

**NASDA WAREHOUSE TASK FORCE REPORT  
PREPARED BY RALPH PECK  
TO NASDA**

The NASDA Warehouse Task Force Meeting convened, Wednesday, November 13, 2002 with Co-Chairs, Illinois Director Joe Hampton and Montana Director Ralph Peck giving an overview of the agenda and introductions.

- Opening Statements were provided by the NASDA Task Force Members (List of task force members - Attachment 1; Meeting Notes - Attachment 2)
- USDA presented U.S. Warehouse Act and Regulations (Attachment 3 - presentation from USDA, Bert Farrish, Deputy Administrator, Commodity Operations-DACO)
- Association of American Warehouse Control Officials (AAWCO) presentation on state warehouse regulations (Bob Leach, AAWCO President)
- Industry presented the regulated industries perspective led by the National Grain and Feed Association (Randy Gordon, Vice President, Communications and Government Relations -NGFA) (Attachment 4)
- Issues were identified for resolution
- USDA left the November 13<sup>th</sup> meeting during lunch
- The task force approved a resolution. **(Louisiana Commissioner Bob Odom moved, Iowa Secretary Patty Judge seconded and amended by Idaho Secretary Pat Takasugi)** (see meeting notes, page 2)
- Based upon discussions at the Task Force Meeting, the decision was made to have the co-chairs meet with Under Secretary J.B. Penn Friday morning, November 15 to further identify options to facilitate NASDA'S Task Force discussion.
- At the request of Mr. Penn, Montana Director Ralph Peck, Idaho Secretary Patrick A. Takasugi and Indiana Assistant Commissioner Joseph Pearson met on December 2, 2002 in Washington, D.C. to facilitate further discussion on the U.S. warehouse issue. At that time, USDA presented their position of legal standing. (Attachment 5) List of participants at meeting:

**NASDA**

Director Ralph Peck, Chair, Warehouse Task Force, Montana  
Secretary Patrick A. Takasugi, Idaho  
Assistant Commissioner Joe Pearson, Indiana  
Rick Kirchhoff  
Jennifer Yezak Molen

## USDA

J.B. Penn, Under Secretary, Farm and Foreign Agricultural Service

Hunt Shipman, Deputy Under Secretary

Beth Bechdol, Special Assistant to the Under Secretary

James Little, Administrator, Farm Service Agency

Bert Farrish, Deputy Administrator, Commodity Operations (DACO)

Steve Gill, FSA, DACO, Warehouse and Inventory Division

Candy Thompson, FSA, DACO, Warehouse and Inventory Division

Ralph Linden, Office of General Counsel

- The USDA presented Points of Understanding on December 3, 2002. (Attachment 6)
- On December 3, NASDA and USDA met with industry representatives from the National Feed and Grain Association and USDA presented a proposal for discussion.
- On December 19, NASDA and AAWCO representatives met with FSA Administrator James Little, Deputy Administrator Bert Farrish and other members of the DACO staff and NGFA representatives to discuss the latest proposals on providing improved protection for storage obligations and protection grain merchandising. The group agreed to meet in late January.
- On January 6, 2003, Montana Director Ralph Peck and Indiana Assistant Commissioner Joseph Pearson provided an update to commodity organization representatives and Congressional staff members by telephone conference call. Those organizations invited to participate:

National Farmers Union; American Farm Bureau Federation; National Cotton Council; American Soybean Association; National Barley Growers Association; National Association of Wheat Growers; American Corn Growers Association; National Corn Growers Association; National Farmers Organization; U.S.A. Rice Federation; U.S. Rice Producers Group; and National Grain Sorghum Producers Association

- On January 9, during a meeting organized by USDA for commodity organization representatives, including NASDA staff, USDA announced an extension of the moratorium of grain licensing until mid-February.

