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M|J|B Banking Law Today

TEN LOAN DOCUMENTS ALL AG BANKERS SHOULD BE USING IN THE 2020 RENEWAL SEASON (BUT PROBABLY AREN'T)

One of the most frequent questions I get from my banking clients is whether there are problems with the loan documents that they are using. Very frequently my answer is that the problem is not with the loan documents they are using, the problem is with the loan documents they *are not* using. While existing loan documents can generally be optomized, and they can even contain flaws that can cause substantial problems down the line, the bigger problems tend to exist when banks do not use certain documents that they should be using.

This article will identify, and briefly discuss, ten custom loan documents that all ag banks should be using during the 2020 renewal season (but probably are not).

Document 1: Commodity Buyer Disclosure Form

What is it? On this form, the borrower discloses all commodity buyers that they are currently working with and all buyers that they intend to work with in the forseeable future.

Why should it be used? One of the largest sources of risk when a credit goes into collections is that the borrower has been secretly liquidating agirultural commodities. While it is possible they will do this through a completely new buyer, it is equally possible that they will do this through an existing buyer. If said buyer is located in a different state, or if the buyer has a documented pattern of ignoring CNS Financing Statements, the bank can send them direct notice of security interest, or other correspondence demanding the remission of all payments, to maximize the chances that they capture all commodity sale proceeds.

Document 2: Equipment Transfer Disclosure Form

What is it? On this form, the borrower discloses all equipment that has been sold or transferred over the last year.

Why should it be used? A liquidation of assets to pay off ancillary creditors is one of the biggest warning signs of a failing operation. Often the borrower does not disclose to the bank when they sell or transfer equipment, even though the bank has a security interest in said equipment. It is likewise not always readily apparent that this has occurred when reviewing financial documentation. This disclosure form puts the issue front and center and can reveal important information regarding equipment transfers.

Document 3: Commodity Production and Transfer Disclosure Form

What is it? This form requires the borrower to fully account for the flow of commodities over the last year by dislcosing on one form all production numbers, sales, transfers, and changes in inventory levels that occurred over the last year.

Why should it be used? Perhaps the most important thing for an agricultural bank to know is what happened to its commodity collateral over the last year. While financial documentation does provide much of this information, the bank might be forced to run a complicated and time consuming review of past and present financial submissions and deposit records to fully reconstruct the flow of commodities. This form simplifies the process by putting everything on one document that must be filled out by the borrower.

Document 4: Additional Agricultural Operations Disclosure Form

What is it? On this form, the borrower is required to list and describe all 3rd party agricultural operations being conducted on the borrower's premises.

Why should it be used? One of the biggest problems that arise in a liquidation context is borrowers fraudulently transferring assets to family members/related parties and then claiming said assets belonged to the other party all along. This form seeks to mitigate this risk by getting early information about the nature and size of any additional agricultural operations located on the same premises. Knowing this information can make it exponentially more difficult for the borrower to effectuate fraudulent transfers to family members since the borrower has already locked themself into statements regarding who owns what.

Document 5: Third Party Acknowledgment of Agricultural Assets

What is it? On this form, third parties who either operate on the borrower's premises, or have assets on the borrower's premises, acknowledge that the borrower owns all assets represented to the bank.

Why should it be used? While an additional agricultural operation disclosure form is binding on a borrower, it is not binding on a third party who has assets or operations on the borrower's premises. A Third Party Acknowledgement of Agricultural Assets form can both protect a bank against fraudulent transfers to related parties and also provide an early alert to the bank of ownership disputes or misrepresentations of assets. If the third party is unwilling to acknowledge that they have no ownership interest in the borrower's assets, that could be a major red flag for the bank that evidences a need for either non-renewal or at least decisive action.

Document 6: Third Party Acknowledgment of Commodity Buyers

What is it? This form has third parties with related farming operations disclose either who they use for their commodities buyers, or else acknowledge that they do not work with commodities buyers utilized by the borrower.

Why should it be used? This may seem like a bit of overkill, but it actually can be an incredibly useful form. One of the easiest ways to practically defeat a CNS Financing Statement is to sell commodities under the name of a relative or related third party. Knowing who those third parties use, or do not use, for commodities buyers can help head trouble off at the pass because it allows the bank to: (1) identify commodities buyers who are likely to be utilized for fraudulent commodities sales and (2) help prove that a fraudulent sale occurred in situations where third parties suddenly, and inexplicably, sell commodities to a buyer utilized by the borrower and whom said third party has never used before.

Document 7: Pledge of MFP Payment Form

What is it? This form is a separate security pledge agreement that applies specifically to MFP payments.

