

AGRICULTURE AND TRANSPORTATION COMMITTEE - CENTRAL INDEXING SYSTEM - BACKGROUND MEMORANDUM

Section 1 of House Bill No. 1220 (2019) directs the Legislative Management, in coordination with the Secretary of State, to study how the state's central indexing system can be used to provide notification to a secured lender when a super priority lien is filed on the collateral of a secured lender.

HOUSE BILL NO. 1220

Study Directive

House Bill No. 1220, as introduced, would have amended North Dakota Century Code Section 35-31-03. Section 35-31-03 gives priority to an agricultural supplier's lien obtained under Chapter 35-31 over all other liens and encumbrances, except agricultural processor's liens, relating to crops and agricultural products covered by the supplier's lien. The bill, as introduced, would have created a new subsection to Section 35-31-03 to provide an exception whereby an agricultural supplier's lien of more than \$50,000 would have had to meet certain conditions to have priority over other liens and encumbrances. Under the introduced bill, to have priority with a lien of more than \$50,000, an agricultural supplier would have been required to send an authenticated notification to the holder of a conflicting security interest of record stating the supplier may acquire a lien over the crops, agricultural products, or livestock of the debtor in an amount exceeding \$50,000; and the holder of the conflicting security would have had to receive the notification no later than 20 days after the date the agricultural supplies were furnished or the services performed.

The House amended the bill to provide for this study. The legislative history indicates support for a study of the issue before changing the law because there were legitimate questions on both sides of the issue. Testimony indicated while a supplier still could file a lien, the bill would have caused a supplier to lose their priority that currently exists under law if the supplier did not comply with the conditions as described in the bill.

Testimony also indicated the need to study the central indexing system rather than only the priority of liens to determine whether the central indexing system has the capability of providing notice to a lender when a priority lien is filed. Testimony indicated allowing the central indexing system to generate electronic notice to the originating lender when a priority lien is filed could be an acceptable solution to the issue of transparency.

Lien Process

Banks and other lenders often extend farmers or producers a line of credit as an operating loan for farming operations secured by the farmer's crop. Issues arise if the line of credit is not used to pay for the current year's operating costs and the producer instead purchases operating needs on credit from an agricultural supplier. Some producers use the line of credit to purchase supplies, such as seed or equipment, from an agricultural supplier for the current year or to pay back a supplier for supplies furnished from a previous year, resulting in double financing of the crop. Testimony indicated many suppliers are not in a position to wait until harvest to receive payment for the supplies furnished to producers, and many suppliers want to be paid within 30 days. As a result, the supplier may place a lien on the producer's crop to secure the value of the supplies. Testimony indicated after harvest, the producer sells the crop and the buyer writes checks to both banks and agricultural suppliers as payees. The bank is then placed in a position in which it assumed it supplied the majority of the capital for the producer to create the crop, only to learn an agricultural supplier has a priority lien on the crop as well. Testimony indicated a notice requirement from an agricultural supplier to a lender can inform the lender of the situation and limit the extension of additional bank credit to a producer who may be overextended.

A bank has the ability to designate funds for a specific purpose when it offers a line of credit to a farmer, but the bank does not always know how the line of credit is being used when it is drawn against by a farmer. Testimony indicated if a lender is aware of the intended use of the line of credit, the lender often works with the producer to help pay the outstanding balance to a supplier. However, a lender may not be made aware of how the farmer intends to use a line of credit. Testimony indicated a notification requirement to a bank or lender when a supplier's lien is placed on a producer's crop would be beneficial so the lender is made aware of an additional loan being secured by the single crop and collateral of the farmer, which has priority over the lender's original loan. Testimony further indicated a notification requirement would allow the lender to ask the producer questions to ensure the operation is running smoothly and the lender has necessary information regarding the line of credit.

Testimony indicated by allowing agricultural suppliers to wait months and then jump first in line by filing a priority lien, the system is not equitable unless there is notification to the lender of the situation. Testimony indicated the bill and subsequent study may provide transparency for all parties involved.

Representatives of the Secretary of State's office, the North Dakota Grain Dealers Association, the North Dakota Agricultural Association, North Dakota Farm Credit Council, Independent Community Banks of North Dakota, and the North Dakota Bankers Association testified in support of the study.

LIENS AND THE UNIFORM COMMERCIAL CODE

Agricultural Liens

Three main areas of Century Code govern agricultural liens and the central indexing system. Title 35 addresses liens, Title 41 addresses the Uniform Commercial Code (UCC), and Chapter 54-09 addresses the Secretary of State and the central indexing system. General statutory provisions applicable to all liens are located in Chapter 35-01, and provisions specific to agricultural supplier's liens are located in Chapter 35-31.

