



## An Agricultural Law Research Article

### **A Potpourri of Agricultural U.C.C Issues: Attachment, Real Estate-Growing Crops and Federalization**

by

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# A POTPOURRI OF AGRICULTURAL U.C.C. ISSUES: ATTACHMENT, REAL ESTATE-GROWING CROPS AND FEDERALIZATION

*Keith Meyer\**

## *Attachment*

Personal property secured transactions involve a two-step process: (1) Attachment must occur<sup>1</sup> and (2) the security interest created may be perfected.<sup>2</sup> Attachment makes the security interest enforceable against the debtor<sup>3</sup> and against unsecured creditors and certain purchasers.<sup>4</sup> A properly created security interest is effective between the parties whether or not it is perfected.<sup>5</sup> Perfection, however, is required for the security interest to be effective against perfected secured creditors, most purchasers of the collateral subject to the security interest, and the trustee in bankruptcy.

Section 9-203 of the Uniform Commercial Code (U.C.C.) defines the requirements of attachment. The three requirements of section 9-203(1) are: (1) The debtor must sign an agreement adequately describing the collateral unless the collateral is in the possession of the secured party pursuant to agreement, (2) value must be given, and (3) the debtor must have rights in the collateral.<sup>6</sup> Each of these requirements will be considered.

## *Agreement*

There must be an agreement<sup>7</sup> creating a security interest in the

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1. See U.C.C. § 9-203 (1988).

2. See U.C.C. § 9-303 (1988).

3. See U.C.C. §§ 9-201, 9-502, 9-503 (1988).

4. See U.C.C. §§ 9-201, 9-307(2) (1988). *But see* § 9-301(1)(c) (1988).

5. See U.C.C. §§ 9-501, 501-03; *In re Pubs, Inc. of Champaign*, 618 F.2d 432 (7th Cir. 1980); *State v. Eagle Petroleum Co.*, 261 Iowa 58, 153 N.W.2d 115 (1967); *Kansas State Bank v. Overseas Motorsport, Inc.*, 222 Kan. 26, 563 P.2d 414 (1977). For a general discussion of attachment, see Meyer, "Crops" as Collateral for an Article 9 Security Interest and Related Problems, 15 U.C.C. L.J. 3, 11 (1982).

6. U.C.C. § 9-203(1) (1988).

7. See U.C.C. §§ 1-201(3), 9-105(1) (1988).

particular collateral. This agreement must be in writing when the debtor has possession of the collateral.<sup>8</sup> The writing requirement provides an evidentiary record of what the parties intended the collateral to be and it satisfies the Statute of Frauds. Even if an oral agreement is appropriate, the best practice is to have a written security agreement. For example, consider the opportunity given in sections 1-102(3) and 9-207 to contractually define the duties of the secured party in possession.

If a written agreement is required, which is generally the case, it must contain a description of the collateral.<sup>9</sup> The purpose of the description in the security agreement is to evidence the agreement and to create a security interest in the collateral. The description therefore, must make it possible to identify the collateral involved. The benchmark section 9-110 provides that: "For the purposes of this Article [9] any description of personal property or real estate is sufficient whether or not it is specific if it reasonably identifies what is described."<sup>10</sup>

Numerous courts have resolved disputes concerning poorly drafted security agreements. Almost all of this litigation could be avoided if drafters of security agreements were more careful. It is crucial that drafters of security agreements clearly designate the collateral to be covered.

The collateral need not, and should not, be described in U.C.C. terms. Rather, collateral should be described in terms so that any non-lawyer or nonloan officer will know what property the parties intended to be subject to the security interest. As part of closing procedure, each party should be asked what property of the debtor the secured party is entitled to if the debtor defaults. Thus, if the bank is going to take a security interest in all of the debtor's hens and eggs in his egg production business, the security agreement should describe the collateral "as all hens and eggs presently owned and after-acquired," rather than "all farm products" or "all inventory and equipment."<sup>11</sup>

Generic descriptions may present problems of their own. For example, in *In re Laminated Veneers*,<sup>12</sup> the security agreement specifically described an International truck and this description was followed by a general provision which stated: "In addition all the above enumer-

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8. See U.C.C. § 9-203(1)(a) (1988).

9. *Id.*

10. U.C.C. § 9-110 (1988).

11. See *In re K.L. Smith Enters., Ltd.*, 2 Bankr. 280 (Bankr. D. Colo. 1980); see also *In re Northeast Chick Serv., Inc.*, 43 Bankr. 326 (Bankr. D. Mass. 1984).

12. 471 F.2d 1124 (2d Cir. 1973).

ated items, it is the intention that this mortgage shall cover all chattels, machinery, equipment, tables, chairs, work benches, factory chairs, stools, shelving, cabinets, power lines . . . at the plant of [debtor] . . . ." <sup>13</sup> The issue in *Laminated Veneers* was whether two cars used in the business, but not specifically mentioned, were covered by the term "equipment" in the security agreement. The majority held that they were not.<sup>14</sup> Use of the specific description, "International truck", preceding the general provision had a limiting effect on the generic description.

On the other hand, specific description security agreements may pose problems for creditors. If the debtor is giving an interest only in specific property, the lender must police the collateral and amend the security agreement when the nature of the debtor's collateral changes. Courts confronted with description controversies have developed some general rules have been developed to resolve contract construction issues.<sup>15</sup> Courts are generally unwilling to second guess unambiguous descriptions by considering the conduct of the parties.<sup>16</sup> Vague or imprecise terms in the security agreement normally are construed against the drafter.<sup>17</sup> Formal "granting" language in the security agreement usually is not necessary.<sup>18</sup> If the creditor asserts that a financing statement should serve as both the security agreement and financing statement, then granting language will be necessary. A financing statement alone cannot double as a security agreement unless it objectively shows an agreement by debtor to grant creditor rights in the collateral.<sup>19</sup> Other documents, however, may be read together with the financing statement to form an adequate security agreement under the so-called composite document theory.<sup>20</sup>

Three cases deserve special attention. In *Landen v. Production*

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13. *Id.* at 1125 n.1.

14. *But see In re Sarex Corp.*, 509 F.2d 689 (2d Cir. 1975).

15. *Borg-Warner Acceptance Corp. v. First Nat'l Bank*, 307 Minn. 20, 238 N.W.2d 612 (1976) (evidence of parties' conduct is inadmissible); *In re Sarex Corp.*, 509 F.2d 689 (2d Cir. 1975) (reliance on purely generic terminology may be insufficient).

16. *Borg-Warner Acceptance Corp.*, 307 Minn. at 25, 238 N.W.2d at 615.

17. *See, e.g., In re Hunerdosse*, 85 Bankr. 999 (Bankr. S.D. Iowa 1988).

18. For cases addressing "granting language," see *Transport Equip. Co. v. Guaranty State Bank*, 518 F.2d 377 (10th Cir. 1975); *In re Amek-Protein Dev. Corp.*, 15 U.C.C. Rep. Serv. (Callaghan) 286 (9th Cir. 1974); *Kaiser Aluminum and Chem. Sales v. Hurst*, 176 N.W.2d 166 (Iowa 1970); *In re Tile Unlimited Inc.*, 8 U.C.C. Rep. Serv. (Callaghan) 750 (W.D. Wis. 1971).

19. *See, e.g., In re Bossingham*, 42 U.C.C. Rep. Serv. (Callaghan) 1766, 49 Bankr. 345 (Bankr. S.D. Iowa 1985).

20. *Transportation Equip. Co. v. Guaranty State Bank*, 518 F.2d 377 (10th Cir. 1975); *In re Tile Unlimited, Inc.*, 8 U.C.C. Rep. Serv. (Callaghan) 750 (W.D. Wis. 1971).

