IN THE SUPREME COURT

STATE OF NORTH DAKOTA

Supreme Court Case No.: 20080068
Bowman County District Court No.: 06-07-C-18-1
PSC Case No.: GE-07-99

PUBLIC SERVICE COMMISSION,

Petitioner and Appellee,

v.

MINNESOTA GRAIN, INC., AND
HARTFORD FIRE INSURANCE CO.,

Respondents and Appellees,

JIM BROTEN, ERIC BROTEN, AND BROTEN FARMS,

Appellants.

APPELLANTS' REPLY BRIEF

APPEAL FROM JANUARY 23, 2008 JUDGMENT ISSUED
BY JUDGE ALAN L. SCHMALENBERGER
BOWMAN COUNTY DISTRICT COURT

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I. N.D.C.C. ch. 60-04 is the Controlling Law that the Public Service Commission Must Follow in Administering the Estate of an Insolvent Grain Warehouseman

1. The Public Service Commission ("PSC") claims, at page 2 of its Brief, that Chapter 60-04 cannot be looked at in isolation in determining the valid claimants in an insolvency proceeding. Brotens do not claim that Chapter 60-04 should be looked at in isolation. Indeed, Brotens discussed the sections of Chapter 60-02 so heavily relied upon by the PSC in Brotens' prior brief, and acknowledged that selected language in that chapter was confusing when read with language in Chapter 60-04. *See* Appellant's Brief, pp. 16-19.

2. For instance, the PSC points to N.D.C.C. §60-02-09(3), which states that the bond filed by a warehousemen shall "run to the state of North Dakota for the benefit of all persons storing or selling grain in such warehouse." The PSC focuses on the last three words of this sentence, and ignores the legislative intent for the 1983 amendment to this provision. Brotens pointed out in their prior brief that this section was "amended to require the bond to run to persons storing or selling grain in such warehouse as well as to the State of North Dakota. This [amendment was intended to] allow individual receipt holders to sue the bonding company if the Commission fails to seek or is refused appointment as trustee of an insolvent warehousemen." *See* Appellant's Brief, p. 17 and App.195. The last three words of N.D.C.C. §60-02-09(3) do not control the meaning of "warehouseman" as defined in Chapter 60-04, and it is spurious to place too much significance on them in light of the aforementioned legislative intent.

3. The PSC repeatedly cherry-picks such language from Chapter 60-02, and proceeds to claim that because of the language referring to warehouses and the locations of warehouses in Chapter 60-02, the Court should adopt its interpretation of all provisions in both Chapter 60-02 and 60-04. Further, the PSC disregards other language that is not

helpful to its arguments. The PSC's analysis flies in the face of all rules of statutory interpretation.

4. For example, the PSC apparently maintains that scattered references to warehouses and locations of warehouses in Chapter 60-02 control the interpretation of the term "warehouse" in Chapter 60-04. It also apparently argues that the definition of the term "warehouseman" is not established by the clear statutory language in both Chapter 60-02 and 60-04, but rather is best defined by outdated laws it has dug out of the archives. The nature of the grain storage and grain trading industry has changed immensely in the years since the laws cited by the PSC. Regardless, the legislature made a very clear distinction between "public warehouse" and "public warehouseman" when it defined them separately in N.D.C.C. §60-02-01(5) and (6), and in N.D.C.C. §60-04-01(4) and (5). The PSC actually argues that under North Dakota law the term "warehouseman" means "warehouse." PSC Brief, p.19. Although it is "perfectly clear" to the PSC that laws from 1927 apparently trump the laws presently on the books in North Dakota, this is simply not the case. To argue that "when statutes in chapter 60-02 or chapter 60-04 use the term 'warehouseman,' the term means 'warehouse'" is ludicrous. *See* PSC Brief, p.15. This begs the all too obvious question: Why would the legislature then define them separately, and differently?

5. Hartford Fire Insurance Company ("Hartford") makes the argument that the bond amount is based upon the physical capacity of the Rhame facility as per N.D.A.C. §69-07-02-02, and this apparently supports its contention that bond coverage only extends to holders of receipts for that facility. *See* Hartford Brief, p. 7. Drawing such a conclusion not only contravenes the clear language of N.D.C.C. ch. 60-04, it is simply illogical in

light of the practices of grain warehouses in today's industry. Grain warehouses routinely trade in grain far in excess of their physical capacity. Whether it still makes sense to base bond amounts on warehouse capacity is beyond the scope of presently relevant issues, but it is certainly weak support to rely upon such basis for bond amounts when that capacity no longer has a meaningful connection to possible liabilities from grain merchandising.

