

# NORTH DAKOTA LEGISLATIVE MANAGEMENT

## Minutes of the

### AGRICULTURE COMMITTEE

Tuesday and Wednesday, January 12-13, 2010

Northern Crops Institute  
North Dakota State University  
Fargo, North Dakota

Representative Phillip Mueller, Chairman, called the meeting to order at 9:00 a.m.

**Members present:** Representatives Phillip Mueller, Mike Brandenburg, Curt Hofstad, Richard Holman, Dennis Johnson, Joyce M. Kingsbury, Shirley Meyer, Gerry Uglem, Benjamin A. Vig, John D. Wall; Senators Arthur H. Behm, Bill Bowman, Tim Flakoll, Terry L. Jacobs, Curtis Olafson, Terry M. Wanzek, John Warner

**Members absent:** Representatives Mary Ekstrom, Rod Froelich, Keith Kempenich

**Others present:** Matthew M. Klein, State Representative, Minot

Representative David Monson, member of the Legislative Management, was also in attendance.

See [Appendix A](#) for additional persons present.

**It was moved by Representative Brandenburg, seconded by Senator Bowman, and carried on a voice vote that the minutes of the previous meeting be approved as distributed.**

Chairman Mueller said Representative Monson would be joining the committee in his capacity as a member of the Legislative Management.

With the permission of Chairman Mueller, Mr. Brian Sorenson, Director, Northern Crops Institute, welcomed the committee members and guests. He said the annual update of activities at the Northern Crops Institute will be available shortly.

#### GRAIN DISCOUNTS

At the request of Chairman Mueller, Mr. Neal Fisher, Administrator, Wheat Commission, presented testimony regarding grain discounts. Mr. Fisher distributed a document entitled *U.S. Hard Red Spring Wheat*. The document is on file in the Legislative Council office. He said North Dakota has very high-quality hard red spring wheat. He said the growth has been seen in the market and in production. He said if a producer applies nitrogen it will be used by the plant to produce greater yield or greater protein levels. He said the end result is an either-or. He said this year there was a 25 percent to 30 percent increase in yield. However, he said, the protein level was more than one percentage point below average.

Mr. Fisher said this year was an exception. He said the crop was much more like a hard red winter wheat. He said in Kansas the industry refers to generic wheat. He said Kansans do not reflect protein

in the price. He said producers are paid the elevator average.

Mr. Fisher said wheat markets are complex. He said the demand is driven by the end users. He said many customers are premium customers and demand high quality. However, he said, the customers are not willing to pay premium prices for wheat that does not quite meet their expectations.

Mr. Fisher said when wheat was selling for \$10 a bushel, those in the baking industry wanted the government to do something about it. He said the wheat growers tried to dissuade the bakers from pursuing their goal. He said the market is self-correcting. He said if prices are high, producers will grow more wheat. He said reactions that call for regulation of market prices can cause more problems on the other end of the spectrum.

Mr. Fisher said elevator discounts are largely dependent on the protein level in the area from which the elevators obtain wheat and where the wheat subsequently can be sold.

In response to a question from Representative Johnson, Mr. Fisher said he too is hearing that producers are looking at opportunities to plant soybeans next season rather than wheat. He said he expects that the wheat crop might be down as much as 14 percent. He said producers have to look at costs and benefits in making their crop decisions.

Senator Olafson said producers profited very nicely when there were high yields and high prices. He commended the Wheat Commission for encouraging wheat purchasers to stay with North Dakota producers.

At the request of Chairman Mueller, Mr. Steve Strege, Executive Vice President, North Dakota Grain Dealers Association, Fargo, presented testimony ([Appendix B](#)) regarding grain discounts. Mr. Strege said elevators typically blend to get the most value out of the protein they have. He said one can blend 15 percent or 16 percent proteins with 12 percent and 13 percent proteins to make 14 percent protein wheat. However, he said, if there are 10 bushels of lower protein wheat for every 1 bushel of higher protein wheat, the desired result will not be achieved. He said that is exactly what happened in the 2009 growing season.

Senator Wanzek said some of the problem stems from grain that was forward contracted. He said this

grain had to be delivered at the time specified and was therefore subject to the market at that point.

Mr. Strege said the discount is usually the market rate at the time of delivery.

In response to a question from Representative Mueller, Mr. Strege said the price per bushel can be locked but not the discounts.

Representative Hofstad said the discounts do not seem to balance the premiums.

Mr. Strege said that too is a function of the market. He said it all depends on what can be blended for sale.

Mr. Paul Coppin, Manager, Reynolds United Cooperative, Reynolds, said right now there is not an equal amount of high- and low-protein wheat. Mr. Coppin said most of what he has in his elevator is low-protein wheat.