Pursuant to Section 35-01-02, a lien is defined as a charge imposed upon specific property by which the property is made security for the performance of an act. Section 35-01-01 applies the general statutes relating to all liens, including mortgages and pledges, unless the context indicates a different intention, except as modified by the UCC in Chapter 41-09. The recorder is required to file and index a statutory lien upon personal property required by law to be filed in the recorder's office, designate the person filing the lien as lien creditor, and designate the person against whom the lien is filed as debtor. The lien statement filed against an individual must contain the last-known address of the debtor to be valid.

Section 35-01-14 provides different liens upon the same property have priority based upon the time of creation, and a person having an interest in property subject to a lien has a right to redeem it from the lien at any time after the claim is due and before the person's right of redemption is foreclosed. Redemption from a lien may be made by performing or offering to perform the act for the performance of which it is a security and paying or offering to pay the damages, if any, to which the holder of the lien is entitled for delay. An obligation for the payment of money may be extinguished by complying with Sections 9-12-24 and 9-12-25.

Pursuant to Section 35-01-24, a lien or mortgage upon property may be satisfied by the mortgagor before the date of maturity by the payment or tender of the full amount due on the date of maturity. Additionally, pursuant to Section 35-01-29, upon default in the payment of a debt secured by a statutory lien on personal property, the lien may be foreclosed by action pursuant to Chapter 32-20.

Under Section 35-31-03, an agricultural supplier's lien obtained under Chapter 35-31 takes priority over all other liens and encumbrances, except agricultural processor's liens authorized under Chapter 35-30, which relates to crops and agricultural products covered by the supplier's lien. A supplier has 120 days from the date of delivery of supplies to file a lien. If the supplier files the lien within the 120 days, the supplier receives a super priority lien. A supplier's lien ensures a supplier is able to recoup its costs, but only for the amount of the supplies furnished and only in the crop grown with the supplies.

Statutory provisions related specifically to agricultural supplier's liens and agricultural processor's liens are located in Chapters 35-31 and 35-30, respectively.

Section 35-31-01 provides any person that furnishes supplies used in the production of crops, agricultural products, or livestock is entitled to a lien upon the crops, products produced by the use of the supplies, and livestock and their products, including milk. An agricultural supplier's lien filed in accordance with Section 35-31-02 is effective from the date the supplies are furnished or the services performed.

Section 35-31-02 codifies the procedure to obtain an agricultural supplier's lien and requires certain information to be filed in the central notice system. The Secretary of State is required to provide an electronic means to obtain a lien or gain protection under the central notice system. The Secretary of State is required to remove and destroy liens filed in the Secretary of State's office in the manner provided for in Section 11-18-14.

Section 11-18-14 requires county recorders to remove and destroy files related to mortgages, sales contracts, and liens, including agricultural processor's and supplier's liens, along with releases for the liens if a claim for relief has accrued and is at least 10 years old. The section also requires the recorder to note the date the files were removed and destroyed.

Section 35-31-05 provides the means for amending agricultural supplier's liens. Section 35-31-06 establishes the fee for filing an agricultural supplier's lien, as well as the fee for failing to file a termination statement within 60 days after a lien has been satisfied. The fee for failing to terminate a satisfied lien is \$60, and the fee for filing an agricultural supplier's lien in the central notice system is determined in Section 41-09-96.

Uniform Commercial Code

In addition to Chapters 35-01 and 35-31, agricultural supplier's liens also must comply with certain provisions located in the UCC chapters regarding general provisions under Chapter 41-01 and secured transactions under Chapter 41-09.

Section 41-01-09 provides applicable definitions for bank, creditor, and security interest. Section 41-01-10 provides the criteria and definitions for when a person has notice of a fact.

Within the context of a secured transaction, Section 41-09-02 provides definitions of an agricultural lien, collateral, farm products, and farming operations. Section 41-09-09 provides Chapter 41-09 applies to agricultural liens. Section 41-09-22 provides the local law of a jurisdiction in which farm products are located governs perfection of a lien, the effect of perfection or nonperfection, and the priority of an agricultural lien on the farm products.

Section 41-09-40(6) requires a secured party with a perfected agricultural lien which intends to impose liability for the lien against a crop buyer to have the name of the secured party on the most current list distributed by the Secretary of State pursuant to Section 54-09-10. The subsection also states the criteria that must be met to appear on the list.