Why should it be used? This form is valuable because there is case law (in some jurisdictions) that casts doubt on whether a security interest in a government payment is valid when the form does not specifically refer to the applicable program by name. While this form is never a bad idea, it is particularly a good idea to be used in connection with a very weak security agreement that has a very sparse granting clause.

Document 8: Direct Notice of Security Interest in Agricultural Commodities

What is it? This is a form that notifies commodities buyers in non-CNS states of the bank's security interest in a borrower's agricultural commodities.

Why should it be used? This form is valuable because CNS Financing Statements are not effective in states that have not created a central notification system (e.g. Iowa). Even in a CNS state, the bank may want to consider sending such a notice of commodities interest to a commodity buyer in situations where: (1) the commodity buyer has previously disregarded a CNS filing or (2) there is an apparent likelihood that a particular buyer may be used in a fraudulent sale of commodities (e.g. multiple members of a farming family all use one particular buyer).

Document 9: Dislcosure of Additional Financing Form

What is it? On this form, a borrower discloses any additional financing of any kind that was obtained over the last year, along with any additional financing it intends to obtain over the next year.

Why should it be used? In failing agricultural operations, it is incredibly common for borrowers to start resorting to additional financing sources when the financial picture begins to unravel. Sometimes these additional financiers are disclosed to the bank, and sometimes they are hidden. While it is true that the borrower could simply lie on this form, it makes it less likely that a financier is (either intentionally or unintentionally) ommitted when the borrower is presented a specific form used solely for this purpose. Finding out about a large additional financier prior to renewal could tip the bank off that the operation is no longer viable and could save the immense trouble of renewing an operation doomed to fail in the very near future.

Document 10: Disclosure of Additional Bank Accounts Form

What is it? A form where borrowers disclose any additional bank accounts that they have at other banks.

Why should it be used? Perhaps the number one warning sign of an operation that is fraudulently liquidating commodity collateral without the bank's knowledge or consent is the presence of multiple operating accounts. This is because when borrowers opt to secretly liquidate collateral, they tend to deposit the proceeds in an account at a different bank so that their primary lender cannot see what they are doing. Once again, it is true that the borrower may simply lie on the form, but it is less likely that they will do so when presented with the issue directly, and even if the borrower does lie, this form will strengthen the bank's position in a collections scenario.

Conclusion

While not all of the above documents are appropriate in all circumstances, many are appropriate – and very helpful – in many situations. It is true that borrowers may object to executing some of the documents, but it is for the bank to decide whether the business implications of such objections override the additional protections that they gain through the use of the form.

Ultimately, even if all of the above documents are used, there is no guaranty the a material loss will be avoided in the future. However, the use of some or all of the forms, as appropriate, will help maximize the chances that: (1) the bank has all the information it needs in making the renewal decision and (2) the bank is protected as much as possible if the credit ends up going into liquidation.

-Matthew J. Bialick, Esq.

THE ENLIGHTENING ROUND

Q: How do statutory agricultural liens in North Dakota differ from those in Minnesota?

A: North Dakota statutory agricultural liens are similar in many ways to Minnesota liens. In both states the liens apply to a variety of agricultural goods and services, and in both states they must be perfected through an additional filing during a prescribed time period.

The North Dakota analog for the Harvester's Lien is called a "Processor's Lien." This must be perfected by the service provider filing a lien statement with the North Dakota Central Indexing System within 90 days of the service being provided. The North Dakota analog for the Crop Production Input Lien is the "Agricultural Supplier's Lien." This lien must be perfected by the supplier filing a lien statement in the Central Notice System within 120 days of providing the supplies.

In both cases, for the liens to be effective, the supplier/service provider must provide a billing statement that includes a notice stating that if the amount due is not satisfied then a lien may be filed – this is different from Minnesota. A second difference exists in the fact that North Dakota, unlike Minnesota, does not require that a lien notification statement be sent to lenders in the case of crop inputs. This means that input liens can attach without lenders directly knowing about them and without the ability for lenders to object to the inputs like they can in Minnesota.

Upcoming Webinar Through MBA

- On January 14th from 9:00 AM to 11:00 AM, Matthew Bialick will be presenting a webinar through the Minnesota Bankers Association entitled "Properly Documenting and Renewing Agricultural Loans."
- Learning Objectives:
    - How to avoid common documentation mistakes
    - How to avoid common collateral perfection/encumbrance mistakes
    - How to identify latent indications of borrower fraud/misappropriation from borrower financials and deposit account records
    - What additional loan documents should be used with high risk borrowers
- Registration Link: https://www.minnbankers.com/MBA/Education/Event_Display_2.aspx?EventKey=201_0244&WebsiteKey=9116537d-c5ad-4c32-8401-68fb014de7bd

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