In response to a question from Representative Mueller, Mr. Coppin said Reynolds United Cooperative is a country elevator. He said it stores wheat for farmers. He said the discount is set when the farmer comes in, pays his storage contract, and sells the wheat.

Representative Meyer said some producers believe that the results of protein tests vary according to the needs of the elevator and the needs of the market. She said there is a certain amount of trust involved in this process.

Mr. Coppin said an elevator manager can rely only on the manager's reputation. He said if the producers are not treated fairly, the producers will haul their wheat elsewhere.

Mr. Strege said the North Dakota Century Code provides a procedure for the resolution of disputes governing things such as protein levels. He said 400 elevators in this state handle 500,000,000 to 700,000,000 bushels a year. He said the number of complaints amount to a mere handful.

In response to a question from Representative Johnson, Mr. David Fiebiger, Manager, Finley Farmers Grain and Elevator Company, Finley, said he worked in Kansas in 2003. Mr. Fiebiger said some Kansas elevators literally consider wheat to be wheat. He said there were only a few elevators that took the time to segregate wheat according to protein levels so the wheat could be sold at a higher price. He said in Kansas there is very little onfarm storage. He said wheat goes from the fields to the elevator and to the terminal very quickly.

Senator Behm said elevators need to make a profit in order to exist.

In response to a question from Senator Flakoll, Mr. Strege said cooperatives have an annual meeting and anyone can ask to see the balance sheets.

Mr. Coppin said elevator margins can range from 10 cents to 25 cents depending on the year. He said margins are traditionally about 20 cents per bushel. He said the margin is affected by things such as transportation.

Mr. Strege said the margins referred to by Mr. Coppin are gross. He said the risks that the

elevators take are so much greater than they were in the past.

Senator Wanzek said the commodity markets are very complex and are often affected by things like the value of the dollar.

Mr. Coppin said elevators can set the premiums as high as they want. He said if there is not any high-protein wheat in the area, the price on the board does not matter.

In response to a question from Representative Monson, Mr. Coppin said he believes that 14 percent will be the standard protein measure for a very long time.

Mr. Fisher said Japan is definitely a 14 percent protein demand market. He said there is very little variation. He said that volume of interest is in part causing the market reaction.

At the request of Chairman Mueller, Mr. Vance Taylor, General Manager, Mill and Elevator, Grand Forks, presented testimony ([Appendix C](#)) regarding grain discounts. Mr. Taylor said he believes that in the future protein discounts will be even more volatile in large part because of the quality requirement established by customers. He said one need look only to an entity such as McDonald's. He said the consistency of their buns is unquestioned. He said in order to ensure that consistency, McDonald's wants the same quality flour every time.

Senator Wanzek said any minor variation can throw off efficiency on a high-volume line.

Mr. Taylor said that is correct. He said the variations may not be based solely on protein. He said there may also be considerations with respect to moisture consistency.

Mr. Taylor said 300 different types of flour are blended at the state Mill and Elevator.

Mr. Fisher said in the milling process 1 percent protein is lost because it is not separable from the bran layer.

## THE USE OF BYPRODUCTS FROM BIOFUELS PRODUCTION AS A FEEDSTOCK

Chairman Mueller said a memorandum entitled [Development of Livestock Feeding Facilities and the Use of Byproducts From Biofuels Production as a Feedstock - Background Memorandum](#) has been distributed.

At the request of Chairman Mueller, Mr. Steven Edwardson, Executive Administrator, North Dakota Barley Council, Fargo, and Dr. Vern Anderson, Animal Scientist, Carrington Research Extension Center, Carrington, presented testimony regarding the use of byproducts from biofuels production as a feedstock.

Mr. Edwardson said this presentation will address the North Dakota superfeed project. He said North Dakota has a lot of value-added processing facilities. He said the Mill and Elevator in Grand Forks produces wheat middlings. He said the sunflower pressing plant in Enderlin produces meal. He said Red Trail

Energy in Richardton produces distillers grains. He said the coproducts are going to be targeted primarily toward ruminant feeds. He said each of the products has physical and nutritional issues that can be improved and ultimately result in nutrient-dense feeds for the enhancement of livestock performance.

Dr. Anderson said there is high variability in the price of commodities over the course of a year. He said this is an effort to try and stabilize some of that value and add value beyond that. He said it is recognized that if they create a new superfeed, they will not be competing with the dairies and the feedlots that currently buy individual feeding ingredients from the manufacturing plants. He said they are looking at new markets that are far away. He said most of these products are very high in fiber and that results in the main focus of ruminant feed. He said there is not the same opportunity to look at poultry or swine feed. He said he believes there are opportunities to market superfeed regionally, nationally, and internationally.

