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An Agricultural Law Research Article

**Annual Review of Agricultural Law:  
Commercial Law Developments**

by

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# ANNUAL REVIEW OF AGRICULTURAL LAW: COMMERCIAL LAW DEVELOPMENTS

Gordon W. Tanner\*

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This is a summary of recent cases, decided between September 20, 1994, and September 19, 1995, that involve issues of interest to agricultural lenders and borrowers. Most cases construe Article Nine of the Uniform Commercial Code ("U.C.C."). The case synopses include: scope and classification issues (Article One), cases involving sales and warranty issues (Article Two), followed by the annual parade of cases dealing with security interests (Article Nine). The Article Nine cases cover validity and attachment (Parts One and Two), competing priorities (Part Three), perfection (Part Four), and remedies (Part Five). Also included are some non-U.C.C. cases on mortgage foreclosures, federal preemption, PACA, bankruptcy issues, and some related topics.

The cases were identified using WESTLAW searches done in the "All cases" and "UCC-CS" databases. For those who would like to update the searches or determine whether there may be other relevant cases not included here, the search terms used were "ranch or farm or orchard or crop or timber or livestock or aquaculture" and "security or mortgage or 'deed of trust'" and "commercial code," except that "commercial code" was deleted in searching the "UCC-CS" database. Cases involving agricultural issues or the U.C.C. in only a peripheral way have been omitted from this summary.

In each topical section below, the federal cases appear before the state cases with decisions of higher courts before lower courts. The state cases are listed alphabetically by state. Some of the cases highlighted deal with more than one issue relevant to the U.C.C. Thus, seven of the forty-two cases summarized appear more than once in the text below. A Table of Contents of the topics covered is included to help make this summary a useful reference tool.

## I. GENERAL INTERPRETATION AND SCOPE

### A. Farmers Loan & Trust Co. v. Letsinger.<sup>1</sup>

*Holding:*  Common law, not the U.C.C., controls a bank's claim on an unlimited guaranty.

In this case the bank allowed its security interest to lapse in the collateral that T-C Crop Care, Inc. (T-C), a fertilizer company, gave to secure several loans. Thereafter, the bank renewed T-C's loans and accepted new guaranties from the Letsingers, T-C's shareholders, in favor of the bank. Despite its knowledge of the lapsed security interest, the bank neglected to advise the Letsingers of the impairment to its collateral. When T-C filed for bankruptcy protection, the majority of the proceeds of the liquidation sale went to another creditor who held a perfected security interest in the same collateral. The bank sued the Letsingers under their guaranty.

The Indiana Supreme Court upheld the trial court's discharge of the Letsingers' claim because common law, not the U.C.C., controls, a bank's claim on an unlimited guaranty. The court held the "guaranty executed by the Letsingers was not a negotiable instrument because, *inter alia*, it was an unlimited guarantee, and so not a promise to pay a sum certain."<sup>2</sup>

## II. ARTICLE TWO ISSUES

### A. Rayle Tech, Inc. v. DEKALB Swine Breeders, Inc.<sup>3</sup>

*Holding:*  A swine breeder who purchased diseased pigs cannot sue the seller for fraud when the seller clearly disclaimed any liability for disease in the sales contract, despite a salesperson's assurances to the contrary.

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1. 652 N.E.2d 63 (Ind. 1995).

2. *Id.* at 65.

3. 897 F. Supp. 1472 (S.D. Ga. 1995).

In this case, Rayle Tech purchased swine breeding stock from DEKALB regularly over a number of years under contracts stating that DEKALB had no liability for any damage caused by any disease found in swine sold to Rayle Tech. Despite this, one of DEKALB's salesmen gave assurances to Rayle Tech that DEKALB pigs were not diseased. When one shipment of DEKALB pigs were found to be diseased, Rayle Tech sued DEKALB for fraud.

The court found that while knowingly shipping diseased hogs to a breeding farm is not consistent with reasonable commercial standards of fair dealing in the contract, Rayle Tech assumed the risk that the swine it purchased from DEKALB might be diseased; parol evidence to the contrary was not permitted. Therefore, DEKALB was not liable to Rayle Tech for damages caused by the diseased pigs, and summary judgment in DEKALB's favor was granted.

#### B. Brookside Farms v. Mama Rizzo's, Inc.<sup>4</sup>

*Holding:* An oral modification of the price term in a written contract for the sale of herbs is enforceable when there is reasonable reliance on a promise to put the oral agreement in writing.<sup>5</sup>

In this case, Brookside and Mama Rizzo's, Inc. (MRI) entered into a one-year contract under which MRI agreed to buy at least 91,000 pounds of basil from Brookside. The parties later verbally agreed to a higher price for the herbs than the price stated in the written contract, because MRI requested additional processing which was not part of the original contract. They agreed to put the modification in writing at a future date. When MRI subsequently refused to pay the higher price, Brookside sued MRI for breach of contract.

The court held that an oral modification of the price term in the written contract was enforceable because Brookside reasonably relied on MRI's promise to put the oral agreement in writing. MRI breached the contract by failing to pay the higher price for the basil.

#### C. Morken v. Kunkel (In re Morken).<sup>6</sup>

*Holding:* A cattle producer's sale of cattle to a debtor, even on a few days credit, is a credit sale under the Uniform Commercial Code.<sup>7</sup>

Despite their classification as "cash" sales under the Packers and Stockyards Act,<sup>8</sup> the sales in this case did not meet the Uniform Commercial Code requirement for prompt payment on demand.<sup>9</sup> Spring Grove Livestock Exchange, Inc. and the Morkens were engaged in raising, feeding, and marketing cattle. Both filed separate petitions in bankruptcy. Because the cattle producers did not insist on immediate payment, they were left with the "credit" seller's right of reclamation under the U.C.C.<sup>10</sup>

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4. 873 F. Supp. 1029 (S.D. Tex. 1995).

5. See TEX. BUS. & COM. ANN. § 2-201(c)(3) (West 1995).

6. 182 B.R. 1007 (Bankr. D. Minn. 1995).

7. MINN. STAT. § 336.2-702 (1995).

8. 7 U.S.C. §§ 181-229 (1994).

9. MINN. STAT. § 336.2-507(2) (1995).

10. MINN. STAT. § 336.2-702 (1995).

The court also held that the cattle producers who sold the cattle to the Morkens on a few days credit had no continuing Article Two security interest in the cattle or the proceeds of sale under § 2-401(1) because they had failed to perfect by filing and because § 9-113 did not apply.<sup>11</sup> In addition, the Federal Food Security Act<sup>12</sup> cut off any security interest the producers may have had. Therefore, the cattle producers held general unsecured claims in the Morken bankruptcy.

D. Indian Harbor Citrus, Inc. v. Poppell.<sup>13</sup>

*Holding:* The buyer in a picking contract is not required to pick the fruit at any particular time prior to the deadline stated in the contract.

In this case, Poppell, a grapefruit grower, contracted with Indian Harbor Citrus to pick and purchase his grapefruit crop by a certain date. Due to slow growth and repeated wind damage, Indian Harbor Citrus chose not to harvest the fruit, even though the end of the contract period was approaching. In addition, Indian Harbor Citrus chose not to "spot pick" the crop to stimulate growth.

