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Financial newsletter

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INSIDE THIS ISSUE

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SECURED CREDITORS ARE GIVEN A ROAD MAP TO RECOVER SEIZED VEHICLES

Minnesota has long authorized police departments and similar agencies to seize property associated with certain crimes and, under proceedings known as "civil forfeiture," assume ownership of the property. In the past, criminal property seizures have caused problems for secured creditors who have a properly perfected security interest in vehicles or other equipment that is seized by police departments because the applicable law did not define a secured creditor's rights to the forfeited property or provide a procedure to recover the property. Luckily, the legislature listened to the concerns of secured creditors and recently amended the law to include an "innocent owner" right of recovery for vehicles to be forfeited as part of a controlled substance seizure, lawful arrest or search, or other designated offense.

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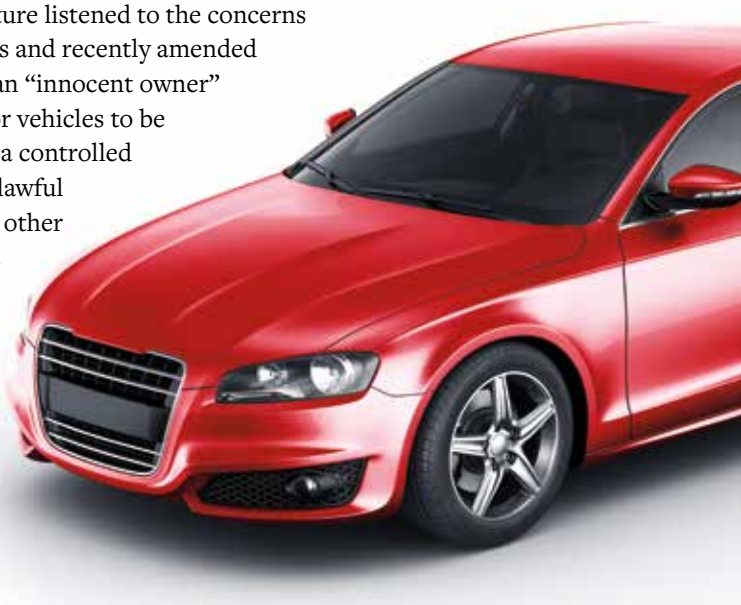

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SECURED CREDITORS ARE GIVEN A ROAD MAP TO RECOVER SEIZED VEHICLES

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Minn. Stat. §§ 169A.63 & 609.5314, Subd. 1a.[1] The new "innocent owner" law went into effect January 1, 2022, and applies to seizures under Minnesota Statute Sections 169A.63 (vehicle forfeiture related to impaired driving and other offenses) and 609.5314 (forfeiture of property in connection with a controlled substance seizure) that take place on or after that date.

Under the law, an "innocent owner" includes, "[a]ny person, other than the defendant driver, alleged to have used a vehicle in the transportation or exchange of a controlled substance intended for distribution or sale, claiming an ownership interest in a vehicle that has been seized or restrained" by law enforcement. § 609.5314, Subd. 1a(a).

When law enforcement seizes a vehicle, they are required to provide "all persons known to have an ownership, possessory, or security interest in seized property" notice of the seizure and the intent to forfeit the property. §§ 169A.63, Subd. 8(b) & 509.5314, Subd. 2.[2] The "innocent owner" may then assert its right to recover the vehicle by serving written notice of its claim to the prosecuting authority. This notice must be provided to the prosecuting authority within 60 days of the service of the notice of seizure. Although there is no specific case law on the subject, as the law is so new, a secured creditor could assert its right of recovery in a letter requesting recovery of vehicle as an "innocent owner". Although the law does not specifically state what needs to be included with the notice, a secured creditor should include a copy of the promissory note, security agreement, and lien card to assist the prosecuting authority in determining what property is at issue and whether the secured creditor is an "innocent owner" under the law and entitled to recovery of the vehicle.

Upon receipt of the notice from the secured creditor, the prosecuting authority may either release the vehicle to the secured creditor or proceed with the forfeiture. §§ 169A.63, Subd. 7a(b) & 609.5314, Subd. 1(b). If the prosecuting authority

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[1] The "innocent owner" right of recovery is currently limited to forfeitures related to a controlled substance seizure under Minnesota Statute Section 609.5314. It has not been extended to forfeitures related to other criminal activity, such as crimes associated with prostitution and fleeing a police officer under Section 609.5312.