6. The PSC also argues that the "definition of 'public warehouse' under N.D.C.C. §60-02-01(5) does not include a warehouse facility that is licensed as a warehouse facility by another licensing entity." *See* PSC Brief, p. 9. In support of this conclusion it offers the following premise: "For example, a facility licensed under the United States Warehouse Act...is specifically excluded." *See* PSC Brief, p. 9. This is an artfully employed logical fallacy. An example does not prove a conclusion. If the legislature wanted to say that the definition of public warehouse does not include a warehouse facility licensed *by another entity*, it would have said that. It did not. It specifically stated that is does not include a facility "licensed under the United States Warehouse Act." N.D.C.C. §60-02-01(5). It could have easily stated "or by another State" and it could have stated also that a public warehouseman, when used in chapter 60-02 and 60-04 means nothing more than a public warehouse. It did not.

7. In its most blatant attempt to rewrite the law, the PSC claims that the legislature, through all the amendments and changes in the law since statehood, has never thought to remove purportedly inapplicable language from the definition of "public warehouseman" in chapter 60-02 and 60-04. A public warehouseman is currently defined as a "person operating a public warehouse that is located *or doing business within this state.*"

N.D.C.C. §60-02-01(6), N.D.C.C. §60-04-01(5) (emphasis added). The PSC does not agree with this definition. It states, "The PSC assumes that the language was intended to cover transactions that now fall under the grain buyer laws, and the language, which now is inapplicable, was never removed from the law." PSC Brief, p. 18. Though it might lessen the administrative burdens of the PSC, a court is not at liberty to rewrite the clear language of North Dakota law based upon what the PSC assumes. The PSC also alleges that Brotens go into a "convoluted analysis" of the word "or". PSC Brief, p. 18. In interpreting a statute, words are to be understood in their ordinary sense. N.D.C.C. §1-02-02. This is not convoluted, it is fairly straightforward. As Brotens argued previously, a public warehouseman is a person who operates a facility that is "located or doing business within this state" and the PSC's argument that a warehouse must be located in the state for bond coverage makes this language nonsensical. It's assumption that the legislature must have forgotten to remove the language does not overcome the clear meaning of North Dakota law.

8. The PSC's interpretation that the phrase "or doing business in the state of North Dakota" is obsolete and "inapplicable" and that "warehouse" and "warehouseman" have the same meaning is not due any deference by this court because it flies in the face of the statutory scheme to provide protection for North Dakota producers and is contrary to the clear and unambiguous statutory language. *Compare,* North Dakota PSC v. Valley Farmers Bean Association, 365 N.W. 528, 547 (N.D. 1985) (PSC interpretation given "some weight" when it was consistent with public policy and statutory language).

9. As already noted, the Brotens concede that there is language in N.D.C.C. ch. 60-02 that is confusing when read with language in N.D.C.C. ch. 60-04. Brotens' arguments

are based on the language of the law, standards of interpretation, and on logical analysis. Brotens have attempted to address the confusing language, and have offered a reading of chapters 60-02 and 60-04 that gives both effect, and is in keeping with the clear legislative intent to create a remedial statute with chapter 60-04. Brotens do not base their arguments on assumptions and laws from the early 1900s.

II. The Court Should Not be Misled by Mischaracterizations of Brotens' Arguments

10. The PSC claims that under "Brotens' theory, if a company has a warehouse licensed and bonded anywhere in North Dakota, the bond covers sales by North Dakota farmers to grain warehouses owned or operated by the company wherever those facilities are located, whether in Minnesota, South Dakota, Montana, Wisconsin, or anywhere in the world." PSC Brief, p.6. The PSC successfully knocks its straw man down, noting that such expansive bond coverage "is not the purpose of North Dakota law." Brotens do not claim, however, that a bond would cover a warehouse owned by a North Dakota warehousemen if that warehouse were located anywhere in the world, nor does Brotens' theory necessitate such an absurd result. As Broten has explained at length, N.D.C.C. §60-04-03.1 establishes a trust for receiptholders of an insolvent warehouseman, and the coverage of that trust extends to a facility that does business in North Dakota with North Dakota producers who present claims and where the facility is owned and operated by the insolvent licensed North Dakota warehouseman. A facility on the border of Minnesota and North Dakota in a larger city like East Grand Forks is in a unique position to be owned and operated by a North Dakota warehouseman and to do business in North Dakota. A warehouse located "anywhere in the world" would have little reason or incentive to do business in North Dakota. If it is not doing business in North Dakota, it