When Poppell demanded that Indian Harbor Citrus pick the fruit by the contract date, Indian Harbor Citrus exercised its option under the natural disaster clause in the contract to cancel the contract. Poppell sued Indian Harbor Citrus for the difference between the amount he was able to realize from the sale of the crop to other purchasers and the amount Indian Harbor Citrus had agreed to pay in the contract.

The court held that because the contract was unambiguous, the industry practice of spot picking was not required, even though it might have allowed faster growth of the remaining crop and harvesting by the contract date. Further, Indian Harbor Citrus was not compelled to pick and purchase the fruit at any particular time before the contract deadline.

E. Snelten v. Schmidt Implement Co.<sup>14</sup>

*Holding:* The seller of a used tractor who represented that the tractor had been inspected and no alterations had been made is liable to the buyer for the buyer's injuries even though the tractor was sold "as is."

In this case, Schmidt Implement sold a tractor to Snelten "as is," according to the sales contract. However, the seller also attached a checklist to the contract verifying that the equipment had been inspected and that no alterations had been made. The tractor subsequently malfunctioned and ran over Snelten when he attempted to start it. The tractor had been altered to bypass the neutral safety switch. Snelten sued the seller, and the seller claimed it had no liability because the tractor had been sold "as is."

The Illinois Appellate Court held that the seller could not rely on the "as is" language in the contract to protect it from liability for Snelten's injuries when the attachment to the contract expressly stated that the seller had inspected the tractor and that no alterations had been made.

11. MINN. STAT. § 336.2-401, 9-113 (1995).

12. 7 U.S.C. § 1631 (1994).

13. 658 So. 2d 605 (Fla. Dist. Ct. App. 1995).

14. 647 N.E.2d 1071 (Ill. App. Ct. 1995).

F. Tomka v. Hoechst Celanese Corp.<sup>15</sup>

*Holding:* A cattle feeding operator cannot recover damages from a manufacturer of a growth hormone even though certain cattle given the hormone gained weight slower than expected when the cattle feeding contract was signed.

In this case, Tomka, a custom cattle feeder, contracted to feed cattle owned by Brummer. The cattle were implanted with two synthetic growth hormones at Brummer's direction. Tomka claimed that the hormones failed to cause the cattle to gain weight as quickly as expected. Thus, Tomka contended, the drug manufacturer was responsible for Tomka's delay in selling the fattened cattle and his loss of money on the Brummer contracts. Tomka sued Hoechst Celanese, alleging a breach of express and implied warranties.

The Iowa Supreme Court held that Tomka could not recover economic damages solely on the ground that the cattle gained weight at a slower pace than expected. The court also held that Tomka could not recover consequential damages against Hoechst Celanese under an express or implied warranty theory because Tomka did not own the cattle which were given the drug.

G. Lewis v. Nine Mile Mines, Inc.<sup>16</sup>

*Holding:* A logger is not entitled to recover damages for lost profits when he fails to present evidence of a timber shortage or other market force justifying his failure to cover alleged losses.

In this case, the logger entered into a contract to log timber on land owned by Nine Mile Mines. After a dispute regarding the agreement, Nine Mile Mines prevented the logger from entering the property to remove the timber. The logger sued Nine Mile Mines for breach of contract and anticipatory repudiation of contract.

The Montana Supreme Court held that when a seller breaches a sales contract, the buyer may either (1) purchase substitute goods and recover the difference between the price paid and the contract price; or (2) recover the difference between the current market price and the contract price, if any. Because the logger failed to buy substitute timber, and his testimony concerning the lack of availability of substitute timber was speculative, the logger was not entitled to recover damages from Nine Mile Mines.

H. Kysar v. Lambert.<sup>17</sup>

*Holding:* A valid contract is formed under Washington law<sup>18</sup> even though the terms of shipment were not agreed upon by the parties.

In this case, the Kysars sued Lambert for the balance due on a contract under which Lambert had agreed to sell Christmas trees for the Kysars' account. The Kysars shipped three loads of trees by truck to Lambert. The trees were off-color and the trucks were warm inside when they arrived in Boston. Lambert phoned the Kysars regarding the trees; the parties disagreed as to the content of that discussion.

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15. 528 N.W.2d 103 (Iowa 1995).

16. 886 P.2d 912 (Mont. 1994).

17. 887 P.2d 431 (Wash. Ct. App. 1995).

18. WASH. REV. CODE § 62A.2-204(3) (1995).

The court found that (1) the Kysars had agreed to substantially reduce the number of trees Lambert was obligated to sell and that Lambert had made reasonable efforts to sell the trees; (2) the Kysars' oral agreement to reduce the quantity of Christmas trees Lambert was required to sell was enforceable even though the parties had not agreed to the terms of reshipment of the unsold trees; and (3) the Kysars were entitled to the proceeds of Lambert's sale of the Christmas trees.<sup>19</sup>

### III. TYPE OF COLLATERAL

#### A. *In re Barr*.<sup>20</sup>

*Holding:* The equity retainages held by cooperatives in Texas, called "co-op capital credits," are general intangibles, and a "utility deposit" is money under Article Nine of the U.C.C.

In this case, the Barrs, who farmed in James County, Texas, but resided in New Mexico, took out two bank loans to finance 1994 farm and ranch operations, secured by a perfected first security interest in various personal property, including capital credits and a utility deposit. The Barrs defaulted on both notes and filed a Chapter Seven bankruptcy petition. The issue was whether a bank's perfected security interest covered a debtor's utility deposit and capital credits with a cooperative.

The court held that (1) "capital credits" are general intangibles under Article Nine, which means they were covered by the bank's properly perfected security agreement; and (2) the utility deposit was neither a deposit account nor a general intangible, but, rather, is treated as money. And, because money can only be perfected by possession, the bank was not perfected in the utility deposit.

### IV. VALIDITY/ ATTACHMENT OF SECURITY INTEREST

#### A. Gibson County Farm Bureau Cooperative Ass'n, v. Greer.<sup>21</sup>

*Holding:* A financing statement without a security agreement is sufficient to create a security interest under certain circumstances.

This case might be called "the case of the phantom security agreement." The financing agreement at issue contained a proper description of the collateral, a description of the land, involved crops or timber, and had the debtor's signature. The factors were construed to provide evidence that the parties intended to create a security interest.

The Miles Farm Center (MFC) advanced credit to Greer in connection with Greer's farming operation. MFC filed a U.C.C.-1 financing statement covering Greer's crops, which was signed by Greer as debtor, identified MFC as a secured party, identified the crop collateral, and identified the land on which the crops were to be grown.

The Indiana Supreme Court acknowledged that, a financing statement alone will not generally qualify as a security agreement, but because MFC's financing

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19. WASH. REV. CODE § 62A.2-603 (1995).

20. 180 B.R. 156 (Bankr. N.D. Tex. 1995).

