Issue 08-05, July 30, 2008

AGRICULTURAL LAW AND TAXATION BRIEFS

DEPARTMENT OF AGRICULTURAL AND CONSUMER ECONOMICS, UNIVERSITY OF ILLINOIS AT URBANA-CHAMPAIGN

ILLINOIS GRAIN INSURANCE FUND: PROTECTING FARMERS IF AN ELEVATOR FAILS

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Abstract: This article, an update of an article first published in 2003, describes the protections provided to farmers and lenders by the Illinois Grain Code in the event an Illinois-licensed grain elevator fails. A checklist of "Good Practices" designed to maximize these protections for farmers is included. This article is part of a law-related educational program for Illinois family farmers made possible by a gift from the Illinois Bar Foundation. The assistance of the Agricultural Law Section Council of the Illinois State Bar Association in reviewing the article also is appreciated.

Introduction

When a producer or share landlord ("farmer") delivers grain to an elevator, what payment assurances does the farmer have if the elevator fails? This article describes the current Illinois Grain Insurance Fund (IGIF) protection afforded farmers and their lenders under the Illinois Grain Code. The article may be of special interest to farmers in light of the failure of several Illinois elevators during the past year. Before describing the protections of the IGIF, it is helpful to understand some basic Grain Code concepts.

Overview: Warehouses, Grain Dealers, and Different Arrangements for Selling Grain

When grain elevators *store* grain for a farmer, the elevator is acting as a *warehouse*. The farmer may have a "warehouse receipt" as evidence that the elevator is storing the farmer's grain, or at least scale tickets indicating the grain is stored. Lenders also may accept warehouse receipts as security for loans made to the elevator or a farmer. This warehouse function – storing grain – is regulated by the state or federal government, depending on whether the warehouse has a state or federal warehouse license. Most warehouses in Illinois are licensed by the Illinois Department of Agriculture and are subject to the requirements of the Illinois Grain Code. A federally licensed warehouse may not be covered by the IGIF.

When an elevator *buys* grain from a farmer, it is acting as a *grain dealer*. This grain dealer function – buying grain – has traditionally been regulated by the states. For example, Illinois grain dealers are regulated by the Illinois Department of Agriculture under provisions of the Illinois Grain Code and have an Illinois Grain Dealer License.

Farmers typically sell grain to an elevator under any of the following four arrangements. Under the first, the farmer sells grain for the current price. The farmer receives the check as soon as the business office can process the transaction. This arrangement called a "spot sale."

Under the second arrangement, the farmer delivers the grain to the elevator at the current price, but the contract for sale does not call for payment until a future date (perhaps after the start of the farmer's new tax year). This arrangement can be described as a "deferred payment sale."

The third arrangement is where the farmer sells the grain under a "price later" contract, also known as "deferred pricing" or "delayed pricing." Under the "price later" contract, ownership of the grain passes to the elevator at the time of delivery, but the price to be received by the farmer is determined at a future date with final payment made at a later date.

The fourth arrangement is where the farmer sells the grain by use of a "forward contract" which calls for the delivery of grain in the future at a price described in the contract.

If a grain elevator holding an Illinois Grain Dealer License and an Illinois warehouse license fails, the IGIF is available, in most circumstances, to assure payment to farmers who stored and/or sold grain to the elevator. In addition, the IGIF provides payment assurance to lenders holding collateral warehouse receipts. In both cases, the IGIF is "tapped" to the extent that the grain assets and equity assets of the failed elevator are insufficient to fund the payment of warehouse and grain dealer claims guaranteed by the act. However, as described below, the payments guaranteed by the Illinois Grain Code will not necessarily cover all the losses incurred by farmers and lenders.

Claims under the Illinois Grain Code

A. Warehouse Claims

Claims concerning losses for grain stored at a failed elevator are known as warehouse claims. Warehouse claims can be submitted by farmers with stored grain, and by lenders that hold warehouse receipts as security for loans. In the event of a grain elevator failure, warehouse claims will be paid up to 100%. A claimant's pro rata share of the proceeds from liquidating the elevator's grain assets is first applied against the claim. If the liquidation proceeds fail to fully compensate all warehouse claimants, each claimant is entitled to payment from the IGIF. Payments from the IGIF for warehouse claims, however, are capped at $1 million per claimant.