would not be covered by the trust of an insolvent North Dakota warehouseman, even if owned by one. Thus, the PSC's straw man does little to resolve the dispute at issue. Brotens do not contend that a warehouse owned by an insolvent North Dakota warehouseman is covered by the trust regardless of its location. The crucial consideration is whether it is doing business in North Dakota, and thus subjecting North Dakota's farmers to possible losses as a result of its insolvency.

11. The PSC also contends that because it has no authority to license public warehouses located in another state, the trust therefore could never cover a warehouse in another state doing business in North Dakota and owned by an insolvent North Dakota warehouseman. It also argues that the Brotens' claim "fails because they sold their grain to a warehouse that was not licensed and bonded to purchase grain in North Dakota." PSC Brief, p.17. This argument is a non sequitur. If a warehouseman runs a warehouse in North Dakota, and allows the license to lapse and then becomes insolvent, the trust would still cover "receiptholders of the insolvent warehouseman." N.D.C.C. §60-04-03.1. The facility would not have been licensed, technically, but the receiptholders of that warehouseman would certainly be covered. The same is true under the facts of this case. The PSC claims that "[i]n order to do business within the state of North Dakota, a facility must be licensed and bonded." PSC Brief, p.15. The PSC may prefer form over substance, but to make this claim is to stick its head in the sand. Clearly Minnesota Grain, an insolvent North Dakota warehouseman, was doing business in North Dakota via its EGF facility. Toying with semantics does not change the reality of the situation.

12. The PSC attempts to characterize the facts as if grain was "sold to" an out of state facility, and as if there were "purchases of grain by [an] out-of-state grain warehouse."

PSC Brief, p. 2, p. 5. As indicated in Jim Broten's affidavit, Minnesota Grain reached out to Brotens, solicited the sales from Jim Broten, and initially hauled the grain itself from the Brotens' farm, and later hired the Brotens to haul the grain for Minnesota Grain. This is not simply a case of a farmer delivering grain to another state. Minnesota Grain was very clearly doing a significant amount of business in North Dakota with the Brotens.

III. Minnesota Grain Inc. Violated North Dakota Law by Operating as an Unlicensed Grain Buyer and As A Result, the Bond Conditions Are Triggered

13. All three briefs filed in opposition to the Brotens argue that Brotens' sales neither fell under the protection of N.D.C.C. Chapters 60-02 and 60-04 nor the protections of the bond because the Broten sales were not sales that occurred "in North Dakota" but rather were "Minnesota transactions." The (false) implication of these briefs is that Jim Broten on his own initiative hauled the barley to Minnesota and sold it there. Based on this flawed understanding, the three briefs conclude that Brotens' barley transactions were not entitled to any type of protection of the bond.

14. The PSC acknowledges at page 9 of its Brief that Minnesota Grain could have been licensed and bonded in North Dakota as a roving grain buyer under chapter 60-02.1, but states that it had neither applied nor had been licensed. (The PSC also points out that a number of other entities, such as Archer-Daniels-Midland and Cargill Incorporated were licensed both as facility based grain warehouses and roving grain buyers licensed to buy grain in North Dakota for shipment out of state.) Having pointed out that Minnesota Grain did not have a roving grain buyers license and having pointed out that the Brotens' receipts do not have the word "Rhame" on them, the PSC and its allies do not consider the necessary consequences of this Minnesota transaction analysis.

