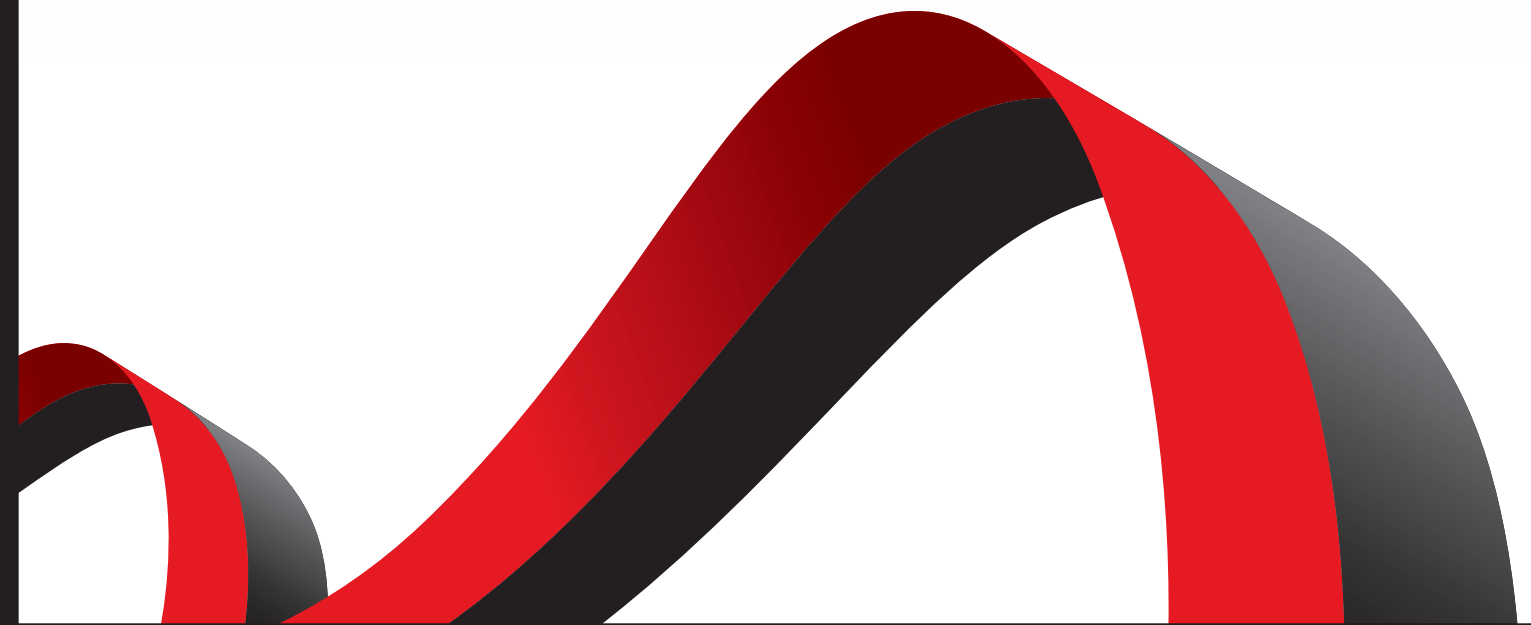


Banking & Finance Law Report

Blog series: **Agricultural Industry Financing**



A relationship of a
different stripe.

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Table of contents

<u>Porter Wright Resources</u>	3
<u>Amendment to Agricultural Lien Law Reinforces Decision in Ohio Dept. of Agriculture v. Central Erie Supply & Elevator Association</u>	4
<u>Lending Issues to Consider With Respect to The Perishable Agricultural Commodities Act of 1930</u>	6
<u>A Hypothetical in Agricultural Lending — Meet Farmer Bob, AgBank and Massive Grain Elevator</u>	8

Porter Wright Resources

Porter Wright's Banking & Finance and Bankruptcy, Workout & Creditors' Rights practice groups include more than 30 attorneys with extensive experience in energy sector financing. These attorneys include:



Jim Grady chairs Porter Wright's Banking & Finance practice group. His puts his depth of financing experience to work for a diverse group of industries and owners. He also advises clients on letters of credit and swap transactions, and conducts seminars on secured transactions under Article 9 of the UCC. (Columbus, OH)