21. 643 N.E.2d 313 (Ind. 1994) (hereinafter Greer).



statement contained a proper description of the collateral, and was signed by the debtor, it was sufficient. Thus, under Indiana law<sup>22</sup> it could create a valid security interest depending on the parties' intent.<sup>23</sup>

B. Mountain Farm Credit Service, ACA v. Purina Mills, Inc.<sup>24</sup>

*Holding:* A security agreement may be valid even if it does not identify the debtor as a partnership and even if the partner who signed the agreement did not indicate that he signed in his representative capacity.

Purina supplied Gray Dawn Farms (GDF) with feed on credit. When Purina realized GDF planned to sell its cattle, Purina obtained a security agreement covering the cattle, allegedly signed by GDF partners Hetherington and Killian. After the sale, GDF's other creditors, including Mountain Farm Credit Service (MFCS) were paid in full, but Purina was not paid because Hetherington did not consider Purina a proper creditor. Hetherington denied that he had signed the security agreement and alleged that Killian had no authority to indebted GDF. Purina demanded contribution from MFCS, and MFCS brought an action to determine the ownership of the proceeds from the cattle sale.

The court held that: (1) Purina's error in identifying individual partners doing business under a particular name instead of the partnership in the security agreement was not fatal to Purina's security interest in the partnership's cattle; (2) the security agreement sufficiently identified the cattle subject to Purina's security interest and the specific location at which the cattle were located even though it identified the cattle as belonging to the partners and not the partnership; and (3) the security agreement created a security interest GDF's livestock even though the partner who signed the security agreement failed to indicate he was signing as a partner.<sup>25</sup>

C. First State Bank v. Moen Enterprises.<sup>26</sup>

*Holding:* The North Dakota statute invalidating security interests in "specific crops"<sup>27</sup> (if any other personal property is taken as collateral by the same agreement) does not apply to harvested crops. Once harvested, crops lose their "specific" identity.

In this case, the Moen brothers, through partnership arrangements, ran a farming operation, which First State Bank (FSB) financed. The Moens defaulted on their loans. FSB agreed to extend the term of the loans, and the Moens signed new security agreements covering their harvested grain and potatoes. The Moens ultimately defaulted on the new agreement and FSB sued to foreclose various mortgages and security interests in the harvested crops.

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22. IND. CODE ANN. § 26-1-9-402 (Burns 1995).

23. See *Greer*, 643 N.E.2d at 321, Justice Givan dissenting. Fortunately we do not see many of these cases in which the plain language of the U.C.C. regarding creation of security interests is ignored.

24. 459 S.E.2d 75 (N.C. Ct. App. 1995).

25. See *id.* at 80. Once again a court comes to the rescue of a careless secured creditor with an appealing set of facts.

26. 529 N.W.2d 887 (N.D. 1995).

27. N.D. CENT. CODE § 35-05-04 (1995).

The court held that the North Dakota crop mortgage statute that invalidates security interests in "specific crops" does not apply to harvested crops.<sup>28</sup> The statute only applies to a definite or particular crop grown on a certain parcel of land in a specific year. Therefore, FSB had a valid security interest in the crops.

## V. PERFECTION OF SECURITY INTEREST

### A. In re Barr.<sup>29</sup>

*Holding:* Possession is required to perfect a security interest in a utility deposit.

In this case, the Barrs took out two loans from the Seminole National Bank to finance 1994 farm and ranch operations. The loans were secured by a perfected first security interest in various property, including certain "co-op capital credits" and a utility deposit for uninterrupted electrical service.

In the Barr's bankruptcy proceeding, the court held that because the capital credits were general intangibles, the bank's security interest in them was perfected by its financing statement covering general intangibles. The bank had not perfected its security interest in the utility deposit because it was money, not a general intangible. A security interest in the deposit could be perfected only by possession, which the bank did not have.

### B. Frost State Bank v. Peavey Co.<sup>30</sup>

*Holding:* A bank's security interest in a farmer's growing crops is unperfected if the financing statement lacks a proper real estate description under the Minnesota version of the U.C.C.<sup>31</sup> However, once the crop is harvested, there is no requirement that the financing statement contain a real estate description.<sup>32</sup>

In this case, Frost State Bank (FSB) filed two financing statements securing its interest in all of the debtor's farm products, including after-acquired crops, and properly notified Peavey. The financing statements contained an incorrect description of the real property where the crops were grown. The debtor harvested the crops and stored them at the Peavey grain elevator. Peavey bought the harvested corn crop and paid the debtor and a supplier who claimed a security interest in the farmer debtor's crops.

The bank then sued Peavey for conversion. The court held: (1) the real estate description requirements of U.C.C. §§ 9-203(1)(a) and 9-402(1) do not apply to harvested crops; and (2) once the farmer's crop is harvested, the crop no longer is a growing crop." Therefore, the real estate description requirement was no longer required. Accordingly, the bank had a perfected security interest in the farmer's stored grain and could recover from Peavey despite the fact that Peavey had purchased the corn.<sup>33</sup>

28. *Id.*

29. 180 B.R. 156 (Bankr. N.D. Tex. 1995).

30. 524 N.W.2d 739 (Minn. Ct. App. 1994).

31. MINN. STAT. § 336.9-203(1)(a), 9-402(1) (1990).

32. *Id.*

33. See 7 U.S.C. § 1631 (1994). This case would have never arisen if Article 9 had been amended pursuant to the recommendation of the Task Force of the ABA Agricultural and Agri-

## VI. WAIVER OF SECURITY INTEREST

A. Mercantile Bank v. Joplin Regional Stockyards, Inc.<sup>34</sup>

*Holding:* A bank waives its security interest under U.C.C. § 9-306(2) by not protesting a sale of collateral in violation of the written consent requirement of the security agreement. The Federal Food Security Act<sup>35</sup> does not preempt U.C.C. waiver rules.<sup>36</sup>

In this case, the Orrs gave the bank a security interest in farm products and offspring of livestock as collateral. Under the terms of the security agreement, the Orrs could not sell, transfer, or encumber the collateral or any interest in the collateral without the bank's prior consent in writing. The Orrs sold the livestock through the stock yard and accepted the proceeds of sale with the bank's knowledge.

The court held that the bank had waived its security interest in the collateral, because the bank had knowledge of the Orrs' conduct, but did not protest the Orrs' actions. Thus, the bank impliedly agreed to alter its right, title, and interest in the collateral.

B. First Bank v. Eastern Livestock Co.<sup>37</sup>

*Holding:* A bank does not waive its security interest in a farmer's after-acquired cattle by acquiescing in farmer's sale of cattle to buyer.

In this case, Eastern, a livestock company, entered into a series of sale and buy-back agreements with cattle farmer Wells under which Eastern agreed to sell cattle to Wells, and repurchase the same cattle after Wells had "grown them out". Although the bank held a valid security interest in the fattened cattle based on the after-acquired property clause in the bank's security agreements with Wells, the bank never received any of the money paid by Eastern to Wells under these contracts. The bank settled with Wells and then sued Eastern.

The court held that (1) the bank had not waived its security interest in the cattle farmer's after-acquired cattle by allowing prior sales from Wells when any waiver was required to be in writing; and (2) the bank's prior settlement with Wells for less than the total amount owed did not release Eastern from liability to the bank.