15. The Bond is on a form drafted by and required by the Public Service Commission as a condition of licensure. (App. 125) The bond states "The condition of this obligation [to pay $100,000] is as follows: "If the PRINCIPAL [Minnesota Grain, Inc.] shall (1) faithfully perform all duties as a public warehouseman, (2) comply with the provisions of law and rules of the North Dakota Public Service Commission (Commission) relating to the storage and purchase of grain by a warehouseman, and (3) pay for all grain purchased and all sums for which the PRINCIPAL shall become liable to the holders of receipts, then this obligation shall be void, otherwise it shall remain in effect, provided, however, that this surety bond shall not accrue to the benefit of any person entering into a credit-sale contract with the PRINCIPAL." It should be noted that the bond broadly requires compliance by the Principal with North Dakota laws and payment for grain purchased in North Dakota by the Principal.

16. While all of the three briefs devote considerable space to urging that the Brotens' sales do not fall under the protections of Chapters 60-04 because they are asserted to be "Minnesota transactions", none of the three briefs discusses the necessary and consequential legal conclusions that flow from exclusion from the protection of Chapters 60-02 and 60-04.

17. The Minnesota transaction analysis (that none of the laws of North Dakota apply) is wholly inconsistent with the laws of this state. The laws passed by the North Dakota legislature are intended to provide broad and encompassing protection for North Dakota farmers. *See, e.g.*, N.D.C.C. §60-02-03; §60-02.1-03. For example, it is not necessary that a grain buyer have a facility in North Dakota to fall under the laws of the state of North Dakota. This is made perfectly clear by N.D.C.C. §60-02.1-07.1 ("Roving grain

buyers that purchase, solicit, merchandise or take possession of grain in this state must obtain an annual license from the commission ... ." The phrase "or doing business in the state of North Dakota" that appears in N.D.C.C. §60-04-01(5) is to the same effect.

18. The evidence in the record of this case shows that Minnesota Grain solicited, purchased and took actual and constructive possession of Brotens' grain in North Dakota. *See* Jim Broten's Affidavit, Docket No.21. It is important to emphasize that --contrary to the innuendo and implication and false statements in the opposition briefs -- Broten did not load up trucks and drive toward Minnesota in search of a buyer. Rather, Minnesota Grain, Inc. sought him out by calls to Broten's Dazey farm where all negotiations of the sales occurred. Id.

19. In support of the Affidavit, Brotens submitted extensive legal argument that use of standard choice of law principles and "significant contacts" analysis mandated that North Dakota law, not Minnesota law, governed these transactions. *See*, Docket No. 19, Brotens' August 7, 2007 Objection to Approval and Adoption of Report and Recommendation of Trustee and Brief In Support of Objection, *passim*, and in particular, pp.7-10 (arguing that standard choice of law principles required application of North Dakota law) and pp.10-14 (arguing that Minnesota Grain Inc. was either acting under the umbrella of its North Dakota warehouse license, or was buying illegally as an unlicensed roving grain buyer, but that the bond was in either case triggered.)

20. The PSC urges the Supreme Court to give little or no credence to Jim Broten's Affidavit regarding the circumstances of the sales Brotens made to Minnesota Grain on the sketchy basis that there was no cross examination of Jim Broten at the trial court. *See* Appellees Brief, p.1. Brotens concede that the PSC did not interview Jim Broten

regarding the circumstances of the sales at either the trial court or during the pendency of the insolvency proceeding. The blame for this failure rests entirely with the PSC. Jim Broten was at the trial court in person and did his utmost to bring the facts on the sales in question to the attention of the trial court. Broten specifically requested that the trial court reject the "Minnesota transaction" analysis of the PSC and remand for further investigation. Rather than agreeing to the remand or affirmatively agreeing to have the court consider these arguments, the PSC obdurately opposed any change to its initial Report, and consistently refused to consider the information in Broten's Affidavit in any meaningful way. When a regulatory agency refuses to conduct any type of meaningful analysis of a victim's claims, it should not blame the victim for its own failures.

21. Here, Minnesota Grain, acting either as a warehouseman "doing business in North Dakota" or as an illegal and unlicensed roving grain buyer (which is the natural consequence of the Minnesota transaction position taken by the PSC, Hartford and the NDGDA), plainly failed to meet the second and third requirements of the bond.

22. As this court has previously stated, "a warehouseman's bond, unlike an insurance policy, secures the obligations of the warehouseman and is conditioned on the warehouseman's faithful performance of his duties and compliance with the provisions of law and the rules and regulations relating to the storage and purchase of grain." North Dakota Pub. Serv. Comm'n v. Valley Farmers Bean Ass'n., 365 N.W.2d at 547 (N.D. 1985). Here, the terms of the bond were breached as to Brotens.