*Credit Ass'n of the Midlands*,<sup>21</sup> the Supreme Court of Wyoming was confronted with a security agreement that contained a description different than the one used in the financing statement. Specifically, the security agreement stated that it covered "2569 head of cattle branded . . . on the left hip and more particularly described as 1172 Cows, 889 Calves . . . ." <sup>22</sup> The financing statement's description covered "all of debtor's livestock."<sup>23</sup> The court held that where the descriptions of collateral in a financing statement and a security agreement differ, the description in the security agreement controls for attachment purposes. Because the security agreement is a contract between the parties, greater particularity in the description of the collateral is required than in the financing statement which is merely intended to be a means of putting third parties on notice of a possible security interest in collateral. If the descriptions were reversed, however, with the security agreement covering all of debtor's livestock of whatever kind and the financing statement describing the collateral as a specific number of animals, the secured party would have a security interest in all livestock but would be perfected only as to the specific number described in the Uniform Commercial Code.<sup>24</sup>

Another description problem which frequently arises is whether the security agreement must refer to after-acquired property. Section 9-204(1) provides: "Except as provided in subsection (2), a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral."<sup>25</sup> The use of the permissive term "may" means that an after-acquired property clause is enforceable and if secured parties want to rely upon after-acquired property they may do so. It is not precatory in the sense that after-acquired property clauses are optional if a secured creditor wants to claim a security interest in after-acquired property. This is consistent with the security agreement function of memorializing the parties' intent as to what collateral secures the debtor's promise to perform.

The general rule, therefore, is that the security agreement must include an after-acquired property clause if the parties intend after-acquired property to be made subject to a security interest. If the security agreement does not include an after-acquired clause, it is possi-

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21. 737 P.2d 1325 (Wyo. 1987).

22. *Landen*, 737 P.2d at 1327.

23. *Id.* at 1328.

24. U.C.C. § 9-402(1) (1988).

25. U.C.C. § 9-204(1) (1988).

ble, assuming the facts support it, for the secured party to argue prior course of dealing and usage of trade under section 1-205 to show that the parties intended after-acquired property to be collateral.

*In re Engle*<sup>26</sup> considered the situation where financing statements did not include any reference to after-acquired property of the secured creditor. The security agreement, however, covered after-acquired livestock and equipment. The bankruptcy trustee in *Engle* argued that the secured creditor did not have a perfected security interest in the debtor's after-acquired property. The court correctly adopted the view that there is no need to refer to after-acquired property or future advances in the financing statement because of comment 5 to U.C.C. section 9-204(1) which states: "The effect of after-acquired property and future advance clauses in the security agreement should not be confused with the use of financing statements in notice filing. The references to after-acquired property clauses and future advance clauses in section 9-204 are limited to security agreements . . . . There is no need to refer to after-acquired property or future advances in the financing statement."<sup>27</sup> The financing statement need only identify the "type" of collateral.<sup>28</sup>

Another relevant case concerning security agreement descriptions is *Charles v. Fidelity State Bank and Trust Co.*<sup>29</sup> The security agreement, made in January, 1982, described the collateral as, *inter alia*, "All growing crops . . . [and] any and all increases, additions, accretions, substitutions and proceeds therefore."<sup>30</sup> This description did not give the lender a security interest in crops to be planted in the future. Specifically, the court noted that the security agreement did not contain the statement "crops growing or to be grown," which is needed for the agreement to cover crops to be produced in the future.<sup>31</sup>

### Value

The second requirement for attachment is that value be given. "Value" is defined in 1-201(44) which states: "[A] person gives 'value'

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26. 73 Bankr. 870 (Bankr. E.D. Pa. 1987).

27. U.C.C. § 9-204 (1) comment 5 (1988).

28. U.C.C. § 9-204(1) (1988). Remember that under 11 U.S.C. §§ 547(b) and 547(c)(3) (1989), after-acquired property obtained within 90 days of bankruptcy may be attacked by the trustee. There is an exception for farm products because farm products are inventory under 11 U.S.C. §§ 547(a) and 547(c)(5) (1989).

29. 4 U.C.C. Rep. Serv. 2d (Callaghan) 259 (D. Ct. Kan. 1987).

30. *Id.* at 261.

31. *Id.*

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 claim . . . or (d) generally, in return for any consideration sufficient to support a simple contract".<sup>32</sup> Because the definition of value is so broad, this requirement normally is not a problem.

### *Rights in the Collateral*

The third and final requirement for attachment is that the debtor have rights in the collateral.<sup>33</sup> This requirement may only be stating the obvious, but the phrase "rights in the collateral" is not defined in the Code. 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 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. In general, it appears that the debtor must have the "power" to create a security interest.

Because the term "rights" is not defined, other Code sections are relevant. For example, section 1-103 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."<sup>34</sup> Thus, the debtor can obtain the power to create a security interest through any of the bodies of law set out in section 1-103. Also, under section 2-403(1)(b), purchasers are granted greater rights than their transferor had. Further, because secured parties are treated as purchasers under sections 1-201(32) and (33), a secured party has the status of a purchaser under section 2-403.

This "rights" issue is a potential problem in several agricultural lending situations. One such situation involves a farmer that leases some or all of the land he farms and who pledges the crops produced on this leased land as collateral. His rights in the growing crops on this leased land will be determined by the type of lease involved. If a cash lease is involved, the debtor farmer has an interest in all of the crops

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32. U.C.C. § 9-203(1)(c) (1988).

33. *Id.*

34. U.C.C. § 1-103 (1988).

grown on the leased land. However, the farmer with a crop-share lease has the power to create a security interest only in that portion of the crops that he is entitled to under the crop-share lease.<sup>35</sup>

Another situation where the rights issue becomes relevant is when a farmer rents his land to a chicken breeder or seed company and then uses the chickens or eggs or grain as collateral. *Germany v. Farmers Home Admin.* considers such a fact situation.<sup>36</sup> Debtor, a farmer, and a chicken breeder entered into an egg production agreement which provided that: 1) the farmer would keep the breeder's chickens and collect the eggs; 2) title to the chickens would remain in breeder who could remove them if the farmer failed to perform his duties; and 3) the farmer would be paid an amount for each chicken he maintained and another amount for each egg that the breeder picked up. Before going bankrupt, the farmer assigned one-half of his income from this contract to the Farmers Home Administration (FmHA). FmHA claimed the assignment was protected from the trustee in bankruptcy because the FmHA had a security interest in "farm products". The court concluded that ownership never rested with the debtor farmer because he had no rights in the collateral; all that the debtor had was a services contract terminable at the will of the breeder. At best, FmHA merely had an interest in the farmer's contract for services. FmHA did not assert that it relied upon the farmer's apparent ownership or lacked notice of the breeder's arrangement with the farmer. Moreover, nothing in the case indicated that FmHA checked the public records to determine if the breeder had filed a financing statement. Arguably, the farmer and breeder had a bailment relationship. Some courts have held against the bailor (breeder) "where the debtor gains possession of collateral pursuant to an agreement endowing him with any interest other than naked possession."<sup>37</sup> Apparently FmHA had no way to determine from public records who owned the birds and the eggs. This same problem may arise when a seed company contracts with a farmer to raise, on farmer's land, seed grain. These contracts may also be referred to as bailments because they provide that the seed will be furnished by the company and the seed crop produced will at all times be the property

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35. See, e.g., *Finley v. McClure*, 22 Kan. 637, 567 P.2d 851 (1977); KAN. STAT. ANN. §§ 58-2525 and 59-1206 (1986). But see *Metropolitan Life Ins. Co. v. Reeves-Gustafson*, 228 Neb. 233, 422 N.W.2d 72 (1988). Crops should be treated as personal property rather than part of the real estate, thus the lease should not affect the landowner's interest in growing crops for which it he paying all of the input costs. *Id.*

36. 73 Bankr. 19 (Bankr. S.D. Miss. 1986).

37. *Morton Booth Co. v. Tiara Furniture, Inc.*, 564 P.2d 210, 214 (Okla. 1977). See also *Kinetics Technology Int'l Corp. v. Fourth Nat'l Bank*, 705 F.2d 396 (10th Cir. 1983).



of the seed company.

The rights issue may also arise when the debtor is a commercial feedlot operator because animals in the facility often will be owned by people who have hired the operator to fatten them. The Oklahoma Court of Appeals considered this issue in *National Livestock Credit Corp. v. First State Bank of Harrah*,<sup>38</sup> and concluded that the feedlot-debtor cannot create a security interest in animals that they do not own but hold as bailee for the limited purpose of fattening. Thus owners of cattle being fattened should make sure their animals are clearly identifiable by utilizing, for example, particular ear tags or brands.

