

---

## Feature Articles: Topics from the AALA Annual Educational Symposium 2020

---

Our 2020 annual conference was an unusual one due to its largely online COVID-19 format, but that didn't hinder the value of education provided by our presenters. We asked a collection of AALA members to tell us about the

sessions they enjoyed at the conference. While we couldn't include all of them here, we invited speakers from three popular conference sessions to convert their presentations into articles. Many thanks to these speakers for spending the

time to share their knowledge not just at the conference, but also here in the Update.

---

### A Primer for Successfully Resolving Distressed Agricultural Loans

**Michael D. Fielding, Stefan Knudsen and Richard Beheler**

*Michael is a Partner, Food & Agribusiness, with Husch Blackwell LLP in Kansas City, Missouri, Stefan is the Vice President and General Counsel for MFA Incorporated in Columbia, Missouri and Richard is a Senior Attorney in Commercial & Special Assets for SouthLaw, P.C., in Overland Park, Kansas.*

---

The past few years have been tough for farmers with the 2019 trade wars and the 2020 COVID-19 pandemic. Despite the recent surge in commodity prices, many producers are still hurting financially. This article briefly discusses how secured lenders view distressed agricultural loans in various contexts. By understanding the rights and remedies that each party has, borrowers can engage in more meaningful discussions with their creditors with the goal of reaching an amicable resolution.

#### *Pre-Loan Enforcement Considerations for Distressed Agricultural Loans*

Pre-loan enforcement begins with the lender reviewing its file to ensure that loan documents have been properly completed and security instruments have been properly recorded and perfected. The lender will also verify whether it has obtained assignments of federal government payments and crop insurance and whether proper notices have been issued under the Food Security Act. Lenders will also determine their respective order of priority versus other secured creditors and consider the financial status of

all guarantors in evaluating possible avenues for repayment. Loan workouts are opportunities to fix past mistakes and structure the deal to enhance the likelihood of full loan performance.

When signs of financial distress appear, lenders may increase the number of on-site visits as they more closely monitor their collateral. If the collateral is livestock the lender will want to ensure that it has been properly tagged, branded, or microchipped. Lenders will also need to verify the location of collateral—particularly items that are easy to move. Lenders should confirm that the collateral is insured and that the lender is named as loss payee. The nature of the collateral and, if living, the collateral's life-cycle will greatly influence how and when a lender may act to protect its interests.

Prudent lenders will also evaluate the borrower's incentives, including their need or desire to continue farming if the collateral is liquidated. The borrower's responsiveness, sophistication, and honesty are also vitally important. Proactive, responsive, and trustworthy farmers are much more likely to work

something out while non-responsive producers who fail to maintain credibility will tend to draw the lender's ire as the level of trust deteriorates. As a lender considers a possible loan resolution it will want to know what assets, collateral pledges, or turnovers it can voluntarily receive through settlement that may be difficult or impossible to achieve through loan enforcement.

For a loan workout to be successful the borrower needs to be honest and personally accountable. The borrower must genuinely understand the reasons for their financial distress, which frequently go beyond market conditions (e.g., poor management, excessive debt, personal issues, etc.). The borrower should be prepared for meaningful discussions with the creditor, providing detailed business records upon request, and creating a truly realistic business plan. Such plans often require the borrower to make substantive compromises. Many borrowers will want to consult with other professionals (e.g., tax advisors, temporary farm managers, or attorneys) for advice.