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Business Finance Subcommittee. The Task Force recommended elimination of the requirement that a description of the land on upon which crops are grown be included in the security agreement and financing statement. In addition, it is odd there was no assertion of the Food Security Act's protection of buyers of farm products.

34. 870 F. Supp. 278 (W.D. Mo. 1994).

35. Food Security Act of 1985, 7 U.S.C. § 1636 (1994).

36. MO. REV. STAT. § 9-306(2) (1994).

37. 886 F. Supp. 1328 (S.D. Miss. 1995).

## VII. PRIORITIES

A. *Among Article 9 Security Interests*1. NBD Bank, N.A. v. Timberjack, Inc.<sup>38</sup>

*Holding:* A seller loses its perfected status as a secured creditor if it files its continuation statement prematurely.

In a case of what might be called "no mercy," Timberjack sold products on credit to Cedar Springs, a tractor and equipment company. The expiration date of the financing statement was five years from the date of filing. Timberjack filed a continuation statement six months and five days before the expiration date. Cedar Springs subsequently entered into a loan agreement with NBD Bank, N.A. (formerly known as Union Bank & Trust Company) and granted a blanket security interest to the bank in all of Cedar Springs' assets. Cedar Springs ultimately defaulted on its bank loan. The court issued a restraining order prohibiting Cedar Springs from disposing of any equipment or inventory. Nevertheless, Cedar Springs voluntarily returned some of its inventory to Timberjack.

The court held that Timberjack lost its status as perfected secured creditor when it filed a continuation financing statement six months and five days before the expiration date of the original financing statement. U.C.C. § 9-403(3) clearly requires that a continuation statement be filed within six months before expiration of the five-year period.<sup>39</sup>

2. *Melcher v. Bank of Madison.*<sup>40</sup>

*Holding:* A bank's preexisting security interest in a son's after-acquired property attaches to his interest in a tractor purchased from his father. Thus, the bank has priority over the seller-father's automatic, but unperfected, purchase money security interest in the tractor.

In this case, Melcher sold his son a tractor and took a purchase money security interest in the tractor. Melcher's son paid for part of tractor, used it, depreciated it on his income tax returns, and listed the tractor on his financial statements. The bank had a preexisting perfected security interest in the son's after-acquired property that attached to the tractor when the son purchased it. Melcher failed to perfect his purchase money security interest by filing. After the son filed for bankruptcy, the bank used a judgment in a replevin action to seize and sell the tractor. Melcher then sued the bank for conversion. The court held that because Melcher did not perfect his purchase money security interest, either by filing or possession, the bank's preexisting security interest had priority, thus precluding a successful conversion action by Melcher.

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38. 527 N.W.2d 50 (Mich. Ct. App. 1994).

39. MICH. COMP. LAWS § 440.9403(3) (1994).

40. 529 N.W.2d 814 (Neb. Ct. App. 1995).

### 3. First National Bank v. Pleasant Hollow Farm, Inc.<sup>41</sup>

*Holding:* A lender's perfected security interest in a farm's crops has priority over ownership rights asserted by financiers who fail to file financing statements to perfect their interests.

In this case, Seixas, through its agent Ceres, contracted with Pleasant Hollow Farm to grow sunflowers to satisfy its agreement with Sigco. Seixas advanced money to the farmer to cover expenses incurred in producing the 1992 crop, but never filed a financing statement, although the crops were promised to Seixas under the farming contract. The bank loaned money to the farmer and perfected a security interest in all of the farmer's crops growing in South Dakota. The bank had checked the state filing system and uncovered no financing statements or other liens of record in the crops.

Not surprisingly, the court held that the bank's perfected security interest in the crop had priority over Sigco's unperfected security interest for which no financing statement was filed.

#### B. *Between an Article 9 Security Interest and a Buyer in the Ordinary Course*

##### 1. First National Bank & Trust v. Miami County Cooperative Ass'n.<sup>42</sup>

*Holding:* As long as the notices of a secured party's interest in farm products are in substantial compliance with the direct notice requirements of the Food Security Act of 1985<sup>43</sup> and are not misleading, they are sufficient.

In this case, a bank and a cooperative association (cooperative) each claimed rights to certain farm products and their proceeds of a bankrupt farming operation. Even though the bank had sent the cooperative written notice of its security interest in the bankrupt's crops, the cooperative argued that the notices failed to comply with the Food Security Act of 1985.

The court found that the lien notices the bank gave to the cooperative sufficiently complied with the direct notification requirements of the Federal Food Security Act. Thus, the bank's security interest in the farm products and proceeds of sale of the bankrupt farming operation survived sale of the farm products to the cooperative.

#### C. *Between an Article 9 Security Interest and Other Claimants*

##### 1. Gibson County Farm Bureau Cooperative Ass'n v. Greer.<sup>44</sup>

*Holding:* The filing of a financing statement without an underlying security agreement may prevail over a judgment lien.

In this case, Miles advanced credit to Greer in connection with Greer's farming operation and filed a financing statement covering Greer's crops. The statement was signed by Greer as debtor, and it identified the secured party (Miles), the collateral, and the land upon which the crops were to be grown. Greer sold some of the crops

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41. 532 N.W.2d 60 (S.D. 1995)

42. 897 P.2d 144 (Kan. 1995).

43. Food Security Act of 1985, 7 U.S.C. § 1636.

44. 643 N.E.2d 313 (Ind. 1994).

to a third party, Consolidated Grain and Barge, Inc., which then issued a check jointly payable to the order of Greer, Miles, Gibson County Farm Bureau, and Princeton Farms. Farm Bureau refused to endorse the check, and the check remained uncashed. Farm Bureau sued Greer and obtained a judgment lien against him.

The court held that Miles had a perfected security interest in the crops and the proceeds superior to Farm Bureau's judgment lien where the parties intended the financing statement to create a security interest in Greer's crops, even though there was no separate security agreement. This was so because the financing statement contained the required information.<sup>45</sup>

## 2. Wilkin Elevator v. Bennett State Bank<sup>46</sup>

*Holding:* A bank's oral agreement to assure payment of accounts receivable owed to a feed supplier does not take priority over the bank's security interest in the proceeds from the sale of hogs owned by the purchaser of the feed.

In this case, the Beuthiens ran a large hog operation. In 1980, the Beuthiens granted the bank a perfected security interest in all of their livestock and proceeds. The feed store challenged the bank's possession of the proceeds of hog sales that were jointly payable to the customer, the feed store, and the bank.

The Iowa Supreme Court held that the bank was entitled to the proceeds of the checks because the bank's perfected security interest in the proceeds of hog sales took priority over any claim by the feed store. The store had claimed that the bank assured it of payment. Nonetheless, because the feed store had no lien on the hogs or their proceeds, the bank prevailed.

## VIII. REPOSSESSION AND FORECLOSURE

### A. Knox v. Phoenix Leasing Inc.<sup>47</sup>

*Holding:* A secured creditor who repossesses collateral from a defaulting borrower is not required to pay restitution to a third party seller of goods to the borrower who has a junior interest in the collateral.

