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April 13, 1981

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ATTORNEY GENERAL OPINION NO. 81- 91

Mr. Donald D. Watson, Director  
Grain Inspection Department  
State of Kansas  
535 Kansas Avenue  
Topeka, Kansas 66603

Re: Grain and Forage -- Inspecting, Storing, Weighing  
Grain; Warehouses -- Insolvent Warehouses; Federal  
Bankruptcy Proceedings

Synopsis: Generally, under Kansas law the relationship  
between the depositor of grain and a grain storage  
warehouse is that of a bailment. The depositor's  
interests are normally preferred over secured and  
unsecured creditors in insolvency proceedings  
under the Federal Bankruptcy Code. Such preferred  
legal status does not prevent the trustee in bank-  
ruptcy from exercising temporary jurisdiction over  
stored grains in the debtor's warehouse until owner-  
ship rights of the bailor can be established. How-  
ever, the trustee must exercise this control in  
the interests of ownership rights of the holders  
of documents of title. Cited herein: K.S.A. 34-227,  
34-270, 34-2104, 84-2-305, 11 U.S.C.A. 725 (Supp. 1980).

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Dear Mr. Watson:

You advise that you have received numerous calls from farmers  
expressing concern about their status in the event that ele-  
vator warehouses where they have grain stored become insolvent.  
Specifically, you ask if a farmer who has a warehouse receipt  
or scale ticket is classified as a secured or common creditor.

Generally speaking, the farmer is neither a secured nor common  
creditor as those words are used in the Uniform Commercial Code  
and Kansas case law. Normally, the farmer is in a bailment

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relationship with a warehouse. Although similar to a creditor/debtor relationship, the bailment usually entitles the farmer to a preferred status to that of creditors. However, your question is very difficult to answer in the abstract. The law in this area is complex, as are the contractual relationships that a farmer and warehouseman may choose to engage in. In light of this complexity we will attempt to answer your question by posing a series of hypothetical factual situations that we think cover common circumstances. We will discuss each hypothetical and explain the law as it relates to that situation. Being fully aware of the context in which your question is raised, our factual situations include reference to the federal bankruptcy laws.

#### Hypothetical 1.

Facts: A farmer has a warehouse receipt for some "stored grain" as defined by K.S.A. 34-227. The elevator that issued the receipt becomes insolvent. The elevator is licensed by the State of Kansas and is incorporated in Kansas. The elevator has less grain in storage than it has in outstanding warehouse receipts. A creditor of the elevator petitions the county district court to appoint a receiver in insolvency.

Discussion: These are the basic facts of State ex rel. Crawford v. Centerville Grain Co., 5 Kan. App. 2d 415 (1980). Because the elevator is licensed in Kansas, the Kansas Grain Inspection Department is authorized by K.S.A. 34-2104 to petition the state district court for permission to seize all grain located in the warehouse. The Department will then notify all owners of stored grain so that they may present their claims to the Department. The Department will then audit to determine the amount of the shortage.

Language in Centerville is not clear as to the relationship of the farmer and elevator or of the farmer and other creditors. However, a long line of cases from both Kansas and federal courts interpreting Kansas law have held that the relationship of farmer and warehouseman concerning stored grain is that of bailor and bailee and that all owners of stored grain are tenants in common in the entire mass of stored grain. See, e.g., Flour Mills of America v. Burrus Mills, 174 Kan. 709, 719 (1953), Central States Corp. v. Luther, 215 F.2d 38, 45 (10th Cir., 1954). We believe this to be the law today.

As bailor, the farmer is neither a secured nor unsecured creditor of the elevator. Basically, the difference between

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0 a creditor and a bailor is that a creditor has relinquished possession and title, while a bailor relinquishes only possession. The warehouse receipt issued to the farmer evidences the farmer's continued ownership.

In our hypothetical situation, the Grain Inspection Department's audit will reveal a shortage. Then, if the elevator and its bond cannot satisfy the outstanding warehouse receipts, the grain will be distributed pro rata to the tenants in common in the grain.

1 Naturally, this process takes time. The farmer may receive grain in return or the entire mass may be liquidated so that the farmer receives cash. The farmer is of course liable for all rents and charges due, and the elevator may retain the grain or its proceeds until the farmer makes payment. K.S.A. 34-270.

If the farmer's pro rata share of grain and bond money is insufficient to cover his warehouse receipts, he may bring a claim against the receiver for that shortage. He is probably a general creditor of the elevator for that shortage.

[Note: In all hypotheticals posed, the same rules apply for scale tickets as for warehouse receipts. United States v. Luther, 225 F.2d 499 (10th Cir. 1955).]

Hypothetical 2.

Facts: Same as No. 1, except that the case is brought in Federal Bankruptcy Court as a chapter 7 "straight bankruptcy."

