June 3, 2019 Late Spring Edition

M|J|B BANKING LAW TODAY

TO PLANT OR NOT TO PLANT, THAT IS THE QUESTION…

Discussion of Legal Issues Surrounding the Prevented Planting vs. MFP Payment Conundrum

Farmers across most of southern Minnesota have been grappling with a very tough decision – should they forego planting crops in 2019 and rely on Prevented Planting crop insurance payments or should they roll the dice and opt for late planting that may result in reduced yields, but would allow them to be eligible for the second wave of MFP payments? This question becomes even stickier given the extreme volatility in crop prices over the last month. At the end of the season will the farmer be looking at $3.50 corn? $4.50? Higher? Nobody knows for certain.

The biggest problem for banks associated with this extreme fork-in-the road is that there will almost certainly be a clearly right answer that will emerge, but that answer is unknowable at this time and thus some borrowers will choose the right path and some will chose the wrong path. Given that things were not exactly rosy economically entering 2019, the question legitimately arises whether struggling operations that choose incorrectly can handle yet another bad (or very bad) year.

So, what should an ag bank do in the face of all this uncertainty, turmoil and wildly disparate courses of action by their borrowers? The answer is simply to be aware of all the legal and practical issues associated with these troubled times and to take whatever risk mitigation measures are reasonably available. This article will discuss major legal issues and best practices that can be utilized by banks in connection to MFP payments and Prevented Planting insurance payments.

List of Issues and Best Practices.

- ❖ Be aware that existing security agreements may not cover the new MFP payments. The reason is that courts sometime find that a security agreement does not cover government programs not in existence as of the date of the security agreement.
- ❖ Consider having the borrower execute a supplemental security agreement explicitly covering the new MFP payments. The agreement should be structured as a clarification that the original security agreement was meant to cover the MFP payments, with a contingent grant of security interest to the extent that a court finds that the original agreement did not cover the MFP payment.
- ❖ Consider doing a supplemental UCC filing to clarify that the bank's security interest covers the new MFP payments. This option has pros and cons, however, so legal counsel should be consulted before going this route.
- ❖ Ensure that borrowers deposit the MFP payments into an account held at your bank. This affords control because virtually all security agreements that grant blanket liens grant the bank a security interest in all deposit accounts of the borrower. This means that in the event of a default under the loan documents the bank can exercise its rights to freeze the deposit account and/or exercise a right of offset on the funds.

- Consider having the borrower execute a form CCC-36 Assignment of Payment. This must be filed after the program has been officially announced because the form specifically requires the program to be identified by name. Note that this assignment is not infallible – the government does occasionally make mistakes and there is no legal recourse against them when it happens.
- Make sure that applicable borrowers have executed an assignment of indemnity on a form approved by their crop insurance provider and have delivered the signed assignment to the insurance provider. This will allow the bank to directly receive insurance proceeds.
- Be vigilant about obtaining refunds on prepaid inputs in a Prevented Planting context. If the supplier refuses to refund the money, or has become insolvent, your borrower, and by extension your bank, may have a legal fight on its hands.
- Be on the lookout for an increase in borrower bankruptcies within the next couple of months. If your borrower is forced into a Preventing Planting context which guarantees another year of losses, they may opt to simply declare bankruptcy.
- Consider whether the bank wants to declare a default for a given borrower based on a general insecurity clause. With most projected scenarios showing either an anemic gain for 2019 or a loss, the bank may want to reassess whether it is time to cut its losses with its weakest borrowers and simply move into a liquidation context.

Conclusion

2019 presents a series of challenges on a scale and complexity not seen since the farm crisis in the 80s. While there is no magic bullet that can solve all problems, an emphasis on sound practices and education can minimize risks and pitfalls and can maximize the chances that banks will be successful in 2019 and beyond.

-Matthew J. Bialick, Esq.

