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FAILURE OF GRAIN ELEVATORS

— by Neil E. Harl*

Grain elevator failures have become all too common in a number of rural communities. Whether failure is attributable to improper or unauthorized activity in futures markets, reduced levels of income from grain storage, employee defalcations or other reasons, the impact on grain depositors and on the community generally is usually decidedly adverse.

Upon learning that failure has occurred or that failure is imminent, individuals affected by the failure are usually interested in knowing the probable amount and timing of any recovery.

Bankruptcy priority. In response to highly publicized problems of depositors of grain in elevators later filing bankruptcy, the Congress in 1984 authorized a limited priority for grain producers.¹ Under the provision, unsecured claims of grain producers, up to \$2,000 per producer, for grain or the proceeds of grain against a debtor owning or operating a grain storage facility (and unsecured claims of fishermen, up to \$2,000 per fisherman, against a debtor operating a fish produce or processing facility, are given a priority for purposes of distributions in bankruptcy of the grain storage facility).² The priority is fifth in line after administration expenses in bankruptcy;³ unsecured claims arising after an involuntary petition is filed and before an order for relief is granted or a trustee is appointed;⁴ unsecured claims for wages, salaries and commissions up to \$2,000 per creditor;⁵ and unsecured claims for contributions to employee benefit plans up to \$2,000 per employee less any amount paid under the preceding priority.⁶ The grain producer priority is ahead of the sixth priority claim (up to \$900 per claim of unsecured amounts for money deposited with the debtor for purchase, lease or rental of property or services that were not delivered or provided)⁷ and the seventh priority claim for unsecured claims for taxes.⁸

For purposes of the fifth priority position of claims by grain producers, "grain" is defined broadly to include wheat, corn, flaxseed, grain sorghum, barley, oats, rye, soybeans, other dry edible beans and rice.⁹ "Grain storage facility" is defined as a site or physical structure used to store grain for

producers or to store grain acquired from producers for resale.¹⁰ "Producer" means an entity which engages in the growing of grain.¹¹

The \$2,000 priority is, indeed, a modest benefit to most affected producers. In addition, the statute authorizes an expedited procedure for determining ownership of the available grain. A bankruptcy court may, notwithstanding any other bankruptcy code provisions concerning adequate protection, use of estate property, assumption of contracts and leases or abandonments of bankruptcy estate property, expedite the procedures for determining interests in and disposition of grain and grain proceeds held by a debtor in a grain storage facility by shortening otherwise applicable time periods so that the entire procedure takes no more than 120 days.¹² A bankruptcy court must, upon the request of a grain producer who is a creditor of a bankruptcy storage facility, expedite the determination of the interests in the disposition of the grain held by the facility.¹³

Several features of the expedited procedure should be noted —

- The expedited procedure can be requested by the trustee *or by any person claiming an interest in the grain.*¹⁴
- The extent to which a court shortens the time period is dependent upon a number of factors including the market for the grain, the conditions under which the grain is stored, the expense of storage and the need of an interested party for a prompt determination.¹⁵
- The court may extend the period for final disposition of grain or grain proceeds beyond 120 days if justice so requires because of the complexity of the case and claimants entitled to the grain will not be materially injured by the additional delay.¹⁶
- Unless an order establishing an expected procedure is stayed pending appeal, reversal or modification of the order on appeal does not effect the validity of any disposition of the grain occurring before the reversal or modification and any proceedings in the case where the order is issued cannot be delayed.¹⁷
- The trustee can recover from the grain, or the proceeds from the grain, the reasonable and necessary costs for preserving or disposing of the grain or the proceeds of the grain.¹⁸

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• If a debtor operating a grain storage facility has more than 10,000 bushels of a specific type of grain, which is usually the case, the trustee must sell the grain and distribute the proceeds as determined by the court.¹⁹

In a case litigated shortly after enactment of the priority provision for grain producers, the Kansas bankruptcy court held that the expedited procedures allowing for determining claims of grain producers in an elevator bankruptcy also accord priority status above even secured creditors as to grain held by the elevator which is owned by the producers.²⁰ Although the court did not cite any specific statutory language for the holding, the court cited the Senate report to S.R. 445:

"The bill would require the court to distribute grain assets or the proceeds of such assets first to producers who have merely stored their grain in such a facility upon a contract of bailment..."²¹

However, the only priority specifically granted by the Bankruptcy Act Amendments of 1984 is a fifth priority for

unsecured claims of grain producers to the extent of \$2,000.²² Thus, it appears that the Kansas Bankruptcy Court holding represents an extension of the statute. In a later Kansas case,²³ the court did not discuss the priority of grain depositors as against an elevator's secured creditors under bankruptcy law. The court relied instead on a state statute²⁴ which gives grain depositors priority over a warehouse owner and the owner's creditors in the grain stored in the elevator.

