

M|J|B BANKING LAW TODAY

2019 PLANTING SEASON PRIMER (PART II)

3 *More* Things Every Ag Bank Should do Around Planting Season

Planting season is always a hectic and challenging time for farmers and Ag banks alike. Borrower financials are reviewed, renewal decisions are made, loan documentation is executed, FSA approvals of operating plans are sought and funds are disbursed, among other things. And, things only get more challenging in a troubled economic climate, like the one farmers and their banks face in 2019.

Going into the 2019 planting season here are three *more* things that every Ag bank should do:

Decide Whether to Allow Payments to Unperfected Statutory Lienholders.

One of the most important, and difficult, decisions that an Ag bank needs to make around planting season is whether to allow the proceeds from 2018 crop sales to be used by the farmer to pay agricultural goods and service providers who have unperfected statutory liens on the crops. From a technical perspective this decision does not necessarily need to match the decision on renewal versus non-renewal of the credit, but from a practical perspective the decision is one in the same given that preventing payment to a supplier will likely destabilize the farming operation either through removing a key business partner or through potentially triggering collection action.

At this point you might be asking – why would I prevent payment to one of my customer's key service providers for amounts that are legitimately owed? The answer is that such a payment, from a legal perspective, functionally represents a voluntary subordination of the

bank's interest in collateral proceeds to a subordinate creditor. Such an action is meaningless in good times, when everyone gets repaid, but if the operation fails in 2019 allowing such a voluntary subordination will likely cause a dollar for dollar loss in a liquidation context. In other words, if you allow a \$100,000 payment now and the operation fails in 3 months that is a direct \$100,000 loss that the bank will likely suffer.

The bottom line here is that banks need to be very discerning on what credits they renew and what payments they allow because if an operation fails mid season it can result in much higher losses to a bank than if the credit was non-renewed before planting occurred.

Develop a Process for Managing and Tracking Crop Production Input Lien Notices.

Under Minnesota Statute, entities providing crop inputs (fertilizer, seed, etc.) are accorded a super priority lien over the farmer's crop in a given year if they send out a lien notification statement to the customer's bank(s). This lien notice gives the bank 10 days to either guaranty payment, object to the notice – which prevents the formation of the lien – or do nothing, which causes a super priority lien to be created. This notice must be sent via certified mail and contain the phrase "IMPORTANT – LEGAL NOTICE" on the envelope for it to be effective.

Case law has established that the notification formalities are strictly construed and the failure to include the required language on the envelope invalidates the lien. That being the case, it is critically important that banks

develop a system for tracking and responding to lien notification statements that includes recording how the notice was sent (regular mail, certified, etc.) and a photo copy of the envelop used.

This may seem like unnecessary tedium, but it is actually an incredibly important endeavor that has significant ramifications if a credit ultimately goes into default for two different reasons. The first, and most basic reason, is that through having a formal system in place the bank can avoid the inadvertent creation of a super priority lien because it can make a timely objection. If the lien notices are simply ignored, thrown away or responded to in an untimely manner the bank is allowing the creation of a lien that could have been avoided.

The second reason why it is important to have a comprehensive lien notice management system in place is because the mere act of being able to prove that the proper formalities were not followed by the input provider allows the bank to defeat any claim by the provider that it has a superior lien. This could allow the bank to realize tens or hundreds of thousands of extra dollars in a liquidation context.

Once again, a little extra work and preparedness on the front end can make a huge difference on the back end.

Consider Whether an Acknowledgment of Reliance on Financial Reporting and Projection Form Should be Executed.

In a prolonged economic downturn, the prevalence of borrowers artificially manipulating the numbers in financial reporting and projections increases exponentially.