Dr. Anderson said there are a number of advantages to a superfeed. He said these include broader market opportunities, improved storability, improved handling characteristics, greater bulk density, increased palatability, improved feed safety, flexibility in manufacturing the product with respect to its shape and formulations, convenience, and simplified animal nutrition.

Dr. Anderson said given the amount of coproducts produced in North Dakota during the course of a year, there is no way that all of it can be used in the state as feed. He said the number of livestock in the state would have to be multiplied by a factor of 10 in order to use all the feedstock being produced in this state.

Mr. Edwardson said the Central Dakota Feeds Initiative in Carrington is a collaborative effort that includes the Carrington Research Extension Center, the Carrington Job Development Authority, Forward Devils Lake Development Corporation, various agricultural commodity organizations, local and regional economic developers, private feed manufacturers, and the North Dakota Department of Agriculture.

Mr. Edwardson said projects like this bring a certain degree of complexity. He said the first step was to quantify the coproducts, and the second step was to identify coproduct combinations that work. He said they also had to determine the efficacy of the superfeed and to evaluate market potential in terms of local, domestic, and international markets. He said a project such as this creates a lot of data that needs to be managed. He said there also are discussions about site-specific feasibility and whether existing sites could be reconfigured or new sites would have to be constructed. He said there are also elements of education and promotion that are part of the superfeed project.

Dr. Anderson said one of the issues to be overcome is the inconsistencies in the supply of the products. Therefore, he said, they have worked with a variety of feed combinations. He said these include

barley, canola meal, and distillers grains. He said another combination includes field peas, wheat middlings, and distillers grains. He said they have found that field peas, when used in combination with other products, make a very palatable feed. He said they also have found that putting field peas in the diet for steers during their final three months makes the ribeyes much juicier and more tender. He said the superfeed project ultimately could result in a product that serves to tenderize beef. He said no feed created to this point has managed to change the texture and tenderness of beef. He said he does not know why field peas appear to do this. He said they have not found the metabolic pathway or the component of field peas that results in the increased tenderness. He said the research done at Carrington with respect to this issue was duplicated by Nebraska with the same end result.

Dr. Anderson said it is not hard to envision the complexity that comes with trying to determine which products to mix and match. He said distillers grains are part of every combination. He said distillers grains provide the bypass protein that is critical to rations for beef steers and lactating dairy cows. He said they have found that cattle can be fed a complete coproduct diet and achieve the same results as cattle that have been fed 60 percent corn. Next, he said, they will explore using the coproduct at a higher level. He said this would allow the capturing of more value from the coproducts and allow the corn to be used for ethanol production.

Dr. Anderson said his role in this project is to conduct the research and determine whether this is a valid opportunity to create feed. He said the team that has been assembled to assist in the research is focused on several species.

Mr. Edwardson said nutritional testing is absolutely critical to the ultimate sale of the product. He said they need to be able to quantify what the product will in fact do. He said that provides the opportunity to determine the product's market potential.

Mr. Edwardson said one of the greatest challenges has been to organize and manage the significant amount of data that is generated through research. He said the data includes the cost of coproducts, grains, transportation, and manufacturing. He said there is also all of the nutritional data. He said the data needs to be managed in order to allow an evaluation of the superfeed's feasibility for a business, a location, or even a producer. He said those results are necessary for business plan implementation. He said a computer model has been developed to integrate the data and evaluate potential business opportunities.

Dr. Anderson said coproduct development and manufacturing could benefit North Dakota communities through the expansion of existing companies or the development of new feed plants. He said current communities of interest that have been identified by the Central Dakota Feeds Initiative include Carrington, Devils Lake, Jamestown, Leeds,

Minot, New Rockford, Velva, Wahpeton, and East Grand Forks. He said economic developers, feed manufacturers, and livestock nutritionists have to come together to determine the potential of such a project.

Dr. Anderson said a number of the potential sites are along railroads in North Dakota. He said in terms of transportation efficiency, one of those towns on a railroad line or close to one might provide the best opportunity for the development of a new plant. In addition, he said, it is important to determine where the final product will go. He said whether the product will go north to Canada or into Montana or to California dairies will make a difference in the location of a plant.

Mr. Edwardson said the Central Dakota Feeds Initiative is the umbrella for adding value through manufacturing of combinatorial nutrient-dense feeds. He said the participants have been meeting quarterly since mid-2008.