Again, the often difficult distinction between ownership and mere possession potentially may mislead the bailee's creditors, as was discussed in the above cases involving farmers who produce eggs and seed grain. Thus, it is important to examine just how much control the feedlot operator has. If the operator, for example, is authorized to sell the animals without consulting the owner and there is no specific identification of the animals, the debtor may have the power to create a security interest in animals that do not belong to him.

*In re Cook*<sup>39</sup> is another case in which the debtor did not own the collateral. Even though the nondebtor son in *Cook* held title in cattle claimed by the secured party, this fact was not dispositive as to whether his debtor parents, who had possession of the cattle, had rights sufficient to grant a security interest in the cattle. The debtor may possess 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 parties' intent is a key factor in determining whether sufficient rights exist and the lender has the burden of proving this element.

A final example of rights involves those gained by virtue of section 2-403(1)(b). In this situation a farmer delivers and sells grain to an elevator and receives a bad check from the elevator. The lender has a perfected security interest in the inventory of the elevator, which consists of company owned grain. Does the elevator have sufficient rights

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38. 503 P.2d 1283 (Okla. Ct. App. 1972).

39. 63 Bankr. 789 (Bankr. D. N.D. 1986). *But see* Thorp Credit v. Wunchter, 412 N.W.2d 641 (Iowa 1987). *See also In re Atchison*, 832 F.2d 1236 (11th Cir. 1987). Owner personally signed the security agreement on behalf of the corporation and the equipment that he owned was being used by the corporation in operation of the corporation business. Owner's permission to use his goods as collateral gives the debtor (corporation) sufficient rights for attachment purposes. The court noted that tests employed by courts to define rights include: 1) owner's permission to use goods as collateral gives debtor sufficient rights to create a security interest; 2) the debtor's right to use and control the collateral gives the debtor sufficient rights to create a security interest. *Id.*

in the collateral so that the lender's security interest will attach to the grain purchased with a bad check? A number of cases relying on section 2-403(1)(b), which gives the elevator voidable title and the power to transfer a good title to a good faith purchaser for value, have held that it does. Because the definition of "purchaser" in sections 1-201(32) and (33) includes a secured party, generally the only question is whether the secured party acted in good faith.<sup>40</sup>

Suppose instead that the Farmer forwards cash contracts with a local elevator to deliver 5000 bushels of wheat. The wheat is growing on Farm X. Farmer then grants the Bank a security interest in the wheat growing on Farm X. Farmer probably has rights in the wheat sufficient to create a security interest, notwithstanding the forward cash contract, because forward cash contracts normally do not identify specific crops from specific land.<sup>41</sup> Also note that title will not pass to the elevator until delivery pursuant to section 2-401; both the buyer and the seller have insurable interests in goods identified to the contract under section 2-501; and nothing in Article 2 impairs the rights of a secured creditor.

### *Real Estate Related Collateral and Article 9*

Pure real estate transactions are not covered by Article 9 of the U.C.C. However, application of Article 9 may arise when installment land contracts are used as collateral for a loan or when crops subject to a security interest are growing on land encumbered by a real estate mortgage.

The U.C.C. sections relevant to such situations are 9-102(1)(a), 9-102(3), and 9-104(j). Section 9-102 provides:

(1) Except as otherwise provided in Section 9-104 on excluded transactions, this Article applies (a) to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper or accounts . . .

(3) The application of this Article to a security interest in a secured

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40. See *Samuels & Co. v. Mahon*, 526 F.2d 1238 (5th Cir. 1976), *cert. denied*, 429 U.S. 834 (1976); *Swets Motor Sales, Inc. v. Pruisner*, 236 N.W.2d 299 (Iowa 1975); *In re McLouth Steel Corp.*, 22 B.R. 722 (Bankr. E.D. Mich. 1982); *In re Western Farmers Ass'n*, 6 B.R. 432 (Bankr. W.D. Wash. 1980).

When poultry, livestock or perishable commodities are involved the unpaid producer is given priority over the perfected secured creditor of the buyer. See generally 7 U.S.C. §§ 196(b), 197(e) (1989).

41. See *In re Sunriver Farms, Inc.*, 27 Bankr. 655 (Bankr. D. Or. 1982).

obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this Article does not apply.

Section 9-104(j) states:

This Article does not apply . . . except to the extent that provision is made for fixtures in Section 9-313, to the creation or transfer of an interest in or lien on real estate, including a lease or rents thereunder . . . .

The installment contract issue arises when a real estate seller (debtor) assigns rights in installment payments under a contract for deed or an installment sales contract to a lender as security for a loan. Two types of collateral are involved: The flow of payments and the seller's interest in the real estate. Most courts have concluded that the flow of payments is personal property and thus Article 9 applies.<sup>42</sup> Under the Code, the flow of payments could be classified as a general intangible,<sup>43</sup> an account,<sup>44</sup> or payments from a negotiable instrument.<sup>45</sup> Security interests in general intangibles and accounts, in most states, are perfected by filing.<sup>46</sup> Therefore, the safest approach for the lender is to execute a security agreement and file a financing statement describing the collateral as the flow of payments from the installment land contract between seller and buyer and take possession of the in-

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42. This result is supported by the U.C.C. Cases supporting this are: *Greiner v. Wilke*, 625 F.2d 281 (9th Cir. 1980); *Frearson v. Wingold*, 617 F.2d 1152 (5th Cir. 1980); *In re Anselmi*, 52 Bankr. 479 (Bankr. D. Wyo 1985) (right to receive payments under a contract for deed is personal property); *In re Northern Acres, Inc.*, 52 Bankr. 641 (Bankr. E.D. Mich. 1985) (security interest in a flow of payments is subject to the U.C.C., *distinguishing In re Hoepfner*, 49 Bankr. 124 (Bankr. E.D. Wis. 1985)); *In re Preston*, 52 Bankr. 296 (Bankr. M.D. Tenn. 1985) (assignment of beneficial interest in a trust of land is subject to the U.C.C.); *In re Himlie Properties, Inc.* 36 Bankr. 32 (Bankr. W.D. Tex. 1983); *Landmark Land Co. v. Sprague*, 529 F. Supp. 971 (S.D.N.Y. 1981), *rev'd* on other grounds, 701 F.2d 1065 (2nd Cir. 1983); *In re Staff Mortgage & Inv. Corp.*, 625 F.2d 281 (9th Cir. 1980); *In re Equitable Dev. Corp.*, 617 F.2d 1152 (5th Cir. 1980); *Crichton v. Himlie Properties*, 105 Wash. 2d 191, 713 P.2d 108 (1986) (flow of payments under real estate contract are general intangibles); *In re Freeborn*, 617 P.2d 424 (Wash. 1980). *But see In re Shuster*, 784 F.2d 883 (8th Cir. 1986); *Peoples Bank v. McDonald*, 743 F.2d 413, 416-17 (6th Cir. 1984); *In re Hoepfner*, 49 Bankr. 124 (Bankr. E.D. Wis. 1985) (specifically rejects *Freeborn* and follows *Bristol*, holding that neither a land contract nor an assignment of a seller's interest thereunder is subject to Article 9); *Rucker v. State Exch. Bank*, 355 So.2d 171 (Fla. App. 1978). *Cf. In re Bristol Assocs., Inc.*, 505 F.2d 1056 (3rd Cir. 1974).

Negotiable instruments can only be perfected by possession. U.C.C. sections 9-304(1), 9-105(1)(i) (1988).

43. U.C.C. § 9-106 (1988) (defines general intangibles).

44. U.C.C. § 9-106 (1988) (defines accounts).

45. U.C.C. §§ 9-105 (1)(i), 3-104 (1988).

46. *See* U.C.C. § 9-401(1) (1988).

stallment land contract, should it be considered a negotiable instrument.<sup>47</sup> The lender should also execute a real estate agreement (e.g., a mortgage) and record it in the real estate records. This enables the lender to claim the real estate if the buyer defaults on the land contract and the debtor defaults on the secured loan.