This temptation seems to be manifesting in the current financial reporting, given that most farms are reporting an – albeit anemic – profit in 2018, despite the facts that observed yields were, on the whole, more or less average, and that corn and soybean prices have fairly consistently stayed below the cost of production over the last year (anywhere from \$3.70-\$4.12 cash corn and \$8.50-\$10.20 cash soybeans depending on yields). While it is possible

that factors such as running a very lean operation or effectively forward pricing grain could render an appeal to the bare cost of production an inappropriate measure of anticipated financial performance it, at the very least, reflects a high probability that at least some inflation in financial reporting is occurring.

Given this current climate, banks should consider whether it is appropriate to have its most troubled borrowers execute an Acknowledgment of Reliance on Financial Reporting and Projection Form. This form is essentially a document that sets the precise parameters as to when deviations from certain financial reporting or projections will be deemed serious enough to warrant not only a declaration of a default, but will also constitute a basis for claiming a defense to a borrower discharge in bankruptcy.

This form is helpful because it is often times very difficult to differentiate between “flawed but reasonable” financial reporting and projections versus those that are fraudulent. Courts addressing this issue will often give the farmer the benefit of the doubt here.

While such a form is not necessarily infallible, it does give a bank more certainty in being able to legitimately declare a default due to false financials and it significantly increases the chances that the bank could avoid having its debt discharged in a bankruptcy scenario.

Conclusion

2019 presents a level of challenges and potential issues not really seen in Minnesota since the farm crisis of the 80s. While we are not necessarily in for a repeat of the 80s, prudent banks understand that the risk profile in ag lending has, at the very least, greatly increased and some type of market correction is a distinct possibility. As such, doing things because “that’s the way they have always been done,” is not a good enough reason anymore. Banks need to be vigilant, diligent, knowledgeable and tight with their lending, workout and FSA practices and procedures to be safe and profitable in 2019 and beyond.

-Matthew J. Bialick, Esq.

J | B Law is now M | J | B Law

- ❖ New name, new email, new website, new marketing, but same office location and same great legal team!
- ❖ Check out our new website: www.mjblawmn.com.
- ❖ New email address for Matthew Bialick: matthew@mjblawmn.com.

GROWING INDUSTRIAL HEMP IS LEGAL – SO NOW WHAT?

The Status of Banks' Ability to Work with Hemp Farmers in the Wake of the 2018 Farm Bill

In a historic development, the Federal government legalized industrial hemp in the 2018 Farm Bill. Specifically, the new farm bill, among other things, brought the following changes:

- Hemp has been removed from the Controlled Substances Act and redefined as an agricultural commodity.
- Hemp has been removed from the purview of the Drug Enforcement Administration.
- The states may regulate hemp growth, but they cannot prohibit it.

However, this legislation should properly be seen as the first step in a longer process, rather than the final destination for several reasons. The first reason is that the legislation calls for states to submit a comprehensive plan to the USDA regarding its proposed hemp growing program, which must include information on gathering, testing, inspecting and disposal procedures. Reports indicate that Minnesota intends to submit such a plan soon, which will then be reviewed by the USDA for a period not to exceed 60 days. Until such plan is in place, and corresponding licenses are obtained, farmers cannot legally grow hemp under this new legislative system.

That said, it is notable that Minnesota had previously elected to be part of a hemp pilot program authorized by the 2014 Farm Bill, and this pilot program does allow farmers to currently submit an application to grow hemp.

As such, even before Minnesota's formal, permanent USDA plan is approved, it is still permissible for farmers to grow hemp under the pilot program.

The second reason why the legislation should be seen as merely a first step in the process is because the farm bill was not the only piece of legislation applicable to hemp growers and agricultural banks seeking to finance hemp growing operations. There is a rich tapestry of Federal and State laws and regulations that directly or indirectly touch on these topics. While the Farm Bill could be seen to amend these other pieces of legal authority by implication, there is still a lack of clarity on the subject. In short, even more legislation is necessary in the area.

Fortunately, this type of legislation is already in the works. On March 7, 2019, federal lawmakers introduced the "Secure and Fair Enforcement Banking Act of 2019" (the "SAFE Banking Act"). The SAFE Banking Act, in its current form, would protect banks from federal prosecution when working with hemp businesses and would prohibit federal banking regulators from sanctioning banks for working with hemp businesses.

