

The Pitfalls of Not Giving a Lien Notice to Buyers of Farm Products

SmithAmundsen Financial Services Alert
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We know the drill for obtaining a perfected security interest in crops (corn and soybeans) and other farm products as collateral: (1) Have the borrower execute a security agreement granting a lien on the crops and (2) File a UCC-1 Financing Statement (UCC-1) on the borrower with the Secretary of State. However, please be aware, you can still lose your lien to a buyer in the ordinary, such as the local grain elevator or ADM/Cargill, unless you provide those buyers with a timely written notice of your lien (Lien Notice) that follows the requirements of the Food Security Act of 1985 and the comparable UCC Article Nine provisions in your state.

To be clear, your perfected lien will not trump the rights of the local elevator that buys the crops from the borrower unless you provided the elevator with a timely Lien Notice. Without the Lien Notice, the elevator purchases the crop free and clear of your perfected lien, even if the elevator owner is holding your UCC-1 in his hand, as he watches the borrower unload his #2 yellow corn into the dump pit.

Why is the Lien Notice essential to protect your lien rights with buyers? The original Article Nine of the Uniform Commercial Code provided that buyers in the ordinary course would purchase goods free and clear of perfected liens, except for buyers of farm products. This protected lenders' liens but it put the local elevator, and ADM/Cargill, at risk of having to pay twice; first to the farmer, then to the lender that still had the lien on the crops. When Congress passed the Food Security Act of 1985 (the Act), it included § 1631 (d) and (e) (7 U.S.C. § 1631). In a nutshell, § 1631 states that a buyer, who has been provided a timely Lien Notice, is not a "buyer in the ordinary course" and therefore that buyer must issue a joint check to the borrower and lender or the buyer is potentially liable to the lender, because the crop was purchased subject to the lender's lien.

The Act preempts state law but Illinois, Indiana, Missouri and Wisconsin have revised Article Nine to generally follow the requirements of the Act. The Act, and our respective States' Article Nine provisions, generally require that the Lien Notice: (1) must state the lender's information, (2) must state the borrower's name, address and social security number or EIN #, (3) must have a description of the farm products, including the amount and the applicable crop year, (4)

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identify very specifically the counties where the crop are raised and include a reasonable description of the real estate and (5) state the amount owed. (Practice Point: Know the exact requirements of your state law on this, each is a little different.) The Lien Notice lapses after one year. If the buyer purchases crops one day after the lapse date, the buyer is a “buyer in the ordinary course” and takes free of the lien.

Stating the locations of the growing crops in the Lien Notice is a must. Require in your documentation that the borrower must provide you those legal descriptions. How do you know who the buyers will be? The Act also provides that your security agreement can require the borrower to furnish a list of buyers that it intends to use. If the borrower sells to someone else, it could be subject to a fine under the Act and/or State Article Nine law.

A borrower may ask that the Lien Notice not be given, arguing that it suggests to the potential buyers that the lender has credit issues with the borrower. But, as emphasized above, a buyer without the Lien Notice takes title to the crops free and clear of your UCC-1 perfected lien. Even though the Lien Notice process does require additional steps, in addition to the usual perfection method of filing a UCC-1, and the borrower may not be keen on it being sent, whether to send a Lien Notice should be on every checklist in the documentation of ag loans.

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