Making the Most of Your Milk Check

What Dairy Farmers Need to Know About Assignments

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Introduction

Many dairy farmers have part of every milk check paid directly to their creditors through something known as an assignment. This booklet explains the legal meaning of assignments for dairy farmers. It gives pointers on things farmers may want to consider before they agree to an assignment. This booklet also discusses farmers' options if they give a milk check assignment and then a change in circumstances leaves them without enough money for living and operating expenses.

This booklet is written for educational purposes. References for the laws and regulations discussed are included at the end in case you wish to read further. This booklet discusses some relevant laws in Minnesota. The laws governing assignments in your state may be different. Federal laws may apply to an assignment to a federal government creditor, such as the Farm Service Agency (FSA). This booklet cannot substitute for an experienced lawyer who is up to date on the latest changes in federal laws and regulations, as well as the laws in your own state. For legal advice about your particular situation, consult an attorney in your area.

What Is an Assignment?

An assignment exists when one party transfers its interest in a right or property to another party. Dairy farmers often assign a part of their right to receive payment for the milk they produce to their creditors. These creditors may include banks, credit unions, Farm Credit Services, FSA, feed and seed suppliers, and equipment dealers.

An assignment is like a three-legged stool involving the farmer, the creditor, and the milk buyer. The milk buyer (sometimes called a creamery) owes the farmer payment for milk. The farmer owes a debt to the creditor. Once the creamery is informed that the farmer has assigned payment rights to the creditor, the creamery is legally bound to pay the creditor. If the creamery disregards a valid assignment, the creditor may be able to take legal action against the creamery.

Get It in Writing

One of the most important steps you can take when granting an assignment is to create a written agreement that includes the important details of the assignment, including a precise description of the types of payment being assigned and the amounts. If there are questions about what was agreed to, you can refer to the written agreement rather than having to rely on either party's memory of what was said. If you agree to change any of the terms of the assignment later, be sure to get that in writing, too.

If you ever need to prove that the assignment is valid over a later creditor's claim, you may need to produce the written agreement signed by both parties. In some states, you may need to prove that the first creditor's claim was recorded with the state or local government.

Two-Party Checks

Typically, when the creamery is made aware of a milk check assignment, it will make payment for the milk in the form of a two-party check. That is, when the creamery issues payment for milk received from the farmer, the check will be made out to both the farmer and the creditor. In general, the creditor is paid first when the check is cashed, because the farmer has transferred his or her interest in the payment to the creditor up to the amount of the assignment. After the creditor is paid, the farmer receives the remainder of the check.

Purposes of Assignments

The legal meaning of an assignment can be confusing for farmers. This is because assignments are used by creditors for two different purposes.

Assignments Used to Simplify Payment

Creditors act according to the first purpose when they request an assignment as a convenient way for the farmer to make payment. Some creditors require an assignment as part of every loan and every agreement to sell equipment, livestock, or other inputs on credit.

Assignments Plus an Interest in Collateral

Creditors act according to the second purpose when they ask for a security interest in the farmer's cows and in milk produced by the cows. A security interest gives the creditor a claim on property the debtor has offered as collateral. Creditors might ask for a security interest every time they extend credit, or only when the farmer applying for credit has had difficulty making payments on time in the past. When an assignment is backed by a security interest, the creditor has an ownership interest in the farmer's property offered as collateral. This puts the creditor in a powerful position. A security agreement makes it difficult for the farmer to avoid serious consequences if the creditor does not receive payment through the agreed-upon assignment. A creditor with a security interest in property may seek to repossess the collateral or to obtain a court judgment for money damages if the debtor defaults on the loan. Default is most commonly caused by failure to make loan payments, but any violation of the loan or security agreement by the farmer could create a default.

Purpose of the Assignment Affects Its Legal Meaning

Creditors seek assignments for two reasons:

1. As an easy way of getting payment directly from the milk buyer to the creditor; or
2. When paired with a security interest, as a way to protect the creditor's ownership interest in property the farmer has offered as collateral for the debt.

