USDA helps keep harvests safe from failing elevators

WASHINGTON, D.C. — After droughts, insects, hail, and other natural disasters, some farmers face another threat: elevator and warehouse bankruptcies.

Statistics indicate that the risk is small. Only about 175 grain elevators out of an estimated 10,000 nationwide have closed or reorganized since 1975. However, the failure rate may be increasing.

"The number of bankruptcies per year rose over the last few years," says USDA economist Bruce Wright. "Because this has been a time of high interest rates and inflation, it looks like the increase is tied to the general state of the economy. Still, the number is small."

Although bankruptcies are few and far between, that's little consolation for farmers unlucky enough to put their crops in a financially shaky elevator at the wrong time. Their crops—and the money they need for next year's plantings—are often tied up as courts sort out the legal tangle.

Both grain and cotton facilities can go bankrupt, but most of the focus is on grain elevators. There are more of them, and cotton warehouses are less likely to fail because they are only involved in storage and not in speculation.

Occasionally, failing elevators sell the grain to avoid bankruptcy. This usually doesn't save the elevator, and farmers lose their crops and money. Even if all the grain is in the elevator when it goes bankrupt, legal expenses often eat away farmers' returns.

In addition to providing storage, elevators and warehouses frequently market crops under delayed-price and deferred-payment contracts. In both cases, the warehouse receives title to the crop but delays payment until the crop can be sold at a price or time advantageous to the farmer.

If the elevator fails before payment is made, bankruptcy laws give other creditors priority claim to the facility's assets. The farmer holding a price-later contract is one of the last to be reimbursed. The producers who are only storing grain in the elevator are in much better shape because they retain title to the grain.

According to one study, just over 3,000 farmers were claimants in elevator bankruptcy suits in 23 states between 1974 and 1979. Although this number is relatively small, a single, well-publicized bankruptcy can affect how farmers view normal transactions with warehouses.

So, how can farmers reduce their risk? That's not an easy question.

"A farmer may lose valuable time trying to check out the solvency of local grain elevators," Wright says. "Many times that information is not even available.

Perhaps the best protection is given when elevators are licensed under USDA's Federal Warehouse Act or meet the Commodity Credit Corporation's Standards for Approval of Warehouses. But, USDA can only regulate warehouses and grain elevators that choose to be licensed under the Act or approved by the CCC. The financial practices of most other storage places still fall under some state review, even though requirements vary from state to state.

To be federally licensed, storage facilities, net assets must equal to 20 cents per bushel of approved capacity. Elevators also must put up a bond of 20 cents per bushel on the first million bushels, 15 cents per bushel on the second million, and 10 cents on the next million and a half. The bond doesn't exceed $500,000.

In addition, USDA recently proposed regulations that would give some protection to farmers who deposit their grain in federally licensed warehouses for marketing under delayed-price and deferred-payment contracts. Just as the present regulations guarantee net assets to partially cover the worth of the bushels stored in a facility, the proposals would cover the amount of money involved in marketing transactions—20 cents per bushel sold. An additional $250,000 bond would also be required.

The standards are different for storage operations under contract with the CCC. Warehouses with capacities between 250,000 and 2.5 million bushels are required to have a net worth equal to 10 cents per bushel of storage capacity.

Ten and 20 cents per bushel aren't enough to cover the total value of the grain, but, in most elevator bankruptcies, at least some of the grain is returned to farmers.

"Elevators volunteer to be licensed because frequently they operate as grain merchants as well as storage warehouses," says James Springfield, director of the USDA warehouse division. "The grain merchant is then able to use warehouse receipts as collateral for a loan. Because the elevator is licensed, the bank would be more willing to grant a loan."

Over 70 percent of the U.S. cotton crop will be stored in federally licensed warehouses sometime before use, and 30 percent of all grain producers will deal with licensed elevators. During the last 2½ years, only eight federally licensed warehouses declared bankruptcy. In these cases, the required bond assured farmers of 20 cents on every bushel lost.

The threat that bankruptcy can strike anywhere, at anytime—sometimes with few safeguards—has been a growing concern to farmers, especially in the wake of recent elevator failures. Even the statistically remote chances of a bankruptcy provide little comfort when an entire year's earnings may be at stake.

Responding to these concerns, USDA Secretary John Block appointed a task force shortly after taking office. The purpose: to review current grain elevator laws and regulations to find out what more could be done to protect the agricultural community from elevator bankruptcies. The task force solicited suggestions from representatives of farm organizations, the warehouse industry, state governments, and the public. In May, it presented several proposals to Congress.

"The options concentrate on ways elevator bankruptcies can be prevented," says Merrill Marxman, a member of the task force an area director with USDA's Agricultural Stabilization and Conservation Service. "They're not aimed at solving the problem after it happens."

The task force ruled out creating a bankruptcy insurance program or starting a new federal agency to deal with the problem. Among the task force's recommendations: greater cooperation and consistency between the federal government and states.

"We recognize there are some good state programs for regulating warehouses, but some states do not have strong laws. That's why we need to work together for greater uniformity," Marxman says.

USDA is also considering ways it can get more involved under current laws and regulations, as well as what possible changes could be made. For example, the task force proposed that the net worth of CCC-approved elevators be raised to 20 cents per bushel of the elevator's capacity, and a $20,000 to $500,000 performance bond.

Since 1963, CCC has not asked warehouses to carry performance bonds, but it does require other types of approved security if the warehouse owner can't meat the net worth requirement.

According to the proposals, warehouses and elevators that contract with the CCC could be required to be licensed under the U.S. Warehouse Act or under state laws and regulations that are comparable with the Act.

Another possible change is that both licensed and CCC-approved storage operations would be required to submit a financial statement prepared by an independent certified public accountant. As well as including an operating statement, it would verify inventory, confirm storage obligations and payments for grain, and list bank loans and the facility's market position.

"This sort of audit is a good working tool for management and

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