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## An Agricultural Law Research Article

### **2005 Commercial Law Update**

by

Keith G. Meyer

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Editors' note: This update was originally prepared for the 2005 Annual Meeting of the American Agricultural Law Association. Rather than being organized in the traditional article format, the material is organized into an extensive, eleven-part narrative outline that the reader should find manageable and informative.

## 2005 Commercial Law Update

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### I. Scope or Coverage of Revised Article 9, Which Became Effective on July 1, 2001

A. § 9-109(a) provides that Article 9 applies to:

1. Any transaction, regardless of form, that creates a security interest in personal property or fixtures. (No change)
2. An agricultural lien. (Major change; applies to nonpossessory statutory liens in farm products; not enacted in Kansas)
3. Sale of accounts, chattel paper, payment intangibles or promissory notes. (Last two are new and definition of accounts expanded)
4. Consignments (a few changes). See 9-102(a)(19-21) and (28); 9-103(d)(consignor' has purchase money security interest in consignee's inventory)
5. Security interests in commercial deposit accounts as original collateral (not treated as proceeds) are now covered. See 9-109(d)(13) cmt. 16.

B. 9-109(c-d) exclude certain transactions such as:

1. Transactions covered by federal legislation or treaty to the extent that it preempts Article 9. 9-109(c)(1)
2. A landlord lien other than a landlord lien that is an agricultural lien. 9-109(d)(1).
3. A lien, other than an agricultural lien, given by statute or other rule of law for services or materials but Section 9-333 applies with respect to the priority of the lien. 9-109(d)(2)
4. “[T]he creation or transfer of an interest in or lien on real property, including a lease or rents thereunder . . . .” 9-109(d)(11).

### II. Real Estate Related Collateral

A. Clearly Article 9 does not cover a pure real estate transaction where a real estate mortgage or contract for deed or deed of trust covering a piece of real estate is involved. The collateral here is only the real estate.

1. Article 9 does apply to some transactions which appear to be pure real estate. An example is *payments* under an installment land contract or a contract for deed.
2. This issue came up in *In re Huntzinger*, 268 B.R. 263 (Bankr. D. Kan. 2001). Here owner of real estate sold the real estate to buyer under a contract for deed providing buyer was to receive monthly payments for twenty years. Seller borrowed money from a bank and mortgaged its interest in the sold real estate and gave bank an interest in the proceeds of the installment land contract. No UCC-1 was filed.

3. Seller ultimately filed a bankruptcy petition and the court determined that bank did not have a secured claim in the monthly payments under the contract for deed. The flow of payments are personal property. Under former Article 9 (F9), most courts held the payments were general intangibles which had to be perfected by the filing of a financing statement centrally. Since bank filed no financing statement, it was an unperfected secured creditor.

This case would come out the same way under revised Article 9 (R9) but the flow of payments are classified as an *account* not a general intangible. The definition of accounts in 9-102(a)(2) is much broader than under old Article 9. It includes the right to payment of a monetary obligation, whether or not earned by performance for "*property*" that has been sold, leased, licensed, assigned or otherwise disposed of. . . ." The old definition of accounts only referred to goods. With the new definition including the right to payment for property sold, the flow of payments under an installment land contract or contract for deed appear now to be clearly considered an account instead of a general intangible.

Perfection of both accounts and general intangibles is by filing with the Secretary of State. § 9-501. *The only difference it makes is how the collateral is described in the security agreement and financing statement.* Types of collateral can be used as descriptions in both under 9-108 and 9-504 but if a drafter calls the collateral a payment intangible or general intangible it is a fatal error. This problem can be avoided by simply describing the collateral in lay terms such as "the monthly payments under the contract for deed between buyer and seller dated . . . ."

4. See *In re Nittolo Land Development Assoc. Inc.*, 2005 WL 3112986 (Bankr. S.D.N.Y. Nov. 18, 2005).

B. Unsevered crops are personal property and not real estate.

1. 9-102(a)(44) defines goods in relevant part as :  
"Goods" means all things that are movable when a security interest attaches. The term includes (i) fixtures, (ii) standing timber that is to be cut and removed under a conveyance or contract for sale, (iii) the unborn young of animals, (iv) crops grown, growing, or to be grown, even if the crops are produced on trees, vines, or bushes, and (v) manufactured homes.
2. 9-334(i) provides: " [Priority of security interest in crops.] A perfected security interest in crops growing on real property has priority over a conflicting interest

of an encumbrancer or owner of the real property if the debtor has an interest of record in or is in possession of the real property.”

3. These issues can arise in a number of contexts.

- a. One example is when a real estate mortgage specifically covers crops but the real estate mortgagee does not comply with Article 9 filing requirements. If the farmer files a bankruptcy petition when crops are in the ground, the Trustee in Bankruptcy (Tib) can avoid the interest under the so-called strong arm clause of 11 U.S.C. section 544(a)(1).
- b. Another situation is where the conflict is between a creditor having a perfected security interest in unsevered crops and real estate mortgagee who has a real estate mortgage specifically covers crops but the real estate mortgagee did not comply with Article 9 filing requirements. Again, article 9 applies and real estate mortgagee is an unperfected secured creditor and will lose.

C. Conservation Reserve Program (CRP) payments.

1. The Bankruptcy Court in *In re Isebart*, 252 B.R. 62 (D.Kan. 2000) held that CRP payments are personal property rather than rent of real estate. They are in the nature of contract rights or general intangibles or accounts under F9. This decision was decided when F9 was in effect. Clearly, R9 applies to any transaction creating a security interest in personal property which the CRP payments are under this decision.
2. Other courts have expressly concluded that CRP payments are not rents. See, e.g., *In re Holte*, 83 B.R. 647, 649 (Bankr.D.Minn.1988) (court comments that debtor's right to payment under the CRP contract was a contract right or general intangible); *In re Koerkenmeier*, 107 B.R. 195, 196-198 (Bankr.W.D.Mo.1989) ( "[R]ather than a lease, a CRP contract is nothing more than a contract not to place farm land into production between Debtors and ASCS [FSA now].")

D. Statutory liens in general.

1. Creditors want to be secured creditors. Secured in general means that the creditor has an enforceable lien on specific property of the debtor.
2. Liens can exist in personal property as well as real property. In general, a lien on specific property may be obtained in three ways: a judicial lien, a statutory lien, or a consensual lien.
  - a. Consensual liens are obtained pursuant to an agreement in which the debtor gives the creditor an interest (security interest) in specific property of the debtor to secure payment of a debt. Upon default the secured creditor has the right to obtain the property. The creation and enforcement of a security interest in personal property is covered by Article 9 of the U.C.C. It must be noted that under Article 9, the term "lien" is used as a contradiction to a security interest that is considered

to be a consensual interest, as opposed to a lien that is not created by contract.

- b. Statutory liens are not consensual and do not depend upon judicial action of the creditor. It is a so-called status lien that arises by operation of law because of a particular creditor's status. The statutory lien gives a creditor an enforceable interest in specific goods to assure payment for goods, services, land, labor or whatever was provided by the person entitled to the lien. Statutory lien holders are, in effect, given the rights of a secured creditor even though they did not bargain for security.

E. Statutory liens are either possessory or nonpossessory.

- 1. If a lien is possessory, the creditor claiming the lien must have possession of the property claimed to be subject to the lien.

F. Possessory statutory liens and Article 9.

- 1. In general, non-consensual liens created in personal property by statute have traditionally not been covered by Article 9 of the Uniform Commercial Code.
- 2. Like its predecessor, Revised Article 9, covers one aspect of conflicts concerning creditor's claims to personal property subject to a possessory statutory lien.
  - a. Priority battles between a statutory lienholder and a perfected secured creditor are governed by Article 9. F9 §§ 9-102(2);9-104;9-310. Today U.C.C. R9 §§ 9-109 (a)(2);9-102(d)(1-2);9-102(a)(5);9-333.
- 3. Section 9-333 (F9 9-310) is the priority rule that governs conflicts when one of the creditors claims a possessory lien arises by operation of law.
  - a. The creditor asserting a possessory statutory lien and claiming priority under § 9-333 must have:
    - (1) possession of the good whose value has been enhanced or preserved by services or materials supplied by the creditor in the ordinary course of its business;
    - (2) a statutory or common law lien; and
    - (3) the effectiveness of the lien is dependent upon the creditor's possession of the good.
  - b. A qualified possessory lienholder defeats a prior perfected secured creditor.
    - (1) This priority rule is very similar in concept to the super priority given to a purchase money security interest under U.C.C. § 9-324.
- 4. Interestingly, § 9-333 does not define the elusive concept of possession.

- a. While some UCC sections suggest that the drafters did not intend to limit possession to physical possession, common law and non-UCC statutes play a large part in defining possession.
- b. Remember that when a term is not defined in the UCC common law rules and principles become relevant. U.C.C. § 1-103.
- c. Courts recognize and distinguish actual possession, constructive possession, and custody, and thereby indicate that an owner may relinquish physical custody but retain legal possession.
- d. Occasionally, possession has not been limited to physical possession under state statutory liens requiring possession.
  - (1) For example, in *Henkel v. Pontiac Farmers Grain Co.*, 55 Ill. App. 3d 898, 13 Ill. Dec. 635, 371 N.E.2d 352 (1977), a thresher's statutory lien continued notwithstanding the thresher-lienor's surrendering physical possession. Other courts have construed the possession requirement narrowly. In *Northeast Kansas Produce Credit Association v. Ferbrache*, 236 Kan. 491, 693 P.2d 1152 (1985), the court, noting that secret liens are disfavored, held that the statutory veterinarian's lien requiring possession could be enforced only if the veterinarian had physical possession of the treated animals.