B. Farmers' Grain Dealer Claims

Claims submitted by unpaid farmers who delivered grain for sale are known as grain dealer claims. Payments from the IGIF for such grain dealer claims are capped at either $1 million or $250,000 per claimant. A farmer, however, may recover separately up to $1 million for farmer's warehouse claims and up to $1 million (or $250,000 if this is the applicable cap) for farmer's grain dealer claims. The lower cap on grain dealer claims may apply where there is a deferral in receiving payment (a "deferred payment" sale) or a delay in pricing the grain (a "price later" sale). Subject to these overall caps, valid claims for some losses are covered at 100% of the loss while others are covered at only 85% of the loss. A brief discussion of the most pertinent rules follows. Note that delivery of the grain before the elevator fails is always required before there can be recovery from the IGIF.

1. 21-Day Rule: 100% Guaranteed Payment Up To $1,000,000

The IGIF guarantees 100% payment of the claim, up to $1 million, so long as the farmer completed delivery of the grain *and* agreed on a price within 21 days of the elevator's failure. Therefore, to ensure 100% coverage for up to $1 million in sales to a grain dealer, farmers must require payment within 21 days of delivering *and* pricing the grain for sale.

> *Example A*: On Oct. 1, 2007, Farmer A delivers to Elevator 50,000 bushels of corn and, on the same day, agrees to a price of $4 per bushel. On Oct. 18, 2007, when Farmer A is still unpaid, the Elevator fails. Farmer A is entitled to full payment of the $200,000 grain dealer claim because (a) the delivery occurred within 21 days of the date of failure and (b) the grain was priced before the day of failure. In fact, Farmer could have sold (delivered and priced) corn and beans for up to $1,000,000 and still been fully protected so long as the elevator failure occurred within 21 days of the delivery and pricing.

2. 22- to 160-Day Rule for Deferred Payment Sales: 85% Guaranteed Up To $250,000

If payment is not made in the first 21 days after delivering *and* pricing the grain, but the grain was delivered and priced within 160 days of the elevator failure, the farmer is entitled to 85% of the amount of the claim, up to a maximum payment from the IGIF of $250,000. Therefore, to assure at least 85% coverage for up to $250,000 in sales to a grain dealer, payment must be required within 160 days of delivering and pricing the grain.

> *Example B*: Same as *Example A* except that Farmer and Elevator have agreed that

the $200,000 payment is due January 2, 2008 and Elevator fails on October 29, 2007. Because delivery and pricing of the grain (10/1/07) occurred more than 21 days before Elevator's failure (10/29/07), Farmer B is not entitled to 100% payment for the $200,000 loss; however, since delivery of the priced grain occurred within the 160 day period before Elevator's failure, Farmer B is guaranteed 85% of the $200,000 loss, i.e., $170,000. (But if Farmer B had sold corn for $300,000 under these circumstances, the guaranteed payment from the IGIF would be capped at $250,000 and B would not receive the full $255,000 which is 85% of $300,000).

Example C: On October 1, 2007 Farmer C delivers to Elevator 50,000 bushels of corn and, on the same day, agrees to a price of $4 per bushel. Farmer agrees to delay payment until July 1, 2008. On May 31, 2008 the Elevator fails. Because both delivery and pricing of the grain occurred more than 160 days before the failure of the elevator, there is no recovery for Farmer C.

3. 160-Day Rule & 365-Day Rule for "Price Later" sales: 85% Guaranteed Payment Up To $250,000

160-day Rule for "Price Later" Sales: Where *either* completion of delivery *or* the date of pricing is within 160 days of the elevator's failure, farmers who file valid claims are also guaranteed 85% of the amount of the claim, up to a cap of $250,000 per claimant (so long as the 365-day rule is not violated – see below). The date of completion of delivery means the date of the last delivery of grain that was to be applied to the contract's quantity requirement.

365-day Rule for "Price Later" Sales: Either the date of the actual execution of the contract *or* delivery of the grain must be no more than 365 days before the date of failure.

If the final price of the grain has not yet been established at the time of failure, the Department will determine the per bushel value of these claims from the average cash bid prices on the date of the failure from grain dealers in the area and cash bid price of the failed grain dealer, less transportation, handling and applicable discounts as of the date of failure.

