SUBJECT: Creating the Texas Grain Producer Indemnity Board

COMMITTEE: Agriculture and Livestock — committee substitute recommended

VOTE: 7 ayes — Hardcastle, C. Anderson, Isaac, Kleinschmidt, Landtroop, Lozano, Miles

0 nays

2 absent — C. Howard, Hughes

WITNESSES: For — Mitchell Harris, Ag Texas FCS; Charles Huddleston and Rodney Schronk, Texas Farm Bureau; Ronnie Settle, AG-POWER, Inc; Dee Vaughan, Corn Producers Association of Texas; (*Registered, but did not testify:* George Caldwell and Ken Hodges, Texas Farm Bureau; David Gibson and Bruce Wetzel, Corn Producers Association of Texas; Eric Akins; Scott Averhoff; Scott Frazier; Mary Gipson; Jerry Harrison; Barbara Parker; Charles Riny)

Against — Ben Boerner, Texas Grain and Feed Association; George Ferguson, Frank Bailey Grain Co.; Gary Holcomb, Texas Agricultural Cooperative Council; David Swinford; (*Registered, but did not testify*: Tommy Engelke, Texas Agricultural Cooperative Council; James Grimm; Texas Poultry Federation; Kenneth Horton, Texas Pork Producers Association; Bob Turner, Texas Poultry Federation and Texas Sheep and Goat Raisers Association)

On — (*Registered, but did not testify:* David Kostroun, Texas Department of Agriculture)

BACKGROUND: Agriculture Code, ch. 41 governs commodity producers' boards in Texas. It allows a nonprofit organization representing the producers of an agricultural commodity to petition the agricultural commission to initiate a process to form a commodity producers' board. The chapter establishes processes and procedures, duties, and other provisions for commodity boards in the state.

DIGEST:

CSHB 1840 would create the Texas Grain Producer Indemnity Board. The board would indemnify grain producers for economic hardship if a grain buyer was unable to pay the producer for the grain. The board could adopt rules as necessary to implement provisions in the bill.

Board. The board would comprise nine members appointed by the agriculture commissioner to serve two-year, staggered terms. The board would include association members, each of whom would be recommended to the commissioner by the association's board of directors, from:

- the Corn Producers Association of Texas;
- the Texas Wheat Producers Association;
- the Texas Grain Sorghum Association;
- the Texas Soybean Association; and
- the Texas Farm Bureau.

It also would include:

- a representative of either the Texas Agricultural Cooperative Council or the Texas Grain and Feed Association;
- a representative of the nonwarehouse grain-buying industry;
- a member with expertise in production agriculture financing; and
- an attorney with expertise in bankruptcy and grain contracts.

The board would have to meet at least once a year to:

- review its expenses, claims made by grain producers, and amounts it paid on those claims;
- coordinate relevant matters, including its budget and revenue necessary to fulfill its duties;
- establish and adjust the rate of assessments collected; and
- determine the most effective means to provide protection to grain producers.

Assessments. The board would apply an assessment to compensate grain producers for incurred hurt, loss, or damage. A grain buyer would collect assessments in accord with procedures in current law. The buyer could retain a portion of the assessment as the board determined for administrative expenses and would have to remit the rest to the board by the 10th day of each quarter.

Assessments would be held outside the state treasury. Existing provisions regarding exemptions from assessments and refunds would not apply to the board.

A producer that paid an assessment could get a refund by filing an application with the board. A producer who received a refund could not make a claim for the value of the grain associated with the refund. Refunds could be paid on a prorated basis if budgetary limitations so necessitated.

Claims. A grain producer that delivered grain to a buyer could initiate a claim if the buyer suffered a financial failure and did not pay a producer or was unable to return grain held as a bailment. The producer would have to provide written documentation showing that the grain was delivered to the buyer and a contract for purchase of the grain showing the specific amount of grain purchased at the agreed price.

