

# LENDER ALERT

*Legal Issues Affecting Financial Institutions*

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## California Producer's Lien Trumps a Valid Perfected Article 9 Lien with Respect to Accounts Receivable

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The California Court of Appeal for the Fifth District held in *Frazier Nuts, Inc. vs. American Ag Credit*, 2006 Westlaw 2136213 (Cal.App.) that the California statutory agricultural producers' lien creates a lien on accounts receivable that is superior to that of a secured party which perfected its security interest in accordance with Article 9 of the California Commercial Code. This is an important development for financial institutions that lend to agricultural processors. If the *Frazier Nuts* decision stands it will mean that the lien granted automatically to agricultural producers which sell product to processors will be prior and superior to such lender's security interest and will extend to accounts receivable as well as inventory.


Prior to the *Frazier Nuts* decision, lender's relied on the plain language of the statute, namely California Food and Agricultural Code Section 55634, which reads:

"Every lien which is provided for in this article is on every farm product and any processed form of the farm product which is in the possession of the processor without segregation of the product. For purposes of this chapter, any and all farm products or processed form of farm products deposited by a processor with a warehouse, whether or not warehouse receipts are given as security to a lender, shall be considered as being in the possession of the processor and subject to the lien."

[Emphasis added]

In addition to the plain statutory language stating that the producers' lien attaches only to product in the possession of the processor, lenders could rely on the Bankruptcy Court decision in *In re Sergent Walnut Ranches, Inc.* (Bankr.E.D.Cal.1998) which stated that the California producers' lien attaches only to inventory sold by the producer to the processor while such inventory is in the possession of the processor and that such lien is extinguished once such inventory is no longer in such processor's possession. The *Sergent* decision also stated clearly that the producers' lien did not attach to proceeds of such inventory.

*(continued)*



The court in *Frazier Nuts*, however, relied on California Food and Agricultural Code Section 55638 for its decision, which reads:

“It is unlawful for any processor to remove, from this state or beyond his ownership or control, any farm product which is delivered to him, or any processed form of the farm product, to which any of the liens provided for in this chapter has attached, except for any of such product or processed product as may be in excess of a quantity on hand which is of a value that is sufficient to satisfy all existing liens. Furthermore, this section shall not prohibit the sale of any farm product or processed form of the product to which such a lien has attached, so long as the total proceeds of the sale are used to satisfy obligations to producers which are secured by a lien established pursuant to this chapter.”

The *Frazier Nuts* court held that the above section was meant to extend the producers' lien to proceeds of the inventory, namely accounts receivable, despite the conflicting language in Section 55634. The *Frazier Nuts* ruling is in disagreement with the analysis of the Sergent court and the Ninth Circuit Court (*In re Loretto Winery Limited*, 898 F.2d 715) of that same section. The courts in *Sergent* and *In re Loretto* determined that a violation of Section 55638 would result in the imposition of civil and criminal penalties on the violators of the statute but not an extension of the producer's lien to proceeds.

The *Frazier Nuts* decision may be appealed to the California Supreme Court. In the meantime, the *Frazier Nuts* interpretation of the producers' lien is the law in California and lenders must protect themselves. One strong defense is to ensure that the processor-borrower obtains a producers' lien waiver from each grower selling product to such borrower. Another important protection is the establishment of reserves against the processor-borrower's borrowing base for the amounts due to growers who have not provided such waivers, although such reserves may be problematic if the borrower's borrowing availability is tight.

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