[2] The notification to a person known to have a security interest in seized property applies only to motor vehicles required to be registered under chapter 168 and only if the security interest is listed on the vehicle's title.

decides to proceed with the forfeiture, it must file a separate complaint, in the name of the jurisdiction pursuing the forfeiture against the vehicle within 30 days of receipt of the secured creditor's notice. The complaint must be served on the "innocent owner". The forfeiture hearing should be held within 30 days of the filing of the complaint, to the extent practicable. §§ 169A.63, Subd 7a(d) & 609.5314, Subd. 1(d).

At a forfeiture hearing, the "innocent owner" must prove that it has an actual ownership interest in the vehicle and "did not have actual or constructive knowledge that the vehicle would be used or operated in any manner contrary to law or that the asserting person took reasonable steps to prevent use of the vehicle by the alleged offender." §§ 169A.63, Subd. 7a(f) & 609.5314, Subd. 1(f). Luckily a secured creditor generally does not have actual or constructive knowledge that the vehicle would be used for unlawful purposes. Thus the secured creditor should be in a better position than the debtor to obtain possession of the vehicle because it is easier for the secured creditor to establish itself as an "innocent owner". As such, the secured creditor should not rely upon the debtor's promises to recover the vehicle but protect its rights to the vehicle itself per the statute.

Unfortunately, however, if the court determines that the secured creditor is an "innocent owner" and orders the vehicle returned to the "innocent owner", the vehicle does not have to be released until the "innocent owner" pays the reasonable costs of towing, seizure, and storage incurred before the "innocent owner" provided the notice asserting its right to the vehicle and storage of the vehicle incurred more than two weeks after the court's order returning the vehicle to the "innocent owner."

If within 60 days after the notice of the seizure and forfeiture was sent, the law enforcement agency does not release the vehicle or bring a claim in court as laid out above, then the secured creditor as an "innocent owner" will need to file a demand with the court in the form of a complaint for judicial determination of the forfeiture.

Thankfully, after years of uncertainty, secured creditors have been given direction and support on how to recover collateral that has been seized by law enforcement.

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ENFORCEABILITY OF A LENDER'S SECURITY INTEREST IN A BORROWER'S MACHINERY AND EQUIPMENT

Over the last two years, the world has grappled with the COVID-19 pandemic. In an effort to address the economic crisis following the arrival of COVID-19, the United States took a number of significant actions, including, among other things, infusing cash into the national economy, generally, and the agricultural industry, in particular. The introduction of liquidity into the agricultural industry altered many aspects of typical lender-borrower relationships.

For example, over the past two years many lenders have not initiated foreclosure or replevin actions because borrowers have often times had sufficient cash reserves to pay their financial obligations to their lenders. In like manner, during this timeframe we have not seen a significant number of farmer-borrowers filing for Chapter 12 bankruptcy protection because these borrowers have been able to maintain their farming operations and pay their bills. That said, given economic uncertainties at home and abroad, lenders should be mindful that the agricultural economy could easily take a turn for the worse. If that were to happen, farmer-borrowers may find themselves cash-strapped and unable to pay their lenders. Given this possibility, it is advantageous for lenders to be mindful of the enforceability of their security interests in their collateral.

This article is intended to be a "refresher" regarding the enforceability of lenders' security interests in their borrowers' machinery and equipment. Depending upon the size of a borrower's operation, this category of collateral can serve as a significant source of recovery for a lender in the event that a borrower is unable or unwilling to voluntarily pay his or her financial obligations to the lender. But machinery and equipment can be easily liquidated by a borrower without the lender's knowledge or consent. This becomes a particular problem when the borrower does not voluntarily turn over the proceeds from the sale of this collateral to the lender. In these situations, in order to obtain a recovery, the lender may need to enforce its security interests against third parties who purchased the borrower's machinery and equipment.

By way of example, a lender may run into a situation similar to the following: Lender has a blanket lien on a farmer debtor's (Farmer) equipment, which includes a non-titled, four-wheel drive tractor. Farmer trades in the tractor to a dealership (Dealer), but Dealer does not obtain a release of the Lender's lien. Dealer subsequently sells the subject tractor to a second farmer (Farmer 2) without authorization from Lender. Lender must then determine (1) whether Lender has any recourse against the Dealer and/or (2) whether Lender has any recourse against Farmer 2. As a threshold matter, the following statutes provide the primary basis for addressing the situation referenced above.

The general rule applicable to traded-in farm equipment subject to a security interest is that "[e]xcept as otherwise provided in this article and in section 336.2-403(2): (1) a security interest or agricultural lien continues in collateral notwithstanding sale, lease, license, exchange, or other disposition thereof unless the secured party authorized the disposition free of the security interest or agricultural lien; and (2) a security interest attaches to any identifiable proceeds of collateral." Minn. Stat. § 336.9-315(a)(1)(2). Consequently, unless the buyer of traded-in farm equipment falls within an exception to Minn. Stat. § 336.9-315(a)

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ENFORCEABILITY OF A LENDER'S SECURITY INTEREST IN A BORROWER'S MACHINERY AND EQUIPMENT

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(1)(2), the buyer buys traded-in farm equipment subject to the security interest.