## *6 Attachments*

**Attachment 1**  
**NASDA WAREHOUSE TASK FORCE REPORT**

**Warehouse Task Force Members (as of 12/7/02)**

|                     |                                     |
|---------------------|-------------------------------------|
| <b>Montana</b>      | Ralph Peck, Director, Chair         |
| <b>Indiana</b>      | Joe Pearson, Assistant Commissioner |
| <b>Missouri</b>     | Lowell Mohler, Director             |
| <b>Idaho</b>        | Patrick A. Takasugi, Secretary      |
| <b>North Dakota</b> | Roger Johnson, Commissioner         |
| <b>Iowa</b>         | Patty Judge, Secretary              |
| <b>Washington</b>   | Valoria Loveland, Director          |
| <b>Kentucky</b>     | Billy Ray Smith, Commissioner       |
| <b>Michigan</b>     | Dan Wyant, Director                 |
| <b>Minnesota</b>    | Gene Hugoson, Commissioner          |
| <b>Louisiana</b>    | Bob Odom, Commissioner              |

## **Attachment 2**

### **NASDA WAREHOUSE TASK FORCE REPORT**

#### **MEETING NOTES, November 13, 2002**

#### **NASDA WAREHOUSE TASK FORCE**

On November 13, Co-Chairs Illinois Agriculture Director Joe Hampton and Montana Agriculture Director Ralph Peck convened the NASDA Warehouse Task Force in its first meeting to hear from interested producer groups and industry organizations about the final rule of the U.S. Warehouse Act of 2000 (USWA) published by USDA in August 2002. In addition to the co-chairs, seven other task force members attended. They included Missouri Agriculture Director Lowell Mohler, Idaho Agriculture Director/Secretary Patrick A. Takasugi, Kansas Agriculture Secretary Jamie Clover Adams, Iowa Agriculture Secretary Patty Judge, Kentucky Agriculture Commissioner Billy Ray Smith, Minnesota Agriculture Commissioner Gene Hugoson, and Louisiana Agriculture Commissioner Bob Odom. The states of Michigan, Indiana, and Georgia were also represented at the meeting. More than 40 people attended the task force meeting.

The purpose of the task force is to resolve issues that have developed due to USDA's final rule. Strong concerns have been expressed on whether the federal rules can adequately protect grain producers from losses in warehouse bankruptcies and whether federal licensing would allow states to maintain functions such as assuring accurate scales and collecting fees for commodity research and promotion programs at federally licensed warehouses. The final rule included a section that reads "Compliance with state laws relating to the warehousing, grading, weighing, storing, merchandising or other similar activities is not required with respect to activities engaged in by a warehouse operator in a warehouse subject to a license issued in accordance with this part." This provision and its interpretation have caused concern among several organizations.

The first meeting was an opportunity for interested organizations to bring forward their questions, comments, and concerns about the final rule and also to provide ideas on how to resolve issues that have developed. USDA was well-represented at the meeting. Participants included: Deputy Under Secretary for Farm and Foreign Agricultural Services Hunt Shipman; Deputy Administrator for Commodity Operations Bert Farrish; Candace Thompson, deputy director, Warehouse and Inventory Division; Roger Hinkle, USWA Program Manager; George Aldaya, director, Kansas City Commodity Office; Bill Turbitt, deputy director, Kansas City Commodity Office; and John Voss, general counsel.

Mr. Farrish provided an overview of the USWA and how USDA has developed rules and regulations over the course of many years. He opened his remarks by stating the main themes for warehouse regulations which include: producer protection; facilitation of orderly trade; and an open, transparent, and improved regulatory environment. Other themes included a cooperative and productive meeting. He stated that USDA has a long-standing position that USWA does cover producer contracts and that case law and the statutes support that position. He further stated that USDA codified its position in the final rule and it is not a change in policy. It was also pointed out that USDA agreed to establish a moratorium on issuing federal grain licenses to allow NASDA and the Association of American Warehouse Control Officials (AAWCO) time to resolve their issues with USWA. The moratorium is in effect from October 9, 2002, to January 8,

2003. USDA also listed several options that were discussed during the meeting. Among the options discussed are: (1) adding bonding or other financial requirements for producer (only) contractual exposure (currently none); (2) raising bonding or other financial requirements for depositor protection; and (3) raising net worth requirements.

After hearing from all the states, USDA, representatives of the National Grain and Feed Association (NGFA), and AAWCO, **task force members considered and approved a motion offered by Louisiana Agriculture Commissioner Bob Odom asking USDA to take no longer than December 10 while negotiating with NASDA, producer groups and industry to determine if the Secretary of Agriculture will withdraw the section of the rule, Subpart 735.1, sec. c, "Applicability." This is the section of the rule that has come under heavy discussion and differences of interpretation.**

Following the discussions related to the motion, representatives of the NGFA, the American Farm Bureau Federation, the National Farmers Union, National Association of Wheat Growers, the National Cotton Council, and AAWCO continued to provide additional input to the task force from each of their organization's perspectives.