Deferred payment contracts. Except for the limited priority in bankruptcy, unsecured creditors typically do not fare well in an elevator failure. Grain producers who have sold and delivered grain to the elevator prior to elevator failure under deferred payment or deferred pricing contracts²⁵ are unsecured creditors in the event of elevator failure and usually do not participate in state indemnity funds²⁶ or elevator bonding protection.²⁷

FOOTNOTES

- ¹ 11 U.S.C. § 507(a)(5). See generally 13 Harl, **Agricultural Law** § 119.02[2] (1990).
- ² 11 U.S.C. § 507(a)(5).
- ³ 11 U.S.C. § 507(a)(1).
- ⁴ 11 U.S.C. § 507(a)(2).
- ⁵ 11 U.S.C. § 507(a)(3).
- ⁶ 11 U.S.C. § 507(a)(4).
- ⁷ 11 U.S.C. § 507(a)(6).
- ⁸ 11 U.S.C. § 507(a)(7).
- ⁹ 11 U.S.C. § 557(b)(1).
- ¹⁰ 11 U.S.C. § 557(b)(2).
- ¹¹ 11 U.S.C. § 557(b)(3).

- ¹² 11 U.S.C. § 557.
- ¹³ 11 U.S.C. § 557(c).
- ¹⁴ 11 U.S.C. § 557(c)(1).
- ¹⁵ 11 U.S.C. § 557(c)(2).
- ¹⁶ 11 U.S.C. § 557(f).
- ¹⁷ 11 U.S.C. § 557(g).
- ¹⁸ 11 U.S.C. § 557(h).
- ¹⁹ 11 U.S.C. § 557(i).
- ²⁰ *In re Esbon Grain Co.*, 55 B.R. 308 [Bankr. D. Kan. 1985].
- ²¹ S. Rep. No. 98-65, 98th Cong., 1st Sess. 26 (1983).
- ²² See 11 U.S.C. § 507(a)(5).

- ²³ *First Nat'l Bank of Smith Center, Kan. v. Nugent*, 72 B.R. 528 (D. Kan. 1987).
- ²⁴ Kan. Stat. Ann. § 34-2107.
- ²⁵ See Harl, "Deferred Payment Contracts" 1 **Agricultural Law Digest** 1 (1989).
- ²⁶ See, e.g., Iowa Code ch. 543A (1989).
- ²⁷ See *In re Woods Farmers Co-op. Elev. Co.*, 107 B.R. 678 (Bankr. D. N.D. 1989) (contract seller of grain to elevator who had not received payment held only liens as to any proceeds remaining and was unsecured creditor).

CASES, REGULATIONS AND STATUTES

BANKRUPTCY

GENERAL

DISCHARGE. While the debtor was a director of a bank which held a mortgage against land held by the debtor, the debtor asked the president of the bank to release the security interest on some of the mortgaged land. The bank agreed to release the mortgage as to the land. After the debtor defaulted on the mortgage and filed bankruptcy, the bank petitioned for nondischargeability of the debt as to the released land because the debtor obtained the release by defalcation while serving in a fiduciary position. The court held that the debtor requested the release as a debtor and not as a director and committed no fraud. Although the debtor, as director, was serving as a fiduciary, the mortgage release was made by the bank at the request of the debtor as debtor and not as a director. *In re Thurman*, 121 B.R. 888 (Bankr. N.D. Fla. 1990).

ESTATE PROPERTY. The court held that the debtor's interest in an ERISA qualified retirement fund was not property of the estate under the anti-alienation clause of ERISA, 28 U.S.C. § 1056(d)(1), even though the debtor could withdraw from the fund upon termination of employment (the debtor was still employed at the time of filing for bankruptcy). *In re Cheaver*, 121 B.R. 665 (Bankr. D. D.C. 1990).

EXEMPTIONS. The debtor was not allowed an exemption for the debtor's interest in an employee retirement plan because the funds were not reasonably necessary for the support of the debtor where the debtor was 44 years old and retained employment with an annual salary and bonuses of \$74,000. *Matter of Hunt*, 121 B.R. 349 (Bankr. S.D. Iowa 1988), *aff'd* 121 B.R. 352 (S.D. Iowa 1989).

The debtor's three television sets, VCR, speakers, phonograph, guitar and lawn mower were held exempt, under 31 Okla. Stat. § 1(A)(3), as household furniture. The court rejected the argument that household furniture could be