Jim Botti, who chairs the firm's Bankruptcy & Reorganization practice group, has spent his 30-year career representing banks and other financial institutions in negotiating and documenting complex commercial loan transactions, and in handling troubled "workout" situations both inside and outside of bankruptcy. (Columbus, OH)



Andy Bojko advises lenders and borrowers in commercial lending, asset-based financing, mezzanine debt and leveraged buyouts. He also handles a variety of real estate matters, with an emphasis on construction and permanent loans, leasing and acquisitions/divestitures. (Columbus, OH)



Don Fisher has substantial experience in the areas of secured transactions, particularly in connection with documentation of loans and workouts, and representing financial institutions in matters involving lender liability claims, letters of credit, bankruptcy, creditor rights and foreclosure and collection litigation. (Cleveland, OH)



Polly Harris counsels financial institutions in commercial transactions and litigation. She represents lenders in commercial loan documentation, workouts, collections, foreclosures and bankruptcies as well as in lender liability, lending discrimination, contract and commercial paper actions. (Columbus, OH)



Tami Hart Kirby practices in the areas of creditor's rights, real estate, and commercial and business transactions. She represents financial institutions and businesses in all aspects of creditor's rights, including the rights and remedies available under UCC, the Bankruptcy Code and applicable state law. (Dayton and Cincinnati, OH)



Phil Langer represents banks and financial institutions on lender liability issues, loan work out, commercial litigation, loan restructuring and documentation. He has also been involved in more than 200 acquisitions of bankrupt companies or their assets, and was lead counsel in several debtor cases. (Cleveland, OH)



Walter Reynolds has developed an excellent reputation representing brokerage firms, banks, insurance companies, savings and loan associations and other financial institutions. He has handled many construction disputes representing owners, contractors, subcontractors, and material suppliers. (Dayton, OH)



Grant Stephenson has vast experience in the law and regulation of financial institutions. He represents clients regarding business acquisitions, financial institution mergers and acquisitions, issuing public and private securities, corporate reorganization and bankruptcy, and technology matters. (Columbus, OH)



Bill Weir represents a variety of financial institutions in the areas of real estate lending. He regularly represents lending institutions as lead counsel in multi-million dollar construction loans on projects located throughout the United States. He also represents financial institutions in real estate loan workouts and restructurings. (Cleveland, OH)

Amendment to Agricultural Lien Law Reinforces Decision in *Ohio Dept. of Agriculture v. Central Erie Supply & Elevator Association*

Nov. 27, 2013 | Amy Strang

A recent change to Ohio's agricultural lien law clarifies the interplay between security interests governed by Article 9 of the UCC and those governed by Ohio's agricultural lien statutes, and confirms the ruling of the Sixth Appellate Court of Erie County in *Ohio Dept. of Agriculture v. Central Erie Supply & Elevator Association*, 2013-Ohio-3061.

Central Erie Supply & Elevator Association (Central Erie) operated a grain elevator that it used to receive grain and other commodities from farmers (known as "claimants" under the statutory scheme) and sell the commodities to third parties. This made Central Erie an "agricultural commodity handler" under Ohio Revised Code Chapter 926. Pursuant to ORC § 926.021(C), the claimants who provided commodities to Central Erie retained a statutory lien on the commodities until they were paid.

Central Erie also had received financing from, and granted security interests in its

assets to, appellant Citizens Banking Company (Citizens), which had perfected its security interests in Central Erie's assets pursuant to Article 9 of the UCC as applicable in Ohio.

Central Erie's operations failed, vesting the director of the Ohio Department of Agriculture (ODA) with exclusive statutory authority under ORC § 926.021(D) to enforce lien claims and allocate proceeds

of the disposition of Central Erie's assets. The ODA filed a complaint against Central Erie and Citizens seeking to enjoin the disposition of commodities subject to statutory liens in favor of the claimants and to bar Citizens from physically seizing the commodities or proceeds therefrom. The ODA also obtained summary judgment granting

it a priority-secured claim in favor of the claimants under Chapter 926.

Citizens appealed this grant of summary judgment, asserting that the trial court erred in concluding that the ODA's lien



under ORC § 926.01 had priority over Citizen's lien under UCC Article 9. The appellate court affirmed the trial court's ruling, citing ORC § 926.33, which provides that, in the event of a conflict between the provisions of Chapter 926 and Article 9 of the UCC, the provisions of Chapter 926 take precedence.