IV. Public Policy Favors Brotens

23. The NDGDA (who sells bonds to many of its members) and Hartford assert that if Brotens prevail in this case that bond costs will go up, warehouses will fail, and insurance

companies will face unanticipated risks. These concerns are vastly overstated. The risks can be adjusted at the end of the current one year bond term which uniformly expire each year as of June 30.

24. If the cost of a $100,000 bond is proportionate to the cost of a $500,000 bond identified in the NDGDA Brief at p.11, the annual cost of $100,000 in coverage for the storage capacity of a warehouse is only $800 a year. When one compares the scale of the elevator insolvency loss that have been suffered by North Dakota producers in recent years and may be potentially suffered in future years, this cost is not unreasonable and would still be reasonable if it were doubled or tripled.

25. The dire predictions of elevator failure by NDGDA that would arise if bond payment was triggered by illegal purchasing activity of warehousemen such as occurred here appears to be significantly overblown unless such actions are common – in which case the protection is all the more necessary. As this court has pointed out, "'To permit the surety to take advantage of the failure of the warehouseman to do what the law compels him to due would permit a surety to profit by its principal's wrong.'" North Dakota Pub. Serv. Comm'n v. Valley Farmers Bean Ass'n., 365 N.W.2d at 548 (quoting Farmers Elevator Mutual Insurance Company v. Jewett, 394 F.2d 896, 900 (10th Cir. 1968). Indeed, unless an elevator is already at the brink of insolvency, purchase of a bond to cover all violations of law (not just some violations) by the warehouseman should not be a barrier to licensure.

26. In any event, the bond on a warehouse is set by the legislature based only on the storage capacity of a warehouse, even though that warehouse can merchandise grain in any amount. Simply put, the bond is not based in whole or in part on a warehouseman's

grain buying activity. The ramifications of the Court's decision in Brotens' case on the overall bonding of warehouses should have minimal negative effect. To the contrary a decision in Brotens' favor will result in salutary changes to the administration of the law for the protection of producers in North Dakota in keeping with the statutory objections of the laws governing grain sales.

27. The PSC argues as well that protection for "valid" receiptholders will be diluted if Brotens and similarly situated persons were to be provided protection by the trustee and become eligible for payment from the trust. The duty of the trustee certainly does not extend to representation of any and all claimants (e.g., the creditor banks in Valley Farmers Bean), but here the Brotens fall squarely into the class of persons that the North Dakota grain laws are intended to protect. Brotens are North Dakota producers who have not been paid for grain sold to the warehouseman who is the principal on the bond and who has done business with them in North Dakota. Brotens admit the bond (whether it be $100,000 or $200,000) is inadequate to pay all of the affected claimants. The PSC should not seek to exclude categories of claimants so other categories of claimants or creditors can have a higher recovery (as the PSC attempted to do in Wimbledon and here) but rather the PSC should ask the legislature to seek better bond or indemnity fund coverage for all producers.[1] At a minimum, the PSC should begin to review the financial soundness of grain buyers as an integral part of licensing. Further, the PSC should take prompt corrective action upon hearing of illegal grain buying in North Dakota by out-of-state buyers and of slow or non-payment of North Dakota producers by licensed

[1] The credit-sale customers received 80% of their claims, up to a maximum of $250,000 pursuant to statutory reforms adopted as a result of the Wimbledon litigation.

warehousemen and grain buyers instead of ignoring warning signs of insolvency until a catastrophic failure occurs.

CONCLUSION

28. N.D.C.C. ch. 60-04 controls these insolvency proceedings, and the PSC erred by rejecting Brotens' claims as ineligible Minnesota transactions. Brotens are receiptholders of the insolvent warehousemen, Minnesota Grain, and as such are entitled to payment of their claims. Further, the bond amount should be aggregated for each license period within which there was a loss, for a total bond amount of $200,000.00.

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Dated this 10th day of June, 2008.

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The following document was electronically served on this date to John J. McDonald and Joel Wiegert of Meagher & Geer, P.L.L.P. at jwiegert@meagher.com and William W. Binek at wbinek@nd.gov, and Gary R. Wolberg at gwolberg@flecklaw.com.

APPELLANTS' REPLY BRIEF

The above-noted document was also served by U.S. Mail on this date to:

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