



National Grain and Feed Association

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Talking Points

National Grain and Feed Association

Presented at

National Association of State Departments of Agriculture

Warehouse Meeting

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Introduction

- The National Grain and Feed Association appreciates the opportunity to share the perspectives of the regulated grain warehouse industry concerning issues that have arisen following the U.S. Department of Agriculture's issuance of final regulations implementing the U.S. Warehouse Act of 2000. We appreciate NASDA organizing and hosting this first get-together.
- The National Grain and Feed Association consists of more than 1,000 member companies that operate approximately 5,000 grain elevators, feed mills and processing plants that handle more than two-thirds of the nation's grains and oilseeds. The NGFA has a mix of privately owned and cooperative companies. Our elevator members represent a mix of state- and federally licensed warehouses. We also have 36 Affiliated State and Regional Grain and Feed Associations.
- The NGFA has formed a Warehouse Task Force to participate in this and future meetings, and to develop industry recommendations and proposals to resolve issues that may arise during these discussions. Our task force consists primarily of members of our Board of Directors and Country Elevator Committee, and represents a microcosm of our membership – large and small companies; private and cooperative; state and federally licensed; as well as an affiliated association

representative. Let me introduce those who are with us today: Roger Fray, vice president, grain, West Central Cooperative, Ralston, Iowa; Gary Beachner general manager, Beachner Grain Inc., St. Paul, Kan.; Ken Klemme, Demeter LP, Fowler, Ind.; John Petty, executive director, Wisconsin Agri-Service Association Inc., Madison, Wis.; Bob Salstrom, senior vice president, North American Grain, ConAgra Trade Group, Omaha, Neb.; and Richard Thomas, manager, Top Flight Grain Cooperative, Bement, Ill. Also accompanying us as a resource person is Karen Suedmeyer, warehouse specialist, Cargill Inc., Minneapolis, Minn.

- The NGFA historically has supported strong, effective, but reasonable warehouse laws and regulations to protect the interests of producers and other depositors, as well as the integrity of the federal and state warehouse systems. We submit that having healthy and constructive competition between the voluntary federal warehouse system and state warehouse regulatory systems offers a choice to the regulated industry and disciplines behavior and costs. The independent, third-party review provided by federal and state warehouse examination personnel can contribute to the stability and integrity of the warehouse industry, thereby benefiting producers and other depositors, as well as warehouse operators and government. Warehouse laws also play an important role in facilitating the orderly marketing of commodities in interstate and export commerce.
- We are pleased to see producer groups involved in this discussion. We urge that as these discussions move forward and various options are considered, that USDA and the states be cognizant of the stake that we (as the regulated industry) and producers (as our customers) have in the outcome.

Need for Cost-Effective Regulation

- We believe state and federal warehouse programs should compete on the same basis as the private sector – relative cost and relative quality.
- The warehouse industry operates in a fiercely competitive market and is under increasing cost pressures to be as efficient as possible. As such, the industry expects warehouse regulations to achieve their purpose while being prudent and reasonable, and for examination programs to be efficient and cost-effective. The reality of today's business environment is that the **costs** associated with compliance with warehouse regulatory and financial requirements will be increasingly important to warehouse firms when they choose whether to be federally or state licensed. It is a major reason why our industry is so adamant about encouraging uniformity between states in warehouse laws and regulations – inconsistency and contradictory legislation and regulation adds costs and inefficiencies.

Industry's Goals for Federal and State Warehouse Laws, Regulations

- From its perspective, the industry believes that the following goals are of paramount importance when it comes to federal and state laws and regulations governing warehouse storage, merchandising and financial security:
 1. Provide protection for the producer/depositor and preserve the collateral value of the warehouse receipt. But we believe policy options to address this objective should encourage prudent business behavior by both farmers and the industry by avoiding the appearance of a risk-free marketplace.
 2. Maintain regulatory choice for warehouse operators by maintaining viable federal and state warehouse programs that are cost-effective.
 3. Bring about greater uniformity in warehouse laws and regulations between states to reduce costs incurred by the industry in complying with varying state warehouse regulations and requirements.

It is these three objectives that the industry will use as the “litmus test” to evaluate the merits of various policy options and solutions that may be offered during these discussions. There is a wide range of potential solutions that could satisfy these criteria. Indeed, we are developing some proposals of our own to offer. But we want to hear the ideas of others, and believe it is premature at this early stage in the dialogue for any party to narrow the range of potentially viable solutions that should be discussed.

Issues that the Industry Believes Should be Addressed

- The grain warehouse industry believes that these and future meetings should examine the following issues:
 1. **Should the U.S. Department of Agriculture establish higher standards governing federally licensed warehouses to provide additional protection to producers for certain types of cash contracts for which payment is not made within 30 days – as customarily is required under both federal and many state warehouse programs – in the event the buyer fails to pay as required by the contract?**

In this regard, the regulated grain warehouse industry is not opposed to examining different approaches that would provide additional protection to producers at some level that is similar to that offered by many states that have enacted state grain dealer laws, implemented grain merchandising regulations and established state grain indemnity funds, bonding or other forms of financial requirements for state-licensed warehouses. That will be a key component to achieving several of our objectives – producer protection and regulatory choice. We are developing some ideas and proposals in this regard that we will be prepared to offer and discuss at a future meeting.

However, higher standards could lead to higher regulatory compliance costs for the industry. To the extent farmers are the beneficiaries of such higher standards, we believe producers should be willing to shoulder their fair share of the costs. Our concern in this area relates primarily to grain indemnity funds, for which numerous variations currently exist among different states.

2. Are there certain features of state grain indemnity funds that should be encouraged? Conversely, are there features that should be avoided?