Farmers need to determine which category a proposed or existing assignment belongs in to understand the assignment's legal meaning.

Types of Assignment

The most common form of assignment gives a creditor the right to a certain amount of money from each milk check. Other types of arrangements, however, may have advantages for farmers. For example, granting an assignment for a certain percentage of the milk check ensures that the farmer will always receive some funds from every milk check, even if the amount of the check changes.

Other arrangements for assignments combine the use of a flat amount and a percentage. For example, a farmer might assign a certain amount of money, not to exceed a certain percentage of the milk check. Or a farmer might assign a certain percentage of a milk check, not to exceed a certain amount.

Deciding the Type of Assignment

When considering a new assignment, it is important to keep in mind that milk prices change frequently. For instance, a flat amount or percentage that seems reasonable at the time a farmer is considering the assignment may not seem reasonable after prices have fallen or risen. Farmers may also want to think about how the assignment arrangement would be affected if the dairy operation changed in size or nature.

Creditors will generally seek to protect their interests when requesting assignments. It makes sense for farmers to try to negotiate with creditors to protect their own interests. Farmers who are able to negotiate the terms of the assignment of their milk checks may find it helpful to set an amount or percentage above which the assignment cannot go.

Do Farmers Have to Agree to an Assignment?

In general, a farmer is free to decline to grant an assignment. However, the creditor may then decline to extend credit, issue a loan, close a sale, or rent property to the farmer. It is important for farmers to try to negotiate for an agreement that protects their interests as much as possible. When the negotiating is done, however, farmers need to consider both the advantages and disadvantages of the terms the creditor is offering, and decide whether the risks are acceptable in light of the benefits.

In some situations where a creditor asks for an assignment, the farmer may feel that he or she has no choice but to agree to the creditor's first offer. In fact, however, the farmer may have other options. The first option has been suggested above: negotiating for more favorable terms, including negotiating for a change in the type of the assignment.

Bankruptcy Can Help Resolve Farm Debts

Another option may be to consider bankruptcy. Chapter 12 is the part of the bankruptcy laws designed especially to allow family farmers to reorganize their debts and remain in operation. In general, a Chapter 12 bankruptcy puts a hold on most creditor collection actions to allow the farmer to propose a reorganization plan. Although the plan must meet certain requirements to be approved, it provides several protections intended to allow debtors to make a "fresh start."

On April 20, 2005, Congress made Chapter 12 a permanent part of the bankruptcy code. Other types of bankruptcy may also enable dairy farmers to reorganize their debts or to make a fresh start. Farmers who might be interested in a bankruptcy should contact an attorney for individual guidance about their situation.

Knowing what relief is available under the bankruptcy code might even help a farmer who never files a bankruptcy petition. A farmer who knows his or her rights in bankruptcy may be better able to negotiate a repayment or restructuring plan with a creditor. The farmer may be able to avoid the use of an assignment or the farmer may be able to retain more of each milk check for family living and farm operating expenses. If a farmer can show the creditor that both the creditor and the farmer will be better off under a negotiated solution, the farmer's negotiating position will be stronger.

Assignments and Staying Current on Your Payments

One surprising problem that some farmers have with their assignments is that assignments keep them current on their major payments. One would not normally think of being current on one's debts as a problem. But it can be a problem for farmers who are not generating enough income to pay for their other essential expenses. It may keep farmers from taking advantage of federal and state laws designed to protect them. For example, the Farm Service Agency generally notifies farmers of its loan servicing programs only after they become delinquent on their FSA loans, even though farmers who have not missed a payment may take advantage of them, too.