### III. Nonpossessory Statutory Liens In Farm Products Under the Uniform Version of R9

- A. One of the significant revisions of R9 concerns nonpossessory liens in agricultural products. For the first time, a nonpossessory statutory lien defined as an “*agriculture lien*” is subject to Article 9's perfection, priority and enforcement rules.
  - 1. Every state except Kansas included this coverage.
    - a. The Kansas legislature excluded from the coverage of Article 9 nonpossessory agricultural liens in farm products created by the statutory liens listed in Kan. Stat. Ann. §§ 84-9-102(a)(76)& 9-102(a)(5). Also see Kan. Stat. Ann. § 84-9-201(b) which purports to say that Article 9 is subject to state statutes that create a different rule “including, but not limited to, K.S.A. 2-1319, 2-2608, 2-3007, 34-239, 47-836, 58-201, 58-203, 58-204, 58-207, 58-218, 58-220, 58-221, 58-241, 58-242, 58-2524, 58-2525, 58-2526, 58-2527, 58-2528 and 84-7-209. [most of these deal with agriculture liens]”
    - b. Creditors' thinking about or taking a security interest in farm products in Kansas have a potpourri of statutory liens which have no uniformity as to creation, perfection, priority and enforcement. This uncertainty also applies to the purchasers of farm products.
    - c. In Kansas, each statute creating an agriculture lien and cases interpreting it must be checked to determine how it is created, when it

attaches, when it is perfected, when it has priority over other creditors or buyers and how the lien is enforced.

2. A number of good law review articles examine agricultural financing and liens under revised Article 9. See, e.g., Donald W. Baker, *Some Thoughts on Agricultural Liens Under the New U.C.C. Article 9*, 51 ALA. L. REV. 1417 (Summer 2000); Linda J. Rusch, *Farm Financing under Revised Article 9*, 73 AM. BANKR. L.J. 211 (Winter 1999); Drew L. Kershen & Alvin C. Harrell, *Agricultural Financing—Comparing the Current and Revised Article 9*, 33 UCC L. J. 169 (Fall 2000); Turner, Barnes, Kershen, Martha Noble & Schumm, *Agricultural Liens and the UCC: A Report of Present Status and Proposals for Change*, 44 OKLA. L. REV. 9 (1991). For a thorough discussion of agriculture liens in general and how former version of Article 9 dealt with them, see Keith G. Meyer, *Should the Unique Treatment of Agricultural Liens Continue?*, 24 IND. L. REV. 1315-56 (1991). Also, my forthcoming article in the Kansas Law Review. Keith G. Meyer, *Kansas's Unique Treatment of Agricultural Liens*, Kan. L.Rev.

B. “Agriculture lien” in general under revised Article 9.

1. The term “Agricultural lien” is defined in Article 9 in § 9-102(a)(5).
2. An agricultural lien does not include a lien that is dependent upon the claimant having possession of the collateral.
3. An agricultural lien is not within the definition of a security interest so that article 9 only applies to the extent it specifically refers to agricultural liens.
4. The definition of a secured party includes a holder of an agricultural lien. 9-102(a)(72)(B).
5. Non-U.C.C. law governs the creation and scope of an agricultural lien.
6. Revised Article 9 governs the perfection, priority and enforcement of an agricultural lien *but not* the creation or scope of the lien.

C. § 9-102(a)(5) defines an “agricultural lien” to mean “an interest, other than a security interest, in farm products:

- (A) which secures payment or performance of an obligation for:
  - (I) goods or services furnished in connection with a debtor’s farming operation; or
  - (ii) rent on real property leased by a debtor in connection with its farming operation;
- (B) which is created by statute in favor of a person that:
  - (I) in the *ordinary course of its business* furnished goods or services to a debtor in connection with a debtor’s farming operation; or
  - (ii) leased real property to a debtor in connection with the debtor’s farming operation; and
- (C) *whose effectiveness does not depend on the person’s possession of the personal property.* (Emphasis supplied)

- D. R9 does not cover the creation and scope of an agricultural lien. The creation and scope of a statutory lien is determined by the state statute creating the lien.
1. Most agricultural states have a number of statutory liens affecting agriculture such as landlord liens, harvester liens and crop production input liens affecting crops and a veterinarian liens, breeder liens and livestock production liens affecting livestock.
  2. One statue Minnesota, has combined these liens in two statutes: MINN. STAT. §§ 514.963-964 (2002) (Agricultural lien in crops including landlord lien, harvester's lien, and crop production input lien), and §§ 514.965-.966 (Livestock lien including veterinarian lien, breeder's lien and livestock production input lien and feeder's lien).
  3. Rev. Article 9 does not appear to deal with proceeds of the lien. See Rev. § 9-302, comment 2, Rev. § 9-315(a)(2) refers to an agricultural lien but not proceeds.
  4. *NOTE*, MINN. STAT. §§ 514.964.subd. 4 and .966.subd. 5 provide that the liens on farm products continue in the proceeds. This is not clear under R9.

E. Perfection

1. Unless a statute as a nonuniform amendment to Article 9, Perfection occurs when the lien is effective under the statute creating it and a proper financing statement has been filed centrally. Rev. §§ 9-308(b); 9-310(a).
2. Some states like Minnesota have special perfection requirements for "agricultural liens." For example, MINN. STAT. § 514.964 (2000) provides the following:

Subd. 5. Perfection. (a) A landlord's lien, harvester's lien, or crop production input lien under this section is perfected if a financing statement is filed pursuant to sections 336.9-501 to 336.9-530 and within the time periods set forth in paragraphs (b) to (d).

(b) A landlord's lien must be perfected on or before 30 days after the crops become growing crops.

(c) A harvester's lien must be perfected on or before 15 days after the last date that harvesting services are provided the obligor.

(d) A crop production input lien must be perfected by six months after the last date that crop production inputs are furnished the obligor.

§ 514.966 provides:

Subd. 6. Perfection. (a) An agricultural lien under this section is perfected if a financing statement is filed pursuant to sections 336.9-501 to 336.9-530 and within the time periods set forth in paragraphs (b) to (e).

(b) A veterinarian's lien must be perfected on or before 180 days after the last item of the veterinary service is performed.

(c) A breeder's lien must be perfected by six months after the last date that breeding services are provided the obligor.

(d) A livestock production input lien must be perfected by six months after the last date that livestock production inputs are furnished the obligor.

(e) A feeder's lien must be perfected on or before 60 days after the last date that feeding services are furnished the obligor.

## F. Priorities

1. Conflicts as to farm products subject to an agricultural lien can arise between the holder of an agriculture lien and creditors or the Trustee in bankruptcy (Tib) or buyers claiming a good subject to the agricultural lien.
2. Creditors versus Agricultural lien holder
  - a. The priority of an agricultural lien created by a state statute will be controlled by the normal priority rules of Article 9 unless, unless the statute creating the lien contains a different priority rule. § 9-322(g); 9-322(a).
  - b. Agricultural liens and security interests have priority according to priority in time of filing or perfection which ever occurs first. Revised § 9-322(a)(1).
  - c. A perfected agricultural lien has priority over a conflicting unperfected security interest or an unperfected agricultural lien. § 9-322(a)(2).
  - d. The first security interest or agricultural lien to attach or become effective has priority if a conflicting security interest or agricultural lien is unperfected. Revised § 9-322(a)(3).
  - e. Again, if the statute creating the agricultural lien provides that the agricultural lien has priority over a conflicting security interest or agricultural lien in the same collateral, that statute governs priority if the agricultural lien is perfected. Revised § 9-322(g).
3. Conflicts between Agricultural lien holder and buyer
  - a. An agricultural lien continues in collateral notwithstanding sale or lease of the collateral “unless the secured party authorized the disposition free of the . . . agricultural lien.” Revised § 9-315(a)(1).
  - b. Agricultural liens and purchasers of farm products subject to a perfected agricultural lien.
    - (1) 7 U.S.C. § 1631 does not apply to involuntary liens. See § 1631(d) which refers to security interest “created by the seller.”
    - (2) Remember that UCC § 9-320 provides “a buyer in the ordinary course of business, other than a person buying farm products from a person engaged in farming operations, takes free of a security interest created by the buyer’s seller, even if the security interest is perfected and the buyer knows of its existence.” Agriculture liens are not mentioned.

- (3) However, UCC § 9-317(b) provides in part “a buyer . . . of . . . goods . . . takes free of a security interest or agricultural lien if the buyer gives value and receives delivery of the collateral without knowledge of the security interest or agricultural lien and before it is perfected.” The negative inference is that, if a agricultural lien holder has perfected its lien, the buyer takes subject to it.
- c. Some states have specific statutes dealing with this issue.
- (1) Minnesota has two specific statutes dealing with the sale of farm products subject to a statutory lien. See Minn. Stat. 336A.15 and .16 (commission merchants who sell farm products subject to a statutory lien).
  - (2) In Minnesota, in addition to a proper financing statement, the lienholder must file an effective financing statement. The requirements are found in *MINN. STAT. § 336A.03*. See also, <http://www.sos.state.mn.us/>.

4. Priority to proceeds

- a. If the collateral subject to the agricultural lien is sold for cash or exchanged for other property, proceeds are generated. See Rev. 9-102(64)(definition of proceeds).
- b. Rev. 9-315(a)(1) specifically refers to agricultural liens and provides unless the secured party waives its security interest or its agriculture lien they continue in the collateral upon sale or disposition.
- c. Rev. 9-315(a)(2) provides only that the security interest attaches to any identifiable proceeds of the collateral. Agricultural liens are not mentioned.
  - (1) The negative inference is that proceeds of collateral subject to an agriculture lien is not covered by Article 9.
  - (2) Comment 2 to Rev. 9-302 provides that Revised Article 9 does not deal with proceeds of collateral subject to an agricultural lien because no agricultural lien on proceeds arises under Article 9.
- d. Arguably, the Code’s silence is not a basis for preventing an agricultural lien’s attachment to proceeds of sold property that was subject to an agricultural lien. Comment 9 to Rev. § 9-315 states:

This Article does not determine whether a lien extends to proceeds of farm products encumbered by an agricultural lien. If, however, the proceeds are themselves farm products on which an “agricultural lien”. . . arises under other law, then the agricultural-lien provisions of this Article apply to the agricultural lien on the proceeds in the same way in which they would apply had the farm products not been proceeds.