In a dissenting opinion, Judge Yarbrough denied that any conflict between the provisions of ORC Chapter 926 and Article 9 of the UCC actually existed. Judge Yarbrough wrote that the provisions of ORC § 926.021 were limited to the determination of priority of liens held by claimants, and did not address the relative priorities of liens held by claimants vs. liens perfected under Article 9 of the UCC. His dissent concluded that ORC § 926.021(D) "simply cannot stand for the proposition that claimants have a security interest that is superior to those held by other, non-claimant, secured parties," because the provision provided no guidance as to the relative priorities amongst claimants and other secured parties.

The Ohio General Assembly clarified the interplay of Chapter 926 and Article 9 by passing Senate Bill 66 on June 26, 2013, adding language to ORC §926.021 stating that "[t]he lien established under this section shall have priority over all competing lien claims asserted against the agricultural commodity assets." This change became effective Oct. 11, 2013, reaffirming the Central Erie court's decision that security interests held by claimants under ORC § 926 will indeed have priority over competing security interests perfected by non-claimant secured parties under UCC Article 9.

Secured lenders lending to agricultural commodity handlers in Ohio should familiarize themselves with these special agricultural lien provisions and seek guidance from experienced legal counsel with respect to their security interests in agricultural commodities.

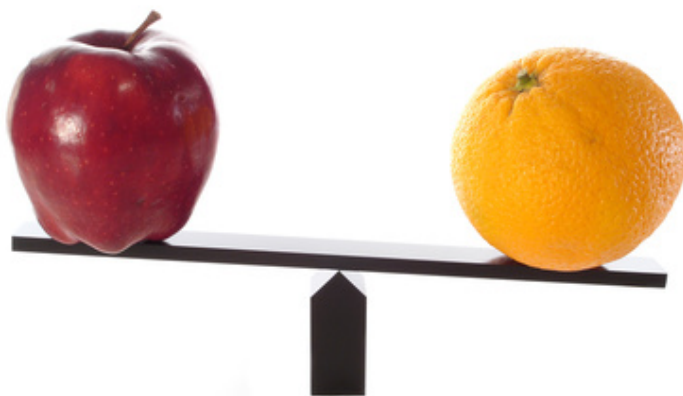
[Back to top](#)

Lending Issues to Consider With Respect to The Perishable Agricultural Commodities Act of 1930

Nov 7, 2013 | Andrew Bojko

Secured lenders extending financial accommodations to borrowers whose collateral includes perishable food items should consider certain specific risks associated with such collateral. Notably, the Perishable Agricultural Commodities Act of 1930 (PACA) creates a statutory trust for the benefit of persons who originally sell the perishable agricultural commodities to such borrowers and are not paid. The PACA trust creates a tier of claims that “float above” the secured lenders’ priority interests in the perishable agricultural commodities. Thus, until all suppliers of perishable agricultural commodities to a borrower are paid in full, a secured lender’s security interests in the borrower’s collateral consisting of perishable agricultural commodities or the proceeds thereof are trumped by the sellers’ PACA claims. Types of borrowers whose collateral may be subject to these PACA statutory trusts include restaurants, grocery stores, or any other businesses that deal with perishable agricultural products.

The burden is on the borrower/PACA debtor (as opposed to the beneficiary of the PACA trust) to establish that the subject assets (including inventory and accounts receivable) are not PACA trust assets. See *Sanzone-Palmisano C. V. M. Seaman Enterprises*, 986 F.2d 1010 (6th Cir. 1993) (finding that the PACA debtor had the burden of proving the assets producing the commingled proceeds were not produce or related assets and thus not subject to a



PACA trust). In certain instances, a lender may be able to avail itself to the bona fide purchaser defense and thus avoid the “floating” PACA claims. However, case law in this area makes it clear that in order to prevail on this issue, a lender must establish that it acquired the subject assets without knowledge of the “floating” PACA claims only after such lender conducted a thorough investigation into the matter. Courts hold that a thorough investigation generally requires the lender to contact all potential sellers within the sale and distribution channels. See *Consumer Produce Co. v. Volante Wholesale Produce*, 16 F.3d 1374 (3d Cir. 1994).

