1) (Reissue 1981). See also *Hearings on L.B. 73*, *supra* note 41, at 11.

313. *Id.* at 10, 18.

314. See NEB. REV. STAT. § 88-503(1) (Reissue 1981).

the CPA. The CPA does not, however, attempt to verify the accuracy of the records when preparing a compilation statement.³¹⁵

An annual audit by an independent CPA would provide more accurate information both for warehouse management and warehouse regulators. The information submitted to the PSC should be reliable enough to permit valid comparisons and use of sophisticated predictive modelling, thus enhancing the PSC's ability to target its resources at those firms most likely to fail.

The USDA's Grain Elevator Task Force concluded in 1981 that warehouses storing CCC-owned or loan grain should be required to submit to an annual CPA audit.³¹⁶ Illinois has an annual audit requirement for all its state-licensed warehouses.³¹⁷ Iowa grain warehouses must choose between an annual CPA audit or double the usual number of state inspections.³¹⁸

The principal objection to an audit requirement is the added cost. The USDA Task Force estimated the 1981 cost at \$3,000 to \$5,000 a year, and noted that this might be burdensome to smaller businesses even though they were well-run and provided a much-needed service.³¹⁹ Another objection sometimes raised is that audits are already performed often enough. Even under current law, most warehouses in fact undergo a periodic full CPA audit, though not on an annual basis. While the Nebraska Grain Warehouse Act does not require an annual audit, it does make a corporate surety bond or a certificate of deposit a prerequisite for a new or renewed license.³²⁰ A corporate surety normally requires an independent audit before initial issuance of a bond and follow-up audits at intervals of one to five years.³²¹ In those years, the warehouse would submit the audited statement to the PSC. Only those warehouses who post a certificate of deposit in lieu of a bond could entirely escape periodic full audits. In addition, the many cooperatively-owned warehouses in Nebraska undergo an annual CPA audit pursuant to their own regulations.³²² Of course, the fact that most warehouses are already paying for audits at intervals of one to five years reduces the effective additional cost if an annual audit were required.

Another proposed change of a preventive nature is increased

315. See *Floor Debate on L.B. 529*, *supra* note 66, at 4534-35.

316. See USDA TASK FORCE REPORT, *supra* note 7, at 23-24.

317. See ILL. ANN. STAT. ch. 111, ¶ 304, § 2 (Smith-Hurd Supp. 1983-1984).

318. See IOWA CODE ANN. § 543.6b (West Supp. 1983-1984).

319. See USDA TASK FORCE REPORT, *supra* note 7, at 24.

320. See NEB. REV. STAT. § 88-503(3)(b) (Reissue 1981).

321. See *Floor Debate on L.B. 529*, *supra* note 66, at 4537-40.

322. *Id.* at 4539.

scrutiny of, and controls on grain merchandising. These controls are increasingly a source of financial difficulty for warehouses and consequently, for producers. Nebraska might adopt its own version of the dual-license pattern emerging in other states, where a warehouse is separately licensed (and separately bonded) for its storage and merchandising activities. The particular advantage of the dual system, as discussed earlier, is that the merchandising license and regulations can be applied to all warehouses, even those licensed for storage under the U.S. Warehouse Act.³²³ This would maximize producer protection and spread the costs of compliance fairly among competing warehouses.

Some insolvency prevention measures that might be considered are price protection and reserve requirements against credit purchases of grain, particularly on the deferred price contracts which have been the downfall of many grain dealers. Several other states now require grain dealers to practice prudence in the form of price protection and reserves of liquid assets. For example, Illinois requires its grain dealers to protect against adverse price fluctuation by purchasing options.³²⁴ Both Illinois and Michigan require their grain dealers to maintain a reserve of liquid assets at a specified percentage of estimated deferred price liabilities so the dealers can pay producers when they eventually price out their grain. Illinois requires a reserve of 90% of estimated deferred price debt to be held in the form of grain in the warehouse, warehouse receipts for grain stored in other warehouses, and proceeds of grain, that is, cash and certain other very liquid assets.³²⁵ Michigan's similar system sets its reserve level at 80%.³²⁶

No regulatory pattern can be devised, of course, which will completely avoid warehouse failures. Mismanagement, fraud and sheer bad luck will continue to bedevil the grain warehousing industry as they do all others. For this reason, preventive measures have long been supplemented with remedial provisions. The prime example is the warehouse bond, a cushion that often proves too thin and which is in some jurisdictions unavailable to unpaid sellers.