Release of Income May Help Farmers Get Access to Needed Cash

Farmers who find that they do not have enough money to live on after an assignment is taken out of their milk check may be able to arrange a release of income. A "release of income" is just what it sounds like: the creditor releases its claim on a portion of the milk check, and the farmer receives it. Release of income is important because a farmer who has no funds for family living and farm operating expenses may be "starved off" the land, but a farmer who has some funds to meet immediate needs is in a better position to negotiate.

Release of Income and Farm Service Agency

Farmers who are direct loan borrowers with the Farm Service Agency (FSA) have the right to a release of income to pay for essential family living or farm operating expenses. This means that any assignment to FSA should leave farmers with enough money to operate their farms and care for their families. If circumstances change (income falls or expenses increase) and a farmer needs to reduce the milk check assignment to FSA in order to pay for essential expenses, FSA generally is required to approve the needed reduction until the loan is accelerated. However, the right to a release of income is generally not available after FSA accelerates a farmer's loans. Changes should be noted on FSA Form 1962-1 ("Agreement for the Use of Proceeds/ Release of Chattel Security").

Essential family living and farm operating expenses are those that are basic, crucial, and indispensable to the farming operation and the farm family. FSA regulations include examples of the types of expenses that will normally be considered essential family living and farm operating expenses. The list includes things like food, clothing and personal care, health and medical expenses including medical insurance, transportation, machinery repair and replacement, rent on equipment, land, and buildings, feed for animals, veterinarian bills, and personal property taxes. Farmers may want to look at their own family and farming operations and make a detailed list of expenses that they consider essential before they meet with FSA to request a release of income.

Minnesota's Farmer-Lender Mediation Act: Protection for Financially Distressed Farmers

Under Minnesota's Farmer-Lender Mediation Act, before creditors can enforce certain delinquent debts against agricultural property, the creditor generally must give the farmer a chance to meet and try to resolve the problem through mediation. When the creditor is required to offer mediation to the farmer to resolve a delinquency, this is called mandatory mediation. During the mandatory farmer-lender mediation process, creditors must release funds from the sale of farm products to be used for the farmer's necessary living and farm operating expenses.

If the farmer is current on his or her debts secured by agricultural property, Minnesota's mandatory farmer-lender mediation law is unlikely to be triggered.

Release of Income and Private Creditors

There is no federal law that requires private creditors to release income to farmers. But some state laws may protect the rights of farmers to a portion of their income. Even if a farmer cannot force a private creditor to release income from a milk check to allow him or her to pay living and operating expenses, it may be possible to convince a private creditor to grant a release. This is because releasing income to pay for necessary expenses may put the operation in a more secure position. The farmer may be able to persuade the creditor that a short-term reduction in payment would be in the creditor's best interests if the release of income would better enable him or her to fully repay the debt.

Long-Term Solutions When a Financial Crisis Strikes

If a farmer has reached the point where there is not enough money left to run the farming operation or meet basic family needs, arranging for a release of income may address the immediate problem. But the farmer may need to restructure debts or change the terms of an assignment to achieve a long-term solution to the problem and achieve a positive cash flow for the farming operation.

Changing the Assignment

When dairy farmers run into financial difficulties, they often wonder if they should contact their creamery to change the assignment. It is important to remember that no creamery wants to get caught in the middle between a farmer and the farmer's creditor. The creamery will be concerned with meeting its own legal obligations. The creamery may fear that if it changed the way it issued a farmer's milk check without the creditor's approval, the creditor could accuse it of converting property in which the creditor had an interest. Farmers should contact their creditors to discuss changing the assignment before they approach their creamery.

Any time a farmer reaches a new agreement with his or her creditor, the farmer should put it in writing. Then the farmer can take the written agreement to the creamery, and all of the parties can be confident that the proper procedure has been followed.

Revoking an Assignment

In general, an assignment of a milk check is valid until it is revoked. It is generally a good idea to approach the creditor to make alternative payment arrangements before revoking an assignment. Farmers may also wish to review their loan agreements, to see whether the assignment is required as a part of the loan agreement. If an assignment is required as part of a loan agreement, any action revoking the assignment could be seen by the creditor as a default on the loan. At a minimum, it is likely that the loan agreement requires the farmer to promptly notify the creditor if the assignment is revoked.