A claim would have to be initiated within 60 days after a buyer declared bankruptcy or exhibited other indications of financial insolvency. The claim also would have to be for a loss of grain delivered to a buyer less than a year before the buyer declared bankruptcy or exhibited other indications of financial insolvency. The board could pay producers for claims on a prorated basis if budgetary limitations so necessitated.

Following the initiation of a claim, the board could take action to investigate the claim and determine the amount due to the producer. In determining the amount due, the board could award the producer no more than 90 percent of: the value of the grain on the claim initiation date if it had not been sold, or the contract price of the grain if it had been sold.

The board would have to either pay the grain producer the amount determined or notify the producer that the claim was denied within 30 days. The board could deny a claim if:

- the producer had a history of failing to pay the board's assessments;
- the applicable buyer had a history of failing to collect assessments; or
- the documentation a buyer submitted as part of a claim was incomplete, false, or fraudulent.

The board also could deny a claim in whole or in part to prevent a producer from recovering from multiple payments an amount that exceeded the losses, or if documentation the producer submitted demonstrated that a deferred payment on sold grain was beyond normal and customary practices.

If the board paid a claim to a producer against a buyer, it would assume the rights of the producer for any payments from the buyer and other payments that entities owed the producer for the loss.

Referendum. The agriculture commissioner would have to conduct a referendum of grain producers to determine the maximum amount that could be assessed upon grain producers. Only a grain producer who sold grain in the last 36 months could vote in the referendum. Each producer would be given equal weight in the vote, and votes would be confidential. A referendum would be approved by a simple majority. The agriculture commissioner would have to give public notice of the vote that conformed with provisions in the bill.

The bill would take effect September 1, 2011. Recommendations for board members would have to be submitted no later than January 1, 2012.

SUPPORTERS SAY:

CSHB 1840 would allow farmers of corn, soybeans, wheat, and grain sorghum in the state of Texas to form an indemnity board to protect themselves from loss and damage due to the financial failure of a grain warehouse. The bill stems from several recent, devastating collapses of grain warehouses that brought financial ruin to farmers who stored their grain in those facilities.

The bill would help to minimize a common liability faced by grain farmers in the state. Grain farmers generally harvest their crop at once. Most grain farmers are not able to sell grain directly from the farm and therefore need to store the grain for a period of six months or more prior to sale. This is necessary due to seasonal market and natural factors that depress the price of grains around the harvest season. Grain farmers are different from other commodity farmers in that they have no means of economically identifying grain deposited into a warehouse, since grains cannot be readily packaged or marked with a unique identifier.

Due to these factors, grain farmers accept great risks when they store their grain. The grain deposited into a warehouse often constitutes the majority

of a farmer's annual income. As such, when a grain warehouse declares bankruptcy or becomes otherwise financially insolvent, the farmer faces a crippling blow. The farmer has no way to reclaim any grain in the warehouse — which cannot be identified and becomes the property of the creditors of the warehouse operator — and the bonding requirements on the warehouse often are sufficient only to compensate for a small fraction of the farmer's loss. In these scenarios, which are common recently due to poor warehouse management in some areas, grain farmers have no legitimate way to reclaim their losses without lengthy legal battles delivering marginal compensation.

CSHB 1840 would establish the Texas Grain Producers Indemnity Board, allowing grain producers to opt to pay assessments to protect themselves from financial ruin in the event of a warehouse collapse. The committee substitute made a number of changes to the introduced bill to address concerns posed by grain warehousers and other agricultural interests. As a result of stakeholder negotiations, the indemnity board would be established as a separate entity from the Texas Department of Agriculture with some oversight from the agriculture commissioner.

The bill would not make participation in the indemnity board mandatory for grain farmers. It would include two opportunities for farmers to opt out of the indemnity program. First, it would establish a referendum process so that grain farmers could vote against imposing an assessment on themselves and thereby creating an indemnity board in the first place. Second, it would allow grain farmers to request from the board a reimbursement for paid assessments if they did not want to participate. This would not represent an undue hassle for grain producers, since they would be given clear receipts from grain warehouses and could then conveniently remit the receipts.