Questions of Article 9 application also arise when a lender takes as collateral all the debtor's rights in certain promissory notes or deeds of trust and real estate mortgages. Comment 4 to section 9-102 makes clear that the drafters of the Code intended Article 9 to apply only to that collateral unrelated to real property, generally promissory notes. The lender must take possession of the promissory notes because they are instruments,<sup>48</sup> and the only way to perfect an interest in instruments is by possession.<sup>49</sup> Conversely, the deed of trust or real estate mortgages represents an interest in real estate so Article 9 does not apply. Thus, real estate recording requirements must be satisfied.<sup>50</sup>

### *Real Estate Foreclosures and Security*

#### Interests in Unsevered Crops

Prior to adoption of the U.C.C., one who purchased real estate with growing crops obtained those crops with the land absent an agreement to the contrary. The unsevered crops were considered part of the realty and thus passed to the purchaser.<sup>51</sup> Moreover, many cases held that unsevered crops at the time of a real estate foreclosure were part of the real estate and passed with the land at the foreclosure.<sup>52</sup>

The question of whether or not these rules still apply is raised when a vendor sells land on contract and then repossesses the land containing growing crops which are subject to a properly perfected security interest created by the evicted farmer-vendee. The Court of Appeals for the Eighth Circuit considered this issue in *United States v. New-*

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47. Negotiable instruments can only be perfected by possession. See U.C.C. § 9-304(1) (1988).

48. U.C.C. § 3-104 (1988).

49. U.C.C. §§ 9-105 (1)(i), 3-104 (1988).

50. See, e.g., *In re Maryville Sav. & Loan Corp.*, 743 F.2d 413 (6th Cir. 1984). For an excellent article on the law relating to mortgages, see Kransnowiecki, *The Kennedy Mortgage Co. Bankruptcy Case: New Light Shed on the Position of Mortgage Warehousing Banks*, 56 AM. BANKR. L.J. 325 (1982).

51. See, e.g., *Singh v. Banes*, 277 P.2d 89 (Cal. 1945). Cf. *Kroh v. Dobson*, 37 N.W.2d 144 (1949). See Scheider, *The Ownership of Growing Crops: The Continuing Struggle Between Property Law and the Uniform Commercial Code*, 8 J. AGRIC. TAX'N & LAW 99 (1986).

52. See, e.g., *Holdsworth v. Key*, 520 S.W.2d 637 (Mo. Ct. App. 1975).

*comb*.<sup>53</sup> In May of 1977, Newcomb sold land on a "contract for deed" to the Rushes. The contract apparently contained no reference to crops. One year later, the Rushes executed and delivered to the FmHA a promissory note, security agreement and a financing statement, in which the FmHA was granted a security interest in the crops to be grown on the land. In August 1978, the Rushes were evicted from the land for failure to make the contract payments. At the time of the eviction, the soybean crop, subject to FmHA's perfected security interest, was growing on the land. Newcomb harvested the crop, sold the beans and retained the proceeds.

In an action to recover the proceeds, the court held for the FmHA, concluding that Article 9 applied and that growing crops are personal property, not part of the real estate. Therefore, because Newcomb failed to comply with the requirements of Article 9 in order to create a security interest in the crops, he lost to a secured party.

This decision is supported by an analysis of Article 9. As the above-quoted provisions of section 9-102(1)(a) indicate, Article 9 applies "to any transaction which is intended to create a security interest in personal property . . . including goods . . ."<sup>54</sup> The definition of "goods" includes growing crops.<sup>55</sup> Additionally, a specific reference to growing crops is found in section 9-203, dealing with attachment and enforceability of security interests. Another indication that crops are separate and distinct from real estate is found in the comments to section 9-402, which indicate that a real estate record filing is not necessary for crops.<sup>56</sup> Consequently, it seems clear that the drafters of the code and the legislatures that have adopted it intended growing crops to be considered personal property.

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53. 682 F.2d 758 (8th Cir. 1982).

54. U.C.C. § 9-102(1)(a) (1988).

55. U.C.C. § 9-105 (1988).

56. Comment 1 to U.C.C. § 9-402 provides in part:

Where the collateral is crops growing or to be grown or when the financing statement is filed as a fixture filing (Section 9-313) or when the collateral is timber to be cut or minerals or the like (including oil and gas) financed at wellhead or minehead or accounts resulting from the sale thereof, the financing statement must also contain a description of the lands concerned. For crops it is merely part of the description of the crops concerned, and the security interest in crops is a Code Security interest, like the pre-Code "crop mortgage" which was a chattel mortgage. In contrast, in the other cases mentioned the function of the description of land is to have the financing statement filed in the county where the land is situated and in the realty records, as distinguished from the chattel records. Subsection (3) suggests a form which complies with the statutory requirements and makes clear that for the types of collateral mentioned other than crops, the financing statement containing a description of the land concerned is to go in the realty records . . .

Because security interests created in growing crops are governed by Article 9, the attachment, perfection, and priority rules apply to any party claiming an interest in crops, whether severed or not. As a result, any party claiming the unsevered crops as part of the real estate will have no possibility of defeating a properly perfected secured party unless the crops are specifically referred to in the real estate mortgage or installment contract *and* a proper Article 9 financing statement is properly filed.<sup>57</sup> Moreover, if the installment land contract does not mention growing crops, it is fair to assume that the parties only intended the land to be covered and did not intend to cover any type of crops (growing or harvested). Under basic contract law no meeting of the minds occurred and the installment contract cannot be construed to cover growing crops.

A question concerning the applicability of Article 9 arises when a real estate mortgagee claims the crops upon default by the mortgagor. Inasmuch as this is very similar to a land contract, the analysis applied in *Newcomb* is applicable.

Unlike the fixture financier who can perfect by complying with the real estate law,<sup>58</sup> the real estate mortgagee, similar to the installment land vendor, must comply with Article 9 to claim a security interest in growing crops, crops to be grown, or harvested crops. This means that the real estate mortgage must satisfy the requirements of sections 9-203 and 9-110 and, to be protected against third parties, the real estate financier must file an appropriate U.C.C. Article 1 in the proper place. Thus, if the real estate mortgage specifically covers crops but the real estate mortgagee does not comply with Article 9 filing requirements and the farmer files a bankruptcy petition, the trustee in bankruptcy can avoid the interest under the so-called strong arm clause of 11 U.S.C. section 544(a)(1).<sup>59</sup>

Almost all real estate mortgages have boiler plate language buried in a "rents, profits and issues clause" which purports to give the mortgagee a claim to any rents, profits and issues produced from the land subject to the mortgage. Scope questions arise again when (1) the real estate mortgagee claims the mortgagor farmer's growing crop under this clause or when (2) the mortgagor farmer has leased the land to a

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57. For thorough discussion of crops as collateral for a security interest, see Meyer, "Crops" as Collateral for an Article 9 Security Interest and Related Problems, 15 U.C.C. L.J. 3 (1982).

58. See U.C.C. § 9-402(6) (1988); Coogan & Clovis, *The Uniform Commercial Code and Real Estate Law: Problems for Both the Real Estate Lawyer and the Chattel Security Lawyer*, 38 IND. L.J. 535, 547-48 (1963).

59. See also U.C.C. §§ 9-301(1)(b), 9-301(3).

tenant and the mortgagee claims the rent under this clause. In the first situation, Article 9 applies because crops are personal property. A much more complex problem is presented when a lease is involved.

Section 9-104(j) provides that Article 9 does not apply to "the creation or transfer of an interest in or lien on real estate, including a lease or rents thereunder . . . ."<sup>60</sup> However, to adequately analyze whether Article 9 applies when a real estate mortgagor has leased the land, it is essential to determine if a cash lease or crop-share lease is involved. In a typical crop-share lease, the rent is paid in a certain proportion of the crops produced on the land and the landlord normally pays part of the production expenses such as seed, fertilizer and other chemicals, as well as all of the real estate taxes.

A variety of cash leases exist. Under straight cash leases the rent is either a fixed number of dollars per acre or a fixed amount for the entire piece of land, payable either in installments or in a lump sum. Flexible cash leases exist, where the amount of cash rent varies according to production conditions and/or crop prices. Hybrid-cash leases, which have some elements similar to those found in crop-share leases, include the cash value of a set number of bushels or guaranteed bushel leases where the tenant agrees to deliver a set amount of a certain type of grain to the land owner by a certain date.