Debt Restructuring with the Farm Service Agency

As discussed above, FSA must release income for essential expenses to its direct loan borrowers. The release of income may cause a farmer to fall behind on his or her payments. If it does, FSA should send the farmer a notice of the availability of primary loan servicing once the farmer becomes 90 days past due. The farmer will have 60 days to apply for loan servicing. Loan servicing may enable the farmer to restructure debt so that he or she can make payments, operate the farm, and meet basic family needs.

Farmers need not wait until they miss a payment on an FSA debt to apply for most types of loan restructuring. FSA direct loan borrowers who are "financially distressed" may request and receive all types of loan servicing except a writedown of the debt. Farmers are considered to be "financially distressed" if they will not be able to make payments as planned for the current year, or if they will not be able to come up with a feasible plan to make the payments for the next year. Farmers who need a release of income to pay family living and farm operating expenses are often "financially distressed."

Detailed regulations govern the loan restructuring, or primary loan servicing programs, administered by FSA. Types of primary loan servicing include loan consolidation, rescheduling, reamortization, interest rate reduction, deferral, conservation easements, and writedown. When FSA restructures a loan, the farmer and FSA should agree to a new Farm and Home Plan (or Farm Business Plan), a new FSA Form 1962-1 ("Agreement for the Use of Proceeds/ Release of Chattel Security"), and a new assignment, if any. If a farmer is not eligible for primary loan servicing, FSA may offer debt settlement or a chance to enter the homestead protection program.

Debt Restructuring with a Private Creditor

Any farmer who is unable to meet living and operating expenses under a current payment arrangement with a private creditor may contact the creditor to discuss restructuring the debt. Some states offer a mediation program with trained mediators who can help farmers and their creditors find creative ways to move forward together. In Minnesota, the law provides for a mandatory mediation process when a farmer falls behind on certain agricultural debts, and the creditor seeks to collect on the debts. Laws in other states may be different.

Farmers should keep in mind, though, that creditors want to be assured of being paid. In general, creditors are most likely to respond if there is a short-term problem specific to one farm or one region. For example, if a farmer has experienced a natural disaster or had illness in the herd, but the farmer has a plan to restore the operation's profitability, the creditor is more likely to be willing to work with the farmer than if he or she is struggling due to nationwide low prices and does not have a plan to address the shortfall.

Garnishment Limits in Minnesota

Minnesota law allows creditors to garnish part of a debtor's disposable income to recover unpaid debt. Disposable income is defined as the earnings that remain after legally required deductions—such as social security and federal and state income tax withholding—are taken out.

At least ten days before the creditor serves the creamery with a garnishment summons, the creditor sends a "Garnishment Exemption Notice and Notice of Intent to Garnish Earnings" to the farmer. A debtor's earnings are completely exempt from garnishment if the debtor is receiving relief based on need, or has received relief based on need within the past six months. Relief based on need includes the Minnesota Family Investment Program (MFIP), Emergency Assistance, Work First Program, Medical Assistance, General Assistance, General Assistance Medical Care, Emergency General Assistance, Minnesota Supplemental Aid (MSA), MSA Emergency Assistance, Supplemental Security Income, and Energy Assistance. One commonly overlooked type of relief received by Minnesota dairy farmers is fuel assistance. If the debtor is not entitled to a complete exemption from garnishment, a pre-existing assignment to another creditor may reduce the amount from the milk check that will be subject to garnishment.

Changes to the Farming Operation

Changes to the farming operation may be part of plans to restore a dairy farm to a positive cash flow. Programs such as the Environmental Quality Incentives Program (EQIP) and the Conservation Security Program (CSP) may provide funds for changes which provide conservation benefits. Such changes may reduce costly environmental risks or have other financial benefits. For example, farmers may decide to adopt grazing techniques which require more intensive management, but reduce feed and other costs. The milk produced on such farms may also have additional marketing opportunities.