Outside Insights

A Forum for Thoughts and Articles from Sources Outside of the M|J|B Law Firm

Challenging Weather Creates Challenging Markets: How to Manage Risk and Use all Marketing Tools

An Article by Al Kluis of Kluis Commodity Publishing

For over 40 years, I have been advising famers on how to market crops, and each year is a new challenge. Most years, you usually get a seasonal rally between April and July. 2019 provided a very wet spring, delayed planting, and created a huge rally in the corn market that pulled soybean futures higher as well. While I do not have a crystal ball to help me make decisions, I have developed a three-step risk management plan to manage price risk for farmers that has helped navigate through uncertain conditions in the past.

My three-step risk management plan:

1. Buy the right RP crop insurance. This crop insurance is subsidized by the US government and provides protection against both prices going down and yield loss.
2. Use a spring summer rally to get 40-60% of your insured bushels hedged ahead using futures.
3. Get the balance of your production protected using put options.

This plan has worked well for the last 10 years. The plan is not designed to "hit the top of the market" but, is instead designed to manage risk and protect profits. In 2012, and possibly in 2019, farmers will deliver some new crop contracts that are underwater. From 2013-2018, farmers delivered on new crop contracts that were highly lucrative, and most importantly has kept the farmers I work with profitable in a tough environment over the past five years.

Each year, I adjust the plan. Below is an example of how I adjusted the plan as the weather has changed the corn and soybean fundamentals over the last 30 days.

A long-time customer from southern Minnesota called me in early May. "I still have 30% of my 2018 cash corn to sell. What is our plan if we have perfect spring weather and the corn market just keeps grinding lower?" I reminded myself while speaking to him that it always looks bearish at the bottom. Then the next week it started to rain, and it kept raining. In one week, the corn market rose to 60 cents. In the month of May, corn rallied over $1.00 per bushel. We used that rally to make cash corn sales, increase 2019 crop hedges, and even placed some 2020 corn hedges. Record rainfall, a huge amount of prevented plant acreage, and the very slow pace of planting in 2019 created a rally that did not seem possible only a few weeks prior.

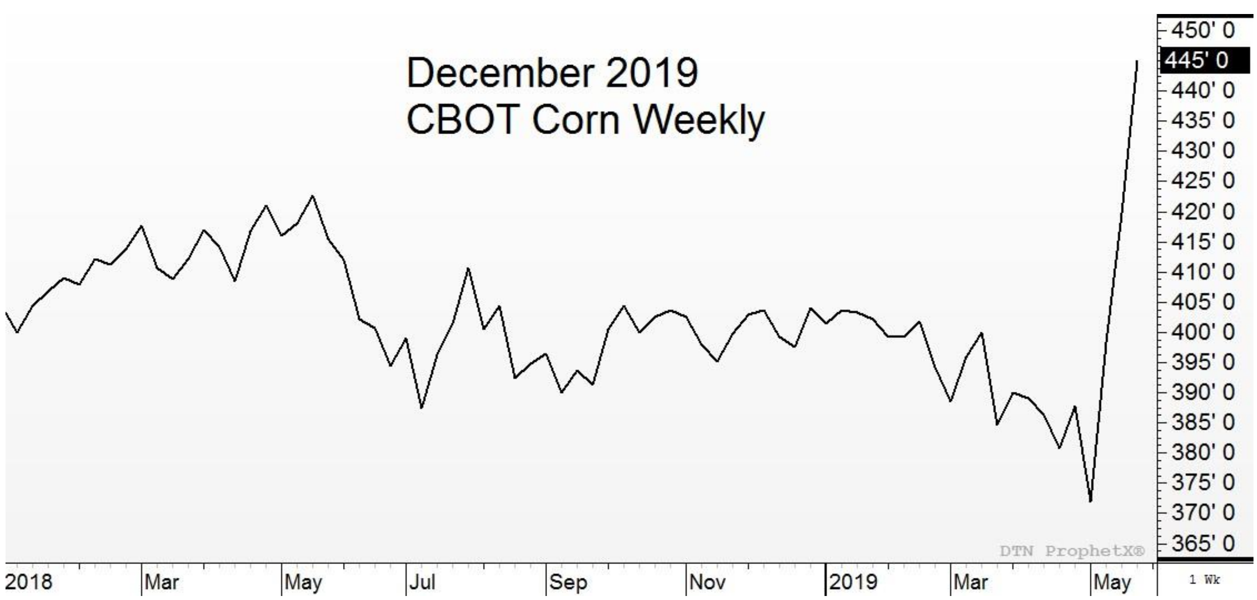
Marketing grain during a weather scare market is tough, but it sure beats the grinding bear market we had this last winter! I could feel bearish emotions present in the attendees at my seminars in January - March of 2019. Then to everyone's disbelief, a bullish optimism developed when corn rallied over $1 per bushel. Now I remind myself that it always looks bullish at the top. I am glad that 40 years ago I learned to make my decisions based on my charts, not emotions. This has kept me from becoming a victim of market sentiment.

