

JB BANKING LAW TODAY

THE COMPETING CREDITOR CRISIS

The Problem of Agricultural Creditors Destabilizing a Borrower's Farming Operation

The 2019 renewal season has presented some difficult decisions for agricultural banks. Some borrowers will be non-renewed, while others will only be renewed by the skin of their teeth. When banks decide to renew, they often believe they have avoided any litigation or liquidation that year. Such a belief may be misguided because they do not always release that ancillary creditors can destabilize a borrower's farming operation through their own collection actions.

Many borrowers – and particularly weaker borrowers – have mounting debt with agricultural goods and service providers. These providers may have been patient in the past, but as debts with the borrower rise, and as past due receivables with other customers rise, their patience will wear thin.

Eventually, all creditors reach a point where they are either tired of working with their debtors or they cannot afford to keep working with their debtors, and they turn their A/R over to an attorney or a collection agency.

The collection process generally begins by the creditor sending a demand letter to the debtor. In connection with this, if the creditor knows what they are doing, they will typically send a Farmer-Lender Mediation notice (unless the debt is less than \$15,000). From here, the debtor will either: (1) request Farmer-Lender Mediation; (2) not request mediation and attempt to conceal the collection action from the bank; or (3) declare bankruptcy. Each scenario has substantial ramifications for the bank.

Farmer-Lender Mediation

In this first scenario, the bank is notified of the pending mediation proceedings and they will be invited to participate. This action alone is generally enough to trigger a default under the loan documents. Or, at the very least, the bank now has to be concerned that: (1) another creditor is taking action that could result in a judgment against the borrower and could threaten the stability of the farming operation; and (2) the borrower has likely burnt a bridge with a supplier or service

provider, necessitating that the borrower find an alternate supplier or service provider in the future.

If the loan is an FSA loan, the bank will need to submit to the FSA a Guaranteed Farm Loan Default Status Report and then follow applicable FSA servicing/collection guidelines.

If the loan is not an FSA loan, the bank would still be well advised to consider formally declaring a default. If the bank chooses not to declare a default, it should at least document its rationale for not doing so for regulatory compliance purposes.

In any event, the bank will need to participate in the Farmer-Lender Mediation process, which lasts up to 90 days.

To avoid having the initiating creditor proceed with collection action after the mediation ends, the bank itself will likely need to advance the funds necessary to pay off the creditor. This gets the bank in deeper with a struggling borrower.

Alternatively, the bank can proceed with liquidation itself. Such action would likely be advisable if other creditors start aggressively pursuing collections against the borrower, since said action will likely destabilize the operation.

In either case, the other creditor has forced the bank into taking significant action with respect to its borrower that the bank likely prefers not to take.

Borrower Conceals Collation Action

The second scenario involves the borrower not requesting mediation because they want to hide from the bank the fact that collection action is occurring. Such failure to notify itself would likely be a default under the loan documents, and would be a very problematic development because it would evidence a fundamental erosion of trust between bank and borrower.

In this scenario, there is a very high risk that the borrower will attempt to solve the problem by liquidating equipment or commodities subject to the bank's security interest to pay off the collecting creditor. Such action would constitute conversion, and would work to undermine the bank's collateral position with respect to the borrower.

This situation may also give rise to direct fraud, if the borrower subsequently represents that s/he still has the collateral that has been liquidated.

All things considered, when something like this happens, the bank really has no option but to pursue liquidation against the borrower given that delay will likely result in a further conversion of collateral.

Borrower Bankruptcy

If the debt to the other creditor is large enough, it is possible that the borrower will opt to declare bankruptcy. The borrower will likely declare Chapter 7 Bankruptcy if they just want to liquidate the operation, Chapter 12 Bankruptcy if they want to restructure the operation through a 3-5 year payment plan, or a Chapter 11 Bankruptcy if they wish to restructure and they are a very large farming operation. In any case, the Borrower will

be in default and the bank will have to file a claim and take steps to protect its collateral and its legal rights.

If the borrower declares Chapter 7 bankruptcy, the bank will likely need to bring a lift-stay motion to get the collateral out of bankruptcy, and then proceed with liquidation action against the collateral.

If the borrower declares Chapter 11 or 12 bankruptcy, the bank will have to work through the plan confirmation process, and will potentially want to bring a lift-stay motion to get collateral out of bankruptcy and then proceed with collection (even though this will be a harder process than under a Chapter 7).

Conclusion

Bottom line, the mere fact that a credit is renewed in 2019 does not guaranty that liquidation action will be avoided in 2019. Agricultural goods and service providers with past due debts can destabilize a borrower's operation in numerous ways that force banks to either advance funds to pay them off, or else proceed with involuntary liquidation.

-Matthew Bialick, Esq.

Outside Insights



A Forum for Thoughts and Articles from
Sources Outside of the Johnson | Bialick Law Firm

The Collateral Conundrum – What Will Happen to Equipment Values in 2019?

An Interview with All States Ag Parts CEO John Dyke

As farm revenues continue to slump, it becomes more and more important for banks that collateral holds its value as much as possible. If collateral values plummet, banks might be forced to declare a non-monetary default and place the credit on non-accrual for regulatory reasons.

One important source of collateral is agricultural equipment. So, an important question for all ag bankers is what will happen to ag equipment prices in 2019?

To find the answer, I talked to John Dyke, the CEO of All-States Ag Parts. As one of the nation's largest buyers of used ag equipment, All States keeps its finger on the pulse of the market.

According to Mr. Dyke: "today's market is a bit unstable with low commodity prices, over supplies in some grains and uncertainty brought about from tariffs. With even more uncertainty than usual, it's particularly difficult to predict where used equipment pricing will go in

2019. That said, overall, All States Ag Parts expects used ag equipment prices to remain stable or decrease slightly in 2019. One notable exception may be the price for good quality, late model, higher horsepower tractors. We have noticed prices there to be strengthening.”

In closing, Mr. Dyke noted that “as it seems to always be for farmers, a new trade deal or unexpected weather

conditions can dramatically change the entire ag economy in a matter of weeks.” As such, all we can do is wait, watch and hope for the best.

John Dyke is the CEO of All-States Ag Parts. Mr. Dyke can be contacted for questions or inquiries at j.dyke@tractorpartsasap.com.

THE ENLIGHTENING ROUND

Q: If collateral is jointly owned by multiple borrowers and one borrower declares bankruptcy, can I still collect against the other borrower?

A: You can still bring a lawsuit against the other borrower, but you cannot take any actions against the collateral until after the collateral is removed from the bankruptcy estate through a “lift stay motion.” As such, from a practical perspective, a bankruptcy by one borrower typically freezes collections against all borrowers.

Q: If a guarantor files bankruptcy can I still collect against the borrowers and their collateral?

A: Yes, a guarantor bankruptcy filing does not affect a bank’s ability to pursue collections against the borrower or the collateral, unless the guarantor has an ownership interest in the collateral, in which case the bank would need to bring a lift stay motion with respect to the collateral.

Q: If a borrower files bankruptcy can I still collect against the guarantor?

A: Yes, except that you cannot take action against any borrower owned assets.

Successfully Navigating Through Farmer Bankruptcies (video replay)

The troubled agricultural economy has already resulted in a sharp increase in bankruptcy filings, with many more projected in 2019. This webinar will examine the various chapters of bankruptcy that are likely to be filed by farmers and it will provide practical insight on how bankers can successfully navigate through the different types of bankruptcy.

Viewing Link: <https://attendee.gotowebinar.com/register/5426665322927917058>

