

# M|J|B BANKING LAW TODAY

## **Commodities Fronting Lawsuits: The Most Powerful Collection Tool Ag Banks Never Knew They Had**

In an agricultural foreclosure it is common for large amounts of farm products to go missing, even when the lender filed a CNS Financing statement on the borrower. This most commonly occurs because the borrower: (1) sold the farm products in a different state; (2) sold the farm products to a buyer that either negligently or purposefully failed to name the bank as a joint payee on the check; or (3) sold the farm products under the name of a relative or business affiliate to circumvent the bank's CNS filing. Many Ag bankers correctly realize that they likely have no recourse against the buyer in situation 1 and that they likely have recourse against the buyer in situation 2. However, most Ag bankers do not realize that they likely also have full recourse against the buyer in situation 3, which is what is referred to as a "fronting" scenario.

In the 2006 case of *Fin Ag Tech v. Hufnagle*, the Minnesota Supreme Court established that buyers of farm products are liable to Ag banks who have a CNS on file in a fronting scenario, regardless of whether the buyer knew, or had reason to know, that fronting occurred. What this means is, for example, if a borrower sells farm products under their child's name

and the bank does not receive the sale proceeds the bank can bring a lawsuit against the buyer for a CNS violation even if the sale did not seem remotely suspicious. And, a lawsuit of this type can be commenced any time within 6 years after the date of the sale, meaning that purchases made as early as February of 2018 can still be challenged.

Plus, because the claim here exists against a third party, rather than the borrower, there is a good likelihood that the claim can survive a borrower bankruptcy (Chapter 7, 11 or 12), a full traditional liquidation process or potentially even an external refinance made at a loss.

Bottom line, if your Ag bank suffered a loss anytime within the last 6 years under circumstances where commodities went missing there is a very real chance it can still recover thousands, hundreds of thousands or even millions of additional dollars. And, even if your bank has no desire to re-open a painful old file, a specialized ag debt buyer may be interested in purchasing the residual rights against third parties. In either case, this presents an unparalleled opportunity to monetize a long-closed file.

# Four Simple Steps You Can Take Today to Reduce the Risk of Commodity Collateral Conversion in the Future

While a *Hufnagle* commodity fronting lawsuit can be incredibly powerful, it is far preferable to simply not have to deal with commodity fronting/conversion in the first place. While a bank can never fully ameliorate the risk of commodity conversion, it can reduce the risk through a few simple steps that should be taken prior to the start of the growing season.

## **Obtain a Complete List of All Commodity Buyers**

This should be done in two ways. The first is to simply ask your borrower for this information. I always recommend the use of a Commodity Buyer Disclosure Form that I developed, but, in a pinch, this information can be obtained either orally or through having your borrower hand write a list of their buyers.

Second, you should review account records for the last 1-3 years to construct your own list of your borrower's commodity buyers. While this can be used to uncover nefarious concealment and past grain fronting, the primary utility is to capture all (likely less frequent) buyers that your borrower simply forgot to list.

## **Send Direct Notices of Security Interest**

If a commodity buyer is located in a different state, a Minnesota CNS filing will not be effective. This means that your bank almost certainly will not be named on commodity checks and will not have recourse against the buyer if proceeds disappear.

Some other states have CNS-like systems where a separate effective financing statement can be filed, but all states recognize a statutorily compliant direct notice of security interest. These notices should be sent to all commodity buyers located in a different state.

Note that the direct notices are very finnickily and must include the right magic language. Note also that direct notices are only good for 12 months, rather than 5 years in the case of a CNS filing.

## **Identify Minnesota Commodity Buyers that are Ignoring CNS Filings**

While all Minnesota commodities buyers are subject to potential liability for ignoring CNS Filings, many still fail to list the bank on all commodity checks. As such, it is important to flag in your initial commodity buyer review those buyers who are located in Minnesota, yet are failing to name your bank on all checks.

If such failure does, or has, occurred, I recommend sending the buyer a letter reminding them of your bank's CNS filing and attaching a copy of the filing itself. While it is possible the buyer will continue ignoring the filing, the odds are far less if they receive a direct notice.

## **Establish a Policy for Dealing with Direct Deposit**

The final thing your bank can do to protect itself from conversion is to establish a policy when it comes to direct deposits of commodities proceeds.

Despite the convenience of direct deposit, I typically recommend against approving this form of payment because the borrower has the ability to potentially transfer funds in and out of the account before your bank may even realize what happened.

While your bank may still have recourse against the buyer under these circumstances, the odds are lower, especially if your bank executed a form authorizing this method of payments.

## **Need Assistance Renewing (or Non-Renewing) a Troubled Borrower? MJB Law Firm Can Help!**

The 2024 renewal season presents a level of risk for agricultural banks not seen in the last few years. Flawed practices, procedures and loan documents that never resulted in harm in a good economy can result in huge losses in troubled times. The M|J|B Law Firm helps guide banks through the renewal process by providing the following services:

- Preparation of all manner of loan documents.
- Assistance with collateral perfection and ensuring proper priority.
- File audits to ascertain early signs of fraud and conversion that would justify non-renewal.
- Advising on proactive measures to be instituted on the front end to ensure success if the credit proceeds into bankruptcy or liquidation.
- Assistance with preparing and submitting materials to the FSA for concurrence on guaranteed loans.

For more information on any of the above services, contact Matthew Bialick at 952-239-3095 or [matthew@mjbblawmn.com](mailto:matthew@mjbblawmn.com) *[Advertising Material]*



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