Section 41-09-40(7) requires a crop buyer, when issuing a check to a crop producer, to issue the check or draft for payment jointly to the person engaged in farming operations and those secured parties or lienholders that have a security interest or lien in the crops or livestock sold and whose names appear on the most current list or lists distributed by the Secretary of State at the time the check or draft is issued. The subsection also requires a lienholder to commence a claim for relief against a crop buyer that did not include the name of the lienholder on the check within 18 months of the date of the check, unless within the 18-month period the secured party or lienholder sends a notice to the crop buyer. The subsection provides a claim for relief may not be commenced more than 5 years after the date of the issuance of the check under any circumstance. The subsection also codifies the information that must be included in the notice from a lienholder to a crop buyer.

Section 41-09-96 determines the fees associated with filing agricultural liens. The fee for filing and indexing an original statement, \$40; for filing and indexing an amendment, assignments, releases, or correction statements, \$40; and for filing and indexing a continuation, \$30. The section prohibits charging fees for electronic requests from the central indexing system for information communicating whether there is any financing statement or statement naming a particular debtor, information on specific filings on a particular debtor, copies of each filing on a particular debtor, or certified copies of filings on a particular debtor on file. The fee for a central indexing response providing information on specific filings submitted by a particular secured party is \$500.

CENTRAL INDEXING SYSTEM

History

According to the Secretary of State's website, the central indexing system is a computer system containing the UCC, central notice, agricultural statutory liens and notices, miscellaneous statutory liens, and state and federal tax liens filed online with the Secretary of State's office. A statewide perfection of a loan may be obtained by completing the filing in the online central indexing system. The debtor's Social Security number or federal employer identification number is required to complete the filing. There are six separate databases in which filing information can be maintained and searched:

1. UCC index;
2. Farm products central notice index;
3. Statutory lien index;
4. Agricultural statutory lien notice index;
5. Federal lien index; and
6. State tax lien index.

Senate Bill No. 2450 (1985) established a central notice system for filing interests and liens on crops and livestock by secured parties and lienholders under Section 41-09-46. The bill required the Secretary of State to develop and implement a central notice system that contained the information filed with the Secretary of State's office pursuant to the requirements of Section 41-09-28(9) regarding the protection of the buyer of goods.

From the central notice system, the bill required the Secretary of State to produce each month one list for crops and one list for livestock, each of which contained the information filed on the forms required under Section 41-09-28. Each list was required to be in alphabetical order according to the last name, or in numerical order according to Social Security number, of the person engaged in farming operations. The list could be prepared in categories according to county, regions as designated by the Secretary of State, or on a statewide basis. If a request was made, the list was required to be in printed form and on microfiche. Each list was required to conspicuously note its effective date. The lists prepared were required to be distributed monthly by mail at least 5 business days in advance of their effective date. If requested, the Secretary of State was required to mail the list to any person making a request for a fee.

Upon a verbal request of any person, the Secretary of State was required to provide verbally information contained on the list generated through the central notice system when the collateral was crops or livestock.

Under Senate Bill No. 2450, if a secured party wished to impose liability against a crop or livestock buyer when a seller defaulted in paying off the obligation, the secured party was required to:

1. Provide the Secretary of State relevant farming operation and security interest information on a form.
2. Serve a notice to the crop or livestock buyer within 18 months after the date of the check containing relevant information regarding the person engaged in farming operations and the date of the check or draft which gave rise to the claim, a statement of intention of the secured party or lienholder to make a claim, a statement of the amount the secured party or lienholder was claiming, a description of or the amount of crops or livestock upon which the claim was based, and a statement that the secured party or lienholder has commenced an action seeking judgment against the person engaged in farming operations.
3. Obtain a judgment and make a good faith effort to collect that judgment against the person engaged in farming operations.
4. List any other collateral taken by a secured party or lienholder as security on the same debt from the person engaged in farming operations.

In addition, the secured party was required to advise the person engaged in farming operations, at the time the loan was made, of the filing with the Secretary of State, the inclusion in the central notice system, the inclusion of that information on the monthly lists, the inclusion of secured parties' names on the check, and of the rights of the parties.

Senate Bill No. 2450 also provided the conditions under which a crop or livestock buyer could take free of any security interest.