So then, what can a secured lender do to protect itself when it lends to a borrower with collateral potentially subject to these “floating” PACA claims? First, a lender may insert representations and warranties within the credit agreement to ensure that all third parties have been, and will continue to be, timely paid in full. Second, a lender

may insert a "PACA Reserve" within the borrowing base formula in order to ensure that obligations under any PACA trust are excluded from the value of collateral that the borrower may borrow against. Here is a sample definition of such a PACA Reserve:

"PACA Reserve" means all amounts owed from time to time by the Borrower to any person on account of the purchase price or other amounts owed in respect of agricultural products or any services related to the foregoing and subject to PACA, to the extent that (i) such amounts are secured (by way of a grower's lien, seller's lien, statutory trust or similar security interest or priority arrangement) by the applicable agricultural products (such lien, a "PACA Super Priority Lien") in accordance with PACA and (ii) the Lender determines in its permitted discretion that such PACA Super Priority Lien would have priority over the Lender's lien in any portion of the Collateral.

Third, a lender should assume that it will not have first-priority security interest in the perishable agricultural commodity inventory of a borrower. Finally, lenders should always consult with experienced legal counsel with knowledge of the PACA statutory framework and related case law.

[Back to top](#)

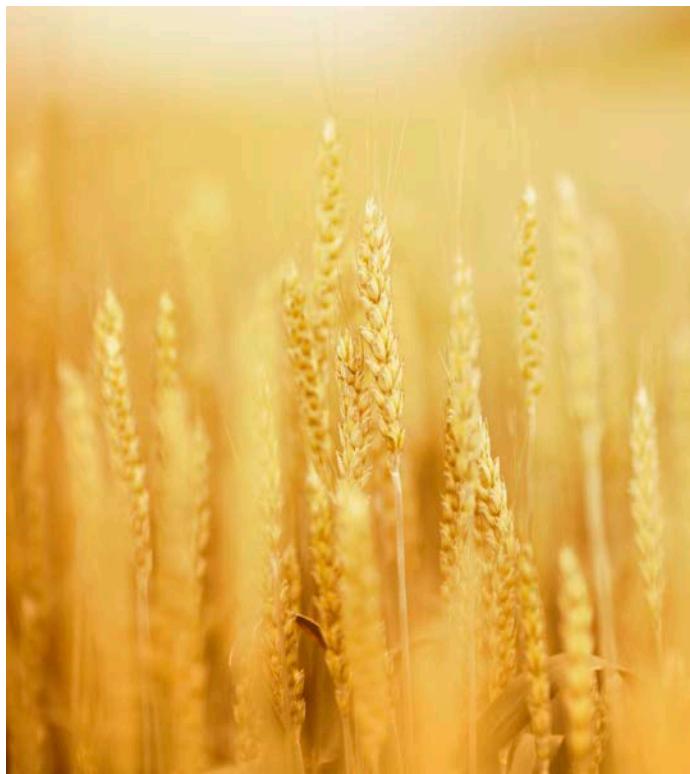
A Hypothetical in Agricultural Lending — Meet Farmer Bob, AgBank and Massive Grain Elevator

Oct. 29, 2013 | Jennifer Strazzella

In this hypothetical, we will consider the following circumstances.

- “Farmer Bob” grows wheat (i.e., crops)
- “AgBank” has loaned Farmer Bob money secured in part by his wheat
- “Massive Grain Elevator” wants to purchase Farmer Bob’s wheat

Can Massive buy the wheat and not get the shaft from AgBank? It depends. In 1985 Congress passed the Food Security Act; the provision 7 U.S.C. Section 1631, titled Protection for Purchasers of Farm Products (FSA), constitutes a wholesale preemption



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of the Uniform Commercial Code (UCC). UCC Revised Article 9-320(a) provides that:

“a buyer in ordinary course of business, **other than a person buying farm products from a person engaged in farming operations**, take free of a security interest created by the buyer’s seller, even if the security interest is perfected and the buyer knows of its existence.”

In addition, Official Comment 4 to 9-320(a) provides that:

“this section does not enable a buyer of farm products to take free of the security interest created by the seller ... however, a buyer of farm products may take free of a security interest under Section 1324 of the Food Security Act of 1985, 7. U.S.C. Section 1631”

Meanwhile, FSA Section 1324 provides that notwithstanding Article 9 of the UCC, farm product buyers, commission merchants and selling agents (buyers in ordinary course) take free of security interests in farm products created by sellers unless one of two exceptions applies: 1) direct notice or 2) special central filing.

