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NORTH DAKOTA GRAIN DEALERS ASSOCIATION

INTERIM AG COMMITTEE -- JANUARY 12, 2010 -- NCI NDGDA COMMENTS ON BONDING

Good afternoon again. For the record my name is Steve Strege and I'm the Executive Vice President of the North Dakota Grain Dealers Association.

I've been with the Association since 1976 and since 1978 have also been a licensed insurance agent. Grain Dealers has written bonds on grain elevators for several decades, maybe since back into the 1930s.

Anita handed out this morning a copy of the Grain Dealers' October 1, 2009 comments to the PSC about bonding alternatives. There's an explanation in there about how bonds differ from insurance. The first purpose of a bond is to act as a screening device to allow only financially capable firms into the business. Infrequently financial situations change and bonded businesses fail. Then the bond becomes a payment mechanism.

A bond underwriter looks at the company's net worth. In the case of CNA Surety the net worth should be equal to or greater than the amount of the bond. If you want a \$500,000 bond, but aren't willing to have \$500,000 of your own money in there, why should the bonding company put that amount at risk? Other considerations include working capital, profit history, credit line and experience of management.

In June 2008 the Licensing Division of the PSC held a meeting about issues impacting grain elevators that included discussion on bonding requirements. Those that attended in person or by phone were: Farmers Union, Grain Growers, Wheat Commission, and Grain Dealers. Those invited but who did not attend included Barley Council, Corn Growers, Dry Bean Council, Farm Bureau, Pulse Growers, Soybean Council and Sunflower Association.

No pressing need for change was seen. Consensus was to leave things as they were. In fact in Sue Richter's summary she wrote that the idea of basing the bond on volume was nixed.

Then toward fall we started hearing of VeraSun's financial problems. Corn Growers started asking questions about bond levels. They talked about raising the indemnity fund cap, but no bill was introduced.

The reason I tell you all that is because it was the problems of a processor that raised this issue on bond requirements. Since then we've had another processor fail, that being Northwood Mills. You have the list of insolvencies. Specialty Export, a 2007 insolvency, handled primarily organic products. Minnesota Grain went down in 2007. That too was a

processor. Sustainable Systems was a roving grain buyer. FYI on December 31, 2009 the PSC suspended the license of Organic Grain and Milling at Clyde, ND. That isn't on this list and let's hope it never is, but it is not a typical grain elevator.

If you look farther back through this list you will see problems primarily with processors or organic handlers, or specialty crop handlers. Northern Organic in 2003. North Central Elevator in 2003, another organic handler. Custom Processors in 2000, a processor of sunflowers I think. Viking Seeds, Goose River Feed. Spenst was a roving grain buyer, not a warehouse. Typical grain elevators have been chugging along quite well. Wimbledon Grain was a typical grain elevator that went down in 2002. But the bond was never called. There were losses on credit-sale contracts and that is the reason we have the credit-sale contract indemnity fund. Some grain assets were used to cover about 43% of those.

And so my primary message to you today is to please deal with the problem areas and not create a hardship or more expense for the normal grain elevators that have been doing okay. I can't promise you that one won't go down tomorrow, but the record is pretty good.

There's always risk in doing business with anyone. It can go the other way between grain elevators and farmers. I asked a grain elevator accountant friend of mine to randomly select some of his client elevators and tell me what their accounts receivables losses had been over ten years. He gave me numbers on 20 companies. From 1997 into 2009, 12 years, those writeoffs were an average of \$92,700 per elevator, which is \$7700 per year per elevator. Not all elevators sell ag inputs on which such losses might happen. But even if you took only 100 companies, that is \$770,000 per year.

You all have a copy of that list of possible changes that came up through the PSC meeting back in August. There was another meeting on December 15. Chairman Mueller was there. Consensus seemed to be that processors needed the most attention.

There was some discussion at that December meeting about basing the bond on bushel volume or handle instead of storage capacity. One of the State Representatives there said he thought the current method, basing the bond on capacity, makes sense when you consider what the bond is covering, which is stored grain and scale tickets or checks to cover either of those. The large volumes sold through credit-sale contracts are not under the bond but are under the credit-sale contract indemnity fund instead.

Let's be careful what we do so we don't create problems for existing successful businesses. Let's also be careful to not get our state bond requirements or costs so much higher than the federal system that grain elevators go there. Then if there is an insolvency our farmers will be going through the federal system in Kansas City rather than the state system in Bismarck.

I'll try to answer any questions you have.