With the permission of Chairman Mueller, Mr. Don Frye, Mayor, city of Carrington, presented testimony regarding the Central Dakota Feeds Initiative. Mr. Frye said he is a professional economic developer. He said with respect to a project such as the Central Dakota Feeds Initiative, it is important to get all necessary players involved and equally important for everyone to understand that this is not a competition. He said they should not be fighting over locations. He said the idea is to do what is best for the state of North Dakota. He said in fact, there might ultimately be multiple locations.

In response to a question from Senator Flakoll, Mr. Frye said they have to be sure that they do not try to tackle too much too quickly. He said that is why to date they have focused only on animal feed and not extended the project to human nutrition.

In response to a question from Representative Meyer, Dr. Anderson said the protocol involves keeping the base level the same coproduct mix. He said the protocol provides the necessary data for critical review and provides a good statistical analysis. He said the animal's weight gain is measured as is feed intake and feed efficiency. He said they also look at the carcasses and the carcass traits and may even go through a taste panel evaluation.

Senator Olafson said one of the major problems he sees going into the future is the current beef grading system. He said the premium product today is that which is most loaded up with intermuscular fat. He said we are trying to sell that product to people who are concerned about their cholesterol levels and their overall health. He said consumer tastes can be addressed by the age of the animal and the diet of the animal.

Dr. Anderson said we know that what an animal is fed can affect the tenderness of the meat. He said we have the potential to provide a premium North Dakota product that guarantees both taste and tenderness.

Senator Bowman said as this project is moving forward there needs to be a recognition that the

efficiencies being advocated must be profitable for a producer. He said you may have a product that produces great results but if the profit factor is not there you will lose all the benefits and the involvement of the producers.

Senator Bowman said finding valid and reliable information about the genetic base of the cattle being fed is every bit as important as having valid and reliable information about the products that the cattle are fed.

Dr. Anderson said the economic viability of the feed is a very significant part of the database that is being put together. He said the goal is to create the most nutrition for the least amount of money. He said with respect to Senator Bowman's comment regarding genetics, the new facility on campus will allow them to conduct individual animal feed efficiencies. He said only in the last two years to three years has feed efficiency been addressed by the industry. He said right now virtually all the cattle that they have access to for research purposes are normal cross-bred feeder cattle. He said the feed efficiencies of individual sires need to be explored and we need to propagate those cattle. He said using DNA markers to determine feed efficiency is a new concept and will be incorporated in the coming months.

Mr. Edwardson said this is an integrated effort. He said if you address livestock nutrition, you have to verify the efficacy. He said if you have a lot of data, you have to be able to manage all of it. He said you also have to be able to market, educate, and promote. He said you have to be able to integrate the products through appropriate manufacturing. He said you have to be able to consider the costs of the product, transportation, integration, and location. He said all of this has to be integrated into a site-specific business plan in order to determine whether this is a profitable feed product and a viable product to bring into a feeding operation.

Mr. Edwardson said in the future they hope to identify additional superfeed combinations. In addition, he said, they hope to test the efficacy of additional feed combinations. He said they also are at that point where they are about ready to see how they do with some site-specific business plans.

Dr. Anderson said to date they have had discussions with Cenex Harvest States and Cargill about the concept.

In response to a question from Representative Mueller, Dr. Anderson said he prefers to refer to coproducts rather than byproducts. He said the term "coproduct" indicates a greater value than the term "byproduct." He said all of the individual components have a tremendous amount of value on their own. He said mixing and matching them increase the value.

In response to a question from Representative Mueller, Dr. Anderson said North Dakota is unique in that it has a greater variety of coproducts available for use than do other states. He said he is unaware of anybody who is doing anything similar to the initiative discussed today or even for that matter considering it.

In response to a question from Representative Mueller, Mr. Frye said by the end of 2010 they would like to have a completed document that justifies their efforts. He said the document would be a business plan that then could be implemented. He said the document will include a decision on the necessary facilities. He said this has been a long process, but from the start, they emphasized the need to do it correctly.

In response to a question from Representative Wall, Dr. Anderson said every bushel of corn entering an ethanol plant produces 18 pounds of distillers grain on a dry basis. He said we use very little of that in North Dakota.

Senator Olafson said North Dakota has some of the best cattle genetics in the world. He said we have the kind of genetics here that will lead the industry forward. He said perhaps there is something that the Legislative Assembly could do during the 2011 session to facilitate the work that is being done.

Mr. Edwardson and Dr. Anderson distributed a folder containing various documents governing coproduct integration and alternative feeds for ruminants. The folder is on file in the Legislative Council office.

## **BONDING REQUIREMENTS FOR GRAIN WAREHOUSES AND BUYERS**

Chairman Mueller said a memorandum entitled [\*Bonding Requirements Placed on Grain Warehouses and Buyers - Background Memorandum\*](#) has been distributed.