Storage bonds are not particularly expensive. The premium is about \$5 for each \$1,000 in bond amount. Merchandising bonds are more expensive, running at least \$10 per \$1,000 in bond amount. The premiums are not the only problem for a warehouse, however,

323. See text accompanying note 55 *supra*.

324. ILL. ANN. STAT. ch. 111, ¶ 311, § 10 (Smith-Hurd Supp. 1983-1984).

325. See *id.*

326. See MICH. COMP. LAWS ANN. § 285.67a, § 7a(2)(d) (West Supp. 1982).

for the surety will not issue a bond unless it is convinced the warehouse's net worth is adequate to protect the surety. If storage bond amounts were significantly raised, or very sizeable merchandising bonds were required, it is possible that many warehouses would be unable to obtain a bond.³²⁷ A more affordable package would be a combination of a merchandising bond and an indemnity fund.

The merchandising bond might be tied to the grain dealer's license, and should be set at some percentage of prior year's grain purchases. The merchandising bond would be purchased by a particular warehouse, and could be for the benefit of all persons who delivered grain to the warehouse for purposes of sale but did not receive final payment.

An indemnity fund, on the other hand, is a fund not tied to a particular warehouse, but available as added protection when the bonds, either storage or merchandising, of an insolvent warehouse, prove insufficient. Such a fund has been established in several states.³²⁸ An indemnity fund was considered by the Nebraska Unicameral in 1981, but was not enacted.³²⁹ The fund could be collected by assessing a per bushel charge, perhaps one-tenth of a cent, on first deliveries of grain by a producer to a warehouse for storage or sale. When the fund reached the desired level, perhaps ten million dollars, assessments would cease and the fund could be activated.³³⁰ Claims arising thereafter could be compensated in full or at whatever lesser percentage the legislature deemed appropriate. The fund could be a primary source of recovery, providing relatively quick payment in return for assignment by the producers to the fund of any rights to compensation from the warehouse bankruptcy or other sources. On the other hand, the fund could be last resort coverage, available only after all other resources had been exhausted. It would be most convenient to collect the assessments from grain dealers, but the producers whom it would protect would probably bear the burden through slightly lower prices offered for their grain. Even so, the indemnity fund should be less

327. See Note, *Dealing with Grain Dealers: The Use of State Legislation to Avert Grain Elevator Failures*, 68 IOWA L. REV. 305, 319 n.121 (1983).

328. See note — *supra*.

329. See *Hearings on L.B. 529, supra* note 27, at 39-45. L.B. 529 (1981) as originally introduced contained an indemnity fund proposal. L.B. 529, 1981 Neb. Laws 1679. While the bill passed, the indemnity fund provision was deleted. *Id.*

330. Governor Charles Thone appointed a task force to study grain storage and merchandising problems and many of its recommendations were incorporated into LB 529. The ten million dollar limit was one the task force came up with as the likely maximum liability of a single large warehouse in Nebraska. *Hearings on L.B. 529, supra* note 27, at 59.

expensive protection than individual insurance policies over time, for additional assessments would be needed only if the fund had been considerably depleted.

CONCLUSION

The financial protection of grain warehouse bonds is often inadequate to cover the losses of producers who deliver grain for storage to a warehouse which became insolvent. In many jurisdictions, the bond is unavailable to those who delivered grain for sale to the warehouse but were never paid for it. Producers can protect themselves to some extent, by informal credit investigation, prompt demands for warehouse receipts or payment checks, as well as individual insurance and stand-by letters of credit.

However, the long-recognized public interest in the grain warehousing industry means legislative changes may be necessary to supplement individual initiatives. Therefore, some measures to preserve producer trust in the grain warehousing system are warranted, particularly in the grain merchandising area. Better financial reporting and reserves against credit grain purchases should be required to help prevent insolvency. When prevention fails, both storers and sellers need increased bond protection which might be best provided through an indemnity fund in lieu of or in combination with the bonding of individual warehouses.