In this case, Domaine Laurier Winery (Domaine) contracted to purchase wine barrels from Knox. Thereafter, Domaine executed a loan agreement with Phoenix and granted a security interest to Phoenix in all of Domaine's personal property. Two months after Knox sent Domaine a shipment of barrels, but before Domaine paid for the shipment, Domaine defaulted on the Phoenix loan. Phoenix liquidated Domaine's assets. Knox brought an action against Phoenix for restitution.

The court held that because Phoenix had perfected its security interest in Domaine's assets, it had gained priority over other creditors. Phoenix had the right to take possession and sell the wine barrels when Domaine defaulted. Phoenix could not be held liable for the value of the goods furnished to Domaine debtor by a sub-

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45. See *supra* note 23.

46. 522 N.W.2d 57 (Iowa 1994).

47. 35 Cal. Rptr. 2d 141 (Cal. Ct. App. 1994).

ordinate, secured creditor. Thus, Phoenix had no duty to pay restitution to Knox for the wine barrels.<sup>48</sup>

#### B. Madison-Hunnewell Bank v. Hurt.<sup>49</sup>

*Holding:* A farmer who voluntarily turns over farm equipment to a bank with a perfected security interest in the equipment is still liable to another bank with an unperfected security interest in the same equipment, where none of the proceeds of the sale are turned over to the second bank.

In this case, the Hurts granted security interests in their farm equipment to two banks, Madison and Mercantile. However, Madison's financing statement expired, leaving Mercantile with the only perfected security interest in the equipment. The Hurts were not aware that the Madison loan had lost its perfected status. When the Hurts did not have the cash to pay Madison, they voluntarily put the equipment in a foreclosure sale run by Mercantile in the area. The Hurts intended that the proceeds from the sale of the equipment go to Madison to satisfy their obligation, because they believed that Madison still had a priority security interest in the equipment. However, Mercantile retained the proceeds from the sale to satisfy the obligation Hurt owed them. Madison sued the Hurts for payment on its notes. Hurt claimed that his liability should be limited to the amount owed Madison as of the date of the equipment sale and that his wife should not be liable for the debt.

The court held that both Hurts were liable to Madison. Because both had signed the note and both owned the farm equipment they were co-makers. The court also held that the Hurts' liability under the note was not limited to the amount owed at the date of the voluntary sale, because Hurt had not tendered payment or turned over the equipment to Madison.

#### C. Production Credit Ass'n v. Eldin Haussermann Farms, Inc.<sup>50</sup>

*Holding:* A credit association is not liable to a borrower for wrongfully foreclosing on a farm mortgage securing a defaulted loan, where the credit association declined to make a livestock loan to the cattle rancher that might have allowed him to stay in business.

In this case, Production Credit Association (PCA) had made many operating loans to the Haussermanns that were secured by crops and livestock. When Haussermann died, PCA restructured the operating loans into a term loan and took mortgages on the farm property as collateral. PCA also granted Haussermann's widow an operating loan that did not include money for livestock purchases. When she requested an additional loan to purchase livestock, PCA declined the loan. When Mrs. Haussermann failed to make the term note payment, PCA foreclosed on the farm mortgage. Mrs. Haussermann claimed that PCA failed to deal in good faith by denying the livestock loan, alleging that denial of the loan contributed to the operation's failure to generate a profit, and that she detrimentally relied on PCA's practice of promising to lend as it had in the past.

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48. The lesson for a seller is: get paid promptly, or preserve an Article 2 or Article 9 security interest to protect your right to get paid.

49. 903 S.W.2d 175 (Mo. Ct. App. 1995).

50. 529 N.W.2d 26 (Neb. 1995).

The court held that PCA's refusal to make the livestock loan did not constitute a breach of good faith or violate any reasonable expectations of the parties because PCA had loaned Haussermann all of the money PCA had committed to lend.

D. Coones v. Federal Deposit Insurance Corp.<sup>51</sup>

*Holding:* A secured creditor that fails to notify the debtor of a foreclosure sale of pledged livestock and equipment is not entitled to a deficiency judgment against the debtor. However, the costs incurred in preserving and maintaining collateral during the foreclosure sale are an administrative expense of the bankruptcy estate and the secured creditor is not liable to the debtor for those expenses.

In this case, Coones procured loans from two bank to finance the operation of his farming business. He secured these loans with oil field equipment, livestock, crops, and farm equipment. Subsequently, both banks went under and the FDIC acquired their assets, including Coones' obligations. Coones later filed for Chapter Eleven bankruptcy, and eventually brought this post-foreclosure action against the FDIC to recover expenses incurred in caring for the collateral.

The court held that: (1) a secured creditor, in failing to notify the debtor of its sale of foreclosed property, was precluded from recovering a deficiency judgment from the debtor thereafter; (2) the secured creditor was not liable to the debtor for costs incurred in preserving and maintaining the collateral in the post-default, pre-foreclosure period; and (3) debtor could not claim an agister's lien for expenditures made in preserving and maintaining the collateral during bankruptcy proceedings.

E. Engstrom v. First National Bank of Eagle Lake.<sup>52</sup>

*Holding:* A bank is not liable under the Soldiers' and Sailors' Civil Relief Act<sup>53</sup> for an unauthorized sale of farm equipment if the bank thought the farmer's agent was authorized to sell the equipment.

In this case, Engstrom operated a rice farm, which was financed by the bank. Engstrom was called to active military duty. Prior to his departure, Engstrom arranged for a neighbor to carry out an orderly sale of as much of Engstrom's equipment as was necessary to meet payments due on the bank loans. The bank was advised that the neighbor would assume this agency role. Most of Engstrom's equipment was sold at auction, and the proceeds of sale were applied to the bank loans. Upon his return to Texas, Engstrom filed suit against the bank. He alleged that the bank had violated the Soldiers' and Sailors' Civil Relief Act, which forbids any one to sell the property of military personnel on active duty unless a court orders the sale.

The court held that the bank's organization of the auction, and its acquiescence in the sale of Engstrom's farm equipment, did not render the bank liable under the Act. The bank believed that Engstrom's agent was authorized to sell the equipment, and there was no evidence that Engstrom's agent was also acting as the bank's agent.

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51. 894 P.2d 613 (Wyo. 1995).

52. 47 F.3d 1459 (5th Cir. 1995).

53. Soldiers' and Sailors' Civil Relief Act of 1940, 50 U.S.C §§ 1-703 (1940), as amended by 50 U.S.C. §§ 501-93 (1995).



## IX. CONVERSION

A. In re Recker.<sup>54</sup>

*Holding:* Intentional conversion of crops in which a creditor holds a perfected security interest may result in a denial of discharge in bankruptcy.

In this case, Farmers Home Administration (FmHA) made three loans to the Reckers, secured by the Reckers' crops, and FmHA perfected its security interest. The loans were extended and renewed, but FmHA did not annually renew its financing statements. To pay off a pre-existing debt that he owed his father, Ronald Recker leased 250 acres of encumbered land to his father. Ronald harvested the crop grown on that land, but none of the proceeds of sale or any of the father's monthly management fees was paid to FmHA.

The court held that under Missouri law,<sup>55</sup> which no longer requires annual re-filings of financing statements, FmHA's security interest in the crops remained perfected. The court denied Recker a discharge on the FmHA loans. The court found that Recker had converted the proceeds of the sale of the crops in which the government held a perfected security interest, and that the conversion constituted "willful and malicious injury" to FmHA's interest in the crops.