The most difficult part of this inquiry is presented when the farmer leases to a tenant, on a 50-50 crop share basis,<sup>61</sup> a portion of land subject to a real estate mortgage. The farmer-landlord then borrows money from a bank which obtains a perfected security interest in the landlord's share of the crop under the lease with the tenant. The farmer-landlord defaults on both loans when the crops are growing on the land. The real estate lender and the bank both claim the crops due under the tenant's lease, which are personal property according to Article 9.<sup>62</sup> Clearly, the bank must comply with the attachment and perfection requirements of Article 9 to obtain a valuable security interest in the crops. The question is whether the real estate lender must also satisfy Article 9 to create such a security interest and whether Article 9 will determine priority.

For a number of reasons, I am persuaded that Article 9 applies to the real estate lender notwithstanding the section 9-104(j) exclusion of

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60. U.C.C. § 9-104(j) (1988).

61. Crop-share shares vary across the country with 50-50 arrangements being common in Illinois, Iowa, Minnesota, and Ohio. Normally, the parties will share expenses and risks pro rata in the crops produced.

62. See U.C.C. §§ 9-105(h), 9-102, 9-203, 9-402 (1988).

leases and rents thereunder. Crop-share leases are significantly different than the typical commercial apartment house, hotel or shopping center leases which were apparently the focus of the section 9-104(j) exclusion.<sup>63</sup> Compare the typical commercial lease with a crop-share farm lease. Under the normal commercial lease the landlord will not take part in the management of the tenant's business. The farm landlord, however, almost always is involved in the farm operation, participating in decisions concerning crops to be grown, credit arrangements, government programs, farm improvements, and good husbandry techniques. Commercial landlord-tenant relationships are predicated on a cash rent of the facilities where the tenant pays for the operations costs. Most crop share leases, on the other hand, provide that the landlord is to share in the cost of operations and receive a portion of the crop. Moreover, if a crop failure occurs the landowner gets nothing, as does the tenant. A crop-share lease is analogous to a partnership with each partner making a contribution and each having an undivided interest in the output of the arrangement.

Absent a specific statute or case decision, landlords with cropshare leases have rights in their share of the crop once it is planted. To be sure, a lessee has exclusive possessory rights to the land during the term absent a specific term in the lease which provides otherwise. But this does not mean the landlord has no rights in the crops. If landlord has paid for his/her percentage of cost of seed, fertilizer, and chemicals and has the same production risk as the tenant, it is difficult to conclude that the landlord has no rights in the crops growing on his/her land.

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63. Since 1952 the Note following U.C.C. § 9-102 is the scope section and since 1952 the Note following this section has provided in part:

The adoption of this Article [9] should be accompanied by the repeal of existing statutes dealing with conditional sales, trust receipts, factor's liens where the factor is given a non-possessory lien, chattel mortgages, *crop mortgages*, mortgages on railroad equipment, assignment of accounts and generally statutes regulating security interests in personal property.

U.C.C. § 902 Note (emphasis added). ALI 1956 Recommendations of The Editorial Board for The Uniform Commercial Code 156 (1956) and Selected Commercial Statutes (1988 Ed.). This would indicate that crop mortgages were different before the adoption of the U.C.C. but were to be changed after its adoption. This implies that the drafters wanted all crop mortgages covered by Article 9.

For cases dealing with U.C.C. 9-104(j) see, e.g., *United States v. Newcomb*, 682 F.2d 759 (8th Cir. 1982); *In re Standard Conveyor Co.*, 773 F.2d 198 (8th Cir. 1985); *In re Cook*, 1 U.C.C. Rep. Serv. 1660, 63 Bankr. 789 (Bankr. D. ND 1986); *Citizens Bank & Trust Co. v. Wy-Tex Livestock Co.*, 31 U.C.C. Rep. Serv. 275, 611 S.W.2d 168 (Tex. Civ. App. 1981); *Union Livestock Yards, Inc. v. Merrill Lynch*, 22 U.C.C. Rep. Serv. 523, 552 S.W.2d 392 (Tenn. App. 1976).



In many states the landowner will be considered the owner of a proportion of the crops being produced on the leased land.<sup>64</sup> Some states treat growing crops as personal property in other contexts, such as in the doctrine of emblements, decedent estates and landlord liens.<sup>65</sup> Also, under Article 9, the tenant may not create an enforceable security interest in more than his proportionate share. Furthermore, the landowner can have his share of the crop insured, can sell his crop before harvest, or use it as collateral for a loan.<sup>66</sup>

While it is customary to refer to a share of the crop under a crop-share lease as rent, it is not rent of the customary type; the rent can only come from crops produced on the leased land. Generally, the landlord has the rights in the crops the instant they are planted. Thus, because the landlord's interest is in goods, and Article 9 applies to security interests in goods, the real estate mortgagee is claiming goods in the form of rents. Since the collateral is goods,<sup>67</sup> Article 9 must apply. It seems totally illogical to permit 9-104(j) to make Article 9 inapplicable to interests in goods. It is also interesting to note that the same scope question exists if the tenant harvests the crop and stores it under the landlord's name in a warehouse and then defaults on both loans. Again, Article 9 should apply because both lenders are claiming a security interest in the goods.

Cash leases are much closer to the traditional rentals that section 9-104(j) is designed to exclude than are crop-share leases.<sup>68</sup> Yet,

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64. See, e. g., *In re Sumner*, 3 U.C.C. Rep. Serv. 2d 282 (Bankr. D. Ore. 1986) (the court held that crop-share rent under a lease was subject to Article 9 and under Oregon law the lessor and lessee in a crop-share lease both have an undivided interest in the crops).

Minnesota has an interesting approach to ownership of crops and the right to crops growing on land which has been foreclosed upon. MINN. STAT. ANN. § 557.10 (1988) provides: "Planted and growing crops are personal property of the person or entity that has the property right to plant the crops." MINN. STAT. ANN. § 557.11 (subd. 2) (1988) states: "'Planting crop owner' means the person or entity that has a property right to plant crops, including a leasehold interest, the interest of a contract for deed vendee, and the redemption interest of a foreclosed mortgagor." MINN. STAT. ANN. § 557.12 (subd. 1) (1988) provides: "If the planting crop owner's property right to harvest crops is involuntarily terminated before the crops are harvested, the person or entity with the property right to harvest the crops is liable to the planting crop owner for the crop value."

65. See, e.g., *Finley v. McClure*, 222 Kan. 637, 567 P.2d 851 (1977); KAN. STAT. ANN. §§ 58-2525, 59-1206 (1988).

66. See U.C.C. § 2-107 which deals with crops in a contract for sale. U.C.C. § 2-105 defines goods to include growing crops and buyer has an insurable interest under U.C.C. § 2-501.

67. "Goods" are defined to include growing crops in U.C.C. § 9-105(h) and a security agreement can clearly cover crops growing or to be grown. U.C.C. § 9-203(1).

68. For other cases dealing with § 9-104(j) see, e.g., *United States v. Newcomb*, 682 F.2d 759 (8th Cir. 1982); *In re Standard Conveyor Co.*, 773 F.2d 198 (8th Cir. 1985); *In re Cook*, 1 U.C.C. Rep. Serv. 1660, 63 Bankr. 789 (Bankr. D. N.D. 1986); *Citizens Bank & Trust Co. v.*

unique problems with cash leases can arise. For example, cash payments often are not paid to the landowner until the crop is harvested. To be protected, the landowner should obtain a perfected security interest from the tenant in the crops being produced on the leased land. Suppose the landowner is being financed by Bank who has a perfected security interest in any and all crops wherever produced. Landowner defaults on the real estate mortgage and tenant defaults on his cash lease when crops are growing on the land. Assuming both the real estate mortgagee and the Bank claim the crops, is the conflict resolved under Article 9? I believe it is because the property being claimed is crops. Goods are involved, so Article 9 applies. Thus, the real estate mortgagee would automatically lose unless it had a perfected security interest in the crops.