The statutory provisions regarding agricultural supplier's liens, agricultural processor's liens, and how to obtain a lien under Chapters 35-30 and 35-31 were enacted in 1987 to reflect the newly created central indexing system. Sections 41-09-28 and 41-09-46 regarding the central indexing system and the information to be contained within the system have been amended numerous times. In 1991, Section 41-09-46 was amended to require the Secretary of State to develop and implement a computerized central notice system, and required the system to contain, in addition to other information, the information filed with the Secretary of State pursuant to Sections 35-30-02 and 35-31-02 regarding the procedure to obtain an agricultural supplier's or processor's lien. The Secretary of State still was required to provide, for a fee, monthly lists of information pertaining to agricultural liens to the public.

The Legislative Assembly passed House Bill No. 1105 (2001), which repealed Chapter 41-09 and enacted a new Chapter 41-09 regarding secured transactions under the UCC. The contents of repealed former Section 41-09-46 were recreated as three new sections in the bill, and later designated as Sections 54-09-09, 54-09-10, and 54-09-11, which relate to the duties of the Secretary of State.

Testimony from House Bill No. 1220 (2019) indicated the intent behind the central indexing system was the desire to move away from a direct notice system. Testimony indicated when the central indexing system was created, North Dakota was under a direct notice system that had to be provided via mail. Testimony indicated once the central indexing system was put in place, grain buyers were required to search the indexing system to determine if liens held by other parties existed. Testimony indicated the buyer is required to write multiple checks to lienholders. When the current system was put into place, an agreement was made whereby grain buyers would agree to the system and accept the responsibility to write checks to lienholders through the system and place the lender's and supplier's names on the checks, and in turn agricultural suppliers were given priority liens under law. Once the crop is purchased, there may be three to five names of banks and agricultural suppliers on the payment checks. Determining who has priority usually comes down to the filing date of liens in the system.

The current online central indexing system was put into place in 2011. Before 2011, the central indexing system was paper based and lenders had to pay to determine if priority liens existed. Lenders and buyers still are required to search online to determine if priority liens exist, but in 2016 the Secretary of State's office began allowing free searches for filed liens. A notification system would provide transparency and efficiency. The central indexing system is capable of being enhanced to provide notification. The Secretary of State's office testified it could create a push system within the central indexing system with RSS feeds to notify lenders when a priority lien is filed. Testimony indicated sometimes the first notice received by a lender that a priority lien exists is when the producer sells crops, and the check received by the lender from the buyer includes additional names for suppliers as payees.

Statutory Provisions

The provisions related to the central indexing system are located in Chapter 54-09.

Section 54-09-09 requires the Secretary of State to maintain a computerized central indexing system that contains the information filed pursuant to Sections 35-13-02, 35-17-04, 35-20-16, 35-30-02, 35-31-02, 35-34-04, 35-34-06, 41-09-72, 57-38-49, 57-39.2-13, 57-40.2-16, 57-40.3-07.1, 57-43.1-17.4, 57-43.2-16.3, and 57-51-11. The section requires the system allow access to financing statement information and requires the system have safeguards to allow access to information in the system relating to security interests or liens, and to prevent unauthorized alteration or deletion of that information. The section requires information in a lien statement filed electronically be filed in the central notice system within 2 working days of receipt of the statement.

Section 54-09-10 requires the Secretary of State to produce electronically a list for crops and a list for livestock that each contain the information filed pursuant to Chapter 41-09 and chapters in Title 35 regarding liens. Each list must note the effective date of the list conspicuously. The section requires the Secretary of State to distribute by mail or deliver electronically the lists.

Section 54-09-11 establishes the fees pursuant to the central indexing system and allows the Secretary of State to establish fees for any programming charges specifically incurred to provide information requested by persons which is related to the central indexing system and for other services provided through the computerized system. The section prohibits the Secretary of State from charging a fee for furnishing information on a verbal request. The fee for furnishing a certificate is \$15. The fee for preparing a listing or compilation of any information recorded or filed in the Secretary of State's office is \$40 for each record requested. The section requires the Secretary of State to provide the requested information in an electronic format, unless the Secretary of State agrees to a request to provide the information in a different format. The fee for providing the requested information in a paper format is 50 cents per page.

STUDY APPROACH

In conducting this study, the committee may wish to receive testimony from representatives of the Secretary of State's office regarding the operation and costs of the central indexing system. The committee also may wish to receive testimony from representatives of the Secretary of State's office and the Information Technology Department regarding the feasibility and cost associated with potentially integrating a notification system into the central indexing system. Finally, the committee may wish to receive testimony from stakeholders and interested parties regarding any perceived issues associated with potentially integrating a notification system into the central indexing system.