- e. The proceeds is not an issue in states like Minnesota because Minn. Stat. §§ 514.964.subd. 4 and .966.subd. 5 provide that the liens on farm products continue in the proceeds.

5. Conflict with the Trustee in Bankruptcy (Tib)

- a. A key provision for the Tib is 11 U.S.C. § 545 which provides:

The trustee may avoid the fixing of a statutory lien on property of the debtor to the extent that such lien— . . .

(1) first becomes effective against the debtor--

(A) when a case under this title concerning the debtor is commenced;

(B) when an insolvency proceeding other than under this title concerning the debtor is commenced;

(C) when a custodian is appointed or authorized to take or takes possession;

(D) when the debtor becomes insolvent;

(E) when the debtor's financial condition fails to meet a specified standard; or

(F) at the time of an execution against property of the debtor levied at the instance of an entity other than the holder of such statutory lien;

(2) is not perfected or enforceable at the time of the commencement of the case against a bona fide purchaser that purchases such property at the time of the commencement of the case, whether or not such a purchaser exists;

(3) is for rent; or

(4) is a lien of distress for rent.

- b. What if any impact will § 545 have on a perfected landlord lien?

- c. The key way for the Tib to attack the perfected Agricultural lien is under § 545 (3) that provides the Tib can avoid a statutory lien for rent. Arguably, the Tib should win because this lien is for rent.

- d. Does it make any difference that O filed a proper UCC-1?

(1) *Arguably not!* Section 545 provides the Tib with four possible ways to avoid a claim based upon a statutory lien on property. As can be seen above, each subpart ends with a semi-colon and the last two are connected with "or." This clearly indicates that they are separate and distinct methods. Thus, arguably it is irrelevant that O's landlord's lien is perfected at the date of the petition.

(2) Subsections 3 and 4 empower the Tib may avoid a statutory lien that " (3) is for rent; or (4) is a lien for distress for rent." Scant legislative history exists for section 545. Nothing indicates that residential leases and commercial leases or agricultural leases were to be treated differently when the landowner relied upon a statutory lien to claim property.

- (3) Likewise, nothing indicates that a perfected statutory lien would be treated differently from one that had not been filed. And, Congress in 545(2) clearly used the term “unperfected” when dealing with whether a lien is effective against a bona fide purchaser. Perfection obviously is not mentioned in subsections 3 and 4 and perfection is not made applicable in the preamble of § 545 to all of the possibilities set forth.
  - (4) The upshot is that a serious question exists concerning whether a perfected landlord lien for rent can survive an attack under 11 U.S.C. § 545(3-4). Unless a landlord is willing to deal with the uncertainty of litigation and pay the cost to litigate this issue, it would be better to obtain a perfected security interest in the crops to be grown on the rented land. Even here, however, the landlord has risks if the farmer were to sell the farm products. For the landlord to prevail against a buyer of the crop subject to a perfected security interest, it must comply with the notice requirements of the federal farm products rule of 7 U.S.C. § 1631.
  - (5) The easiest and safest approach for the land owner is to require the cash rent up front. Presumably, this places the financial risk on lenders who are in a position to evaluate the credit worthiness of the tenant. The lender who has or is contemplating financing the tenant-operator has an incentive to provide the cash for the lease.
- e. If the Tib is able to avoid an landlord’s lien under 545, the Tib can cause trouble for a perfected secured party who has a perfected security interest in the crops that were subject to the landlord lien.
- (1) A landlord has priority over a perfected secured party under in many states such as Kansas, Iowa and Minnesota.
  - (2) 11 U.S.C. § 551 provides: "Any transfer avoided under . . . 545 . . . preserved for the benefit of the estate but only with respect to property of the estate." Thus, the Tib can step into the shoes of the landlord who could defeat the perfected secured creditor to the extent of the landlord's lien priority over the secured creditor under the Minn. Stat. 514.964. For a case authorizing this see *In re Coal-X Ltd.*, "76", 103 B.R. 276 (Bankr. D. Utah 1986).

#### **IV. Requirements For *Attachment* of a Security Interest**

- A. Attachment must occur for there to be an enforceable security interest. Once attachment occurs the secured party has the right to enforce the security interest against the debtor and realize on the specific collateral.
- B. The security interest “attaches” to the collateral (i.e., it is enforceable against the debtor should she/he default) when the following three requisites are met (9-203):

1. Value has been given.
2. Debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party. 9-203(b)(2)..
3. An appropriate agreement granting a security interest in specific property is executed.

C. Value

1. Secured party must give value.
2. Value is defined in Revised Uniform Article 1 in § 1-204 and in former uniform Article § 1-201(44):

[A] person gives value for rights if he acquires them (a) in return for a binding commitment to extend credit or for extension of immediately available credit . . . ; or (b) as security for or in total or partial satisfaction of a pre-existing debt covers (after-acquired collateral); . . . or (d) generally, in return for any consideration sufficient to support a simple contract.

**V. Debtor's Rights In the Collateral For Attachment**

A. The term rights for attachment is not defined

1. Rights in the collateral does not necessarily mean "title." § 9-202.
  - a. Clearly an owner has rights in property and a thief who has mere possession does not.

It is also clear that the debtor does not have to be an owner to be able to create an enforceable security interest.

However, it is not clear on the continuum between actual ownership and mere possession what relationship with collateral establishes rights sufficient to create a security interest in goods that the debtor does not own.

Because the term "rights" is not defined, § 1-103 is relevant. It provides: "Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions."

- b. The debtor may have rights in the collateral even before delivery, if his supplier has earmarked the goods for him. §§ 2-401, 2-501.

B. What constitutes power to transfer rights in the collateral to a secured party?

1. The debtor can obtain the power to create a security interest through any of the bodies of law set out in § 1-103.

2. Voidable title under 2-403 gives debtor the power.
  - a. Under § 2-403(1) a person having voidable title has the power to pass good title to a good faith purchaser which includes a secured creditor. R1-201(29-30); F1-201(32-33)(defines a purchaser).
    - (1) An example is that Seller sells computer to Business who pays with a bad check. Business has voidable title and this gives it power to pass good title to a good faith purchaser that can include a secured party who has a security interest in Business' inventory. 2-403(1)(b).
    - (2) The voidable title rule applies to the sale of farm products as well. If a farmer sells corn to a feedlot who pays with a bad check, the buyer/feedlot has sufficient rights in the corn to grant a security interest in the corn that is in its possession but for which it has not paid..
  
3. Entrustment of property does not give debtor the power to transfer rights to a secured party.
  - a. Under comment 6 to § 9-203 a debtor does not have the power to transfer another's rights to a certain class of transferees that does not include a secured creditor. See § 9-403(2).
  - b. Section 2-403(2) provides that entrusting goods to a merchant who deals with goods of that kind gives the merchant power to transfer all rights of the entruster to a "buyer in ordinary course of business."
    - (1) A secured party cannot be a buyer in ordinary course because the secured party is not a buyer. To be a buyer a sale must occur. Under the UCC a secured party is a purchaser but not a buyer.
  - c. For example, owner (O) leaves her watch with a Jeweler to be repaired. The watch has been entrusted to Jeweler which gives him the power to transfer all rights of the transferor to a buyer in the ordinary course. 2-403(2). A secured party cannot be a buyer in the ordinary course under § 1-201(9) because there must be a sale, i.e., there has to be a buyer, not a purchaser. (The definition of purchaser includes both a buyer and a secured party but the term buyer in ordinary course requires a buyer.) Thus, the different treatment of voidable title and entrustment.
  
- C. A number of courts have considered whether the debtor has "rights in the collateral."
  1. The court in *Colorado National Bank-Longmont v. Fegan*, 827 P.2d 796 (Kan. Ct. App. 1992), was confronted with a debtor who had a cropshare lease. The debtor who has a cropshare lease can only grant a security interest in that portion of the crop the debtor is entitled to under the lease.
  2. *Magill v. Schwartz*, 105 P.3d 867 (Ore. Ct. App. 2005), involved a borrower, who owned 24 % of a limited liability company, and purported to grant a security interest in an asset of the limited liability company (LLC). Borrower in

his individual capacity purported to grant a security interest in an expected litigation recover the LLC would receive. Noting that under applicable law a member of a LLC has no interest in specific assets of the LLC, the court held that contingent receivable was an asset of the LCC not that of an individual member.

- a. What if a one member LLC was permitted? Wouldn't this constitute ownership of the asset?
- D. A number of courts have considered the rights issue when the debtor had property that belonged to others.
1. One example is where the debtor is a commercial feedlot operator. It is necessary to determine whether the debtor owns all of the cattle located in the lot. Often some of them will be owned by people who have hired the operator to fatten them.
  2. A debtor cannot create a security interest in animals the debtor does not own and holds as bailee for the limited purpose of fattening. *See Nat'l Livestock Credit Corp. v. First State Bank of Harrah*, 503 P.2d 1283 (Okla. Ct. App. 1972); *see also Kinetics Tech. Int'l Corp. v. Fourth Nat'l Bank*, 705 F.2d 396 (1983); *Morton Booth Co. v. Tiara Furniture, Inc.*, 564 P.2d 210, 214 (Okla. 1977) (noting that rights exist "where debtor gains possession of collateral pursuant to agreement endowing him with any interest other than naked possession"); *Chrysler Corp. v. Adamatic, Inc.*, 208 N.W.2d 97, 104 (Wis. 1973) (indicating that bailee's possessory interest for limited purpose of repair was not sufficient "rights in the collateral").
    - a. The true owner has a problem if his/her cattle are not identifiable for example by pen number or ear tag.
    - b. *In re Cook*, 63 B.R. 789 (Bankr. D.N.D. 1986) (stating that fact the non-debtor son held title in cattle claimed by the secured party was not dispositive as to whether his parents (the debtors), who had possession of the cattle, had sufficient rights to grant a security interest in the cattle). The debtor possesses sufficient rights in collateral if the true owner agrees to the debtor's use of the cattle as collateral or if the true owner is estopped to deny creation of the security interest. The intent of the parties is the key and the lender has the burden of proof. *But see Thorp Credit, Inc. v. Wuchter*, 412 N.W.2d 641 (Iowa Ct. App. 1987) (holding that possession of livestock presented only rebuttable presumption of ownership).
    - c. *In re Haase*, 224 B.R. 673 (Bankr. C.D. Ill. 1998), where the debtor fattened his own cattle and fed cattle that belonged to others. The debtor and Interstate entered into an agreement under which the debtor would feed ninety head of Interstate's cattle, but title to the cattle would remain in Interstate. Interstate would make all marketing decisions as to the cattle and would require the debtor to segregate the cattle. The bank had a security interest in all of the debtor's cattle. When the debtor defaulted, the bank claimed rights in all the cattle in the debtor's possession and proceeds from the sale of them. The court held that the debtor did not have rights in Interstate's ninety head of cattle. The court

concluded that the cattle had been entrusted to the debtor under a contract for bailment for the purpose of fattening the animals. Consequently, the debtor obtained no rights in the cattle in which a security interest could attach.

