

LANDLORD OBTAINING SECURITY FOR DELINQUENT RENT PAYMENTS FROM A FARMER

Many farmers in the Central Coast grow crops on land that they either own or lease from a landowner. Certain farmers have found it difficult to stay current with their rent payments based upon the low commodity prices or not being able to obtain contracts to sell their product. Although these farmers may want to stay current with their rent payments, the reality is that some of them will become delinquent in their rent payments to the landowner. In that event, the landowner has several options. The first is to evict the farmer from the land by pursuing an unlawful detainer action. However, another option is to give the farmer some time to bring the rent payments current. If the landowner decides to pursue the latter option, then the landowner should obtain some type of security in the farmer's crops and equipment for the delinquent rent payments. This article will address the procedures for a landowner to take such actions.

Agricultural Lien

California law distinguishes between an agricultural lien versus a lien that is perfected by a security interest in specific collateral. An agricultural lien is an interest (other than a security interest) in farm products that meets certain specified conditions. The term "farm products" is defined to include crops, livestock and supplies used or produced in a farming operation (Commercial Code Section 9102(a)(34)). An agricultural lien must secure the payment or performance of an obligation for either (i) goods or services in connection with a debtor's farming operation or (ii) rent for real property leased by a debtor in connection with the debtor's farming operation (Commercial Code Section 9102(a)(5)(A)). A landowner will have a valid agricultural lien against the farm products of a farmer-tenant if the landowner leased the land to the tenant in connection with the debtor's farming operation (Commercial Code Section 9102(a)(5)(B)) and the farmer-tenant is delinquent in its rent payments.

However, there are certain limitations on an agricultural lien. The primary limitation is that an agricultural lien only applies to "farm products" and not to any other assets of the farmer. A security interest (as discussed below) can apply to all of the farmer's assets and not just farm products. The second limitation is that an unperfected agricultural lien is only useful to the landlord who retakes possession of the land and only as to crops in the ground. Otherwise, if the crop is in the field and the landlord has not taken possession of the land, then the landlord cannot obtain possession of the crop or do anything with the crop. Furthermore, if the farmer has sold the crop to a bona fide purchaser, then the landlord will be subordinate (or junior) to the bona fide purchaser if the landlord is an unsecured creditor with respect to the crop. For these reasons, if a landowner elects to give a farmer more time to pay the delinquent rent, then the landowner should negotiate to obtain a security interest in the farmer's assets.

Security Interest

In most cases, a landowner will want to have additional assets (and not just farm products) pledged as collateral for the delinquent rent. The landowner will want to obtain

a lien on the farmer's equipment, crops and leased assets (such as tractors or irrigation pipe) and then perfect its security interest in such collateral in case the farmer does not pay the past due rent in a timely manner. Perfecting a security interest (by filing a UCC-1 financing statement with the Secretary of State) will put the landowner in the position of being a secured creditor with respect to the farmer. In evaluating whether to take a lien on the farmer's equipment, crops and leased assets as collateral for the delinquent rent, a landowner should conduct a UCC-1 lien search with both the Secretary of State and the County Recorder's Office in the counties where the assets are located and the farmer conducts business. The lien search will identify the names of all other secured creditors that will be ahead of the landowner. Furthermore, the landowner needs to initially talk with the farmer and get a written representation from the farmer as to any outstanding debts or liens on any equipment that the farmer has purchased. A purchase money lien from the seller of such equipment will have priority over all other liens despite the fact that the seller of such equipment has not filed a UCC-1 financing statement (see Commercial Code Section 9324). The landowner needs to conduct a lien search and separately determine if there are any purchase money liens in order to evaluate whether the assets have any remaining value.

Promissory Note or Lease Amendment

If the landowner determines that there is adequate equity in the farmer's assets and the farmer is willing to grant the landowner a lien on the farmer's assets, then the farmer must specifically acknowledge in writing the amount of the past due rent and when that amount is to be paid to the landowner. This can be done in the form of either a promissory note or an amendment to the lease between the landowner and the farmer. This assumes that there is a written lease between the landowner and the farmer. If there is not, then the landowner and the farmer should enter into a written lease agreement that is contingent upon payment of the delinquent rent at whatever time and in whatever amounts are agreed to by the landowner and the farmer.

The promissory note or the lease amendment must establish a clear and non-conditional payment obligation from the farmer to the landlord, including the amount of delinquent rent and when such rent is due. If the parties sign a lease amendment, then it should state that the lease will automatically terminate if the delinquent rent is not paid by the due date. Even if the lease has terminated because of nonpayment of rent, the landowner will need to proceed with an unlawful detainer action against the farmer if the farmer does not surrender possession of the land to the landowner. The promissory note or the lease amendment should state that such payment obligation is secured by a separate security agreement that the parties have entered into.

Security Agreement

In addition to preparing the lease amendment or promissory note, the landowner and farmer will need to execute a security agreement in which the farmer pledges its equipment, crops in the ground and other assets as collateral for repayment of the past due rent. One key element of the security agreement is to have an adequate description of the assets that are being pledged as collateral. This can be done in one of two ways. The first is by having a general statement that the farmer pledges any and all of his

equipment, accounts, fixtures, goods, inventory, investment property and farm products (and any other types of assets) as collateral for repayment of the past due rent. Commercial Code Section 9102 contains the definitions of the various types of personal property that may be pledged as collateral in a security agreement. It is important that the landowner's attorney carefully review Section 9102 and discuss with the landowner the different types of assets that the farmer should pledge as collateral for the past due rent.