B. Underhill Coal Mining Co. v. Hixon.<sup>56</sup>

*Holding:* A person who makes a good faith purchase of stolen goods is nevertheless liable for conversion.

In this case, a timber merchant unlawfully entered, Underhill's property, cut, and removed a substantial quantity of timber, and sold the stolen timber. Underhill sued the timber merchant and the purchasers of the timber.

The court held that a good faith purchaser of goods from one who converts another's property is himself a converter and is liable for conversion to the true owner. Because Underhill had not assented to the timber merchant's conduct, the timber purchasers could not escape liability by claiming they were bona fide purchasers for value.

C. Frost State Bank v. Peavey Co..<sup>57</sup>

*Holding:* A grain elevator operator that buys crops and does not give the proceeds to the first perfected secured party is liable for conversion.

In this case, the bank took a security interest in a debtor's personal property and filed two financing statements showing that the bank had a security interest in all of the debtor's farm products, including after-acquired crops. Peavey purchased the harvested crop and stored it at its grain elevator. The bank sued Peavey for conversion of the proceeds of the debtor's harvested crops that Peavey had paid to the debtor and a supplier that had claimed a security interest in the debtor's crops.

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54. 180 B.R. 540 (Bankr. E.D. Mo. 1995).

55. Mo. Rev. Stat. § 400.9-204 (1989), § 400.11-103 (1994).

56. 652 A.2d 343 (Pa. Super. Ct. 1994).

57. 524 N.W.2d 739 (Minn. Ct. App. 1994).

The court held that the grain elevator operator was liable to the bank for conversion of proceeds of the crop sale.

## X. PREEMPTION

### A. Lynnbrook Farms v. Smithkline Beecham Corp.<sup>58</sup>

*Holding:* The federal Virus-Serum-Toxins Act (VSTA)<sup>59</sup> preempts state statutory and common law claims.

In this case, a farm partnership sued an animal vaccine manufacturer, alleging that vaccines produced by the manufacturer proximately caused debilitation and death of the partnership's cattle.

The court held that VSTA preempted the partnership's state common law and statutory claims against cattle vaccine manufacturer. It found that VSTA creates a "national, uniform standard for the preparation and sale of animal vaccines." As a result, the manufacture and sale of all animal vaccines is under the control of the federal government, specifically, the USDA. Further, the court held that APHIS, the agency which regulates cattle vaccines, acted within its authority in adopting regulations which preempt state law.

## XI. PERISHABLE AGRICULTURAL COMMODITIES ACT ("PACA").<sup>60</sup>

### A. Brookside Farms v. Mama Rizzo's, Inc.<sup>61</sup>

*Holding:* An oral modification of the price term in a written contract is enforceable under PACA.

In this case, Brookside and Mama Rizzo's entered into a contract for the sale of herbs. Thereafter, the parties verbally agreed to modify the price term of their agreement. The seller brought suit against buyer alleging breach of contract.

The court held that the buyer violated the Perishable Agricultural Commodities Act when it refused to pay the agreed-upon higher price for the last 3,000 pounds of basil leaves accepted for delivery.

### B. In re Kornblum & Co.<sup>62</sup>

*Holding:* A court will not impose a PACA trust where the transaction involved payments that are the functional equivalent of rent paid to a creditor in the ordinary course of business.

In this case, a cooperative association executed a master lease for a twenty-five year term. Under the terms of the lease, a tenant could surrender its existing lease and purchase one or more membership interests in the cooperative. Kornblum, a produce dealer, purchased four membership interests. Kornblum purchased produce on credit from other merchants, then later filed for bankruptcy.

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58. 887 F. Supp. 1100 (C.D. Ill. 1995).

59. Virus-Serum-Toxins Act, 21 U.S.C §§ 151-58 (1995).

60. Perishable Agricultural Commodities Act, 1930, 7 U.S.C. § 499(a) et seq., amended by Pub. L. No. 104-48, 109 Stat. 424 (1995).

61. 873 F. Supp. 1029 (S.D. Tex. 1995).

62. 177 B.R. 187 (Bankr. S.D.N.Y. 1995).

The court held that Kornblum's acquisition of membership interests in the cooperative was unrelated to any transactions between Kornblum and produce merchants. Therefore, the cooperative units could not be held in trust for the benefit of such creditors under PACA.

### C. Battle v. Fresh Preps Distribution, Inc.<sup>63</sup>

*Holding:* A produce distributor's bank is not liable to a produce supplier under PACA for loan payments it accepted from the produce distributor when it did not know the produce distributor was not paying its suppliers.

In this case, Fresh Preps, a produce distributor, advised National Bank of Detroit N.A. ("NBD") that it had lost its largest customer and had been unable to pay several of its produce suppliers. NBD repeatedly requested information regarding potential PACA claimants. Fresh Preps did not provide the requested information, but told NBD that Fresh Prep's owner had contributed enough money to the company and that suppliers would be paid. NBD continued to accept payments from Fresh Preps on its loan. Eventually, however, Fresh Preps and NBD entered into a voluntary liquidation agreement that provided for payment of all PACA claimants. However, Fresh Preps did not make any further loan payments. Battle, one of Fresh Prep's produce suppliers, sued Fresh Preps and NBD on the grounds that the payments accepted by NBD were subject to the PACA trust fund that NBD should have turned over to the produce suppliers.

The court held that (1) NBD had fulfilled its duty to inquire as to whether funds it received were PACA trust funds; (2) NBD was therefore entitled to assert the "bona fide purchaser" defense to the PACA claims because it did not know Fresh Preps was not paying its produce suppliers; and (3) NBD was therefore not liable to PACA claimants.

## XII. FEDERAL FOOD SECURITY ACT OF 1985<sup>64</sup>

### A. Mercantile Bank v. Joplin Regional Stockyards, Inc.<sup>65</sup>

*Holding:* The Federal Food Security Act<sup>66</sup> does not preempt state common law regarding the waiver of a security interest in farm products.

In this case, a secured creditor brought an action against a stockyard, alleging that the stockyard was liable under the Food Security Act for reasonable market value of livestock collateral sold by the stockyard on behalf of debtors. The court in this case undertook a three-prong analysis of the preemption issue and found that the Federal Food Security Act did not: (1) explicitly preempt state law regarding waiver of a security interest; (2) so consume the area that no room was left for state law to supplement; or (3) conflict with state law concerning waiver. Thus, the limitation on the effect of 7 U.S.C. § 1631 has been strengthened. It preempts only the "farm products exception" of U.C.C. § 9-307.<sup>67</sup>

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63. 873 F. Supp. 1062 (E.D. Mich. 1995).

64. 7 U.S.C. § 1631 (1994).

65. 870 F. Supp. 278 (W.D. Mo. 1994).

66. 7 U.S.C. § 1631 (1994).

67. For further discussion of the facts of this case, see case cited *supra* note 34 and accompanying text.

B. Morken v. Kunkel (In re Morken).<sup>68</sup>

*Holding:* The operation of the Federal Food Security Act<sup>69</sup> cut off any U.C.C. Article Two security interest that cattle producers may have had once the cattle were sold to a bona fide purchaser.