- E. Some cases deal with a debtor who has possession of cows that belong to others but the debtor has an interest in the calves to be produced.
1. Debtor does not have to own the collateral to have rights.
    - a. *Border State Bank v. Bagley Livestock Exchange, Inc.*, 690 N.W.2d 326 (Minn. App. Ct. 2004) involves a situation where Anderson, the debtor, agreed to care for and breed cattle owned by another and would receive part of the annual calf crop. Anderson granted Border State Bank a security interest in all of Anderson's "rights, title and interest" in all livestock then owned or thereafter acquired. One of the issues considered by the court was whether "rights" for purposes of attachment of a security interest under U.C.C. § 9-203 was limited to collateral the debtor owned. The court specifically holds that rights is not restricted to collateral the debtor owns. Put another way the court states: "The UCC 'does not require that collateral be owned by the debtor.'" While the court clearly holds that debtor need not own the collateral to have rights, it provides no guidance as to what is sufficient short of ownership to satisfy the requirement that the debtor must have "rights in the collateral or the power to transfer rights in the collateral."
    - b. This case must be compared with the holding in *American Bank & Trust v. Shaull*, 678 N.W.2d 779 (S.D. 2004).
  2. Owner of cattle in the possession of another can be estopped from asserting that the possessor of the cattle did not have sufficient rights in cattle the debtor did not own. This was the situation in *American Bank & Trust v. Shaull*, 678 N.W.2d 779 (S.D. 2004).
  3. In *American Bank & Trust v. Shaull*, 678 N.W.2d 779 (S.D. 2004), the South Dakota Supreme court considered the debtor's rights issue.
    - a. Shaull owned and operated in South Dakota a livestock auction house through which he bought and sold cattle using the name H.S. Cattle. He also had separate land where he kept among other animals, cows.
    - b. On June 8, 2001, Shaull refinanced his operation borrowing money from American to cover an existing line of credit from Fin-Ag and for "breeding livestock." Shaull granted American a security interest in all livestock owned or later acquired and all farm products and all inventory owned or thereafter acquired. Shaull did not tell American that he bought and sold animals through H.S. Cattle and that he had in his possession animals that were owned by someone else.
    - c. In June, 2001, American filed centrally in South Dakota a financing statement that covered livestock and "all cows and future offspring, all increase, issue offspring, products and products from the livestock."

- d. Feldman brothers (Feldman) operated a cattle feeding operation in Minnesota. In 2000, Shaull and Feldman entered into an “bred cow agreement.” It appears that under this “bred cow agreement” Shaull would buy cows and feed and care for them on his land in South Dakota.

Both Feldman and Shaull were to have rights in the calves produced and share in the profit and losses from the sale of the calves. Ag-Finance financed Feldman’s cattle operation and had a security interest in all Feldman’s cows and had filed a proper financing statement in Minnesota but not in South Dakota.

When American did its refinancing, Shaull represented that all of the cattle located on his land in South Dakota belonged to him. American refinancing inspection in June of 2001, showed about 900 cows were located on Shaull’s South Dakota land. All of these apparently belonged to Feldman. It was difficult to get an exact count of the cows because the land was rough terrain and some animals had brands, some had ear tags, and some may not have had any identifying brand or tag. American also examined Shaull’s financial statements, tax returns containing depreciation schedules for cows, and spoke with Shaull’s previous financier. American did not know about Feldman nor that Shaull bought and sold animals through H.S. Cattle.

Shaull defaulted on its loan to American who claimed all of the animals in Shaull’s possession including those belonging to Feldman.

Feldman and AgStar claimed that Feldman owned the animals and the “bred cow agreement,” under which Shaull was to purchase and feed and care for the cows, established a bailment between Feldman and Shaull. Therefore, American did not have a security interest in the its cows in Shaull’s possession because Shaull did not have the ability to grant a security interest in property in which he did not own.

On the other hand, American claimed that Shaull had total control of the animals and that it neither had notice of Feldman or AgStar’s interests nor the ability to discover their interests because neither had filed a prophylactic financing statement under § 9-505. § 9-505 permits an informational filing indicating the filer is a bailor and has an interest in goods held by the named debtor.

The majority of the court held that Feldman and AgStar were *estopped* from claiming an interest in Feldman’s cows in Shaull’s possession. The court’s basic point is that control not ownership determines whether a debtor has sufficient rights to grant a security interest. Here, the owners clothed the debtor with apparent ownership putting the debtor in the position to mislead third parties.

It appears the majority is saying a litmus paper test exists. Owners must file a 9-505 filing or owners will be estopped from asserting that the debtor does not have sufficient rights to create a security interest.

Finally, it may be that the court was really saying that no bailment existed.

In this regard, consider the next case.

4. An older case that illustrates the issues that can arise when property purportedly belonging to owner is placed in the hands of another is *Rohweder v. Aberdeen Production Credit*, 765 F.2d 109 (8<sup>th</sup> Cir. 1985). Here Rohweder placed cows in the hands of another who had granted a security interest in all cattle. Dealing with the rights issue the court concludes that it is a question of fact whether a bailment was involved. The court stated:

At trial, the burden is on Rohweder to show that he actually owned the cattle in question. Evidence that the cattle bore Rohweder's brand, or evidence of the Genre brand plus a bill of sale from Genre to Rohweder, would constitute prima facie proof of ownership. Once Rohweder makes his prima facie showing, the burden shifts to the PCA to demonstrate that Bellman possessed sufficient rights in the cattle for its security interest to attach. The crucial question in this regard is the parties' intent. If Rohweder intended to make a conditional sale when he delivered the cows to Bellman, he retained only a security interest and Bellman had sufficient rights for PCA's security interest to attach. On the other hand, if the parties intended to create a bailment, with Rohweder retaining complete ownership of the cows and relinquishing only possession, Bellman would not have sufficient rights for attachment of PCA's lien and, in the absence of an estoppel, Rohweder should prevail. While the factors of control over the cattle, including the right of sale, and the option to purchase do not necessarily constitute "rights in collateral," they are relevant evidence for the jury in determining the parties' intent to transfer an ownership interest to Bellman. See U.C.C. § 9-505 & cmt.3.

- F. Remember, the application of Article 9 involves two different concepts: a planning strategy and a litigation strategy.

1. Planning after *American Bank & Trust v. Shaull*.
2. Without doubt from a planning perspective, owners placing property in the hands of another and lenders having a security interest in owners' assets placed in the possession of another should file a prophylactic financing statement under § 9-505.
3. This option does present some *not so* apparent issues.
  - a. Where must the financing statement be filed?
    - (1) It would seem that it is filed where the party considered the potential debtor is located..
    - (2) If more than one state is involved, §§ 9-301 and 9-305 control.

- b. Does a 9-505 Financing Statement require debtor authorization under 9-509-10?
- (1) A debtor does not have to sign the financing statement. Under 9-505, when a purported bailment is involved, must the bailee authorize in an authenticated record the filing of the financing statement? Yes!
  - (2) 9-509(a)(1) provides that an initial financing statement may be filed “only if . . . the debtor authorizes the filing in an authenticated record or pursuant to subsection (b) [an authenticated security agreement with a description the same as in financing statement] . . . .
  - (3) From a planning standpoint, the owner or owner’s lender should include in the bailment agreement an authorization to file a financing statement.
- c. The South Dakota Secretary of State has a webpage purporting to deal with the needed filings required by the *Shaul* case. See <http://www.sdsos.gov/ucc/livestock/>.

4. Litigation perspective.

- a. A true bailment is not covered by Article 9 and no filing is required. U.C.C. § 9-505 simply permits a protective filing.
- b. From a litigation perspective, the owner can argue that the failure to file should not be the only way a third party dealing with the bailee (possessor) of the property, here animals, could be put on notice.
  - (1) For example, arguably the lender should be put on notice of the owner’s interest if the owner has placed identifications such as ear tags or brands that indicate owner’s interest. The *Shaul* court seems to suggest that this notice approach does not exist but it is not clear whether that was because Feldman had not sufficiently identified the animals or that only filing will suffice.
- c. Recall that if Article 9 applies, all parties must act in good faith which now includes the “observance of reasonable commercial standards of fair dealing.” § 9-102(a)(43) and CMT. 19.
- d. Finally, a protective § 9-505 filing will not protect the owner or the owner’s lender in all situations if the transfer of the property from the owner is in fact treated as a secured transaction.
  - (1) For example, suppose the owner transfers possession of cattle to a producer, who has prior to the transfer, had granted to another creditor a perfected security interest in all cattle and all inventory including after-acquired cattle. If the owner is considered to have sold the cattle to producer, owner will have a purchase money security interest.

- (2) Even if the owner files a § 9-505 financing statement, it appears that 9-324(d) which deals with purchase money security interests in livestock would apply to this transaction.
  - (a) Under § 9-324(d) owner will lose to the prior perfected secured party unless the owner filed the financing statement before the cattle were delivered to producer and gave appropriate written notice to the prior perfected secured creditor before deliver of the cattle to producer.
  - (b) Also, if the transaction between the owner and the person having the goods is considered not to be a bailment but a secured transaction, the filing of an Article 9 financing statement alone will not protect the original owner if the producer sells the cattle. 7 U.S.C. § 1631 also applies and the original owner-secured creditor will have to make sure that it is protected under this system by giving the required notice.