At the request of Chairman Mueller, Mr. Tony Clark, Public Service Commissioner, presented testimony ([Appendix D](#)) regarding bonding requirements that are placed on grain warehouses and buyers, including ethanol plants and grain processors. Commissioner Clark said during the summer of 2008 the Public Service Commission convened a working group of agriculture industry stakeholders to discuss the manner in which the state licenses grain elevators and grain buyers and to discuss whether the protections offered to farmers should be altered in response to volatile market conditions.

Commissioner Clark distributed a document entitled *License Types & Bonds* ([Appendix E](#)). He said the traditional license is a public grain warehouse license. He said the required bond is based on the physical capacity of the elevator and has a minimum requirement of \$50,000 and a maximum requirement of \$1.5 million. He said the second type of license is a facility-based grain buyer license. He said this is only issued in conjunction with a federal license. He said the federal government gives grain warehouses the option of being licensed federally. He said if there is a federal license for warehousing activities, a farmer's cash sale transactions are not covered. He said the state-created facility-based grain buyer license then covers the cash transactions. He said the bond for

that license is based on a three-year rolling average. He said the minimum is \$50,000 and the maximum is \$1 million. He said the final license is a roving grain buyer license. He said that is applicable when there is no facility. He said that too is based on a three-year average of grain purchases. He said it has a \$50,000 minimum and a \$1.5 million maximum.

Commissioner Clark distributed a document entitled *Grain Buyer's License Fee and Bond Schedule* ([Appendix F](#)). He said this bond schedule is applicable to facility-based grain buyers and roving grain buyers. He said it shows the amount of grain handled and the minimum bond required for such licensure types.

Commissioner Clark distributed a document entitled *Grain Warehouseman's License Fee and Bond Schedule* ([Appendix G](#)). He said this is the bond schedule for grain warehouses.

Commissioner Clark said North Dakota tends to have higher bond levels than some of the other states. He said despite this, the bond levels do not come close to covering many of the obligations that are incurred by the licensees.

Commissioner Clark distributed a document entitled *Bond Comparison Physical Capacity vs. Annual Grain Purchases* ([Appendix H](#)). He said this document shows two fictional companies and the respective bonds required depending on their licensure.

In response to a question from Representative Mueller, Commissioner Clark said an elevator has the option to determine whether it wants to be federally licensed or state licensed. He said North Dakota has approximately 400 grain handling facilities. He said approximately 300 of those are solely state licensed. He said those that are federally licensed must also acquire a state facility-based grain buyer bond. He said the reason that elevators will get licensed federally is because they have operations in multiple states. He said it is easier for them to deal with one license than to deal with licenses in multiple states. He said those that are federally licensed tend to be the larger elevators that deal in multiple states or a smaller elevator situated close to the state line.

In response to a question from Representative Mueller, Commissioner Clark said even though warehouses might be covered by a single federal license, they still have state bonding requirements that they have to meet.

In response to a question from Senator Olafson, Commissioner Clark said the North Dakota Insurance Commissioner oversees the bond companies.

Commissioner Clark said the Public Service Commission has been told that the concern with raising the bonding levels is not based on the amount that licensees would have to pay for their bonds. He said the problem is that the bonding companies often will not write large bonds because of the stress tests that they apply. He said this involves a certain level of collateral and generally must be large enough to cover the amount of the bond. He said this is a particular

problem for startup companies, as well as for facilities that have undergone significant upgrades and may have become leveraged to have accomplished that. He said the balancing act has to do with wanting to provide as much protection as possible for the farmers, yet not get in the way of economic development activities, including startup processors. He said the state of North Dakota outsources the financial audits to the bonding companies.

With the permission of Chairman Mueller, Ms. Sue Richter, Director, Licensing Division, Public Service Commission, said bond fees are usually \$10 per thousand for the first \$100,000, \$7.50 per thousand for the next \$400,000, and \$5 per thousand for anything over \$500,000.

Commissioner Clark distributed a document entitled *Processors* ([Appendix I](#)). He said the document shows the bonds on file for various ethanol facilities from those having licensed storage capacities of 1.1 million bushels to those having licensed storage capacities of almost 10 million bushels. He said the largest facility at almost 10 million bushels has a bond of \$1.5 million. He said a facility that purchases 40 million bushels of corn a year at \$2.50 per bushel has \$100 million in annual purchases. He said if divided by 12 months, this is a monthly purchase of \$8.3 million and a daily purchase of \$277,000.

Commissioner Clark said the problem is that some of the processors do not have storage facilities that are commensurate with the amount of risk that they have.