A second option is to describe the collateral in specific terms, which may include (i) the manufacturer, make and serial number of different types of tractors, (ii) the number and types of irrigation pipes or joints, (iii) the number and types of discs or farm implements, and (iv) other specific types of farming equipment or assets. If the landowner decides to pursue this alternative, then any equipment that cannot be specifically described (such as irrigation joints) should be marked in such a manner that they can be readily identified as equipment that has been pledged as collateral for the delinquent rent. Such identification should include some type of permanent marking or etching on all such equipment. The marking should also be done in such a manner that would make it difficult for the farmer to remove the marking by painting the collateral. Whatever type of marking is placed on the equipment should be specifically referenced and identified in the security agreement so that all parties acknowledge that any such readily marked equipment has been pledged as collateral.

In order to take a security interest in crops, the security agreement simply needs to state that the farmer pledges all crops as collateral for the delinquent rent. The security agreement will then apply to all crops that the farmer is currently growing. The California Commercial Code used to require that a security interest in crops growing or to be grown could only be perfected if the security agreement contained a description of the real property on which the crops were grown. However, the real estate requirement no longer applies and the security agreement simply needs to include a statement that all crops are pledged as collateral. However, if the farmer only wants to pledge crops in a particular field or on a particular ranch, then the security agreement will need to identify the field or ranch upon which such crops are located.

Once the lease amendment (or promissory note) and the security agreement have been duly executed, then the landowner must file a UCC-1 financing statement with the Secretary of State in order to perfect the landowner's security interest. Failure to file the UCC-1 financing statement will effectively result in the landowner being an unsecured, as opposed to a secured, creditor. The UCC-1 financing statement does not need to contain a description of the real property on which the crops are located, unless identifying crops in a particular field or on a specific ranch. However, the description of the collateral should be the same in the UCC-1 and the security agreement in order to avoid any inconsistencies. The filing of the UCC-1 will perfect the landowner's security interest in the farmer's equipment, crops and tangible assets identified as collateral.

The Commercial Code used to require that the landowner record a certified copy of the UCC-1 financing statement filed with the Secretary of State with the County Recorder's Office in the county in which the crops are growing. However, the Commercial Code has been revised and this is no longer a requirement in order to establish a valid security interest in the crops. That being said, it may be a good idea to still record a certified copy

of the UCC-1 financing statement in the County Recorder's Office so as to put anyone on notice of the existence of this lien if someone does a lien search at the County Recorder's Office. Also, a landowner may consider recording a copy of the UCC-1 financing statement with the County Recorder's Office if the crops are deemed to be fixtures to the land. Commercial Code Section 9102(a)(4) defines "fixtures" as being "goods that have become so related to particular real property that an interest in them arises under real property law." This would apply to crops such as tree fruit or almond orchards.

Conclusion

A landowner should do the following if he wants to take a security interest in a delinquent farmer's equipment, crops and other assets:

1. Run a UCC-1 lien search with both the Secretary of State and the County Recorder to determine all outstanding liens.
2. Have the farmer give the landowner a list in writing of all equipment that the farmer has purchased for which the farmer still owes money.
3. Obtain an accurate description of the collateral to be secured and the location of the crops.
4. Negotiate, prepare and execute a lease amendment (or a promissory note) and a security agreement, paying particular attention to the description of the collateral.
5. Prepare a UCC-1 financing statement with the description of the collateral.
6. File a UCC-1 financing statement with the Secretary of State. In addition, the landowner should consider recording a certified copy of the UCC-1 financing statement with the County Recorder in the county in which the crops are located.

In the appropriate circumstances, a landowner may consider taking a security interest in a farmer's assets to insure the payment of delinquent rent. Before taking this step, a landowner must determine the likelihood of the farmer paying the past due rent in a timely manner. If this is likely, then the landowner may take a security interest in the farmer's equipment, crops and other assets. If it is not likely that the farmer will be able to pay the delinquent rent, then the landowner should not pursue this option and rather should terminate the farmer's lease and find a new farmer to lease the land.

Brief biography for the beginning section of Coastal Grower:

Patrick Casey is an attorney at Lombardo & Gilles, LLP, in Salinas and he manages the business department at Lombardo & Gilles. He has been practicing law for 15 years and he is a licensed Certified Public Accountant in addition to being a licensed attorney. Patrick uses his financial and legal background to negotiate the purchase or sale of stock, assets or real estate, section 1031 tax deferred exchanges, easement agreements, and various types of business and real estate disputes. He has also negotiated numerous agricultural leases (on the side of both landowners and farmers) and has represented landowners in obtaining security interests in a farmer's assets for delinquent rent payments. Patrick serves on the Board of Managers for the Salinas Community YMCA and has been involved in its annual community support campaign for more than 10 years. He may be reached at Patrick@lomgil.com.