## **VI. Security Agreement Requirements**

- A. A security agreement is special kind of contract.
- B. An “authenticated” agreement is required unless:
  - 1. The collateral is in the possession of the secured party pursuant to the debtor’s security agreement and the collateral is not a certificated security.
  - 2. The collateral is a certificated security in registered form delivered to the secured party pursuant to the debtor’s security agreement.
  - 3. The collateral is deposit accounts, electronic chattel paper, investment property or letter-of-credit rights, and the secured party has control under 9-104, 9-105, or 9-107 pursuant to the debtor’s security agreement.
- C. Authenticate is defined in 9-102(a)(7) to mean: “(A) to sign; or (B) to execute or otherwise adopt a symbol, or encrypt or similarly process a record in whole or in part, with the present intent of the authenticating person to identify the person and adopt or accept a record.
  - 1. “Record” “means information that is inscribed on a tangible medium or which is stored in an electronic or other medium and is retrievable in perceivable form.” 9-102(a)(69).
  - 2. Thus, when the debtor has possession of the collateral, Article 9 no longer requiring a signature of the debtor on a writing called a security agreement. Rather, the debtor must authenticate a security agreement.
    - a. A debtor who signs a writing containing a security agreement identifying itself as the debtor has authenticated the agreement. 9-102(a)(7)(A).

- b. This is also the case with a debtor who sends an electronic message containing a security agreement in an encrypted form that identifies the debtor as the sender. 9-102(a)(7)(B).
    - 3. The definition of authentication does not in fact require the execution of a separate symbol but only that the record itself be produced or adopted with the present intent to authenticate the record. The presence of a symbol will help show the present intent needed.
    - 4. Note also that under § 9-502 the debtor does not have to sign a financing statement.
      - a. However, the filed financing statement is effective only if it is filed by a person who was authorized to file it. §§ 9-509-10.
        - (1) This occurs if the debtor specifically authorizes the secured party to file in a separate authenticated record or the filed financing statement describes the collateral in the same way as in the authenticated security agreement.
- D. What language is necessary to create show debtor executed proper authenticated a security agreement?
- 1. The bankruptcy court in *In re Thompson*, 315 B.R. 94, 102 (WD Mo. 2004), noted that prior to 2001 (when R9 became effective,) “There is no magic language to create or provide for a security agreement but in the Eight Circuit there must be some language in the agreement itself that can be construed to convey a security interest.”
    - a. Under R9, the key is not the intent of the parties but whether “the transaction falls within the definition of ‘security interest § 1-201(35)(F1-201(37) . . .” This section defines a security interest to be “ an interest in personal property or fixtures to secure an obligation. . . .”
    - b. The agreement in *Thompson* provided that if the buyer did not pay, the cattle became the property of the seller until seller was paid in full and that “this agreement is the only encumbrance that will be placed on the cattle.”
- E. The *description* requirement of a security agreement.
- 1. The agreement must contain a description that reasonably identifies the collateral. 9-110; Rev. 9-108.
  - 2. 9-108(b) provides examples of reasonable identification.
    - (a)These include: specific listing or category, or type of collateral as defined in the U.C.C. [THIS IS A CHANGE]
  - 3. Description by type is not acceptable for a commercial tort claim, consumer goods, a security entitlement, a securities account or a commodity account.
  - 4. Supergeneric descriptions.

- a. Such descriptions as “all the debtors assets” or “all the debtor’s personal property are not sufficient. 9-108(c).
  - b. These descriptions are ok for the financing statement. 9-504(2).
5. Real estate descriptions
- a. A real estate description is no longer needed in a security agreement or financing statement covering growing crops or to be grown crops. [THIS IS A CHANGE]. It might be required to reasonably identify the collateral if debtor owns multiple pieces of land and only crops growing on one of them are subject to the security interest.
  - b. If the security interest is in timber to be cut, a land description is needed.
6. In *Baldwin v. Castro Country Feeders I, Ltd.* 678 N.W.2d 796 (S.D. 2004), the South Dakota Supreme Court was confronted with a description issue. The security agreement described the collateral as “[A]ll of Feeder’s interest in farm products, limited to livestock . . . with all proceeds and products of all or any of the foregoing, such livestock being specifically located in Lot(s) # \_\_\_\_\_ at Castro County Feeders, I, Ltd., Hart, Castro County, Texas.”<sup>1</sup> Castro County Feeders, the Creditor, failed to fill in the blank for the Lot number.
- a. In litigation between the debtor and creditor, debtor argued that the security agreement did not reasonably identify the specific cattle subject to a security interest because it did not specify the particular pens in which the cattle were located.. The court concluded the description satisfied Article 9’s test that the description must reasonably identify the collateral. The court recognizes that the term “livestock” is an example of collateral by “category” which is permitted under Article 9 but also recognizes that the security agreement does not simply cover “ all livestock of debtor.” It then goes on to conclude:

Here, the Agreement did not attempt to give Castro County a security interest in all of Baldwin’s property as prohibited by 57A-9-108(c). Although the parties did not specify a particular lot or lots, the Agreement restricted the security interest to the cattle Baldwin delivered to Castro County’s feedlot complex in the city of Hart, Texas. According to the Agreement, Baldwin [Debtor] also granted Castro County a security interest in the sale of these cattle. We believe this description was sufficient to make the collateral objectively determinable. A reasonable reading of the Agreement gave Castro County a security interest in only those cattle of Baldwin’s to which it advanced feed and related services. It was not necessary for the agreement to list each individual head of livestock to which Castro County’s security interest attached. Moreover, it was also reasonable for the Agreement to leave a specific lot number blank given

the fact the cattle were not usually located in one of Castro County's lots when sold.

- b. This case has some interesting facets. Arguably, the South Dakota holding reflects revised Article 9's liberal attitude toward collateral descriptions in a security agreement. But, remember that a security agreement is a contract. Also, if a default occurs the security agreement description is important for repossession. The description must provide adequate guidance for the person doing the repossessing.
  
- c. *Baldwin* involves a conflict between the debtor and the alleged secured party.
  - (1) Would the result be the same, if this was raised in a bankruptcy proceeding where the trustee attacked the description or if another secured creditor claimed a security interest in debtor's livestock, or if the collateral subject to the security interest had been sold by the feedlot without permission.
  
  - (2) Second, according to the court, "the parties stipulated to most of the facts in the case and agreed that only a question of law was before the court [trial]." Would the court apply the same approach, if the debtor asserted that it had intended to grant a security interest in certain animals and not all? Would parol evidence be able to be used? Would the court have treated a security agreement that contained an incorrect pen or lot number the same as a complete omission? Consider the following case dealing with defective description.
  
- d. Suppose that the debtor and the secured party intended the security agreement to cover inventory and accounts but the security agreement described the collateral "as all equipment, furniture and fixtures." The financing statement described the collateral as "as all equipment, furniture and fixtures, inventory and accounts." Does secured creditor have a security interest in all inventory and accounts? No, said the court in *In re Martin Grinding*, 793 F.2d 592 (7<sup>th</sup> Cir. 1986), barred parol evidence. The parol evidence rule applied because this was an unambiguous integrated document. The court stated: "[a]lthough the rule excluding parol evidence works results contrary to the parties' intentions in particular cases, it reduces the cost and uncertainty of secured transactions generally."
  
- e. Can a security agreement containing a defective description be reformed?
  - (1) Yes, says the bankruptcy court in *In re Shutz*, 241 B.R. 646 (Bankr. W.D. Mo. 1999). Normally a security agreement that describes the collateral as 100 head of Holstein cows would not cover 100 brown Swiss cows the debtor also owned. In this case, the security agreement described the collateral as a "1996 Titan Home" when the intended collateral was a "Sunshine-382 serial number "AL-S-01258" mobile home. Creditor did get its

security interest noted accurately on the mobile home title application and certificate of title. Debtor filed for bankruptcy and the trustee asserted that creditor was an unsecured creditor because the security agreement was defective and no attachment occurred. The court rejected this argument and permitted reformation of the contract because the defective description was the result of a mutual mistake.

The court seems to conclude that, because the security agreement was clear on its face, the parol evidence rule prevented the introduction of extrinsic evidence to alter the result. However, the court concludes that under Missouri law the extrinsic evidence is admissible under parol evidence rule to correct a mutual mistake. See Restatement (Second) of Contracts § 214(d). Reformation is in order when three conditions are met:

(1) a preexisting agreement between the parties affected by the proposed reformation that is consistent with the change sought; (2) an assertion that a mistake was made in that the [document] did not reflect what had been agreed upon; and (3) an assertion that the mistake was common to both parties.

The facts showed these conditions were met. Inasmuch as the reformation of the contract simply enforced the parties intent, the court held that the effective date of the reformed contract was the date the original one was signed.

Restatement (Second) of Contracts § 155 mutual mistake and reformation provides an exception to the parol evidence rule "to the extent that rights of third parties such as good faith purchasers for value will be unfairly affected."

While the trustee is normally not considered a good faith purchaser, it would appear that, because the certificate of title contained the correct information about the collateral, the world was on notice of the security interest. Moreover, once attachment was established here, the creditor was perfected because of the proper notation on the certificate of title.

- (2) Another reformation case is *In re Ivenux, Inc.*, 298 B.R. 442, 2003 WL 22094504 (Bankr. D. Colo. Aug. 21, 2003). Here the court held that § 9-203 does not displace the common law right to reform a writing -- here, the security agreement -- on the basis of mutual mistake regarding the description of collateral. Moreover, the parol evidence rule does not bar the secured party from proffering extrinsic evidence supporting its claim of mutual mistake notwithstanding the "crystal clear" language of the security agreement. Specifically the court stated: "[w]here there is a claim of mutual mistake, the parol evidence rule simply has

no application and a court may consider extrinsic evidence which goes to the question of exactly what the agreement of the parties was and whether that agreement was expressed in the written document."

