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An Agricultural Law Research Article

Agricultural Law: The Definition of Secured Collateral Encompasses Genetic Engineering

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I. *Agricultural Law*

The Definition of Secured Collateral Encompasses Genetic Engineering

In *Fairview State Bank v. Edwards*,[1] a case of first impression in the United States, the court interpreted Oklahoma statutory law[2] and concluded that creditors who have security interests in a debtor's livestock also have a security interest in the proceeds received from the sale of embryos produced by the debtor's donor cows.[3] In addition, the court found that the Uniform Commercial Code contemplates and approves security agreements that provide that a debtor's obligations will be secured by after-acquired collateral.[4]

Factual Background

The defendant debtors formerly did business as D&B Brangus and were engaged in farming and ranching operations. They filed a petition for bankruptcy under Chapter 11 of the United States Bankruptcy Code in January of 1984. Plaintiff, Fairview State Bank, and the United States of America, acting through Farmers Home Administration (FmHA), were secured creditors. The bank initiated an action against the debtors and FmHA seeking a declaration of its rights as a secured creditor. The bank contended that its security interest in the debtors' livestock included the payments debtors received from cattle embryo transfers.

In July 1983, the debtors entered into a contract for the sale of embryos from the debtors' cattle to the Granada Land and Cattle Company. Granada paid the debtors $500 for each embryo successfully transferred into one of Granada's cows. Pregnancies were confirmed approximately sixty days after the transfer of embryos to Granada's cows. The debtors agreed to leave their donor cows at Granada long enough to produce at least one hundred pregnancies.

The debtors did not dispute that the bank and the FmHA had security interests in the donor cows. The priorities of the bank and FmHA as to the donor cows was established by the trial court. In addition, the debtors did not dispute that any calves carried by the donor cows until birth were subject to the security interest. However, the debtors contended that the security interests of the bank and the FmHA did not extend to payments received for confirmed pregnancies resulting from the embryo transfer program. The debtors argued that the parties did not contemplate an embryo transfer program when they entered into the security agreements. The debtors also con-

1. 739 P.2d 994 (Okla. 1987).

2. 12A OKLA. STAT. § 9-204(1) (Supp. 1984); 12A OKLA. STAT. § 2-105(1), (2) (1981); 12A OKLA. STAT. § 9-306(1) (Supp. 1984).

3. 739 P.2d at 995.

4. *Id.* at 997.

tended that the security agreements neither forbade such use of the donor cows nor provided for a security interest in the "products" generated by such use.

The Court's Analysis

The court first considered whether the bank's security interest included the embryos produced by the debtors' donor cows. Second, it considered whether such security interest would extend to the payments received by the debtors from those embryos.[5]

The court began its analysis by addressing the formal requirements for the attachment of a security interest. Section 9-203 of the Oklahoma Uniform Commercial Code (UCC) provides in pertinent part:

> (1) [A] security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless: (a) the collateral is in the possession of the secured party pursuant to agreement, or the debtor has signed a security agreement *which contains a description of the collateral*, . . .; (b) value has been given; and (c) the *debtor has rights in the collateral.*
>
> (2) Attachment occurs as soon as all of the events specified in subsection (1) of this section have taken place unless explicit agreement postpones the time of attaching.[6]

Where the collateral is not in the possession of the secured party, the first requirement for attachment of a security interest is that the security agreement describe the collateral.[7] Section 9-110 of the UCC provides: "For the purpose of this Article any description of personal property or real estate is sufficient whether or not it is specific if it *reasonably identifies* what is described."[8]

By a series of analogies, the court determined that the security agreements executed by the debtors in favor of the bank and the FmHA included provisions describing the debtors' after-acquired livestock, that after-acquired livestock included increases in the debtors' herd, that embryos were included in such increase, and that under the UCC embryos could be included in the definition of goods.[9]

5. Because it was outside the scope of the certified question, the court did not consider whether the security interests of the creditors in the proceeds from the embryo transfer program were properly perfected under 12A OKLA. STAT. § 9-306(3) (Supp. 1984). Nor did the court determine how the creditors' interests in these proceeds were affected by the bankruptcy proceedings instituted by the debtors. *See id.* § 9-306(4). The court noted that the security agreement of FmHA provided that disposition of collateral required prior written consent. However, this issue was not raised by the parties. Finally, the court did not address the question of whether the embryo transfers constituted an unauthorized disposition of the collateral, making third-party buyers of the embryos subject to FmHA's security interest. *See id.* §§ 9-306(2), 9-307.

6. *Id.* § 9-203 (1981 & Supp. 1984) (emphasis added).

7. *Id.* § 9-110 (1981) (emphasis added).

8. *Id.*

9. 739 P.2d at 997.

To secure payment of the promissory notes, the debtors executed a security agreement with the FmHA in June 1979. The agreement described the collateral as follows: "Item 3. All livestock now owned or hereafter acquired by Debtor, together with all increases, replacements, substitutions, and additions, thereto."[10]

The security agreement between the bank and the debtors included an attached list describing various livestock pledged as collateral by the debtors, including "10 Donar [sic] Cows Brangus."[11] The description was accompanied by the following provision: "This security interest also includes all additions and replacements to the property, along with all proceeds I might receive from the sale of the property. . . . This security interest will also secure any other or future debts of mine to you and will include any after-acquired property."[12] This language persuaded the court that the debtors had granted the bank and the FmHA security interests in the embryos produced by the debtors' cows.[13] The court reached this conclusion after determining that the language in the security agreements covered the debtors' after-acquired livestock.[14]

The court found the language was sufficient to include the embryos based upon the UCC's acknowledgment and approval of security agreements that provide that obligations will be secured by after-acquired collateral.[15] An after-acquired clause may be used to cover an entire herd without specific identification of each animal. As a debtor acquires new livestock by birth or purchase, the after-acquired property clause automatically covers these additions. Thus, security agreements between farm lenders and debtors engaged in livestock breeding operations often include general descriptions of livestock as collateral.[16]

The language in the security agreements also persuaded the court that the debtors intended to give a security interest in the increase of the debtors' herd. "Increase" was defined by the court as including the issue or offspring of animals.[17] Therefore, the court deduced, the embryos were clearly increases; the fact that Granada purchased these increases prior to birth of the calves did not change the nature of the basic contractual relationship.[18]

10. *Id.* at 996.