The following table provides an overview of options that exist for both parties in the context of a troubled loan.

| Lender  | Borrower/Producer  |             |                |             |                         |
|---|--|-------------|----------------|-------------|-------------------------|
| Amend loan documents  | Pledge new collateral  |             |                |             |                         |
| Forbearance agreement   | Provide an additional guaranty   |             |                |             |                         |
| Mediation   | Mediation  |             |                |             |                         |
| Initiate legal action*  | Liquidate or surrender collateral (remember taxes will be associated with selling appreciated land)  |             |                |             |                         |
| Foreclosure/liquidate collateral (real or personal property; judicial* or non-judicial foreclosure) | Refinance with a new lender. Other lenders include:<br><table border="0" style="margin-left: 20px;"> <tr> <td>Local banks</td> <td>National banks</td> </tr> <tr> <td>Farm Credit</td> <td>Non-traditional lenders</td> </tr> </table> | Local banks | National banks | Farm Credit | Non-traditional lenders |
| Local banks   | National banks   |             |                |             |                         |
| Farm Credit   | Non-traditional lenders  |             |                |             |                         |
| Appoint a Receiver*   | File bankruptcy*   |             |                |             |                         |

\*Involves legal proceedings

With these options in mind, it is important to consider certain key aspects of distressed agricultural loans to better understand how the lender may pursue its remedies.

#### *Government Payments and Crop Insurance*

Government payments are general intangibles for purposes of the Uniform Commercial Code (UCC). For the government to recognize the lender's security interest an assignment of the government payments must be filed with the local USDA's Farm Service Agency (FSA) office. Similarly, crop insurance is also a general intangible under the UCC. To perfect a security interest in crop insurance proceeds the lender needs to obtain an assignment on the insurer's form. Payment will be by joint check to borrower and creditor. Federal preemption ends and the UCC applies once the government payments or crop insurance proceeds are deposited in the borrower's account. Borrowers build trust when they fully cooperate with their lender to ensure the proper assignment of government payments and crop insurance proceeds.

#### *Farm Personal Property*

It is important to most agriculture lenders to have a first-priority position in collateral, though some lenders will lend based upon a junior lien position. For a security interest to attach to collateral there must be value given, the debtor must have rights in the collateral, and there must be a security agreement. UCC § 9-203. Perfection in personal property is typically done by filing a financing statement. See UCC §§ 9-310, 9-312, 9-502 and 9-503. However, perfection in titled vehicles must be done through a notice filed through the state's vehicle registration agency responsible for titled vehicles. The general rule regarding priority is the creditor that is either first in time of filing or perfection wins. UCC § 9-322. But there are special priority rules that apply to purchase money security interests (i.e., security interests where the lender provides the capital to obtain the personal property). UCC §§ 9-103 and 9-324. Additionally, certain collateral (most notably a deposit account) requires control for priority purposes. UCC § 9-327.

Significantly, not all methods of protecting an interest in farm products are covered by the UCC. Congress has enacted the Food Security Act (FSA). 7 U.S.C. § 1631. The FSA's general rule is that "a buyer who in the ordinary course of business buys a farm product from a seller engaged in farming operations shall take free of a security interest created by the seller, even though the security interest is perfected; and the buyer knows of the existence of such interest." 7 U.S.C. § 1631(d). But there is a major exception—if the lender has submitted a Notice of Security Interest then the buyer will acquire the farm products subject to the lender's lien if the buyer fails to remit payment to the lender as instructed. 7 U.S.C. § 1631(e). To facilitate the notice process the FSA allows states to create a centralized filing system that allows a single filing noting the lender's security interest, but so far only 19 states have adopted a such a system.<sup>1</sup>

Lenders will employ traditional means as allowed by the UCC to enforce their liens in collateral. This includes pursuit of both nonjudicial and judicial remedies to enforce a security interest. UCC § 9-601. "After default, a secured party may sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing." UCC § 9-610(a). A secured party may set-off a deposit account and apply the cash to debt. Regarding personal property, they may repossess the collateral or render it unusable. UCC § 9-609. However, a secured party cannot "breach the peace" in pursuing its default remedies. UCC § 9-609. Some borrowers will post "No Trespassing" signs on their property or otherwise prevent unauthorized entry by repossession professionals. Sales of collateral may be by private or public sale. Sales must be commercially reasonable or the lender will lose its deficiency rights. Notice is required before disposing of collateral. UCC § 9-611. Secured creditors may also accomplish a strict foreclosure by accepting the collateral in full or partial satisfaction of the obligations owed. UCC § 9-620.