Unfortunately, however, this new legislation is still in process and has not yet even been presented to the House of Representatives for a full vote. As such, the new legislation will not be in place prior to the 2019 planting season.

So, where do we stand coming into the 2019 growing season? Should banks treat hemp farming operations like any other customer? Should they avoid dealing with hemp farms altogether in 2019? Should they be willing to work with hemp farms but be careful and wary? The answer is that it depends on your bank's risk tolerance.

Option number 1 – treat a hemp operation like any other customer – is an option that, while lucrative, seems a bit reckless. Even if you view the 2018 Farm Bill as fully giving the green light to work with hemp operations, you still need to keep in mind that the customers must be licensed under the current pilot program and they need to stay in compliance with all applicable standards. As such, it is improper to treat hemp farmers like any other customers, because they are still in a much more carefully regulated area of operation.

Option number 2 – avoid working with hemp operations until the legal dust settles – is certainly the safest option and the option most banks are likely to take. There is no downside to this option, other than the fact that more aggressive banks that choose to work with hemp operations in 2019 will likely pick up greater market share in the area, and it is possible that there will be far less opportunities, and far greater competition, if the bank enters this space in 2020, rather than 2019.

Option number 3 – working with hemp operations in 2019, but doing so very carefully – is a potentially risky, but also potentially viable option. Ultimately, it appears

that the intent of the 2018 Farm Bill was to make hemp legal (if proper procedures and regulations are followed) and to allow banks to finance these operations in the same way it finances other agricultural commodity producers. As such, it seems the most likely result is that there will be no problems working with these operations immediately. However, even a sliver of uncertainty here can cause some disconcertment.

But, if the bank is willing to take the risk, it should still document the loan very carefully, and should make sure to evaluate the borrower's compliance with state regulatory requirements as part of its due diligence. It should also make sure that it specifies in the loan documents that it is an immediate default for the borrower to violate any regulatory requirements.

Conclusion.

While the 2018 Farm Bill certainly moved the ball forward on legal hemp farming, it by no means created safety and certainty for banks to work with these operations quite yet. In fact, at the end of the day the legislation may have created more questions than answers. However, clarity is on the horizon, and hopefully by the 2020 planting season it will be indisputably permissible for banks to treat hemp farmers just like any other farming operation.

-Matthew J. Bialick, Esq.

Staying Interactive and Up-to-Date

M|J|B Law prides itself on providing relevant, useful and up-to-date information in its newsletters. To assist in this regard, we welcome any specific questions, comments or suggestions for article topics you may have. Are you seeing a certain type of problem/issue repeatedly coming up? If so, we want to know about it and we want to provide corresponding legal insight on the matter to all of our readers. If you have any questions, comments or potential article topics, please email Matthew Bialick at Matthew@mjbblawmn.com or call him at 952-239-3095.

THE ENLIGHTENING ROUND

Q: Does the unequivocal revelation by an agricultural borrower that s/he will be declaring bankruptcy limit the ability of the bank to engage in collection action?

A: No, the automatic stay on collection actions in a bankruptcy only kicks in after bankruptcy has been formally filed. Nothing about the fact that it is an agricultural debtor changes this analysis. That said, the bank does have to be mindful of the fact that certain, unscheduled additional payments made by the borrower within 90 days of bankruptcy could be considered a *preference* under bankruptcy law and may be avoided by the bankruptcy trustee.

Q: Is it possible to obtain a waiver of farmer lender mediation rights in renewal or forbearance documents?

A: No, it is not possible to obtain such a waiver, and attempting to do so could get the bank subject to a \$2,500 penalty pursuant to Minnesota Statutes Section 550.42.



M|J|B Law Firm
952-239-3095; matthew@mjblawmn.com
www.mjblawmn.com