The NGFA has never been enamored with the concept of indemnity funds, even though we recognize that producers have a right to select this type of protection if they are willing to pay for it, since they arguably are the “beneficiaries” in a short-term sense. But the NGFA has concerns over how some state indemnity funds are structured; the types of losses they cover (for instance, bailment versus deferred payment or credit-sales transactions, where title to grain is already transferred); who pays the costs of these programs; and what kind of marketplace behavior they encourage. Our concern is that – either in appearance or reality – indemnity funds can encourage a mindset in the producer that he or she does not need to apply prudent business practices when choosing which warehouses to do business with or what contracting practices in which to engage. The risk of that happening increases exponentially the closer an indemnity fund comes to covering 100 percent of risk, although our sense is that even funds that provide a lesser degree of coverage probably encourage some ill-advised conduct. Such marketplace behavior is not in the best long-term interest of producers, industry or government.

If state grain indemnity funds continue, the industry believes some careful thought needs to be given the level of coverage that should be provided and what kinds of contracting they should cover. For instance, should credit sales transactions be covered? Should contracts whose principal use is to provide an income tax management tool for producers be covered? Should farm inputs, such as seed, fertilizer and other farm supplies be covered?

The problem with trying to eliminate all risks was outlined by Professor Jerry Skees of the University of Kentucky in a 1999 white paper. He provided an analogy concerning tractor accidents, noting “Twenty years ago, farmers often died or suffered serious injury when pinned beneath wayward tractors. Upon examining the problem, the engineering solution was straightforward – a steel-reinforced bar over the driver’s seat would prevent the tractor from crushing the driver. A few years after mandated roll bars on tractors were in place, the death rate and rate of serious injury remained the same. People with roll bar-equipped tractors were driving harder, faster, and on steeper slopes, resulting in the same rate of fatal accidents....” Dr. Skees concluded by saying, “Analogously, farmers with subsidized risk-management will push harder and faster taking on more risk.”

Even if farmers are not subsidized by government or by elevators being taxed to pay part of the bill for indemnity programs, such risk-sharing forces the same costs on everyone, forcing those producers who continue to operate prudently to subsidize the risk created by those prone to more reckless behavior. As Dr. Skees further notes, such risk-subsidization and risk-sharing can lead to moral hazards in crop insurance and other activities. The moral hazard issue in grain marketing could lead farmers to do more business with known “high-risk” facilities simply because it will be profitable in the short run. Thus, the marketplace may be deprived of an important enforcement mechanism – quicker identification of a problem facility leading to quick action to stop the losses.

3. Can we develop an action plan for enhancing uniformity between state grain dealer and warehouse laws and regulatory requirements to reduce the industry’s costs of compliance?

We are prepared to discuss specific examples of inconsistencies between state laws and regulatory requirements that arguably do not serve any useful purpose in protecting producers or depositors that we would like to see addressed by state governments. Improvements in this area will go a long way toward making state warehouse and grain dealer licensing programs an attractive and competitive alternative, particularly to warehouses operating in multiple states – a trend that is growing, even among smaller companies as they seek to remain economically viable and serve a useful market role.

We believe this discussion should include state-specific restrictions on cash grain contracts, including proposals to provide producers with a right to back out of grain contracts if they do so within three days after the contract is consummated. Such a development would make elevators reluctant to offer cash-forward contracts, since they would be unable to hedge their grain purchases in a timely manner. Other states have considered banning mandatory arbitration clauses in grain and livestock contracts, which also would create additional risk for grain warehouse buyers. We submit that these proposals would hurt both the warehouse and the producer; add substantial costs to the system; and would be counterproductive to warehouses remaining within a state licensing system. We appreciate states being cognizant of these developments and their potential consequences.

4. Are there ways to enhance the efficiency and cost-effectiveness of both federal and state warehouse programs through increased cooperation?

While one of our tenets is to preserve regulatory choice for warehouse operators, the NGFA has long advocated making state and federal warehouse regulations and examinations more uniform and seamless. This gets back to our previous point on the industry’s need to be as cost-effective as possible. For instance, can a uniform structure be established whereby USDA and states can share examination results with one another, particularly in instances where there are serious infractions or warning flags? That would be good for both producers and the industry.

Further, could we work together to explore the feasibility – starting with a pilot program – to cross-train warehouse examiners so they are able to perform examinations of both federal- and state-licensed warehouses? Presumably, that could lead to cost savings and efficiencies by having examiners that are within the geographic proximity of a warehouse perform the exam.

In addition, the NGFA has encouraged government to employ a statistical, risk-based approach to warehouse examinations, in which exam frequency correlates with the degree of risk posed by a particular warehouse locations. Some states already are doing this. Other states, and USDA, are not.

Moving Forward

- As we move forward collectively, the NGFA believes it is important to identify issues that are not germane to future discussions.
- In this regard, we would encourage that we not mix warehouse storage-related issues with “producer cash contracting”-related issues addressed by state grain dealer laws and regulations.
- We also hope that there is an agreement to strive to arrive at “solutions” that **avoid legislative action**. In particular, the NGFA does not support legislative language that would expressly reserve to states authority to regulate grain merchandising activity at federally licensed warehouses. Doing so would preclude USDA from ever attempting to exercise jurisdiction over merchandising activity under a federal law – the USWA – or at best result in a system of dual regulation if USDA did try to do so. It also would effectively preclude competition between federal and state systems, and create a form of regulatory monopoly that is inconsistent with previous congressional intent under a federal law – namely, the USWA.

The industry’s strong desire is to discuss these issues openly. And we think the high profile this issue currently has provides us all with a unique opportunity to engage in truly meaningful dialogue as to how to balance the federal and state interest while at the same time protecting producers and other depositors, and preserving the role of federal and state warehouse laws in facilitating commerce.

- For its part, the NGFA pledges to be a constructive and engaged participant as these discussions move forward.