Despite their classification as "cash" sales under the Packers and Stockyards Act,<sup>70</sup> the sales in this case did not meet the Uniform Commercial Code requirement for prompt payment on demand.<sup>71</sup> Spring Grove Livestock Exchange, Inc. and the Morkens were engaged in raising, feeding, and marketing cattle. Both filed separate petitions in bankruptcy. Because the cattle producers did not insist on immediate payment, they were left with the "credit" seller's right of reclamation under the U.C.C.<sup>72</sup>

A cattle producer's sale of cattle to a debtor, who then resold them to third parties, triggered the operation of the Federal Food Security Act's elimination of the "farm products exception" in U.C.C. § 9-307. This case is an interesting application of the use of 7 U.S.C. § 1631 to an Article Two security interest.<sup>73</sup>

C. First National Bank & Trust v. Miami County Cooperative Ass'n.<sup>74</sup>

*Holding:* In Kansas, under the Federal Food Security Act,<sup>75</sup> the survival of a lender's security interest in farm products purchased by a buyer in the ordinary course of business depends on whether the lender provides the buyer with direct notice of the bank's lien.

In this case, the bank and the buyer cooperative each claimed rights to farm products and proceeds of sale of a bankrupt farming operation.

The court found that the lien notices from the bank to the cooperative substantially complied with the Federal Food Security Act,<sup>76</sup> which provides that a lender may use alternate means of notifying buyers of the lender's security interest in farm products either by central filing system or direct notification. Thus, the bank's security interest in the farm products and proceeds from the sale of the bankrupt farming operation survived the sale of the farm products to the cooperative.

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68. 182 B.R. 1007 (Bankr.D. Minn. 1995).

69. 7 U.S.C. § 1631 (1994).

70. 7 U.S.C. §§ 181-229 (1994).

71. MINN. STAT. § 336.2-507(2) (1995).

72. MINN. STAT. § 336.2-702 (1995).

73. For further discussion of the facts of this case, see case cited *supra*, note 6 and accompanying text.

74. 897 P.2d 144 (Kan. 1995).

75. 7 U.S.C. § 1631 (1994).

76. *Id.*

D. Farmers & Merchants State Bank v. Teveldal.<sup>77</sup>

*Holding:* A lender's failure to designate an Effective Financing Statement (EFS) code number for its hog collateral on its financing statements does not void its perfected security interest in the hogs.

In this case, Teveldal, a feed supplier, provided hog producer Haiar with feed on credit. When Haiar did not pay, Teveldal called the Secretary of State and inquired if there were any liens on Haiar's animals. Teveldal was told that the EFS code listing on the bank's financing statement indicated that the bank had a security interest in Haiar's beef and dairy cattle, but the inquiry did not reveal an EFS code number for hogs. Teveldal then filed a financing statement perfecting a security interest in Haiar's hogs.

First, the court held that the bank did not lose the perfected status of its security interest because the financing statement provided general notice that the bank held a security interest in the hogs. Second, the court held that Teveldal should have conducted a search more thorough than a mere EFS code inquiry. The omission of the code number in the EFS section did not render the bank's financing statement insufficient. Finally, the court held that Teveldal placed too much reliance on a telephone call to the Secretary of State. A reasonable inquiry would have been to ask for a printed copy of the entire financing statement.<sup>78</sup>

## XIII. COMPETING STATUTORY LIENS

A. Jakubaitis v. Fischer.<sup>79</sup>

*Holding:* When a "specific" veterinarian lien statute and a "general" livestock service lien are applicable to the same set of facts, the specific statute governs.

In this case, a horse owned by Jakubaitis fell ill and was admitted to an animal hospital. At the time of the admission, the hospital notified Jakubaitis that it would not release the horse until it had received payment of the outstanding hospital bill, and, further, that a failure to make payment within ten days would result in a sale of the horse. The bill was never paid, and the animal hospital retained possession of the horse. The Jakubaitises sued, alleging conversion and intentional infliction of emotional distress, among other things.

The court held that a specific veterinarian lien statute,<sup>80</sup> rather than a general livestock service lien statute,<sup>81</sup> governed the dispute between the parties. The court reasoned that the legislature's omission of veterinary care from the general statute indicated its intention to retain the specific statute as the governing scheme for veterinary surgeons and veterinary proprietors in possession.

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77. 524 N.W.2d 874 (S.D. 1994).

78. Although this case is a dispute between Article 9 secured parties, it is placed here because of the significance of 7 U.S.C. § 1631 in the court's decision. This case correctly distinguishes between the effect of a perfected security interest through filing a financing statement and the effect of an EFS, which preserves that status but does not effect it.

79. 40 Cal. Rptr. 2d 39 (Cal. App. 1995).

80. CAL. CIV. CODE §§ 3051, 3052 (West 1993).

81. CAL. CIV. CODE § 3080 et seq. (West 1993).

B. *In re Schlote*.<sup>82</sup>

*Holding:* Under Nebraska law, a farm products supplier's lien, which attached when crops were growing, is enforceable against the harvested crops even though the lien expired before harvest.

In this case, the Schlotzes purchased farm products and services from Osmond. Osmond perfected a lien in the Schlotzes' corn crop in compliance with a Nebraska statute governing fertilizer and agricultural-chemical liens.<sup>83</sup> The statute provides that a valid lien is created at the time products, labor, or machinery are supplied upon "crops produced within one year upon the land where such product was applied." Osmond's lien, however, expired while the crops were growing.

The court in the Schlotzes' bankruptcy proceeding held that Osmond had a secured claim against the 1993 corn crop, which was growing when the lien expired, because the lien was valid for the entire crop cycle, from planting through harvest and storage.

## XIV. BANKRUPTCY

A. *In re Penrod*.<sup>84</sup>

*Holding:* If a reorganization plan makes a provision for the payment of a secured creditor's claim, but remains silent as to whether the creditor's security interest is extinguished, then the security interest is deemed extinguished.

In this case, the Penrods were hog farmers who executed a promissory note to Mutual Guaranty Corporation (MGC). A year later, the Penrods filed for reorganization protection under Chapter Eleven.<sup>85</sup> Shortly after the reorganization plan went into effect, the Penrod hogs became infected with a disease that causes miscarriages in female hogs. The infected hogs were sold for slaughter, but the proceeds of sale were not remitted to MGC.

The court held that when secured parties participate in a bankruptcy plan, they have notice that their security interests are likely to be affected. If a secured party participates in a reorganization, unless the plan of reorganization or order confirming the plan states that their interests are preserved, its security interest is extinguished upon confirmation of the plan.

B. *In re Foust*.<sup>86</sup>

*Holding:* A debtor in bankruptcy may be denied a discharge if it fraudulently induced a lender to make a secured loan, or converted a secured party's interest in crops.

In this case, Foust and his brother operated Foust Brothers Farms, Inc., as well as numerous other farm-related corporations which were financially interdependent. The Fousts obtained Small Business Administration (SBA) and Farmers' Home

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82. 177 B.R. 315 (Bankr. D. Neb. 1995).