#### *Farm Foreclosures*

Some states require a judicial proceeding to foreclose mortgages on real property while other states have a non-judicial foreclosure process whereby foreclosure occurs without a legal proceeding being filed. Regardless of the method the final result is the same: the property is liquidated to pay the debt owed. A borrower's right of redemption will vary from state to state, but as a general rule, the property may remain in possession of the property during the redemption period and may redeem the foreclosed property by paying the debt that was secured by the property.

<sup>1</sup> States with centralized filing systems: Alabama; Colorado; Idaho; Louisiana; Maine; Minnesota; Mississippi; Montana; Nebraska; New Hampshire; New Mexico; North Dakota; Oklahoma; Oregon; South Dakota; Utah; Vermont; West Virginia; and Wyoming. Source: <https://www.gipsa.usda.gov/laws/cleartitle.aspx> (last visited Aug. 28, 2020).

### *Farm Receiverships*

Both state and federal law allow for the appointment of a receiver. The grounds for appointing a receiver can be contractual (i.e., a specified remedy in the loan documents) or legal (e.g., imminent danger of loss of assets, possible fraud, or managing property pending a foreclosure and redemption period). Receivership benefits include: (a) the receiver has control of assets instead of the borrower; (b) the receiver prevents waste or mismanagement of assets; (c) the order appointing a receiver can be very broad and include additional protections; and (d) the receivership proceeding allows for the orderly liquidation of assets. Conversely, courts sometimes refuse to appoint a receiver. When granted, receiverships can be expensive due to the engagement of professionals and the requirement to post a bond. And even then an adverse borrower can try to thwart the receiver's efforts.

### *Chapter 12 (Farm) Bankruptcies*

Borrowers file for bankruptcy protection because it immediately invokes the automatic stay which stops enforcement of all creditor actions. 11 U.S.C. 362. During the stay period the borrower can sell real or personal property free and clear of liens and restructure debt repayment terms while keeping their essential property. Bankruptcies can be expensive and their outcomes uncertain. In the context of a corporation or limited liability company, the filing may trigger personal guaranty obligations of the owner.

Only "family farmers" or family fisherman with regular annual income may file for Chapter 12 relief. The term "family farmer" is broadly defined, however, and in addition to individual farmers, includes any entity in which 50% or more is owned by a farmer, 80% of its assets are related to farming, and at least 50% of its debts is related

to farming. There is a \$10 million debt limit for Chapter 12 bankruptcy filings. Any person or entity with debts exceeding that limit must seek Chapter 11 bankruptcy protection, which is more costly and complicated than a Chapter 12 proceeding.

A Chapter 12 debtor retains all property (except property voluntarily surrendered to a creditor). A Chapter 12 debtor can use the bankruptcy to modify liens on real and personal property. Secured debts can be bifurcated into secured portions and unsecured portions. If the debtor completes all of the payments over the required three or five year period then the debtor typically obtains their bankruptcy discharge, which is an injunction barring creditors from seeking to collect certain debts of the debtor. Factors that tend to make a bankruptcy successful for a borrower include: (a) sufficient liquidity; (b) a realistic and feasible plan of reorganization; and (c) sufficient operating capital to make the bankruptcy plan work. If a farmer cannot cash flow their farm within a Chapter 12 bankruptcy proceeding then it is unlikely that a plan will be confirmed or that a plan will be successful.

### **Conclusion**

While financial troubles can be an emotional experience, wise borrowers will take a business-like approach when addressing such challenges. Agricultural lenders prefer amicable workouts for distressed loans, but successful resolution often requires the producer to communicate, cooperate, and make meaningful compromises. A borrower who does not want to make genuine concessions will quickly find themselves mired in costly and uncertain legal proceedings as the lender likely transitions from focusing on a voluntary work-out to enforcing its rights.