Commissioner Clark distributed a document entitled *North Dakota Public Service Commission Grain Warehouse/Grain Buyer Insolvencies - 2007 Through Current* ([Appendix J](#)). He said in recent years the insolvencies have tended to be with processing facilities. He said there have also been a few insolvencies of facilities that handle organic products. He said this is a highly specialized market and if a sale down the line falls through there is generally a ripple effect.

Commissioner Clark distributed a document ([Appendix K](#)) showing the licensure and bonding requirements in the surrounding states.

Commissioner Clark distributed a document entitled *Alternative Bonding Options* ([Appendix L](#)). He said the alternatives came about after a Public Service Commission brainstorming session. He said the document also includes comments and preferences that had been expressed by individuals and industry representatives participating in the Public Service Commission study of licensing and bonding. He said it would be the intention of the Public Service Commission to move forward only when there is some level of consensus among the participants.

In response to a question from Representative Meyer, Commissioner Clark said when the Public Service Commission is appointed trustee in a bankruptcy, the funds used to pay the producers come from taking physical possession of the grain in the elevator and selling that grain at the best price

available and from the elevator's bond. He said if that combined amount is unable to fully reimburse the producers, the amount is then prorated. He said the administrative costs incurred by the commission are paid for through the commission's general fund appropriation.

In response to a question from Senator Wanzek, Commissioner Clark said one example of an invalid claim would be if an elevator that had numerous locations went insolvent and the farmer had delivered his grain to one of the Minnesota entities, that farmer's claim would be covered under Minnesota law and not under North Dakota law.

In response to a question from Representative Mueller, Commissioner Clark said bonding companies look at the risk of each individual elevator seeking bond coverage. He said one issue pertains to international companies trying to obtain bonds. He said such companies might want to purchase the grain, and from an economic development perspective, others would like to sell the grain to such companies. However, he said, many of these companies require bonding under state law and the bonding companies are hesitant to issue the bonds in large part because the accounting practices required in other countries are not necessarily the same as those required in the United States.

At the request of Chairman Mueller, Mr. Strege presented testimony ([Appendix M](#)) regarding grain warehouses and buyers, including ethanol plants and grain processors. He also distributed a copy of comments ([Appendix N](#)) he had provided to the Public Service Commission regarding bonding alternatives. He said the principal purpose of a bond is to function as a screening device and allow only financially viable firms into the business sector. He said a bond underwriter looks at a company's net worth. He said in the case of CNA Surety, it is required that the net worth be equal to or greater than the amount of the bond sought. He said if a company is not willing to invest \$500,000 of its own assets, why should the bonding company put \$500,000 at risk. He said in addition to net worth, a bonding company will look at a business's working capital, profit history, credit line, and managerial experience.

Mr. Strege said beginning in June 2008, the Licensing Division of the Public Service Commission began holding meetings regarding issues that impact grain elevators. He said those discussions included bonding requirements. He said at the time there was no pressing need for change, and the consensus among the participants was to leave things as they were. However, he said, in the fall of 2008, people started to hear about VeraSun's financial problems. He said the corn growers started asking questions about bonding levels. He said it is important to understand that the discussion regarding bonding levels was raised because of processor problems. He said in recent months Northwood Mills also failed. He said that too was a processor. He said Specialty Export failed in 2007. He said that entity handled

primarily organic products. He said in 2007 Minnesota Grain became insolvent. He said Minnesota Grain was a processor. He said on December 31, 2009, the Public Service Commission suspended the license of Organic Grain and Milling at Clyde. He said that too was not a typical grain elevator.

Mr. Strege said it is very important that we do not create hardships or additional expenses for regular grain elevators. He said he cannot promise that a regular elevator will not go into insolvency. However, he said, their record is pretty good. He said if there are problem areas, those areas should be addressed in isolation. He also said it is important to ensure that our state bonding requirements are not set so high that those affected will choose to become licensed through the federal system. He said if that happens and there is an insolvency, our farmers will be working through the federal system in Kansas City rather than through the state system in Bismarck.

Mr. Strege said right now a \$500,000 bond costs \$4,000 a year. He said at those premium rates, it would take 125 years for a surety company to make up its loss.

In response to a question from Senator Olafson, Mr. Strege said his organization does not believe that the typical grain elevator needs to have its bonding level increased. He said if there are problems with the processors, those problems should be addressed. He said the problems that appear in the organic and specialty crop situations exist because those are very thin markets. He said those are not very mature markets. He said they do not have the risk protection mechanisms available through standard futures markets.