Great. What does that mean?

If Massive is purchasing the wheat in a jurisdiction without a USDA certified central

filing system (such as Ohio), then Massive, as a buyer in ordinary course, can take the wheat without the shaft (i.e., AgBank's trailing security interest) if AgBank or Farmer Bob failed to notify Massive of AgBank's security interest in the wheat within the year before Massive's purchase of Farmer Bob's wheat.

Why would AgBank even know to notify Massive in the first place? In a direct notice jurisdiction, the burden is shifted to AgBank to notify all of Farmer Bob's buyers or potential buyers of its security interest in the wheat. The notice must be in writing and must contain:

- The names and addresses of the borrower and secured party
- The social security number or tax ID number of the borrower
- A description of the farm products and the crop year
- A reasonable description of the property on which the crops are grown, including the county where the property is located

It is up to Farmer Bob to pony up his buyer information to AgBank on a regular basis. What happens if Farmer Bob is less than honest and doesn't provide AgBank with Massive's name because Farmer Bob wants to keep all of the money he gets from Massive and go to Vegas? AgBank has a cow ... but the FSA provides that if Farmer Bob sells his wheat "off-list," he is subject to a civil penalty of \$5,000 or 15 percent of the value of the farm products, whichever is greater.

What if Farmer Bob "sees the light" and tells Bank about Massive, and AgBank properly notifies Massive — yet Massive still

makes the wheat proceeds check payable only to Farmer Bob? Massive gets the wheat and the shaft by taking the wheat subject to AgBank's security interest, and AgBank can sue Massive for conversion.

What if all the above occurs, but Massive makes the check payable to both Farmer Bob and AgBank? Massive gets the wheat and is not left with the shaft!

What if this hypothetical occurs in a different jurisdiction?

Let's now assume that Massive is purchasing wheat in a jurisdiction that has a USDA-certified central filing system (such as Montana). If Massive is a registered buyer in Montana, then Massive can take the wheat without the shaft (i.e., AgBank's trailing security interest) if AgBank failed to file in accordance with the federal central filing procedures.

So what's the federal central filing system? It's not the same thing as central filing under the UCC. The federal filing system contemplates collecting information from two separate sources:

1. The secured party must send an "effective financing statement" that shows the name of the debtor, the name of the security party, the type of farm product, the social security number or tax ID number of the debtor and a legal description of the realty on which the crops are grown
2. Potential buyers are required to register with the secretary of state and, based on this information, the secretary of state receives a list of all potential buyers

Taking into account the information set forth above, the secretary of state then compiles a Master List organized by type of encumbered farm product and the county where each product is produced. The secretary of state will periodically send this Master List out to all of the registered buyers, thereby providing notice to the registered buyers that the crops are encumbered.

What if Massive failed to register with the Montana secretary of state, AgBank failed to file its financing statement and Massive made the check payable only to Farmer Bob? AgBank gets the shaft, and Massive gets the wheat.

What if all the above occurs, but Massive makes the check payable to both Farmer Bob and AgBank? Massive gets the wheat and is not left with the shaft.

What if Massive failed to register with the Montana secretary of state, AgBank property filed its financing statement and Massive made the check payable only to Farmer Bob? Massive gets the wheat and the shaft by taking the wheat subject to Bank's security interest and Bank can sue Massive for conversion.

To summarize

When purchasing farm products in jurisdictions without a USDA certified central filing system (such as Ohio) if the seller fails to tell its existing lender(s) about the potential purchaser and the potential purchaser pays the proceeds directly to the seller, the seller is subject to civil penalties. If the potential purchaser knows about the existing lender(s) and pays the proceeds directly to the seller, the potential purchaser is subject to a conversion action.

When purchasing farm products in jurisdictions with a USDA certified filing system (such as Montana), it is up to the potential purchaser to check with the applicable secretary of state for any registration requirements in order to comply with registration and notice procedures set forth in such jurisdictions. Failure to comply with such requirements resulting in payment solely to the seller could also result in a conversion action filed against the purchaser.

[Back to top](#)

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