### **Attachment 3**

## **NASDA WAREHOUSE TASK FORCE MEETING – NOVEMBER 13, 2002, MISSOURI Remarks by Bert Farrish**

### **Introduction**

- Welcome and introductions
- State main themes:
  - Producer protection; facilitate orderly trade; open, transparent, and improved regulatory environment; cooperative and productive meeting,

### **Why are we here?**

- United State Warehouse Act (USWA). Completely revised in Nov. 2000.
- USWA has stood the test of time and is a model worldwide.
- It provides a structure to facilitate the orderly marketing of agricultural commodities; and protect depositors.
- FSA has worked on implementing revision. Final Rule published Aug. 5, 2002.
- Continues to work on licensing agreements.
- Where we are today must be looked at in the context of the grain business since the USWA was first passed in 1916.
- We did not get here overnight with the stroke of a pen. USDA has long standing position that USWA does cover producer contracts. Supported by case law such as Byrd Grain.
- USDA did not suddenly, arbitrarily or precipitously change the regulatory landscape. It has been shaped by a series of court cases over the years. USDA codified position in Final Rule. Not a change in policy.
- In the changes to the USWA, USDA wanted to be open and transparent about where it viewed the current regulatory environment. This transparency should be viewed in a positive light and can lead to a better regulatory environment

### **USWA Status.**

USDA agreed to establish moratorium on issuing federal grain licenses to allow NASDA and AAWCO time to resolve their issues with USWA.

- Implemented a 90-day moratorium on the issuance of new federal licenses while we work with NASDA task force. Moratorium in effect from Oct. 9, 2002, to Jan. 8, 2003.
- Evaluating ways to improve federal warehouse licensing requirements & producer protection.
- Will participate in NASDA task force meeting November 13 in Kansas City. USDA will listen carefully to all parties and their ideas.
- Will participate in NGFA/NASDA (AAWCO) meeting December 8-9 in St. Louis. This site could be the second NASDA Task Force meeting.
- USDA anticipates that NASDA will resolve their issues with USWA on producer protection within the 90 day moratorium.

## **NASDA WAREHOUSE TASK FORCE MEETING – NOVEMBER 13, 2002, MISSOURI**

### **Remarks by Bert Farrish**

#### **Task force objectives.**

- Identify stakeholders
- Identify issues - complex since we have diverse crops, varying trading practices, and fifty states with varying approaches to regulation.
- Identify State regulatory landscape. There are 7 combinations of regulations including no warehouse or producer contractual (merchandising) regulation.
- Identify challenges:
  - Continue to foster the orderly and efficient storage & marketing of ag. commodities.
  - Recognize the inter-state or global nature of commodity merchandising and movement with respect to regulatory actions while commodity storage tends to be an intra-state activity.
  - Bring some continuity and consistency to the regulation of the storage and merchandising of agricultural commodities.
  - Define merchandising or change the term
  - Consider quality and phyto-sanitary issues at the same time.
  - Find elusive middle ground.
- COMMON GOAL: Protect producers and facilitate orderly trade.
- Plot course of action

#### **Options.**

USDA is exploring options, analyzing potential effects of each option, and trying to reach goal of implementing a USWA licensing program that meets our goals of improved producer protection, foster the orderly, efficient storage and marketing, both nationally and globally of agricultural commodities. Some options we have discussed include:

- Add bonding or other financial requirements for producer (only) contractual exposure (currently none) Example: Require a bond equal to 5% of dollar amount of producer transactions based on a 5 year average. Coverage would be at a maximum of 80% of producer loss. No coverage for commercial transactions.
- Raise bonding or other financial requirements for depositor protection; currently \$500,000 cap for grain and \$250,000 for cotton. Example: Raise minimums and maximums to \$50,000 and \$1,000,000.
- Weights and Measures (require federal license holders to adhere to state requirements with the exception of elevators where GIPSA has jurisdiction)
- Raise net worth requirements. Example: Move to \$.35 per bushel of capacity; Minimum of \$75,000 or Minimum of \$50,000 if participating in state fund or insurance fund also.
- Establish Federal grain merchandising regulations with a grain indemnity fund.

