COMMERCIAL LENDING

LEGAL NEWS ALERT

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Message from **the Chair**

Karen DeSalvo

The Commercial Lending Alert is designed to give you an overview of important topics and issues facing the business and lending communities today. To continue to serve the needs of our clients and friends, we bring you the latest edition of the Commercial Lending Alert. This issue contains articles on making asset-based loans to companies in the healthcare industry and companies that purchase certain agricultural products.

The failure to recognize and account for the added risk associated with loans to companies in the healthcare field and companies that purchase certain agricultural products directly impacts the degree to which a lender is secured. I encourage you to email me with your questions so that I can devote future articles to issues you deem critical to your field. I hope to hear from you soon at kdesalvo@rmfpc.com or 516.663.6585.

Commercial Lending Practice Capabilities

- Commercial Loan Transactions
- Factoring and Purchase Order Financing
- Intercreditor and Subordination Agreements
- Loan Workouts

Healthcare Asset-Based Lending

by Karen J. DeSalvo, Esq.

Lenders who do not normally make loans to companies in the healthcare field need to be careful when structuring an asset-based loan for a healthcare company. The rules and regulations governing the assignment of government healthcare receivables can increase the credit risk of an unwary lender. Generally, lenders that make asset-based loans to healthcare companies on a regular basis rely primarily on the company's accounts receivable as collateral. Typically, there is a limited market for the resale of medical inventory and equipment and, therefore, they are not normally relied on as collateral.

The assignment of federal and state healthcare receivables are restricted by various statutes and regulations. However, none of the statutes and regulations prohibit the company providing healthcare services from granting to third parties a security interest in its receivables.

In *DFS Secured Healthcare Receivables Trust*, 384 F.3d 338 (7th Cir. 2004), the Court held that the federal re-assignment provisions that prohibit the assignment of Medicare and Medicaid receivables do not prohibit the assignment of such receivables to a lender, provided the receivables flow through the company providing the healthcare services to the lender. Lenders in the healthcare field have utilized a double-lockbox structure in order to comply with the anti-assignment regulations. The company providing healthcare services will establish a deposit account (the "Government Depository Account") in which all government healthcare receivables will be deposited. The company will have the right to control this account. The company, lender and the depository bank will enter into a control agreement that acknowledges the lender's security interest in the Government Depository Account (the "Government Control Agreement"). The company will issue wire instructions directing the bank to wire funds from the Government Depository Account on a daily basis to another account in the lender's name and under its control (the "Lender's Account").

The Government Control Agreement generally provides that the company can only change the wire instructions and/or close the account on thirty (30) days' prior written notice to the lender. In addition, all non-government accounts receivables will be deposited in a separate account under the control of the lender (the "Deposit Account"). The lender maintains control over the Deposit Account and generally instructs the bank to wire funds deposited in such account to the Lender's Account on a daily basis. The funds deposited into the Lender's Account from both the Government Depository Account and the Deposit Account will then be wired to the lender.

The provisions in the Government Control Agreement requiring that the asset-based lender receive prior written notice of any change in wire instructions or a request to close the Government Depository Account before such instructions become effective are incorporated into the agreement to provide comfort to the lender that its collateral is secure. This notice provision permits the lender to stop making advances and take steps to obtain control over its collateral.

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Lenders Beware: New York State Has Its Own Version of PACA

by Michael S. Amato, Esq.

Michael S. Amato

Lenders should be aware of Article 20 of the New York Agriculture and Markets Law ("Article 20") which grants certain rights and remedies to New York producers that sell farm products in the state of New York.

Article 20 provides that all farm products and/or products derived from farm products, and any receivables or proceeds thereof, received by a dealer of farm products, shall be held in trust for the benefit of the producer until the producer is paid in full. This trust fund for unpaid producers primes prior perfected security interests.

To preserve its trust fund rights, a producer only needs to provide written notice to the dealer that it is electing the trust benefits within sixty (60) days of when the payment is due. A producer may incorporate the trust election language into its invoice, or any other document related to the transaction.

In addition to the trust provisions set forth above, a producer that has not received full payment within thirty (30) days of delivery may also file a written claim with the Commissioner of the Department of Agriculture and Markets (the "Commissioner"). The Commissioner can seek to collect any unpaid claims on behalf of the producer. Ultimately, the Commissioner can pay up to 80% of the value of the claims, utilizing a combination of the proceeds of the licensed dealer's indemnity bond, and the Agricultural Producers Security Fund which is made up of licensing fee payments made to the Commissioner.

The Department of Agriculture has a lien upon the dealer's assets for all payments made to satisfy claims of unpaid producers, which lien relates back to the date that the first default in payment occurred. Therefore, a lender's secured position may be primed by claims of producers for payment of outstanding invoices that became due and payable prior to the date that a lender perfected its security interest. Lenders that make secured loans to dealers of farm products in New York State must be vigilant and engage in additional due diligence and monitoring to confirm that the borrower does not have any past due claims from New York producers of farm products. In addition, in the event that a producer prevails in its action to enforce payment on the trust, the producer may be entitled to recover costs, fees, disbursements and attorney's fees.

The Trust provision and the Security Fund provision under Article 20 provide two separate and distinct remedies wherein an unsuspecting lender could find its lien position primed by producers of farm products in the state of New York. The producer has the option of electing to make a claim under either (or both) provisions of Article 20.

Article 20 establishes a state law vehicle for the protection of New York producers, including a statutory constructive trust upon delivery of farm products, which may adversely affect a lender's rights. Lenders must educate themselves as to the terms and conditions of Article 20, and take steps to protect their interests when dealing with businesses that buy or sell farm products in the state of New York.

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