Until 1987, the cases construing section 9-104(j) did not deal with farm leases. However, three subsequent cases have addressed cash leases: *Federal Land Bank of Omaha v. Lower*,<sup>69</sup> *Metropolitan Life Insurance Co. v. Reeves-Gustafson*,<sup>70</sup> and *Anna National Bank v. Prater*.<sup>71</sup> In *Lower*,<sup>72</sup> the mortgagee executed and filed a mortgage with the Federal Land Bank (FLB). It conveyed an interest in land "together with all of the . . . rents, issues, crops, and profits arising from said lands."<sup>73</sup> The mortgage also provided for the appointment of a receiver upon default. Lowers defaulted and FLB filed a foreclosure action resulting in a foreclosure which specified that FLB's mortgage lien would be superior to any interests of the Lowers or anyone claiming through them. Despite this court order, the Lowers leased the mortgaged land for cash which was paid to them that day. The lease was recorded. Subsequently, the land was sold at a sheriff's sale, with a resulting deficiency judgment, and FLB had the court appoint a receiver. FLB then filed a suit seeking either to have the lease declared void or that the Lowers be required to pay the cash rent to the receiver. The court ordered the Lowers to account and also ordered the lessee to apply his proceeds from the rented land if the Lowers could not pay the deficiency judgment. The tenant did not appeal, but Lowers did.

The issue on appeal was "whether a mortgagor must account to a

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Wy-Tex Livestock Co., 31 U.C.C. Rep. Serv. 275, 611 S.W.2d 168 (Tex. Civ. App. 1981); *Union Livestock Yards, Inc. v. Merrill Lynch*, 22 U.C.C. Rep. Serv. 523, 552 S.W.2d 392 (Tenn. App. 1976).

69. 421 N.W.2d 126 (Iowa 1988).

70. 228 Neb. 233, 422 N.W.2d 72 (1988).

71. 506 N.E.2d 769 (Ill. App. Ct. 1987).

72. 421 N.W.2d 126 (Iowa 1988).

73. *Id.* at 127 (emphasis in original).

mortgagee's receiver for rent on encumbered land during the period between the entry of a foreclosure decree and the request for the appointment of a receiver."<sup>74</sup> FLB argued that the lien on the rents was created when the mortgage containing the rents and profits clause was executed and that Lowers conveyed an interest in the rents rather than "merely pledging them as security in the event of default."<sup>75</sup> FLB relied on cases which discussed the validity of what the court called a "chattel mortgage clause in real estate mortgages."<sup>76</sup> These cases held that clauses creating an interest in rents as primary security for indebtedness were effective from the date of execution, not appointment of a receiver.

The Lowers position was that the rents were security in the event of default, so FLB had no claim to the rents until they filed a petition for foreclosure *and* requested the appointment of a receiver. Also, the Lowers argued that the chattel mortgage cases relied on by FLB were no longer relevant because they were decided before the adoption of the U.C.C.

The court held that the mortgagee's lien on rents from encumbered land was effective from the date of execution of the mortgage, not from the time of the appointment of the receiver. The only issue then was whether the real estate mortgage was valid between FLB and the Lowers and whether it conveyed an interest in the rents as "*primary security for the indebtedness*."<sup>77</sup> If so, the lien on rents from the land subject to the real estate mortgage is effective from execution, not from appointment of the receiver. No specific definition of "primary security" appears.<sup>78</sup>

Interestingly, there is no discussion of what the parties intended when the real estate mortgage was signed. Normally, rents and profits clauses are in the boiler plate language, no specific reference is made to them at the time of closing of a real estate loan, and generally the real estate lender does not think about rentals as primary security for a farm real estate loan. Prior to the collapse of the real estate market in the early 1980's lenders were generally interested only in the real estate

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74. *Id.*

75. *Id.* at 128.

76. *Id.*

77. *Id.* at 129 (emphasis added).

78. It is interesting to compare U.C.C. § 9-502(1) which states:

When so agreed and in any event on default of the secured party is entitled to notify an account debtor or obligor on an instrument to make payments to him whether or not the assignor was theretofore making collections on the collateral and also to take control of any proceeds to which he is entitled under Section 9-306.

value. Moreover, most farm land is not rented at the time it is mortgaged to a real estate lender. Lowers, like many other farmers who were in deep financial trouble, experimented with imaginative methods to try to remain in farming. One such method is to rent the land and use the cash. It is at this point that real estate lenders become interested in rents. The court no doubt was influenced by the fact that the lease occurred after the foreclosure decree which gave FLB's mortgage lien superiority to claims of the Lowers or anyone claiming through them.

The *Lower* court also concluded, without any discussion, that the U.C.C. was not relevant because Article 9 does not apply "to the creation . . . of . . . [a] lien on real estate including . . . rents thereunder."<sup>79</sup> Thus, FLB did not have to comply with the perfection requirements of Article 9. However, the court specifically noted it did not have to decide how a lien on real estate rents is perfected because the contest was between the parties to the agreement and not third parties. Lost in the court's analysis is that the tenant did not appeal the trial court decision ordering him to give the bank his "proceeds" from the land to the extent that the Lowers could not satisfy the deficiency judgment.

A second case dealing with cash leases is *Metropolitan Life Insurance Co. v. Reeves-Gustafson*,<sup>80</sup> where the parties executed, in December 1980, real estate mortgages with clauses providing that upon default the mortgagee has the right to take immediate possession of the real estate and all crops thereon and the right to collect rents therefrom. In April 1980 and June 1981 Reeves-Gustafson signed security agreements granting Bank A a security interest in all crops grown on part of the land subject to the real estate mortgage. Another security agreement covering crops produced on all of the mortgaged land was executed with Bank B in June 1982. Petitions to foreclose on the real estate were filed in March 1984. In April 1984 Reeves-Gustafson leased part of the land subject to the mortgages to Dobson who was to pay 35 bushels of corn per acre as rent for two parcels and rent in the form of crops from parcel three (the record does not show the amount). Dobson produced the 1984 crop and, upon harvest, delivered the correct amount to the designated buyer whereupon the crops were sold. The proceeds were claimed by Metropolitan under the real estate mortgages and by the two banks with perfected security interests in crops produced on the land subject to the real estate mortgages but rented to

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79. *Id.* at 129 (quoting IOWA CODE ANN. § 554.9104(j) (1985).

80. 228 Neb. 233, 422 N.W.2d 72 (1988).

a tenant.

Initially, without specifically stating so, the court concluded that Reeves-Gustafson and Dobson had a type of cash lease. Under this guaranteed bushel lease the tenant agreed to deliver a set amount of a certain type of grain to the land owner by a certain date. Though the rent was paid in crops, the opinion does not indicate that lessor was to share in any expenses connected with producing the crop or would receive less or no crop if the tenant was unable to produce any crop on the land. Thus, a true crop-share lease was not involved.

The rent payable was not a percentage-share of the crop. Instead, it was a fixed bushel lease payable at harvest, analogous to a cash-rent lease because the landlord's share is fixed, not at risk or subject to fluctuation in price or production. The rent payable to the landlord/debtors just happens to be in the form of bushels of corn, but need not come from the harvested crop in question. This is not a growing crop in which the landlord/debtor had any interest or rights. Dobson, the tenant, had rights in all of the crop being produced on the rented land and could have created an enforceable security interest in all of the crop. Thus, Reeves-Gustafson was only entitled to the payment of a fixed rent under the lease and this triggered the application of section 9-104(j), making Article 9 inapplicable.

If a true crop-share lease had been involved, the issue would have been much more difficult. As indicated above, once the real estate mortgagee is trying to claim crops in which the debtor has rights, Article 9 applies because personal property in the form of goods exists. Thus, as the court in *Reeves-Gustafson* intimates, the result would have been different if a true crop-share lease had been involved.

The last case regarding a cash lease, is *Anna National Bank v. Prater*.<sup>81</sup> The intermediary appellate court of Illinois was confronted with real estate foreclosure where the land owners (Praters) "purportedly" leased the land subject to the mortgage for cash to White, their son-in-law. Specifically, Praters had executed with Anna National Bank (ANB) a real estate mortgage which entitled ANB, upon default, to "all rents, issues, proceeds and profits." In June 1984 ANB initiated foreclosure proceedings to which Praters responded that the land had been "cash leased" to White. White obtained financing from Goreville State Bank (GSB) and gave GSB a perfected security interest in soybeans to be produced on the leased land. When the trial court permitted ANB to take possession of the property a soybean crop was growing

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81. 506 N.E.2d 769 (Ill. App. Ct. 1987).

on the land. The beans were ultimately harvested and the question was whether ANB or GSB, each claiming to have all of Whites' interest, had priority to the beans and the process thereof. The trial court granted summary judgment in favor of ANB on the assumption that no lease existed. Therefore, as mortgagee in possession, ANB had a right to the crops under their rents and profits clause superior to White's and GSB's interest.