11. *Id.*

12. In addition, the security agreement provided that:

> This security interest also includes all *additions*, replacements, *increases* in the property and *after-acquired property*. Also included in this security interest will be *proceeds from the sale of property*. . . . If the property I have pledged as security includes livestock, I grant to the bank a security interest in all *increases* in that livestock.

Id. at 996-97 (emphasis added).

13. 739 P.2d at 997.

14. *Id.* at 996.

15. *Id.* at 997.

16. *See, e.g.*, United States v. Southeastern Miss. Livestock Farmers Ass'n, 619 F.2d 435 (5th Cir. 1980); *In re* Malzac, 14 U.C.C. Rep. Serv. (Callaghan) 1223 (D. Vt. 1974); Bartle Bros. v. Billings, 68 Wis. 2d 80, 227 N.W.2d 673 (1975).

17. 739 P.2d at 997.

18. *Id.*

In addition, the court found that the Uniform Commercial Code's definition of goods includes "the unborn young of animals." However, in reaching this conclusion, the court relied on the 1981 version of section 2-105. In 1984, section 9-105 was revised to delete this portion of the definition of goods. Assuming this was not an unintended deletion by the Oklahoma legislature, the court's rationale should have ended here. If the UCC does not recognize "unborn young" as goods in a secured transaction, then no security interests in the embryos could have passed to either the FmHA or the bank. Nevertheless, the court found that the security agreements signed by the debtors reasonably described this collateral and, therefore, the first requirement under section 9-203 for attachment of the security interests was met.[19]

The court next addressed the third requirement for the attachment of a security interest, noting that before any interest in the embryos could have passed from the debtors to Granada, the debtors had to have rights in the collateral.[20] Because goods must be both existing and identified before any interest in them can pass,[21] the court had to determine when the embryos fulfilled these characteristics. In the case of the sale of unborn young, identification of goods to a contract occurs "when the young are conceived."[22] The court concluded that the embryos were identified to the contract when they "came into existence."[23] Thus, this right or interest was then passed by the debtors to Granada under the terms of their contract. The court did not address the question of when the debtors' rights in the embryos were actually transferred to Granada.[24] When the debtors acquired rights in the embryos, the last event necessary in order for attachment of the security interest of the bank in the embryos occurred.[25]

The second issue addressed by the court was whether the security interest extended to payments received by the debtors for the embryos.[26] Because proceeds include anything received upon the sale of collateral,[27] and a creditor whose security interest in the collateral has attached is given an interest in the proceeds,[28] the court found that the language of the security agreement plainly included the right to these proceeds.[29]

Impact

In *Fairview State Bank v. Edwards*, the Oklahoma Supreme Court addressed an issue never addressed by any court and has, understandably, left many

19. The debtors conceded that value in the form of loans was given by the bank and the FmHA as consideration for the security agreements and promissory notes. Thus, the second requirement for attachment under § 9-203 was also met. *Id.*

20. *Id.* at 999.

21. 12A OKLA. STAT. § 2-105 (1981).

22. *Id.* § 2-501.

23. 739 P.2d at 998.

24. *Id.* at 999.

25. 12A OKLA. STAT. § 9-203(1)(2) (Supp. 1984).

26. 739 P.2d at 999.

27. 12A OKLA. STAT. § 9-206 (Supp. 1984).

28. *Id.* § 9-203(3).

29. 739 P.2d at 999.

questions unanswered. The court determined that embryos can be "reasonably" described as collateral through an after-acquired property clause minimizing the necessity of specific identification and rendering general descriptions sufficient. This allows the court to find that embryos are adequately described either as increases or goods. However, the court's reasoning is questionable. The definition of increase as the issue or offspring of animals cannot reasonably include embryos. Issue or offspring are merely products of embryos. Likewise, the definition of goods to which a security interest attaches under UCC section 9-105 does not even include the "unborn young" of animals. It is surprising that the court relies on section 9-105 throughout the decision until it begins searching for a definition of goods that will include embryos. Nevertheless, the description of embryos in the security agreements between the debtors and their creditors were approved by the court as adequate and will suffice in the future to secure an interest in this type of transaction.

This opinion also impacts third party purchasers, such as Granada. If the debtors' sale to Granada was an unauthorized disposition of the collateral, Granada took the embryos subject to FmHA's security interest. Consequently, secured creditors may now have a cause of action against third party embryo purchasers for replevin. Because the transfer of cattle embryos is a new and evolving area in agricultural law, it is important to understand when embryo transfers will be included in a description of goods in a security agreement covering livestock, what an adequate description of goods entails, and the legal effect of transferring this type of collateral.

Other significant questions that must be addressed in the future will be whether the "offspring" is the "property" of the owner of the donor cow that provided the ovum or the owner of the recipient cow that carried the embryo to birth; whether the owner is, in fact, the bull's owner or the cow's owner; and whether the process of uniting ovum and sperm creates a manufactured product.