Bankruptcy

Sometimes farmers are not able to reach an agreement with their creditors. Private creditors are generally under no obligation to make releases of income to borrowers who are current on their payments. As a result, farmers who are current on major secured debts as a result of an assignment, but who are unable to meet basic family living and farm operating expenses, may have few options other than filing bankruptcy. Farmers who are not able to reach an agreement with their creditors regarding a release of income may conclude that filing bankruptcy shows the most promise of allowing them to restore their farming operation to economic health.

Can Milk Checks Be Garnished?

Dairy farmers should be aware that even if they do not give a creditor a milk check assignment, the creditor may be able to claim a portion of the milk check proceeds in certain circumstances. Some states allow payments for milk or milk products to be garnished or levied upon to pay the farmer's debts. Garnishment and levy are different from assignments, because the creditor must obtain a court judgment, rather than the farmer's consent, before the earnings may be taken.

Can Farmers Get Around an Assignment by Taking Their Milk to Another Creamery?

Dairy farmers who find that they lack the funds needed to pay family living and farm operating expenses sometimes feel tempted to take matters into their own hands. They may begin to believe that if they simply take their milk to another creamery—one that they have not told about the assignment—they can gain access to some needed cash.

The consequences for a farmer who takes his or her milk to another creamery can be serious and depend partly upon whether or not the assignment is paired with a security interest. As was discussed on page two, creditors request assignments for one of two reasons. If the creditor does not claim a security interest in the milk, and the assignment was merely a convenient way for the farmer and the creditor to ensure that the creditor would be paid, there may be no direct harmful result of taking the milk to another creamery. However, if the farmer does not make the payment to the creditor, the farmer will be in default on the loan, and the creditor could pursue action to recover on its debt. In addition, as was discussed on page five with respect to revoking a milk check assignment, taking the milk to another creamery may be a default on the terms of the loan agreement if the assignment was required under the loan. Even if the farmer made the payment, the creditor could accelerate the debt (call in the loan) based on the default.

Taking Collateral May Result in Criminal Charges

If the creditor took a security interest in the milk, the consequences for a farmer of taking milk to another creamery may be quite serious. The second creamery might search the public records and discover that the creditor has a security interest in the milk. The second creamery would probably still list the creditor on the milk checks. If the second creamery did not discover the security interest and released the full milk check to the farmer, it could be drawn into a dispute with the farmer's creditor. If this happened, the farmer might have difficulty finding a creamery willing to buy his or her milk in the future. Even more seriously, if the second creamery issued a check solely to the farmer, the creditor could regard the farmer's act of taking its collateral to another creamery as conversion, or theft. The farmer could face criminal charges.

As a general rule, farmers should be aware that taking their milk to another creamery is unlikely to resolve their financial difficulties for the long-term, and may make their situation worse. Seeking a release of income, requesting loan servicing from FSA or restructuring from a private creditor, or filing bankruptcy are all more likely to help farmers find a long-term resolution for financial difficulties. □

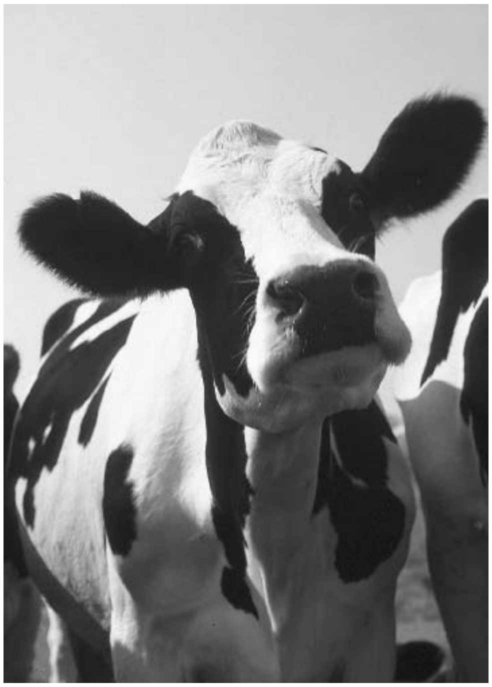
How Do Farmers Know if a Creditor Has Perfected a Security Interest in Their Milk?