#### **USDA's plan.**

- Provide some level of producer protection on grain contracts with warehouse operator.
- No changes proposed to check-off funds or producer assessments-Federal preemption has no effect.

**NASDA WAREHOUSE TASK FORCE MEETING – NOVEMBER 13, 2002, MISSOURI**  
**Remarks by Bert Farrish**

**Closing Remarks.**

Repeat main themes.

- USDA looks to improve producer protection, offer a competitive regulatory product or environment and provide a structure to facilitate the movement of grains nationally-- especially if a large scale disruption, such as StarLink, occurs in the market.
- Recognize the inter-state or global nature of commodity merchandising and movement with respect to regulatory actions while commodity storage tends to be an intra-state activity.
- Bring some continuity and consistency to the regulation of the storage and merchandising of agricultural commodities.



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**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**

**Nov. 13, 2002**

#### **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.

## United States Warehouse Act

### Federal Preemption

### Increasing Producer Protection

## Federal Preemption

- Has evolved over 70 years
- Communicated through industry meetings, 1981 USDA proposed rule, congressional action, court rulings and correspondence.
- Congressional action
  - 1931 amendment to Act
- Court rulings
  - 1947 Rice v. Santa Fe Elevator
  - 1988 Demeter, Inc. v. Werries
  - 1999 Appley Brothers v. USA

## 1931 USWA Amendment

In 1931, Congress amended Section 29 of the USWA to read as follows:

“In the discretion of the Secretary of Agriculture he is authorized to cooperate with State officials charged with the enforcement of State laws relating to warehousemen, weighers, graders, inspectors, samplers or classifiers; but the power, jurisdiction and authority conferred upon the Secretary of Agriculture under this chapter shall be exclusive with respect to all persons securing a license hereunder so long as said license remains in effect.

## 1931 USWA Amendment

- In amending Section 29, Congress indicated that it intended the USWA to be the exclusive and only regulatory authority governing a USWA licensee.

## Rice v. Santa Fe Elevator Corp.

- The elevators argued that once a Federal scheme is applicable:
  - The Federal statute and regulations are the only rules applicable to the Federal licensee
  - Once Congress, through a Federal statute, has indicated its intent to control an area:
    - The Federal regulatory scheme prevails even if it is less onerous or is basically silent on an issue

## Rice v. Santa Fe Elevator Corp.

Ultimately the Supreme Court agreed with the elevators, in ruling:

- That the Federal licensee need only comply with the Federal plan
- “Even where State regulation is found not to conflict in its actual operation:
  - With the substantive policy underlying Federal legislation,
  - That it must still be established,
  - If the State regulation is to survive judicial scrutiny,
  - That Congress did not exercise its jurisdictional veto.”

## Demeter, Inc. v. Werries

- In U.S. District Court, on June 12, 1988, nine Federally licensed warehousemen with grain warehouses in Illinois challenged amendments to the Illinois Grain Dealers Act.
- These amendments required Federally licensed warehousemen to:
  - Participate in the Illinois Grain Dealers Act grain insurance fund or
  - Provide financial protection equal to their licensed capacity through:
    - a bond or
    - some other form of collateral.

## Demeter, Inc. v. Werries

- The Court:
  - Reiterated the 1931 USWA amendments ending the dual system of regulation and substituted exclusive Federal regulation over USWA licensed warehouseman.
  - Expressly rejected the State's argument that their scheme be allowed to "supplement" the USWA.
  - Stated that the Illinois Grain Dealer Act amendments cannot be used to regulate Federally licensed warehousemen.

## Appley Brothers v. U.S.A.

- In 1999, the U.S. Court of Appeals affirmed the circuit court's actions in Appley Brothers v. USA (commonly referred to as Bird Grain).
- The case examined USWA's regulatory role and legal responsibility involving grain warehousing.
- The Court found USWA liable for the merchandising activities in addition to storage obligations for the bankrupt warehouseman.

## Federal Preemption

- USWA licensee need not comply with any State law that levies an assessment on the licensee or requires any other financial assurance with respect to the storing, selling or purchasing of grain by the licensee.