The execution of subsequent price later contracts by a farmer and grain elevator for grain previously covered by a price later contract will not extend the coverage of an IGIF claim beyond the original 365 day period. Therefore, in order to ensure at least 85% coverage on "price later" grain sales, farmers must be paid within 365 days of either delivering the grain or entering into the priced later contract, *and* within 160 days of delivering or pricing the grain.

Example D: On Sept. 1, 2007, Farmer D and Elevator enter into a "price later" contract for 20,000 bushels of beans. Farmer delivers 20,000 bu. on Nov. 1, 2007. On March 1, 2008, Elevator fails. Because the grain was delivered (11/1/07) within 160 days of Elevator's failure (3/1/08), Farmer is entitled to 85% of the grain's value as *of the date of failure* (grain was not priced at time of failure), subject to a maximum payment from the IGIF of $250,000. If the price of beans on 3/1/08 were $10.00, Farmer D would recover 85% of $200,000 (i.e., $170,000) (If Elevator had failed on 5/1/08 and Farmer still had not priced the grain, Farmer D would not be protected because neither delivery nor pricing had occurred within 160 days of the failure.)

Example E: On September 1, 2007, Farmer E and Elevator enter into a "price later" contract for 20,000 bushels of beans. Farmer completes delivery of the 20,000 bushels on November 1, 2007. On July 1, 2008, Farmer and Elevator agree on a price of $14.50 per bushel with payment to be made on January 1, 2009. On August 1, 2008 Elevator fails. Because the grain was priced within 160 days of Elevator's failure, Farmer E is entitled to 85% of the amount owed, subject to a maximum payment from the

IGIF of $250,000. Farmer E will recover $246,500 (85% of 20,000 bu. x $14.50/bu. price-later price). (Note: If Elevator had failed on November 5, Farmer would not be protected by the IGIF because both the date of the contract (9/1/07) and delivery (11/1/07) would be more than 365 days before the elevator failure (11/5/08).

4. $250,000 Cap Is on Combined Claims for Deferred Payment and Price Later Sales

Where a farmer has claims for both deferred payment and price later sales, the maximum payment from the IGIF for the combined claims is $250,000.

Example F: In the preceding examples Farmers B and E received the following amounts …
B: $170,000 (85% of a deferred payment sale),
E: $246,500 (85% of a price later sale),
from the IGIF (each subject to the $250,000 payment limit per claimant).
If the same claims had been filed by one claimant, Farmer F, then Farmer F's recovery from the IGIF would be capped at $250,000.

Summary: A List of Farmer "Good Practices" to Maximize Protection under the Illinois Grain Code

√ Do not store grain worth more than $1 million at any one warehouse licensed by the Ill. Dept. of Agriculture (maximum recovery available from the IGIF for "Warehouse Claims" is $1,000,000 per claimant).

√ To assure 100% coverage for up to $1 million in sales of grain to a Grain Dealer, always insist on being paid within 21 days of delivering and pricing the grain for sale (if you delay payment beyond 21 days but not more than 160 days, you are guaranteed only 85% of the sale proceeds if the elevator fails, or $250,000, whichever is less).

√ To assure at least 85% coverage on grain delivered for sale, for which the price has been determined but payment has been delayed more than 21 days:
- never let more than 160 days pass before being paid in full, and
- never let the amount owed to you by any one licensee for such delayed payment sales (plus amounts owed for price later sales) exceed $250,000.

√ To assure at least 85% coverage on "price later" grain sales
- always be paid ►within 160 days of the later of delivering or pricing the grain, and ►within 365 days of the later of delivering the grain or entering into the price later contract
- never let the unpaid value of such price later sales (plus amounts owed for delayed payment sales) to any one licensee exceed $250,000.

√ Also, understand the risks and benefits associated with "farmer marketing programs" or other "higher risk" services offered by licensees (losses from trading activity are not covered by the IGIF).

The complete language (unofficial) of the revised Illinois Grain Code is available on the Internet. Go to http://www.ilga.gov/legislation/ilcs/ilcs.asp and CLICK on "CHAPTER 240 WAREHOUSES." Then CLICK on "240 ILCS 40/ Grain Code."

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