Testimony of Randal E. Melvin

Public Policy Committee Chairman

North Dakota Corn Growers Association

Before the

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Licensing

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Good Afternoon Chairman Kalk, and Commissioners Christmann and Fedorchak. My name is Randy Melvin. I am a fourth generation farmer from Buffalo, North Dakota in Cass County. I currently serve as the public policy committee chairman for the North Dakota Corn Growers Association, which represents over 1,300 members across our state. I appreciate the opportunity to give input on behalf of our organization as to why changes to our bonding laws are necessary.

The North Dakota Corn Growers Association supports improvements to our bonding laws in order to better protect farmers in the case of financial defaults. On August 21, 2009 the Corn Growers and a number of other organizations submitted testimony on the structure of bond levels in North Dakota. At that point in time the Corn Growers were convinced that our capacity based system of bonds was outdated. We stated in a letter dated September 30, 2009 that the commission should consider <u>financial value</u> vs. physical storage capacity as a mechanism for issuing bonds. There were no changes that came out of the 2009 hearings.

In 2013-14 we co-funded a study along with the North Dakota Soybean Growers Association and the US Durum Growers Association. This study by Dr. William Wilson and Bruce Dahl of the Department of Agribusiness and Applied Economics at North Dakota State University entitled "Risk Exposure of Financial Failure for North Dakota Grain Handling" was concluded in October of 2014. The report documents the risks to growers and the mechanisms used to mitigate risks related to buyer default. Along with our testimony here today, we wish to place a copy of this report into the public record.

The report contains five sections, with recommendations on page 24. Dr. Wilson compiled a detailed analysis of mechanisms our state and others offer to protect farmers. At the heart of the matter is market volatility. Dr. Wilson's work suggests that volatility (as conventionally measured) has increased from about .18 in the early 1980's to about .4 or more in recent years. This increase is due to a change in commodity price levels, and the increased cost and value of inputs (notably fertilizer). Other key points in the study are an evaluation of how volumes handled by individual shippers have increased, and a simulation model (or stress test) ranking the most-to-least important factors that would contribute to financial stresses. In 2000-01, 100 car shippers were 9% of total grain handling capacity. In 2012-13, these facilities accounted for 44% of total grain capacity. Clearly we have seen more concentration in the last 12 year period.

Rather than reading the report in its entirety, I would like to focus on the recommendations on page 24 and summarize them.

Recommendations for further review and/or analysis: The purpose of this study was to identify the changes in relevant risks that confront grain and oilseed producers in North Dakota and to assess the adequacy of mechanisms designed to mitigate these risks. The intent was not to prescribe specific changes but, rather, to identify those areas worthy of consideration for legislative changes to assure protections for growers. It appears that the most important considerations for North Dakota include:

1) Increasing the maximum payment from the indemnity fund. Currently, the fund pays 80% of the claims, up to a maximum of $280,000 per producer.

   Given the increase in producer size, production and market volatility, this value is probably inadequate. Indeed, given current market parameters, the maximum would have to increase to provide equivalent coverage as originally intended by this mechanism.

Allow me to add to this point: In 1991, estimated gross receipts per farm were $100,000. In 2012, that number was $803,351.

2) There are several recent insolvencies that could potentially lower the Indemnity fund balance to near $3.6 million, which is much less than earlier minimum levels at which assessments would be re-imposed.

3) Re-evaluating the structure of the mechanisms. Alternatives include considering
   - Value of the commodity. Currently, the mechanisms in North Dakota are based on storage capacity (or sales).
   - Whether to use indemnity funds or bonding, or to use both. Currently, North Dakota is one of the few states that uses both methods.
   - Adding net worth requirements. Typically, minimum net worth requirements are imposed and an additional bond is required to make up the difference for shortfalls.

- The relationships between claims and indemnity fund min/max suggest that, if average payouts for claims increase, then minimums and maximums for the indemnity fund would likely need to increase to be consistent with other states.

4) Dry beans: This crop has greater risks than other crops. Other states' bonding requirements for dry beans are much greater than those in North Dakota.

In conclusion, the North Dakota Corn Growers Association will go on record as supporting a thorough review of North Dakota's current bonding structure. We view the study "Risk Exposure of Financial Failure for North Dakota Grain Handling" as good analysis. We believe this will help enhance the dialogue for the Public Service Commission to make the most beneficial changes. We thank the Commission for your attention to the issue of improving farmer protections. I would be happy to answer any questions but would defer any technical questions on this study to Dr. William Wilson to accurately answer.