In response to a question from Representative Mueller, Mr. Strege said if the Legislative Assembly would require higher bonding levels across the board, the producers will end up paying the cost because it will be passed along as a cost of doing business. In addition, he said, if bonds are set too high, some elevators will go out of business.

In response to a question from Representative Hofstad, Mr. Strege said some of the bonded elevators have assets approximately equal to the amount of their bond. He said others have assets well in excess of their bond. He said the bonding companies are understanding when historically well-run elevators have a year or two with less prosperity. However, he said, if an elevator does not have a railroad line, if an elevator is situated in a part of the state where it is surrounded by shuttle loaders, or if a goodly number of farmers in the area have enrolled in the conservation reserve program, the difficulty that the elevator is experiencing might not be able to be turned around.

Representative Holman said if we set up two levels of bonding, i.e., one for elevators and one for processors, we would need to determine who is in fact a processor.

At the request of Chairman Mueller, Mr. Keith Finney, grain buyer, Clifford Farmers Cooperative Elevator, Clifford, presented testimony regarding bonding levels. Mr. Finney said the Clifford elevator buys corn for Tharaldson Ethanol in Casselton. He said the discussions regarding what constitutes a processor are troublesome. He said at one point he operated a shuttle loader for Burlington Northern. He said he would handle the equivalent of 60 million bushels a year. However, he said, the handling of that amount of product was condensed into three months. He said the volume risk was much greater at the shuttle loader than in his current position where the purchases are spread over an entire year. He said in his present situation the Clifford elevator purchases the corn but leases the grain handling facility from Tharaldson Ethanol. He said the elevator has a \$1.5 million bond. He said Tharaldson Ethanol is not required to have a \$1.5 million bond because they have a smaller storage space. However, he said, the Clifford elevator currently requires Tharaldson Ethanol to have a \$1.5 million bond and has asked Tharaldson Ethanol to raise that bond to \$2 million.

Mr. Finney said he has been in the grain business since 1973. He said he deals with risk every day. He said there is a risk involved with to whom he is selling and from whom he is buying. He said the Clifford elevator requires payment from Tharaldson Ethanol twice per week. He said if corn goes to \$5 per bushel, the elevator will require a \$2 million bond. He said that is the extent of its exposure and is the extent of the bond that would be required to protect the elevator.

Mr. Finney said one of the problems is the manner in which business is conducted. He said there are farmers who want to leave grain in the elevator for three or four months because they have not decided whether they want to take income in a current year or in the ensuing year. He said they engage in all sorts of poor business practices.

Mr. Finney said the Legislative Assembly needs to be very cautious about differentiating processors. He said some people believe that cattle feeders are processors.

Mr. Finney said the cost of the bond is not an issue. He said whether an entity can get a bond is the issue. He said bond requirements could be set so high as to be very unfriendly to processors coming into the state. He said this is particularly pertinent for people thinking about starting a new processing business or a superfeed business.

In response to a question from Representative Mueller, Commissioner Clark said the commission will be scheduling a work session within which they will discuss among themselves options for addressing the bonding requirements. He said from the testimony presented to the interim committee it appears that there is not yet a consensus on how to proceed.

Senator Wanzek said he wonders if there would not be some merit in considering catastrophic

insurance policies to provide greater coverage in the event that there is a very large insolvency.

### **GREENHOUSE FACILITY TOUR**

At the invitation of Dr. D. C. Coston, Vice President for Agriculture and University Extension, North Dakota State University, Fargo, the members of the interim Agriculture Committee toured the North Dakota State University greenhouse facility.

Chairman Mueller recessed the meeting at 4:00 p.m. and reconvened the meeting at 9:00 a.m. on Wednesday, January 13, 2010.

### **STATE SEED DEPARTMENT**

At the request of Chairman Mueller, Mr. Ken Bertsch, Seed Commissioner, State Seed Department, Fargo, presented testimony ([Appendix O](#)) regarding the State Seed Department. Mr. Bertsch said the department was established in 1931 and is responsible for seed certification, the operation of the state seed laboratory, the administration of various state and federal cooperative programs, and various regulatory functions. He said the department is unique among its peers in that the statutory and regulatory functions are all conducted within the department, the department is under the direction of a citizens' board, and the department is self-funded through fees.

In response to a question from Senator Warner, Mr. Bertsch said in one greenhouse production cycle, they can grow 2,000 pounds to 3,000 pounds of potatoes. He said because potatoes are referenced by hundredweight, this translates to 200 hundredweight to 300 hundredweight. He said the growth in one greenhouse production cycle could probably plant 10 acres to 15 acres of seed. He said with a decent yield those 10 acres might produce 2,000 hundredweight to 3,000 hundredweight. He said that would be the first generation production period. He said it takes about 20 hundredweight to plant one acre of commercial production seed. He said it takes a long time to achieve a large seed stock. He said blowing up potato seed stocks is a lot different from blowing up wheat.