The Appellate Court of Illinois remanded the case directing the trial court to determine if a valid, arms-length cash lease had in fact existed between the Praters and White. The court correctly indicated that ANB would not be entitled to the crop if a cash lease existed because Praters would not have rights in the crop growing on the land. The only claim ANB could have would be to the cash rent. White, and anyone having a perfected security interest in White's crop, would defeat ANB because Article 9 would apply.

The *Prater* court concluded that ANB's only claim to the crop growing on the land prior to taking possession pursuant to foreclosure proceedings was through the rents and profits clause of the real estate mortgage. This clause did not, and was not, intended by the parties to give ANB an Article 9 security interest in the growing crop. However, ANB could, according to the court, have a claim to the growing crop upon taking possession of the real estate because unsevered crops are deemed to be part of the real estate under applicable real estate law. Absent a special statute to the contrary, this statement is incorrect.<sup>82</sup>

Growing crops are personal property under the U.C.C. and, unless the real estate mortgage is considered an agreement under Article 9<sup>83</sup> giving ANB an enforceable security interest in the crops under section 9-203(1), ANB would be considered an unsecured creditor as to the crops.<sup>84</sup> Moreover, had the Praters filed a bankruptcy petition, the trustee could assert that ANB was either an unsecured creditor or, if the real estate mortgage was considered to grant a security interest in the crops, an unperfected secured creditor because no financing statement was filed. Thus, the trustee could defeat ANB, a lien creditor.<sup>85</sup>

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82. See *supra* notes 52-56 and accompanying text.

83. U.C.C. §§ 9-105, 1-201(3) (1988).

84. See *United States v. Newcomb*, 682 F.2d 759 (8th Cir. 1982) (applying Missouri law) (held that repossession upon default under an installment land contract by seller of land did not give the landowner a claim to the crops growing upon the land when it took possession.); see *supra* notes 44-56 and accompanying text.

85. 11 U.S.C. § 544(a)(1) (1988). See, e. g., *In re Hill*, 83 Bankr. 522 (Bankr. E.D. Tenn. 1988) which involved a Chapter 12 Bankruptcy where the mortgagee claimed priority to unharvested matured crops (nursery plants), is also relevant. The real estate mortgage did not de-

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When any conflicts as to priority claims in crops surface, Article 9 should control whether the crops represent rent, collateral for a loan, or are claimed under a real estate mortgage. The drafters of the U.C.C. and legislatures in enacting Article 9 created a scheme with simple, understandable rules producing predictable results when issues concerning security interests in personal property arise.<sup>86</sup> Thus, any conflict dealing with personal property should be governed by Article 9. Because all forms of crops, such as crops to be planted, growing crops, harvested crops, and stored crops, are personal property, Article 9 should control when the farmer defaults on any loan.

Any lender desiring to secure a loan with a security interest in crops should not have to be concerned about real estate law. Lenders should not have to file in both U.C.C. records as well as in real estate records to have an enforceable security interest in crops. Likewise they should not have to search both places to determine priority positions or to obtain subordination agreements from real estate mortgagees who

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scribe the collateral as crops, rents and profits of the land, or products of the land. The mortgagee did not file a U.C.C. financing statement to cover nursery plants either. Under Tennessee real property law which predated the adoption of the U.C.C. in Tennessee, mature but unharvested crops are subject to a mortgage on the land. The mortgagor's right to harvest a crop continued after default, but this right was cut off when the mortgagee took possession of the land. Under real property law, the mortgage applies to unharvested crops simply because of their attachment to the land. The debtors filed for bankruptcy, though, before the mortgagee could foreclose and take possession. The issue was one of priority and whether real property law or Article 9 controlled the priority battle.

The court said that between the mortgagee and mortgagor real property law may make the mortgage apply to the plants. However, this is not dispositive of the priority issue with the trustee in bankruptcy. The debtor may avoid the mortgage as to the plants because mortgagee was not perfected pursuant to Article 9 before the trustee in bankruptcy's rights under section 544(a) attached to the plants. The section 9-104(j) exception applies to "rents" (real property law would control) but not to the mortgagor's interest in "crops" (Article 9 controls).

See also *Saline State Bank v. Mahloch*, 834 F.2d 690 (8th Cir. 1987) applied Nebraska law when a rents and profits clause is in a real estate mortgage. The court concluded that the real estate mortgagee did not have perfected lien until it filed in bankruptcy court a petition to sequester the rents and profits.

For other cases dealing with 9-104(j), see, e.g., *United States v. Newcomb*, 682 F.2d 758 (8th Cir. 1982); *In re Standard Conveyor Co.*, 773 F.2d 198 (8th Cir. 1985); *In re Cook*, 1 U.C.C. Rep. Serv. 1660, 63 Bankr. 789 (Bankr. D. N.D. 1986); *Citizens Bank & Trust Co. v. Wy-Tex Livestock Co.*, 31 U.C.C. Rep. Serv. 275, 611 S.W.2d 168 (Tex. Civ. App. 1981); *Union Livestock Yards, Inc. v. Merrill Lynch*, 22 U.C.C. Rep. Serv. 523, 552 S.W.2d 392 (Tenn. App. 1976).

86. For other cases dealing with U.C.C. § 9-104(j), see, e.g., *United States v. Newcomb*, 682 F.2d 758 (8th Cir. 1982); *In re Standard Conveyor Co.*, 773 F.2d 758 (8th Cir. 1985); *In re Cook*, 1 U.C.C. Rep. Serv. 1660, 63 Bankr. 789 (Bankr. D. N.D. 1986); *Citizens Bank & Trust Co. v. Wy-Tex Livestock Co.*, 31 U.C.C. Rep. Serv. 275, 611 S.W.2d 168 (Tex. Civ. App. 1981); *Union Livestock Yards, Inc. v. Merrill Lynch*, 22 U.C.C. Rep. Serv. 523, 552 S.W.2d 392 (Tenn. App. 1976).

have not filed financing statements in the Article 9 records. In short, any lender, including a real estate lender, who wants a security interest in crops should be required to comply only with Article 9. Any pre-U.C.C. case law to the contrary should be considered overruled by the adoption of the U.C.C. and statutory law to the contrary should be changed.

To make clear that Article 9 governs any claim to crops, it may be necessary to make a non-uniform amendment to section 9-104(j). The 1988 Illinois legislature, although not amending section 9-104(j), did modify certain statutes dealing with real estate trusts (mortgages) to make clear that only Article 9 governed claims to crops in an apparent response to the *Prater* case. The Illinois law provides as follows:

Rights to crops. With respect to any crops growing or to be grown on real estate held in a land trust, the rights of a holder of an obligation secured by a collateral assignment of beneficial interest in such land trust, including rights by virtue of an equitable lien, shall be subject to a security interest property perfected pursuant to Article 9 of the Uniform Commercial Code.<sup>87</sup>

Right to crops. With respect to any crops growing or to be grown on the mortgaged real estate, the rights of a holder of any obligation secured by a collateral assignment of beneficial interest in a land trust, the rights of a mortgagee in possession, or the rights of a receiver, including rights by virtue of an equitable lien, shall be subject to a security interest properly perfected pursuant to Article 9 of the Uniform Commercial Code, where the holder of a collateral assignment, mortgagee in possession, or receiver becomes entitled to crops by obtaining possession on or after the effective date of this Amendment Act of 1988.<sup>88</sup>

This legislation may serve as a model for other states in rectifying the uncertainty which has permeated the law in this area.

### *Federalization Issues*

Federal legislation and regulations promulgated by federal agencies are a major source of uniform law. Historically though, states rather than Congress have regulated sales transactions, including payments and security interests in personal property. The National Conference of Commissioners on Uniform laws was organized in 1892 to pro-

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87. 1988 ILL. LAWS PUBLIC ACT 85-1427 and 85-1428 (Dec. 1988) which amended ILL. ANN. STAT. ch. 2501, 2502, 2503, 2504, ch. 110, § 15-1702.