Here is what my plan originally looked like for corn in January and how it was adjusted in May of 2019.

My initial plan was to get 30-40% of the corn hedged ahead between $4.06 and $4.50 in the December 2019 corn futures. A few fortunate farmers were able to get all of their corn planted, placed those hedges. For those farmers who were struggling to get their corn planted, we cut back on the amount of the hedges to just 20%. We also placed some of those hedges out into a December 2020 contract that was trading at about a 10 cent premium to the December 2019 corn contract, and could be used as a hedge against either the 2019 or 2020 crop. We then bought December 2019 corn put options on 20% of the projected corn crop. With put options, you do not have a delivery commitment if you do not get a crop. Thus, you make money if the market moves lower or lose money if corn goes higher.

I like being in a position where I have 40% of the downside protected, yet will be able to gain on 80% of my corn production if prices move higher. My old three step risk management plan recommends buying crop insurance, getting 20-40% of your crop hedged, and having the remaining bushels protected with puts. In this exciting volatile corn market of 2019, the plan is working. As I said before, the goal is not to hit the high of the market, but to help you make more profits and reduce your worries about the grain markets. Remember, it always looks bullish at the top.

Making recommendations for the soybean market has been tough this year. The offers we had above the market that we had at very minimal profit levels, were not hit. The late wet spring brought more soybean acres than predicted in my earlier forecast. Another negative factor as of recently, has been a halt in trade talks with China. By early July, you will need to sell the last 10-30% of your cash soybeans. If I am not satisfied with the price, I may buy some August soybean calls. For November soybeans, I have lowered my initial price target to make some 2019 soybean sales go down to $9.88. If I do not sell a lot of 2019 soybeans, I will consider using the $6.20 loan on my 2019 soybeans. I predict that either we will have an agreement in place with China or that weather problems will develop in the US or South America over the next 9 months that will address this issue.



This is the December 2019 Weekly Corn chart. This chart shows the double top at $4.24 in August of 2017 and May of 2018. From that, high prices went down to a major low at $3.64 in early May of 2019. From that low, prices rallied over 90 cents per bushel to the high in June of 2019.

Below the November 2019 Soybean chart.

This is the November 2019 Weekly Soybeans chart. This chart shows the high at $10.10 in March of 2018 from that high prices dropped to a major low in July of 2018 at $8.65 per bushel. Prices then rallied to $9.70 in December of 2018 before crashing down to the major low at $8.15 in May of 2019. From the early May low prices have rallied by over $1.00 per bushel.

-Al Kluis is managing director of Kluis Commodity Publishing. Al is the marketing editor for Successful Farming magazine where he writes the Your Profit column. Al is a is a frequent speaker and farm and bank conferences across the nation. He can be reached at info@kluiscommodityadvisors.com or toll free 888-345-2855.

THE ENLIGHTENING ROUND

Q: Does a supplier providing chemicals still have a crop production input lien even if the farmer opts not to plant crop for that given year?

A: Chemical suppliers do have a crop production input lien that attaches to the next crop grown on the land – provided the crop is grown within 16 months of when the chemicals were applied.

Q: Does fuel constitute a "crop production input" for purposes of the agricultural lien statute?

A: Yes, petroleum products do constitute crop production inputs.