- (3) *Sims v. First State Bank of Plainview*, 43 S.W.3d 175 (Ark. Ct. App. 2001) is another erroneous description case. One of the issues in this case was whether a security agreement describing the collateral as "a John Deere Model 750 Backhoe SR# CHO750SO28578" along with all accessions and additions, as collateral for a loan covered the front end loader that had been attached to the tractor when the loan was made but had apparently been removed by the debtor before repossession was attempted. The court does not discuss 9-203 or what description is adequate under Article 9. Rather it notes that the trial court heard extensive testimony that indicated that "the front-end loader was in fact attached to, and an integral part of, the tractor. Under R9-203(b)(3)(A) and 9-108, the question is: did the security agreement description reasonably identify the collateral to be a tractor that had both a front-end loader and a backhoe? In effect, the court was saying that tractor with a backhoe always has a front-end loader. Remember the security interest is a contract and is designed to memorialize the agreement between the parties and make clear if default occurs what the secured party can repossess.

## VII. Can A Security Agreement Create A Fiduciary Relationship For Purposes Of Bankruptcy § 523 Exception To Discharge?

- A. This question of whether a security agreement could create a fiduciary relationship between the debtor and the secured party was raised in *In re Ellis*, 310 B.R. 762 (D. Okla. 2004). In *Ellis*, Bank loaned money to Debtor, who signed a security agreement purporting to grant Bank a security interest in crops but it contained no real estate description. Debtor sold the crops without Bank's consent and did not remit the proceeds to Bank. Subsequently, Debtor filed a Chapter 7 petition. Bank sought an exception to discharge for its debt under 11 U.S.C. §§ 523 (a)(4) and (a)(6). Section 523(a)(4) prohibits discharge for "fraud or defalcation while acting in a fiduciary capacity and § 523(a)(6) prevents discharge "for willful and malicious injury by the debtor to another entity or to the property of another entity."
- B. With regard to the fiduciary status, the court rejected the Bank's argument that the security agreement language ". . . all proceeds from disposition of the collateral . . . shall be held in trust for the lender and shall not be commingled with any other funds . . ." was sufficient to create a fiduciary relationship. The court concluded that this language was insufficient as a matter of law to create a fiduciary relationship for purposes keeping its debt from being excepted from discharge under § 523(a)(4).
  1. It appears that under 523(a)(4), the existence of a fiduciary relationship is determined under federal law, to find that a fiduciary relationship existed under § 523(a)(4), the court must find that the money or property on which the debt at issue was based was entrusted to the debtor (older standard, more recent language calls for an express or technical trust). Neither a general fiduciary

duty of confidence, trust, loyalty, and good faith, see *In re Evans*, 161 B.R. 474, 477 (9th Cir. BAP Cal.1993); nor an inequality between the parties' knowledge or bargaining power is sufficient to establish a fiduciary relationship for purposes of discharge ability. *In re Klippel*, 183 B.R. 252, 260 (Bankr.D.Kan.1995) "Further, the fiduciary relationship must be shown to exist prior to the creation of the debt in controversy." *In re Romero*, 535 F.2d 618, 621(10 Cir.N.M. 1976); see also *In re Evans*, 161 Bankr. at 477. Cf. *In re Robert Young*, 91 F.3d 1367 (10<sup>th</sup> Cir. 1996) (federal law determines if fiduciary relationship exists).

a. Would it have made any difference if it is a crime for a debtor to dispose of collateral subject to a security interest?<sup>2</sup> It is unclear whether the fiduciary relationship conclusion was affected by the fact that the court also found that no effective security agreement had been executed by the Debtors. This finding is discussed next.

2. 11 U.S.C. 523(a)(4) provides: "A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt— (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny . . . ."

a. An interesting question is whether the sale of property subject to a security interest could constitute embezzlement or larceny for purposes of this exception to discharge. Some states like Iowa and Kansas make it a crime to impair a security interest or agricultural lien. It is interesting to speculate whether that might qualify as larceny or embezzlement. See, e.g., Iowa Stat. Ann. § 570.9 (1992) and Kan. Stat. Ann. § 21-3734 (1995).

C. DOES THE SALE OF COLLATERAL SUBJECT TO A SECURITY INTEREST CONSTITUTE WILLFUL AND MALICIOUS DAMAGE TO PROPERTY THAT MAKES THE DEBT NON-DISCHARGE ABLE UNDER § 523?

1. As to the wilful and malicious damage to Bank's collateral or its proceeds, the court *In re Ellis*, 310 B.R.762 (D. Okla. 2004) accepts Debtors' argument that Debtors did not cause any damage to Bank's property. Bank had no property interest in the crops because it did not have a security interest in the crops. The document specially delineated "Security Agreement," did not contain a real estate description. While R9 does not require a real estate description, F9 did. U.C.C. § 9-203 (b)(3)(A);9-108.

2. Interestingly, even though the security agreements involved was executed before the effective date of R9, the bankruptcy petition was filed in Oklahoma after R9 became effective. The court specifically notes that the parties agreed that F9 not R9 was the controlling law, and the court apparently agreed because it applied F9. This is questionable for two reasons. First, most courts look to the date the petition is filed to determine whether Revised 9 applies to a transaction entered into when former 9 was in effect. E.G. *In re Outboard Marine Corp.*, 300 B.R. 308 (Bkrcty.N.D.Ill.,2003) and cases cited therein. Also, it appears that R9's transition rules apply. The argument is that section 9-702(a) transformed the security agreement and make the omission of the real estate description irrelevant. § 9-702(a) provides: "Except as otherwise provided in this part, this [Act] applies to a transaction or lien within its scope,

even if the transaction or lien was entered into or created before this [Act] takes effect.” A compelling construction of the savings clause of § 9-702(a) is that it was intended to make R9 applicable to any action brought after the effective date of R9 unless a specific section of the 9-700's provided otherwise.

3. The transaction involved in the case was an attempt to obtain a security interest in crops and this is within the scope of Article 9. § 9-109(a)(1) covers any transaction that creates a security interest in personal property. Crops are farm products and this is a type of good that is personal property. In addition, no section specifically provides that a security agreement ineffective under F9 will also be considered ineffective under R9. Official comment 1 to § 9-705 seems to accept the proposition that attachment under R9 relates back to transactions occurring before the effective date of R9. It provides: “This section addresses primarily the situation in which the perfection step is taken under former Article 9 or other applicable law before the effective date of this Article, but the security interest does not attach until after this date.” It should be noted that the bankruptcy court in *In re Stout*, 284 B.R. 511 (D. Kan. 2002) seems to have rejected a similar argument. I am unpersuaded by the *Stout* opinion.

D. A Missouri bankruptcy court in *In re Thompson*, 315 B.R. 94 (W.D. Mo. 2004), held that a debt was exempt from discharge under 11 U.S.C. § 523(a)(6) because the collateral subject to a security interest was sold out of trust and the debtor offered no credible explanation for their actions.

1. Conversion of property alone is not enough to prevent discharge. The debtor must wilfully and maliciously intend to cause injury to the creditor i.e. financial harm. Here 25% of the cattle (collateral) were missing and the debtor offered no justification for the conversion. The debtor simply say that cattle from time to time just wandered off.
2. The amount of debt excepted from discharge is the damages resulting from the conversion of creditor’s collateral (cattle). It is the reasonable market value of the cattle when converted.

## VIII. Proceeds

- A. Must a security agreement specifically refer to or describe proceeds for attachment to occur?
1. No specific reference to proceeds is required in the security agreement under 9-203 if certain conditions are met.
  2. § 9-203(f) provides that attachment of a security interest in collateral automatically gives the secured party an interest in the proceeds if they are identifiable. U.C.C. § § 9-315(a)(2) & (b).
- B. Proceeds clearly cover the replacement or substitute for original collateral and are defined in part in § 9-102(a)(64) among other things to be “(A) whatever is acquired upon sale, lease, license, exchange or other disposition of the collateral . . . .” They can be cash or noncash. Cash proceeds are defined in § 9-102(a)(9) to mean “money, checks, deposit accounts or the like.” Noncash are those that are not cash such as trade-ins and tangible chattel paper. U.C.C. § 9-102(a)(58).

C. 9-102(a)(64) broadened the definition of proceeds. It now provides:

64) 'Proceeds' are

(A) Whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral;

(B) whatever is collected on, or distributed on account of, collateral;

(C) rights arising out of collateral;

(D) to the extent of the value of collateral, claims arising out of the loss, nonconformity, or interference with the use of, defects or infringement of rights in, or damage to, the collateral; or

(E) to the extent of the value of collateral and to the extent payable to the debtor or the secured party, insurance payable by reason of the loss or nonconformity of, defects or infringement of rights in, or damage to, the collateral.

D. The scope is expanded in two ways. First, the debtor is no longer required to receive what ever is produced by the disposition of the original collateral. Second, subsections B-E do not require a disposition. For example, under (b) stock dividends are covered by whatever is "distributed on account, collateral." Claims arising from loss or damage to the collateral or insurance proceeds for loss or damage to collateral is covered under (D).

E. *Western Farm Service v. Olsen*, 59 P.3d 93 (Wash. Ct. App. 2003), *rev'd* 90 P.3d. 1053 (2004) is an example a very broad application of the new definition. Producer of potatoes, who had granted Bank a perfected security interest in the potatoes, contracted to sell the potatoes to Simplot. One of the terms of the contract was that Simplot would pay Producer, in addition to the payment for the potatoes, a separate amount for hauling the potatoes to buyer's place of business. The court of appeals held that the Debtor's reimbursement for hauling the potatoes was not proceeds because the payment was for services and not arising out of the sale or exchange of the potatoes. Thus, the Bank's security interest in the potatoes did not extend to the hauling reimbursement.