The bill would establish the indemnity board in the likeness of other boards in states with concentrations of grain farming. Most of the major grain farming states have had indemnity boards or similar arrangements for decades, to good effect. While preventative measures to reduce the likelihood of financial collapse and to increase bonding to lessen the resultant damage are laudable, they are not enough. These measures do not adequately protect farmers who lose an entire season's investment to a financially irresponsible grain warehouse. Increasing the bonding requirement to 10 cents per bushel, for instance, would cover only a fraction of the value of a bushel of wheat — currently set at about $7.50

per bushel. That would be token recompense for a farmer with tens or hundreds of thousands of bushels.

The indemnity board proposed in the bill would be a necessary and singular protection against worst-case scenarios. Still, the bill would not preclude additional measures to increase bonding requirements for warehouses and other measures designed to reduce the likelihood of warehouse collapse.

OPPONENTS SAY:

CSHB 1840 would adopt a problematic response to a genuine problem. There have indeed been a number of financial collapses at grain warehouses that have been devastating to farmers in recent years. Yet by creating an indemnity board, the bill could subject farmers and grain warehouse operators to unwanted assessments and unnecessary hassles.

The assessments required through the indemnity board could prove an administrative burden for grain warehouses. Grain warehouses would have to calculate and impose all assessments received and remit the payments to the board. This could be a challenge for some warehouses that would have to establish appropriate systems for accounting and processing the assessments. While the bill would provide for some portion of assessments to be retained to offset administrative costs, it would make no guarantee that the portion that could be retained would be adequate to make up for the burden.

While the bill would allow farmers to seek reimbursement, it still would require them to go through the hassle of remitting requests for reimbursement. In addition to being difficult to process, reimbursements also take time to process. If approved, the indemnity board would make unwilling participants out of some farmers who did not want to participate but also did not want to go through the trouble of seeking reimbursement for a small amount.

Creating an indemnity board, moreover, could have certain unintended consequences. Farmers who were very careful about the warehouses where they chose to house their grain still would have to pay for the program, but would not benefit. On the other hand, farmers who felt confident that any losses they incurred to a warehouse could be less selective in choosing the warehouses where they stored their grain.

Few would disagree that practices among some grain warehouses in the state are in need of reform. The agriculture commissioner, in fact, deemed the problem pressing enough to appoint a grain warehouse task force and charge it with studying existing grain warehouse laws and developing recommendations to enhance oversight and increase protections for grain depositors. The task force issued a report in November 2010 with 13 recommendations for improving warehouse operations in the state. While the task force discussed the possibility of establishing an indemnity fund for grain farmers, it did not include this in its recommendations.

Instead, recommendations from the task force focus on ways to reduce the frequency of financial collapse of grain warehouses. Some of the recommendations are included in a bill that has passed the Senate and been approved by the House Agriculture and Livestock Committee, SB 248 by Estes. That bill would implement the task force's recommendations to increase the bond coverage assumed by warehouses from 6 cents to 10 cents per bushel, increase the minimum bond amount from $20,000 to $30,000, establish a maximum bond amount of $500,000 for grain stored in a public warehouse, and other recommendations. If enacted, SB 248 would go a long way toward protecting grain farmers without the need for the stronger and less predictable measure of an indemnity board.

OTHER OPPONENTS SAY:

This bill potentially would authorize an unfair practice by allowing the board to deny a farmer's claim if the grain buyer had a history of failing to collect assessments as required. This language has two problems. First, it is vague in that it does not specify that the buyer did not remit assessments from the particular farmer who is the subject of the claim. As such, the board could deny a farmer's claim even though he or she paid all assessments to a buyer. Second, it assumes farmers have responsibility for ensuring that buyers are properly charging, paying, and collecting assessments. This is an unfair burden to place upon the farmer.

The bill should be amended to either delete this provision or clarify the conditions under which a claim may be denied as a result of a buyer's actions.

NOTES:

The companion bill, SB 1232 by Estes, was referred to the Senate Agriculture and Rural Affairs Committee on March 16.