In response to a question from Representative Meyer, Mr. Bertsch said if seed is not certified, the potatoes are sold into commercial channels for table stock or French fries or dehydrated potatoes.

Mr. Bertsch said seed potato growers put between \$1,000 and \$2,000 per acre into the crop in order to get certified.

In response to a question from Representative Mueller, Mr. Bertsch said the North Dakota Century Code requires growers to plant certified seed in order to produce commercial potatoes. He said an exception provides that a grower can save seed for one year. He said other states have a pure seed law that simply mandates growers plant certified seed. He said the North Dakota law was put into place in the early 1980s. He said the requirement for certified

seed was a response to pathogens and viruses that existed in commercial fields and were impacting the seed industry. He said those things get transmitted primarily by insects. He said it was tough to produce good seed because there were fields with viruses. He said the seed law was put in place to help protect the entire industry. He said the use of good quality certified seed in commercial production keeps the environment cleaner.

Mr. Bertsch said in terms of challenges the agency must be willing and able to be versatile in order to meet the needs of the industry. He said the State Seed Department operates in a very litigious environment. He said it is getting more pronounced each year and taking more and more of department staff time. He said it is also imperative that the department create partnerships and cooperative ventures with others, such as seed companies, and with research institutions, such as North Dakota State University. He said the other challenge faced by the department is the balancing of fee levels that are not excessive for the customers yet substantial enough to ensure financial stability of the department.

In response to a question from Senator Olafson, Mr. Bertsch said there are things that can be done to protect the agency from litigation. He said other states have been able to do that. He said it would be nice not to have the agency exposed to the extent that it is. He said the best the agency can do is take snapshots of the seed at various stages. He said the product is seen once, twice, maybe three times in the field. He said they see the product in the laboratory but without any knowledge of where the samples come from. Thereafter, he said, the seed is handled in a variety of ways. He said the State Seed Department puts a stamp of certification on the product but has no way of knowing whether in fact that is the product that was certified by the department. He said the biggest issue is that the department does not have full control over how the product is handled. Yet, he said, the department has risk with respect to the final product and how it performs.

Chairman Mueller said during the 2009 legislative session he met with Representative Dennis Johnson, Mr. Bertsch, and the committee counsel and discussed this particular issue at length. He said there is a need to balance protection for the agency and protection for the grower. He said at the time the parties met, they were unable to come to an agreement regarding what that level of protection should be. However, he said, he hopes that the issue will be discussed further by the interim committee. He said it is not likely that a policy change of this sort will be incorporated in the bill draft. However, he said, the discussion might provide the impetus for an individual legislator to have a bill drafted.

Senator Olafson said the State Seed Department is literally dealing with the honor system and that works most of the time.

been mislabeled. He said the matter did not go to trial, and, therefore, he cannot state with certainty that this is what had happened. He said the potato was grown in the Red River Valley and delivered to a Minnesota grower. He said it turns out that the potato was suspected of being the wrong variety. He said unfortunately, we do not know where or how that happened, if in fact it was the wrong variety. He said the agency went through approximately a year's worth of discovery and preliminary actions, but it never went to trial. He said at one point it was dismissed on summary judgment and the attorney for the other side managed to have it brought back on a technicality. He said this was a \$10 million claim, and it cost the state \$600,000 to settle it. He said the frustrating part is the department does not even know if it was at fault. He said he does not believe that the facts of the case were a function of anything that the State Seed Department did. He said he firmly believes that the State Seed Department should be accountable for what it does. However, he said, in this case, he still does not believe that the department did anything wrong. He said the end result was a significant impact to the state treasury.

## **STATE SEED DEPARTMENT TOUR**

At the invitation of Mr. Bertsch, the members of the interim Agriculture Committee toured the State Seed Department.

## **OTHER MATTERS**

Chairman Mueller said even though the committee is considering a 50-plus page bill draft pertaining to seed laws, nothing in that bill draft as of yet addresses the issue of seed potato certification.

In response to a question from Representative Meyer, Chairman Mueller said he does not believe that significant updates on the superfeed project will be available for the next meeting. However, he said, it would be appropriate to address this issue again when the State Board of Agricultural Research and Education provides its update to the committee, and it might be appropriate to include an update at a joint meeting of the House and Senate Agriculture Committees during the 2011 session.

No further business appearing, Chairman Mueller adjourned the meeting at 12:00 noon.

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L. Anita Thomas  
Committee Counsel

ATTACH:15