However, there are two primary exceptions to this general rule which may apply to the above situation. First, [e]xcept as otherwise provided in subsection (e), a buyer, other than a secured party, of . . . goods . . . takes free of a security interest or agricultural lien if the buyer gives value and receives delivery of the collateral without knowledge of the security interest or agricultural lien and *before it is perfected*." Minn. Stat. § 336.9-317(b) (emphasis added). Second, "[e]xcept as otherwise provided in subsection (e), a buyer in ordinary course of business, other than a person buying farm products from a person engaged in farming operations, takes 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." Minn. Stat. § 336.9-320(a) (emphasis added).

With these principles in mind, a lender encountering a fact-pattern like the one mentioned above may run into one of the following scenarios:

Hypothetical 1

On January 1, Lender loans $300,000 to Farmer, and Farmer grants Lender an enforceable security interest in all farm equipment, including but not limited to a non-titled, four-wheel drive tractor. On January 2, Lender files a properly completed financing statement describing the collateral as "all equipment." On August 1, unbeknownst to Lender, Farmer trades the subject tractor in to Dealer as part payment of the purchase price for a new tractor. On August 10, Dealer sells the subject tractor to Farmer 2. Lender does not know about the sale, and hence did not authorize the sale. On October 1, Farmer defaults on his obligations to Lender. On November 1, Lender learns that Farmer 2 has the subject tractor and seeks replevin. Who wins between Lender and Farmer 2?

Lender should win because no exceptions exist to the general rule in Minn. Stat. § 336.9-315(a) that the security interest follows the subject tractor notwithstanding the sale. As a threshold matter, Lender did not know about the sale, and hence Lender did not authorize the sale. Second, none of the "buyer rules" in Minn. Stat. § 336.9-317(b) and Minn. Stat. § 336.9-320(a) protect Farmer 2.

The exception in Minn. Stat. § 336.9-317(b) does not apply in this hypothetical because Lender had a perfected security interest *before* Farmer 2 purchased the subject tractor. Furthermore, the exception in Minn. Stat. § 336.9-320(a) does not apply because although Farmer 2 is a buyer in the ordinary course because it bought from someone (the Dealer) in the business of selling goods of that kind, the Dealer (the seller in this case), did not create the security interest. Rather, Farmer created the underlying security interest. In order for the exception in Minn. Stat. § 336.9-320(a) to apply the (1) buyer must be a buyer in the ordinary course, and (2) Farmer 2's seller must have created the security interest in the subject tractor.

Hypothetical 2

On January 1, Lender loans $300,000 to Farmer who grants Lender an enforceable security interest in all farm equipment, including but not limited to a non-titled, four-wheel drive tractor. On January 2, Lender files a properly completed financing statement describing the collateral as "all equipment." On August 1, unbeknownst to Lender, Farmer trades the subject tractor in to Dealer as part payment of the purchase price for a new tractor. On August 10, Dealer sells the subject tractor to Farmer 2. Lender does not know about the sale, and hence did not authorize the sale. On October 1, Farmer defaults on his obligations to Lender. On November 1, Lender learns that Dealer sold the subject tractor to Farmer 2, but Farmer 2 has himself since sold the tractor and Dealer cannot locate it. What remedy does Lender have against the Dealer?

Lender has a conversion claim against the Dealer because the Dealer purchased the subject tractor (by taking it on a trade) subject to Lender's security interest.

In sum, under certain circumstances a lender may seek to recover its collateral or monetary damages from persons or entities *other than* the lender's borrower. This is especially important to keep in mind in situations where a borrower may be judgment proof or file for bankruptcy after the lender commences a replevin action. In either case, recovering collateral from a cash-strapped borrower may not be an option, but the lender may be able to recover its collateral or obtain other relief from a third party who previously purchased the lender's collateral. Of course, each case is different, and a lender's collection options will vary depending upon the circumstances. Nonetheless, the "takeaway" from this article is that in many situations a lender's security interest will continue in its collateral following a borrower's disposition of that collateral. It may be worth pursuing that collateral from a third party in situations where a lender has limited options for recovering funds or collateral from a borrower who is unable or unwilling to honors its financial obligations to the lender.