The Supreme Court of Washington reversed holding that the hauling allowance was proceeds. It stated:

"The hauling allowance was an integral part of the potato-sales contract.... Although he [Olsen] was entitled to the hauling allowance along with the payment for potatoes, Olsen could collect these sums only after the potatoes were delivered. Plainly, these sums were received upon the sale, exchange, collection or other disposition of Olsen's potatoes and thus properly viewed as proceeds.

## IX. Perfection

A. Perfection of security interests.

B. In general, attachment makes the security interest enforceable against the debtor and it allows the secured party to pursue its remedies on default as articulated in Part 6 whether or not the security interest is perfected.

- C. A security interest cannot be perfected until it has attached and all steps required for perfection have been taken. § 9-308.
- D. The key to determining how to perfect is the correct classification of the collateral.
- E. In general, six possible ways to perfect exist.
  - 1. Filing — § 9-310 (most common)
  - 2. Possession by secured party § 9-313
  - 3. Automatic — § 9-309
  - 4. Certificate of Title — §§ 9-310(b); 9-311
  - 5. Control—deposit accounts, letter of credit rights, electronic chattel paper and investment property. §§ 9-104-07 and 9-314.
  - 6. Temporary — § 9-312(e-d)(20 days certificated securities, negotiable documents or instruments when new value given, 20 days when bailee makes goods or documents available to debtor).
  - 7. Assignment of a Perfected Security Interest under 9-310(b).
    - a. If a secured party assigns a perfected security interest or agricultural lien, a filing under this article is not required to continue the perfected status of the security interest against creditors of and transferees from the original debtor.

## **X. Perfection of a *Security Interest* By Filing**

- A. Two general questions: what to file and where to file.
- B. Where to file.
  - 1. Under the uniform version of Article 9, all filings are made with the secretary of state except for fixtures, timber to be cut, as extracted collateral and transmitting utilities which are filed locally. U.C.C. § 9-501.
- C. § 9-502(a) and (b) state the basic requirements for a financing statement.
  - 1. 9-502(a) deals with non-real estate related filings and requires only:
    - a. Name of the debtor
    - b. Name of the secured party or a representative of the secured party
    - c. Description of the collateral.
- D. § 9-516(b) contains additional requirements for the financing statement than those required in § 9-502. This section states that the filing officer *may reject* a filing for any of the following reasons:

- a. A record is not communicated in a manner authorized by the filing office.
- b. Appropriate fee is not tendered.
- c. The file cannot be indexed because the name of the debtor is not provided.
- d. If the financing statement contains no name or mailing address of the secured party.
- e. If the financing statement contains no mailing address of the debtor.
- f. If the financing statement contains no indication that the debtor is an individual or organization.
- g. If the debtor is an organization and the financing statement contains no indication of the type of organization.
- h. If a perfected secured party tries to continue an existing financing statement more than six months before the existing one expires.

E. Name of the debtor — § 9-503

- 1. The name of the debtor for the financing statement has been clarified. Trade names are legally insufficient.
- 2. The requirement of the debtor's signature has been eliminated so long as the person filing is authorized, which automatically occurs if the description in the financing statement is the same as in an "authenticated" security agreement. U.C.C. §§ 9-509-10.
- 3. The financing statement must contain the name of the debtor. 9-502(a)(1).
- 4. The name of the debtor is the key to the notice system and priority. The financing statement is indexed under the name of the debtor.
- 5. 9-503 states when the debtor's name is sufficient.
  - a. Registered organization
    - (1) If the debtor is a registered organization, the name used in the financing statement must be the one that is the registered name in the public record of the debtor's jurisdiction of organization.
    - (2) Under § 9-102(70) "Registered organization" means an organization organized solely under the law of the single State or the United States and as to which the State or the United States must maintain a public record showing the organization to have been organized. Typically this includes a corporation, limited liability company, limited partnership and a limited liability partnership.
    - (3) Are federal tax liens subject to the same exact match standard when a registered organization is involved?

- (a) No, according to the Court of Appeals for the Sixth Circuit in *In re SPEARING TOOL AND MANUFACTURING CO.*, 412 F.3d 653 (6th Cir. Jun 21, 2005), reversing 302 B.R. 351 (E.D. Mich 2003), which had reversed 292 B.R. 579 (E.D. Bankr. 2003). The District court had held that the exact registered name must be used in the tax lien notice and concluded that the government's notice which substituted "Mfg." for "Manufacturing" was defective reversing the bankruptcy court. The Sixth Circuit rejected this reasoning. First, federal law not state law controls whether the taxpayer's identity in the tax lien is adequate. Federal tax liens are not required to meet same precise-identification requirement other lien notices must meet under Uniform Commercial Code Article 9. In effect, the test is whether a reasonable searcher would find the lien notwithstanding the use of an abbreviation.
  - (b) This case apparently means that a searcher searching for Article 9 financing statements and I.R.S. liens will have to search more than under the legal name of the debtor. It is interesting to speculate whether filing officers will have two search engines. Also, if the search engine exists for non legal names, it would seem that this search will be up incorrect legal names.
- b. Non-registered organization.
- (1) The name of the organization.
  - (2) If it has no name, the names of the partners, associates or others making up the debtor.
- c. Individuals
- (1) The name of the individual.
    - (a) What name of an individual is sufficient?
      - i) Only the person's exact legal name?
      - ii) What about a correct surname but a nonlegal first name such as a nickname or a trade name?
    - (b) 9-503 simply says that if the debtor is an individual the financing statement is sufficient if it provides the "individual name" of the debtor.
    - (c) § 9-503(c) provides that a financing statement that provides only the debtor's trade name does not sufficiently provide the name of the debtor.

- (d) Assuming that the legal name is required, how does one determine the legal name of the individual?
  - i) Look at a birth certificate? Social security card? Passport? I.R.S. form 1040?
- (e) While the drafters did not explicitly say the legal name of an individual is required, the intent of the drafters was to place the burden on the filing creditor to get the name of the debtor correct rather than putting the burden on the as opposed to putting the burden on the searching creditor to make multiple searches under various name possibilities.
- (f) Support of the argument that the drafters intended the exact legal name to be used is found the so-called minor error rule of 9-506.

6. Incorrect debtor name and the minor error rule--9-506.

- a. § 9-506 purports to continue the minor error rule of former Article 9-402(8).
  - (1) It provides that a financing statement substantially complying with the requirements of the 9-500's is effective even if it has minor errors or omissions unless those errors or omissions make the financing statement seriously misleading.
  - (2) A financing statement containing an incorrect debtor's name is not seriously misleading under § 9-506(c) if a search of the records of the filing office under the debtors' correct name, using the filing office's standard search logic, if any, discloses the financing statement filed under the incorrect name.
    - (a) The key questions are:
      - i) What is the debtor's correct name and
      - ii) What is the official search logic of the filing office.
  - (3) Many states' filing offices are using an exact match search logic. This means that a search under the correct name of an individual using the exact match logic will only produce a financing statement indexed under the identical name of the debtor.
    - (a) In effect there is no minor error rule when an exact match logic is used. If the correct name of the debtor is the debtor's legal name, financing statements filed under a

non-legal name are misleading because an exact match search would not find them.

- (4) Some states like Kansas have promulgated regulations which define the search logic to be used.
  - (a) For example K.A.R. 7-17-22 (a)(1) provides “Punctuation marks, accents, and suffixes are disregarded.” “Words and abbreviations at the end of a name that indicate the existence or nature of an organization are disregarded.” *Id.* at (a)(5). Examples include association, bank, church, college, company, corporation, incorporated, limited, LP, limited liability company, LLC, limited liability partnership, and LLP. *Id.* at (a)(5). “For middle names of individuals, initials are equated with all names that begin with these initials, and the absence of a middle name or initial is equated with all middle names or initials.” *Id.* at (a)(8).
  - (b) The Kansas regulations are available on the Secretary of State’s web page. See [http://www.kssos.org/resources/resources\\_links\\_ucc.html](http://www.kssos.org/resources/resources_links_ucc.html).
- (5) The Missouri Secretary of State website for UCC matters in general is <http://www.sos.mo.gov/ucc/>. You can also find all of the relevant UCC forms on <http://www.sos.mo.gov/forms.asp>. Most can be filed while on line. Search forms are also provided.

7. Incorrect debtor name cases.

- a. The court in *Pankratz Implement Co. V. Citizens National Bank*, 102 P.3d 1165 (Kan Ct. App. 2004), review granted (May 03, 2005)(to be argued in early October) considered a financing statement that misspelled the debtor’s first name (“Roger” for real name “Rodger”). The court held that financing statement was ineffective because the legal name of the debtor was not used. The misspelling was not a minor error under U.C.C. § 9-506. The financing statement is seriously misleading because a searching creditor utilizing the standard search logic which searches under the debtor’s legal name would not find the financing statement filed under the misspelled name.
- b. The Bankruptcy Panel of the Tenth Circuit in *In re Kinderknecht*, 308 B.R.71 (10th Cir.BAP 2004). The court held that under Kansas law the financing statement must list the legal name of the individual, not a nickname. Here the “legal name” of the debtor was “Terrance Joseph Kinderknecht” but he was informally known by the nickname “Terry Kinderknecht.” The financing statement was filed under the nickname “Terry Kinderknecht.” Thus, the filing was defective.

- c. The upshot is that the filing creditor has the burden of getting the debtor's name correct and filing under the correct legal name.
  - (1) Remember that Article 9 provides guidance as to the legal names of organizations but does not as to individuals. U.C.C. § 9-503(a)(1) and (4)(A).