It can be difficult for farmers to determine whether a creditor has taken a security interest in their milk. A security interest may be described in a way that applies only to milk produced on the farmer's farm. Or a security interest in milk may be described more broadly, so that it applies to "proceeds" of the farmer's cows or of the farmer's farm generally. Farmers who are unsure whether anyone has perfected a security interest in their milk may want to contact the officials in charge of the property records in their state. In Minnesota, farmers may contact either the Secretary of State or their county recorder.

The appropriate official in each state can search to find out if a financing statement, also known as a "UCC-1," has been filed with respect to a farmer or a farmer's property, including milk. There may be a fee for this search. In some cases, a creditor may claim a security interest in more of a farmer's property than just the milk, so the UCC-1 must be read carefully. Farmers who are unsure of what property is affected by a UCC-1 may want to consult a lawyer.

A Summary of What Dairy Farmers Should Know About Assignments

- seek advice before agreeing to an assignment
- consider trying to negotiate for a minimum amount or percentage of each check to be available to you, regardless of the milk price
- make sure you understand what your rights and responsibilities would be under the assignment
- know whether your creditor plans to or already has taken a security interest in your milk
- if you do not have enough money to pay your basic family living and farm operating expenses, you may be entitled to have some of the income from your milk check released to you, particularly if you are a direct loan borrower from FSA
- if you are a direct loan borrower from FSA, you may be able to have your loan restructured to create a more manageable payment schedule and restore your farm's cash flow
- consider negotiating with private creditors for a release of income to pay for essential needs in emergency situations
- if you have had financial problems, yet have a plan to restore your farm's cash flow, you may be able to convince a private creditor to change the assignment or restructure your loan
- taking your milk to another creamery most likely will not solve your problems, and may make them worse
- filing bankruptcy may be a better option than agreeing to an assignment if the assignment is likely to leave you unable to pay for your basic family living and farm operating expenses



Photos courtesy of USDA NRCS

If you'd like to learn more about . . .

Bankruptcy, contact FLAG for an article entitled, *Introduction to Agricultural Bankruptcy*. For Chapter 12 bankruptcy in particular, see 11 U.S.C. §§ 1201 – 1231.

Release of income by the Farm Service Agency, see 7 C.F.R. § 1962.17.

Restructuring, or primary loan servicing, offered by the Farm Service Agency, see 7 C.F.R. part 1951, subpart S. You may also want to contact FLAG for educational materials relating to FSA loan servicing programs.

Security agreements and UCC-1's, contact FLAG for our Focus Report, *UCC Revised Article 9: What It Means for Farmers Seeking Credit*.

Minnesota's laws governing garnishment, see Minnesota Statutes, chapter 571.

Minnesota's Farmer-Lender Mediation Act, see Minnesota Statutes Chapter 583. Minnesota farmers may also want to contact FLAG for a copy of the 2003 edition of *Farmers' Guide to Minnesota Lending Law*.

For financially distressed Minnesota farmers in need of legal assistance:

Mid-Minnesota Legal Assistance
(Minnesota Family Farm Law Project)
830 W. Germain, Suite 300
P.O. Box 886
St. Cloud, MN 56302
Phone: 320-253-0121 / Toll-Free: 888-360-2889

Southern Minnesota Regional Legal Services
(Minnesota Family Farm Law Project)
12 Civic Center Plaza, Suite 3000
P.O. Box 3304
Mankato, MN 56002-3304
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