## What USWA does not regulate:

- Central filing systems for filing of financing statements or notice of financing statements.
- Rules to determine the security interests of persons affected by the Act.
- Programs operated by other USDA agencies:
  - FGIS, grain standards, equipment standards & testing.
  - AMS, other agricultural commodities standards.
- Programs and participants in programs run by various States
  - Warehouse operators who have chosen to be State licensed.
  - Grain dealers who operate in a specific State.
  - Weights and measures.
  - Producer funded indemnity funds.
  - Producer check-off programs or other assessments.

## Increasing Producer Protection

- Option 1  
Establish bonding or other financial assurance requirements to cover producers' contractual obligations.
- Option 2  
Establish a grain indemnity fund to cover producers' contractual obligations.

## Depositor/Producer

Covering both:

- Storage obligations
- Contractual obligations

### Coverage for Producers' Contractual Obligations

- Unpaid cash contracts executed during the previous 9 months before the insolvency date.
- Coverage of loss up to a maximum of 80 percent dependent upon option choice.
- Grain value established on date of insolvency.

## Unpaid Cash Contracts Include...

- Basis
- Deferred payment
- Delayed pricing
- Draw or draft
- Forward
- Grower
- Spot
- Verbal

## Additional Bonding or Financial Assurance Requirement

- Adding producer protection for contractual obligations along with current depositor bonding requirements.
- Computed based upon X% of total producer contract volume for a marketing year.

## Grain Indemnity Fund

- Participation
- Method of funding
- Level of funding
- Length of existence
- Maximum coverage
- Claim filing cost
- Administrative cost

## Merits/Differences Between Option 1 and Option 2

Industry Acceptance?

Producer Acceptance?

Associated Costs?

## USDA Federal Licensee Failures

- 1997 – Bean Acres, Sharon Springs, KS – Liquidation
- 1998 – Chester Grain, Chester, IA - Liquidation
- 2000 – Alcester Feed & Grain, Alcester, SD - Liquidation
- 2000 – Farmers Coop, Lawrence, KS – Bankruptcy
- 2000 – Farmers Union Coop, Nora, NE - Liquidation
- 2000 – Prairie Pea & Bean, Ruleton, KS – Bankruptcy
- 2001 – Crestland Coop, Crestland, IA – Bankruptcy
- 2002 – Farmers Merchant, Idaho Falls, ID – Liquidation
- 2002 – Rock Grain, Rock, KS - Liquidation
- 2002 – Wimbledon Grain Company, Wimbledon, ND -  
Liquidation

## **Attachment 6**

### NASDA WAREHOUSE TASK FORCE REPORT

#### **POINTS OF UNDERSTANDING**

- USDA has indicated that the U.S. Warehouse Act (USWA) final rule will stand as published. However, USDA will establish a program to regulate merchandising.
- Contractual protection of unpaid grain sales contracts will be a requirement to obtain a Federal License
  - Concepts of implementation are under discussion
  - 80% protection of unpaid obligations is the goal
- Depositor protection will be upgraded
- Examination procedures will be reviewed in applicable states with producer indemnity programs with exposure in Federal warehouses
- Areas subject to state law or regulation will be defined in the Federal licensing agreements
- Financial requirements to obtain a Federal license will be increased
- Financial reporting requirements will be upgraded to require audited financial statements
- States will work together through NASDA and AAWCO to minimize differences between states and create more uniformity
- The parties will meet in St. Louis, December 9-10, 2002
- The parties will meet in Washington, DC, December 19, 2002

During the USDA/NASDA meetings the following information was shared with the working group:

#### **What USWA does not regulate:**

Central filing systems for filing of financing statements or notice of financing statements. (statutory requirement)

Rules to determine the security interests of persons affected by the Act. (statutory requirement)

Program operated by other USDA agencies:

---Federal Grain Inspection Service (FGIS), grain standards, equipment standards & testing

---Agricultural Marketing Service (AMS), other agricultural commodities standards.

(policy decision)

Programs and participants in programs run by the various States

---Warehouse operators who have chosen to be State licensed.

---Grain dealers who operate in a specific state.

---Weight and measures

---Producer funded indemnity funds

---Producer check-off programs or other assessments

(policy decision)