## **XI. Priority**

- A. Two perfected secured creditors with no PMSI.
  - 1. The first-to-file or perfect, whichever is earlier, wins.
  - 2. First to attach if both are unperfected.
  - 3. If one is perfected and the other not, the perfected wins.
  - 4. 9-322 (f) recognizes that exceptions to these rules can apply. Examples include PMSIs(9-324), deposit accounts (9-327) and set off ( 9-340).
- B. Purchase Money Security Interest (PMSI).
  - 1. A number of special priority rules apply to conflicts between a PMSI and other creditors.
    - a. A PMSI perfected by filing “before or within 20 days after the debtor receives delivery of the collateral” has priority over certain buyers such as a buyer not in the ordinary course, lessees and lien creditors interests “which arise between the time the security interest attaches and the time of filing.” 9-317(e).
    - b. A PMSI can trump the first-to-file rule of 9-322.
      - (1) 9-324(a) gives a qualifying holder of a PMSI in equipment priority over the first-to-file.
      - (2) 9-324(b) gives a qualifying holder of a PMSI in inventory priority over the first-to-file.
      - (3) 9-324(d) gives a qualifying holder of a PMSI in livestock that are farm products priority over the first-to-file. [NEW]
      - (4) 9-324(f) gives a qualifying holder of a PMSI in software priority over the first-to-file. [NEW]
      - (5) 9-324(g) deals with a conflict between two PMSIs and gives a seller who has a PMSI priority over a lender who has a PMSI in the same collateral; if the conflict is between two lenders each having a PMSI, the first-to-file wins. [NEW]

- (6) 9-334(d) gives a qualifying holder of a PMSI in fixtures priority over a prior recorded real estate mortgagee if a fixture filing was made before or within 20 days of a good becoming a fixture. Also see 9-334(e).
  - (7) Revised 9 has no special PMSI for production money used to produce crops. Former 9-312(2) is repealed but not replaced.
- C. For a general discussion of PMSIs, see Keith G. Meyer, *A Primer on Purchase Money Security Interests Under Revised Article 9 of the Uniform Commercial Code*, 50 Kan. L. Rev. 143 (2001).
- D. No special PMSI for production money used to produce crops.
1. Crop financiers providing production financing cannot fit under 9-324(a) which provides:
 

Except as otherwise provided in subsection (g), a perfected purchase-money security interest in *goods other than inventory or livestock* has priority over a conflicting security interest in the same goods . . . if the purchase-money security interest is perfected when the debtor receives possession of the collateral or within 20 days thereafter. [Emphasis added.]
  2. While the definition of goods in § 9-102(a)(44) covers growing crops and crops to be grown, the clear negative inference of comment 2 to 9-324 is that former § 9-312(2) that gave a super priority in limited circumstances for a pmsi in crops was eliminated and not replaced in revised Article 9. States could adopt § 9-324A if they wanted to provide a super priority for pmsi's in crops. § 324A is found in Appendix II to the 2001 version of Article 9.
  3. Also, I cannot see how the possession requirement of 9-324(a) could be applied. 9324(a) gives a super priority "if the pmsi is perfected when the debtor receives possession of the collateral or within 20 days thereafter."
    - a. What is the collateral that the debtor possesses? The inputs like seed, fertilizer etc or the crops? If it is the seed, then the crops have to be proceeds. I do not think that the crops are proceeds of the inputs. 9-102(a)(64)(A) contemplates a sale or some sort of exchange and (B-E) do not seem to apply.
    - b. If the collateral is the crops, the possession concept does not seem be apply. Possession, while not defined, would have to be in effect when the crops become growing crops. Does than mean the 20 day filing requirement would not begin to run until the seed was planted and the crops become growing crops. What about the other inputs such as chemicals and fertilizer?
    - c. In my opinion 9-324(a) and F 9-312(4) contemplate discrete, identifiable goods coming into the possession of the debtor. In this case the inputs would be the goods that debtor receives into its possession.

- d. Also, note what § 9-324 (g) (1) dealing with conflicts between two PMSI's provides. If one of the pmsi's is held by a seller, the seller has priority as to "the price of the collateral . . ." What priority would the seller of the inputs have? Just for the inputs? Again, it would appear that the pmsi rules contemplated discrete, identifiable collateral at the outset of a transactions.
- e. It is interesting to remember that, absent the definition of farm products, crops would be farmer's inventory. 9-324(d) clearly treats livestock like inventory. But, unlike crops, the livestock are identifiable collateral when debtor obtains possession.
- f. Finally, whether good policy or not, my recollection is that the ABA committee, of which I was a member, as well as the Article 9 drafting committee believed that revised article 9 did away with the pmsi in crops.

E. PMSI Cases.

- 1. PMSI in equipment
- 2. *In re K & P Logging*, 272 B.R. 867 (Bankr. D S.C 2001) involved a dispute between a lender(ORIX) with a PMSI in equipment and a prior perfected secured creditor (BOA) claiming the equipment under an after-acquired property clause.
  - a. While old Article 9 was applied, the former PMSI rule is basically the same in as the one in Revised 9-324(a) which provides:
    - (a) [General rule: purchase-money priority.] Except as otherwise provided in subsection (g), a perfected purchase-money security interest in goods other than inventory or livestock has priority over a conflicting security interest in the same goods, and, except as otherwise provided in Section 9-327, a perfected security interest in its identifiable proceeds also has priority, if the purchase-money security interest is perfected when the debtor receives possession of the collateral or within 20 days thereafter.
  - b. Prior to ORIX's PMSI loan in 1998, ORIX had loaned Debtor money in 1997 and had filed in 1997 three financing statements describing the collateral as present equipment and after-acquired.
    - (1) When ORIX made the PMSI loan in 1998, ORIX obtained a security interest in specific logging equipment and any other logging equipment presently owned or hereafter acquired.
    - (2) The 1998 financing statement covered the logging equipment but was apparently not filed with 20 days of Debtor's taking possession.

- (a) BOA attached ORIX's claim it had a super priority as a PMSI holder in logging equipment on two grounds.
  - i) First, the 1998 financing statement had not been filed in a timely fashion and the 1997 financing statements covering all equipment could not be used to establish PMSI priority.
  - ii) *Second*, ORIX's PMSI had been transformed into a nonPMSI with the inclusion of a cross-collateralization provision in its security agreement. The court rejected both of these arguments.

(3) The court concluded that the prior filed 1997 financing statements which covered after-acquired equipment were effective to perfect the PMSI in the logging equipment.

(a) The prior financing statement description of equipment covered the specific logging machine and consequently satisfied the notice requirement.

(b) Also, this is no different than if ORIX had filed the 1998 financing statement covering the specific logging equipment before the Debtor took possession of the machine.

(c) The court stressed that the filing of the 1998 statements does not alter the effect of the first. ORIX was simply following a "belt and suspenders" approach.

(4) Finally it is important to note that neither old Article 9 nor revised 9-324(a) requires that a holder of a PMSI in equipment notify existing filed secured creditors of the PMSI. This is not the case for inventory or for livestock. See 9-324(b) & (d).

3. The transformation argument was also rejected.

- a. While the court analyzed law other than Revised 9, the court noted that 9-103 (b)(1) & (f) reject the transformation rule in commercial cases.
- b. First, the basic definition of a PMSI in revised § 9-103(b)(1) recognizes the "dual status" rule by providing that a security interest in goods is a PMSI to the extent that the goods are purchase-money collateral; i.e., to the extent that the goods secure a purchase-money obligation incurred with respect to the goods.
- c. Revised section 9-103(f) specifically rejects the transformation rule in non-consumer transactions. It states:

No loss of status of purchase-money security interest in nonconsumer-goods transaction.] In a transaction other than a consumer goods transaction, a purchase-money security interest does not lose its status as such, even if:

- (1) the purchase-money collateral also secures an obligation that is not a purchase-money obligation;
- (2) collateral that is not purchase-money collateral also secures the purchase money obligation; or
- (3) the purchase-money obligation has been renewed, refinanced, consolidated, or restructured.

- d. In summary, a properly created PMSI is not destroyed when the purchase-money collateral also secures an obligation that is not a purchase-money obligation, when collateral that is non-purchase-money collateral also secures an obligation that is a purchase-money obligation, or when a purchase money obligation has been renewed, refinanced, or consolidated. Thus, a security interest in collateral may be both a PMSI and a non-PMSI.

F. *PMSIs in Livestock and Prior Perfected Security Interests.*

1. Priority change in Revised Article 9
2. Revised 9 changes the priority rule governing conflicts between a PMSI in livestock that are farm products and prior perfected security interests.
3. F9 treated livestock that were farm products as noninventory.
4. Under R § 9-324(d) livestock are generally treated like inventory.
  - a. § 9-324(d) provides that a purchase money security interest in livestock that are farm products has a super priority over a conflicting security interest in the same livestock and in their identifiable proceeds (subject to the rights of a lender with a security interest in deposit accounts) and “identifiable products in their unmanufactured states.”
  - b. In order to qualify for the purchase money priority, there are several requirements which the secured party must meet:
    - (1) the purchase money security interest must be perfected when the debtor receives possession of the livestock;
    - (2) the purchase money secured party must send an authenticated notification to the holder of the conflicting security interest;
    - (3) the holder of the conflicting security interest must receive the notification *within six months before* the debtor receives possession of the livestock; and

- (4) the notification must state that the purchase money secured party has or expects to acquire a purchase money security interest in the described livestock of the debtor.
5. The priority rule of Revised § 9-324(d) extends to “identifiable proceeds.”
- a. The PMSI rules for inventory and livestock are different as to proceeds and differ as length of the effectiveness of the notice (5 years for inventory and six months for livestock).
  - b. Proceeds
    - (1) The super-priority rule governing livestock extends to all “identifiable proceeds” which presumably would include amounts owed by a livestock processor to a debtor who has sold livestock but is paid after delivery of the livestock to the processor.
    - (2) The priority also extends to all identifiable products in their unmanufactured states.
    - (3) Conversely, the purchase money priority rule for inventory under 9-324(b) extends only to “identifiable cash proceeds . . . to the extent . . . received on or before the delivery of the inventory to a buyer . . . .”
  - c. Mo. STAT. Ann. § 441.280. Landlord's lien on crops for rent:

Every landlord shall have a lien upon the crops grown on the demised premises in any year, for the rent that shall accrue for such year, and such lien shall continue for eight months after such rent shall become due and payable, and no longer. When the demised premises or any portion thereof are used for the purpose of growing nursery stock, a lien shall exist and continue on such stock until the same shall have been removed from the premises and sold, and such lien may be enforced by attachment in the manner herein provided.