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THURSDAY, MAY 12, 2022

Mayo Clinic Health System Event Center
Mankato, MN 56001

SCHEDULE

1:30 – SBA Update: What's New? What's Old and Still True?
with Alisha Podobinski (SBA Relationship Specialist) & Pete Stein

2:15 – Special Issues with Commercial Mortgages
with Michael Dove and Dean Zimmerli

3:00 – Short Break

3:15 – Current Topics, Issues and Cases
with Christopher Bowler and Jennifer Lurken

4:00 – Networking

REGISTER ONLINE BY MAY 2, 2022
$40 – Includes seminar, digital materials & networking

Scan code or go to:
gislason.com/event/commercial-lending-seminar-2022

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CASE LAW UPDATE: SECURING GRAIN BINS

At its September 9, 2021 Agricultural Lending Conference, Gislason & Hunter LLP provided a case law and legislative update regarding new legal developments pertinent to the lending industry. One of the cases presented was *Lighthouse Management, Inc. v. Oberg Family Farms et al.*, which was decided by the Minnesota Court of Appeals less than two weeks before the conference and dealt with how to determine whether a grain bin is a real-estate fixture that needs to be pledged as collateral pursuant to a mortgage or is personal property that needs to be pledged as collateral pursuant to a security agreement. Approximately three weeks after the conference, one of the parties to the case petitioned the Minnesota Supreme Court to review the Court of Appeals' decision. On November 16, 2021, the Minnesota Supreme Court denied that petition, and so the Court of Appeals' decision will remain precedential. The purpose of this article is to provide a summary of that decision and the specific factors it lays out for lenders to consider when financing agricultural operations that include grain bins.

Factual Background:

Oberg Family EQ Group, LLC granted Bell Bank a security interest in all of the equipment on its 20.87 acre bin site. In March of 2019, Bell Bank obtained a mortgage for the bin site real property and equipment.

In late 2018, Oberg Family EQ acquired a new grain bin from Gateway Building Systems, Inc., which was financed by American Federal Bank. American Federal Bank took out a mortgage on the bin site, including the real property and all the buildings, structures, and fixtures on the property. Gateway Building Systems, Inc. recorded a mechanic's lien in March of 2019 after its invoices went unpaid. In April of 2019, CITYWide Electric LLC, an electrical contractor, also recorded a mechanic's lien in connection with service to the property.

An assignment-for-the-benefit-of-creditors action arose due to the Obergs' insolvency and inability to pay debts. The District Court appointed respondent Lighthouse Management Inc. as the receiver and assignee. American Federal Bank, Bell Bank, Gateway, and CITYWide each claimed an interest in the sale proceeds following the liquidation of the Obergs' property in September of 2019.

American Federal Bank and Gateway argued that the bin-site structures were fixtures and should be treated as real, not personal, property. By contrast, Bell Bank argued that the bin-site structures were personal property and subject to Bell Bank's security interests, which were perfected in 2010. The District Court determined that "the grain bins are personal property and not fixtures." American Federal Bank and Gateway challenged the decision on appeal.

Issue:

Whether a grain bin constitutes a real-estate fixture or personal property, and whether this is a question of fact to be decided by the factfinder.

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Analysis:

The Court of Appeals held that a grain bin may constitute a real-estate fixture or personal property depending on the circumstances and that the determination should be made by the factfinder. The Court of Appeals also established four factors that should be considered in making the determination: (1) whether the grain bin can be removed without leaving the real property in a substantially worse condition than before; (2) whether the grain bin can be removed without breaking it into pieces and damaging the grain bin itself; (3) whether the grain bin has any independent value once removed from real property; and (4) the intent of the parties.

Applying the above factors to the case, the Court of Appeals then found that there were genuine issues of material fact regarding whether the grain bin at issue could be removed without damaging the real property and whether the grain bin could be removed without damaging the bin itself. If the grain bin could be removed without causing damage to the real property or the bin, the facts would weigh in favor of the bin being personal property. The Court of Appeals also found that a question of fact existed regarding whether the grain bin had independent value after removal, noting that the grain bin had already been moved once before and, as a result, could have distinct value. Lastly, the parties disputed their intent. American Federal Bank argued that the Obergs regarded the grain bin as an improvement and therefore a fixture. However, other evidence suggested that the grain bin was depreciated as personal property for tax purposes. Ultimately, and because it determined that these factual questions existed, the Court of Appeals did not decide whether the grain bin constituted a real-estate fixture or personal property and instead remanded the case back to the District Court for further proceedings.

If anything, the Court of Appeals' decision establishes that there is no clear-cut rule a lender can turn to on this topic. Instead, various facts will need to be considered and evaluated by lenders when determining lien positions and the proper documentation for a loan to agricultural operations that include grain bins.

Save the Date

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AGRICULTURAL LENDING CONFERENCE | 2022

THURSDAY, SEPTEMBER 8, 2022

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