Discussion: This presents a complication in that the State Grain Inspection Department may be stayed from taking control of the warehouse and distributing the proceeds. 11 U.S.C.A. §362.

1 Ultimately, this should not change the result as far as the farmer is concerned, however. The Federal Court will look to the state law to determine the relationship of farmer and elevator. Central States Corp. v. Luther, supra at 41. Thus, as in hypothetical 1, this is a bailment relationship. However, the U.S. Eighth Circuit Court of Appeals has recently established the scope of the federal bankruptcy trustee's jurisdiction and control over bailed goods. The Court observed that the trustee has a claim of possession, a lien for storage charges, and in those cases where some of the grain has been sold on contract, a claim of ownership. In its opinion filed April 8, 1981, the Court stated further:

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"On the record before us, the debtors' interest in the Missouri grain consists of possession and a minute ownership interest. In light of the broad definition of property under section 541 of the Code, these interests in the grain are sufficient to trigger preliminary jurisdiction over the property in the bankruptcy court. Collier on Bankruptcy ¶ 541.08[2] (15th ed. 1979); see In re Farmers Grain Exchange, Inc., 1 Bankr. Ct. Dec. 1621 (W.D. Wis. 1975). Of course, the bankruptcy court must make the final determination of property interests after full presentation of the evidence.

"Although we hold that the bankruptcy court has preliminary jurisdiction over the property, we emphasize that the bankruptcy court must administer the debtors' limited interest consistent with the ownership rights of holders of documents of title under Missouri law or, in the case of Arkansas grain, under Arkansas law. See In re Clemens, 472 F.2d 939, 942 (6th Cir. 1972); In re Universal Medical Services, Inc., 460 F.2d 524, 526 (3d Cir. 1972); In re Farmers Grain Exchange, Inc., supra, 1 Bankr. Ct. Dec. at 1622." In re: State of Missouri, et al. v. U.S. Bankruptcy Court for E.D. of Arkansas et al., Case No. 80-2179 and In re: State of Missouri, et al., v. U.S. Bankruptcy Court for E.D. of Arkansas, et al., Case No. 80-2198, (8th Cir. 1981) at 11,12.

In the typical situation, the farmer will demand his pro rata share of grain, the trustee will demand proof of ownership (warehouse receipts and scale tickets) and payment for storage and costs. When the farmer tenders payment, the trustee in bankruptcy will then distribute the stored grain in the same manner as the receiver would in hypothetical 1. See 11 U.S.C.A. §725 and 725.01 Collier on Bankruptcy (15th Ed., King, 1980).

Hypothetical 3.

Facts: Same as No. 2, except that the case is brought in Federal Bankruptcy Court as a Chapter 11 Reorganization.

Discussion: The purpose of a Chapter 11 proceeding is to rehabilitate the debtor, rather than to liquidate his assets and debt. In a chapter 11 proceeding, a plan is drawn, binding all creditors, which typically reduces the debt and extends time for payment.

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Unlike the previous two examples, an elevator in chapter 11 reorganization will continue to do business. The court will still look to state law to determine the ownership of property in the debtor's possession. The court will recognize the grain as bailed property and order the trustee or debtor in possession to distribute the grain or sell the grain and distribute the proceeds [pro rata], less preservation and administrative expenses, to the grain depositors.

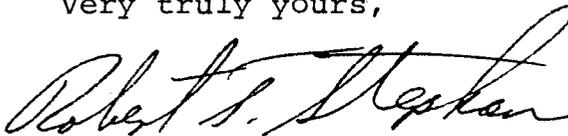
Hypothetical 4.

Facts: The farmer has a deferred pricing arrangement. He has delivered grain to the elevator and the price is to be set sometime in the future. Before a price is set, chapter 7 bankruptcy proceedings are begun in Federal Bankruptcy Court.

Discussion: This situation illustrates the importance to the farmer of maintaining the status of bailor. Here, unlike hypotheticals 1, 2, and 3, the farmer may not be the owner of stored grain as defined in K.S.A. 34-227. Instead he may be a party to a contract to sell. See K.S.A. 84-2-305. If it is held that he has entered a contract for sale, he will probably be treated as a general creditor of the elevator.

Therefore, it is our opinion that generally, under Kansas law, the relationship between the depositor of grain and a grain storage warehouse is that of a bailment. The depositor's interests are normally preferred over secured and unsecured creditors in insolvency proceedings under the Federal Bankruptcy Code. Such preferred legal status does not prevent the trustee in bankruptcy from exercising temporary jurisdiction over stored grains in the debtor's warehouse until ownership rights of the bailor can be established. However, the trustee must exercise this control in the interests of ownership rights of the holders of documents of title.

Very truly yours,



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RTS:BJS:hle