83. NEB. REV. STAT. § 52-1101 (1993).

84. 50 F.3d 459 (7th Cir. 1995).

85. Bankruptcy Code, Pub. L. 95-598, Title I, § 101, 92 Stat. 2549 (1978) (codified as amended in scattered sections of 11 U.S.C.).

86. 52 F.3d 766 (8th Cir. 1995).

Administration (FmHA) disaster loans for Foust Brothers Farms, Inc., but intentionally failed to disclose the company's lack of financial independence from the other companies they owned. The SBA and FmHA loans were secured by the Fousts' 1985 crops and crop proceeds. The Fousts defaulted on the loans, and then filed separate petitions in bankruptcy for their various companies. The government brought an adversary proceeding to prevent the federal disaster loans from being discharged in the bankruptcies.

The court held that the Fousts had defrauded the government by misleading it into believing that Foust Brothers Farms, Inc. was run separately from the Foust brothers' other corporations and held that this fraud prevented the agencies from fully assessing the creditworthiness of Foust Brother Farms, Inc. The court also held that the Fousts had willfully converted crops securing the government loans by covert sale of the crops, placement of the proceeds of sale into a personal account, and by making false reports of grain thefts. Therefore, the debtors were denied a discharge on the federal disaster loans.

### C. In re Flitter.<sup>87</sup>

*Holding:* If exercised first, a bankrupt farmer's right to avoid a secured creditor's lien and retain equipment and machinery as tools of the trade, prevails over a trustee's power to avoid the secured creditor's claim and take the collateral into the bankruptcy estate.

In this case, the Flitters filed for liquidation under a Chapter Seven bankruptcy. They listed their parents as creditors holding a security interest in machinery and a tractor and skid loader. The Flitters claimed exemptions for all of their livestock and farming equipment. The bankruptcy trustee objected to the claimed exemptions.

The court held that the Flitters could avoid their parents' lien on farm machinery and equipment, thereby defeating the claims of the bankruptcy trustee to those assets. However, the secured creditors' liens on animals and crops held as business inventory were effective, notwithstanding Flitters' exemption for animals and crops held primarily for personal use.<sup>88</sup> Therefore, the Flitters could not defeat the liens or the Trustee's claims to those business inventory assets.

### D. In re Childress.<sup>89</sup>

*Holding:* The relationship between grain depositors and elevator owners is that of bailor-bailee. Actual ownership of the grain never passes to the elevator owners, and therefore does not become a part of the bankruptcy estate.

In this case, the Missouri Department of Agriculture took possession of the debtor's grain elevators and sold the grain contained in them under a court order. Before the Department could distribute the proceeds to the grain growers, the debtors filed for Chapter Eleven bankruptcy protection. The elevator owner claimed that the Department could not distribute the funds from the grain sales to the grain growers because the grain proceeds were property of the elevator owner's bankruptcy estate.

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87. 181 B.R. 938 (Bankr. D. Minn. 1995).

88. See generally, 11 U.S.C. § 522(f)(2)(A) (1994).

89. 182 B.R. 545 (Bankr. W.D. Mo. 1995).

The court held that under Missouri law,<sup>90</sup> the relationship between grain depositors and grain elevators is that of bailor and bailee, so that the actual ownership of the grain remained with the grain growers and never passed to the debtors. Thus, the grain growers were entitled to the proceeds from the Department's sale of the grain.

#### E. In re Nebel.<sup>91</sup>

*Holding:* Sale of livestock to pay a secured claim of a bank is an administrative expense of the bankruptcy estate, and any resultant tax consequences of the sale has to be borne by the estate and not the debtor.

In this case, Nebel filed a petition for Chapter Seven bankruptcy. The bank held a security interest in the Nebel livestock and crops. Nebel and the bank entered into a stipulation to grant the bank relief from the automatic stay. This would enable the bank to immediately dispose of quarantined livestock. The court approved the agreement. The livestock was sold, and the proceeds of sale were remitted to the bank.

The court found that any proceeds of sale remaining after the payment of the bank's secured claim would have accrued to the benefit of unsecured creditors. Any resultant sales tax liabilities also accrued to the benefit of the bankruptcy estate. Therefore, the bankruptcy estate was required to pay the taxes before making any distribution of monies to unsecured creditors.

### XV. SECURITIES LAW

#### A. DeWit v. Firststar Corp.<sup>92</sup>

*Holding:* Investors in the soon-to-be infamous Morken defunct cattle investment contract scheme could not recover their losses from the banks that closed the promoter's accounts, thereby causing the scheme to collapse.

In this case, Morken marketed the so-called Adventure Cattle investment program in which he sold investment contracts in cattle with a guaranteed twenty-five percent annual rate of return. As part of this project, Morken concluded agreements with several banks that allowed Morken to generate a substantial "float," which is basically an open-ended line of credit maintained through controlled disbursement services. The banks charged high fees on these accounts, solicited investors for Morken's program, and controlled the float among Morken's accounts. As a result, Morken appeared to be financially strong, even when the cattle market slumped and Morken's accounts were overdrawn. The banks eventually collapsed the float, Morken declared bankruptcy, and the program's investors and suppliers sustained millions of dollars in losses. The investors sued the banks for securities fraud and other claims. The banks claimed that they were in fact the victims of a check kiting scheme engineered by Morken.

The court held that the banks were not guilty of securities fraud because the cattle investment contracts were not securities. After examining several factors, the

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90. Mo. Rev. Stat. § 400.7-207(2), 411.491 (1994).

91. 175 B.R. 306 (Bankr. D. Neb. 1994)

92. 879 F. Supp. 947 (N.D. Iowa 1995).



court concluded that the investment scheme lacked horizontal and vertical commonality, and that it was structured in a way that the investors did not rely on the efforts of others to make the investments profitable. Finally, the court held that the investors did not receive "profits," but a twenty-five percent annualized return on their investment. The court dismissed all claims in this action.

B. *Busse v. Pacific Cattle Feeding Fund No. 1, Ltd.*<sup>93</sup>

*Holding:* "Feeding and finishing" contracts meet the statutory and case-law requirements for an investment contract, which is a "security."

In this case, Pacific, a limited partnership, sued Busse, a cattle seller, for violations of the Texas Securities Act,<sup>94</sup> as well as the Deceptive Trade Practices Act (DTPA), after a cattle marketing program failed.<sup>95</sup>

The court of appeals held that "finishing-and-feeding" contracts were a type of investment contract, and, thus, were "securities" for purposes of Texas Securities Act. Further, all of the statutory elements required to show a violation of the Texas Securities Act were established: Busse was a "control person;" the security should have been registered but wasn't; the sale was made through the use of materially misleading statements and omissions; and Busse was liable for damages because he sold an unregistered security. Therefore, summary judgment for Pacific was proper on that issue.

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93. 896 S.W.2d 807 (Tex. Ct. App. 1995).

94. Texas Securities Act, TEX. REV. CIV. STAT. ANN. art. 581-1 et seq. (West 1996).

95. Texas Deceptive Trade Practices Act, TEX. BUS. & COM. CODE ANN. § 17.44 (WEST 1987).