88. *Id.*



mote uniform laws among the states, in order to assure the free flow of goods, credit, services and persons between the states. The conference drafted the U.C.C., which has now been adopted in some form in every state.<sup>89</sup> Traditionally, Congress has not regulated aspects of sales transactions such as payment and performance or credit or debtor rights other than bankruptcy. Recently, however, Congress has begun to legislate in areas governed by the Code. Areas affected include the check collection process,<sup>90</sup> the sale of farm products subject to a perfected security interest,<sup>91</sup> the unpaid cash seller of agricultural products rights against the secured creditor of the buyer,<sup>92</sup> and the holder in due course doctrine.<sup>93</sup> This short discussion will focus on Congress' acts affecting the U.C.C. and agriculture credit.

Professor Edward Rubin has recently written a very thoughtful article about the federalization of certain sections of U.C.C. Article 4 by the Expedited Funds Availability Act.<sup>94</sup> He discusses, among other things, the merits of a regulatory agency being responsible for enforcing and interpreting all of the U.C.C. Congress' empowering one source, the Federal Reserve, to oversee the check collection process must be compared with what Congress has done with agricultural credit issues. Here, it has simply used a piecemeal approach. One illustration of such regulatory action involves Congress replacing the so-

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89. See U.C.C. § 9-203 (1988). As of January 1, 1989, forty-eight states and the District of Columbia had adopted the so-called 1972 revisions. The states are Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana (effective January 1, 1990), Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri (effective Jan. 1 1989), Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina (effective Jan. 1, 1989), South Dakota, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, Wisconsin, and Wyoming.

90. Expedited Funds Availability Act [Title VI of the Competitive Equality Banking Act], Pub. L. No. 100-86, 101 Stat. 552, codified at 12 U.S.C. §§ 4001-4010 (1988). Pursuant to the authority granted in this statute the Federal Reserve Board promulgated Regulation CC. 12 C.F.R. § 229 which gives the Federal Reserve plenary power over the check collection process.

91. Food Security Act of 1985, § 1324, Pub. L. No. 99-198, 99 Stat. 1324 (codified as 7 U.S.C. § 1631 (1987)).

92. 7 U.S.C. § 196(b) (1987) (livestock), 7 U.S.C. § 197 (1987) (poultry), and 7 U.S.C. § 499a (1987) (perishable commodities).

93. The FTC rule, 16 C.F.R. § 433 (1988), destroyed the holder-in-due course rule when consumer promissory notes are sold to a bank and the bank asserts that it is not subject to any defenses concerning the quality of goods that the consumer could assert against the seller of the good.

94. Rubin, *Uniformity, Regulation, and the Federalization of State Law: Some Lessons from the Payment System*, 49 OHIO ST. L.J. 1251 (1989).

called farm products rule of U.C.C. section 9-307(1).<sup>95</sup>

Section 9-307(1) treats perfected security interests in farm products sold by the farmer differently than sales of inventory to a buyer in the ordinary course.<sup>96</sup> Under section 9-307(1), absent the secured party relinquishing its security interest, the sale of farm products subject to a perfected security interest prior to December 23, 1986 did not cut off the security interest.<sup>97</sup> Thus, the secured party could successfully sue

95. U.C.C. § 9-307 (1) provides:

A buyer in the ordinary course of business [1-201(9)] other than a person buying farm products from a person engaged in farming operation takes free of a security interest created by his seller even though the buyer knows of its existence.

A buyer in the ordinary course is generally one who in good faith buys a good from a person in the business of selling goods of that kind and without knowledge that the good being purchased is subject to a security interest and is not to be sold without consent of the secured creditor.

See U.C.C. § 1-210(9) and comment 2 to § 9-307. The security interest involved *must* have been created by the *seller* of the good.

Under 9-307(1) the purchaser of *farm products*, 9-109(3), from a person engaged in farm operations does not take free of a *perfected* security interest even though the farmer is in the business of selling farm products. The secured party's remedy is either replevin or a conversion action.

There is a major exception to this rule, which is that the secured party has no claim to the collateral if it has authorized the sale or exchange prior to December 23, 1986.

U.C.C. § 9-306(2) provides:

Except where this Article otherwise provides a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor.

Because security agreements almost never specifically authorize sale of farm products, the crucial work in this section is "otherwise." Neither the Code nor the comments define "otherwise" or give any guidance to its meaning. Courts have generally defined the issue a whether the secured party has in any way authorized the sale. Courts have imported to the Code the common law notions of waiver, estoppel, and implied and express consent.

Many cases have involved situation where the security agreement specifically prohibited the sale of collateral without prior written consent of the secured party. The debtor sold covered collateral in the past and the lender knew of the debtor's prior sales, but made no objection. Some courts in these circumstances have construed the prohibition literally and held that the sale where the debtor did not remit the proceeds was unauthorized because the security agreement had an express prohibition against sales. Others have held for the purchaser on the theory that the sale, in which the debtor did not remit the proceeds was authorized by the prior course of dealing where debtor had sold collateral and remitted the proceeds without any objection from the secured party.

96. The federal farm products rule definition of buyer in the ordinary course is very different from the U.C.C. definition in § 1-201(9). The federal definition does not require the buyer to act in good faith or without knowledge that the sale to him is in violation of a security agreement. See 7 U.S.C. § 1631(c)(1) (1987). This is important under the direct notification system in that a buyer can have actual knowledge of a secured creditors security interest and that the farmer is not to sell without written permission and still buy free from the security interest if the secured creditor has not given the required statutory notice; see 7 U.S.C. §§ 1631(c)(1), (d), (e)(1)(A) (1987).

97. See *supra* note 95; see also Kershner & Hardin, *Congress Takes Exception to the Farm Products Exception to the U.C.C.: Retroactivity and Preemption*, 36 KAN. L. REV. 1 (1987);

the buyer in conversion and the buyer had to pay twice. In many states, sales of cattle by commission merchants were also subject to this rule.

The farm products rule generated controversy and litigation, which prompted various reactions by state legislatures. California rejected it entirely and more than twenty states amended the rule.

Trade associations representing buyers of farm products believed the farm products rule was unjustifiable and unfair. Unsatisfied with the changes made by state legislatures, they took their fight to Congress. Congress finally responded favorably in 1985. Section 1324, a provision buried in the immense 1985 farm bill, altered the farm products rule effective December 23, 1986.<sup>98</sup> Congress' justification for its involvement is found in the statute itself. It provides that farm product purchasers' exposure to double payment constitutes a burden and obstruction to interstate commerce in farm products. Section 1324 is intended to eliminate that burden.<sup>99</sup>

The major purpose of section 1324 is to protect both the commission merchants and the buyers farm products subject to a perfected security interest. Congress changed the presumption in the farm products rule of section 9-307(1) from "buyers buy subject to" a perfected security interest, to "buyers buy free from" one. States were to select either a direct notice system or a central filing system.<sup>100</sup> Specifically, section 1324 provides that buyers buy free of a perfected security interest unless the buyer receives either an appropriate written notice directly from the lender within one year prior to the sale *or* from the Secretary of State if the state adopts a central filing system. Under a central filing system in which the Secretary of State or its designate provides information to buyers who register or request information from an "effective financing statement" (EFS). A secured party must file an EFS in addition to its normal financing statement.<sup>101</sup>

While it is beyond the scope of this article to thoroughly discuss the alternatives, a few comments are in order. Under the direct notice alternative, the secured party must send a written notice containing,

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Kershen & Hardin, *Congress Takes Exception to the Farm Products Exception of the U.C.C.: Centralized and Presale Notification Systems*, 36 KAN. L. REV. 383 (1988); Meyer, *The 9-307(1) Farm Products Puzzle: Its Parts and Its Future*, 60 N.D. L. REV. 401 (1984); Meyer, *Congress's Amendment to the U.C.C.: The Farm Products Rule Change*, 55 J. KAN. BAR 17 (Sept./Oct. 1986).

98. Food Security Act of 1985, § 1324, Pub. L. No. 99-198, 99 Stat. 1324 (codified as 7 U.S.C. § 1631 (1987)).

99. 7 U.S.C. § 1631(a), (b) (1987).

100. 7 U.S.C. §§ 1631(d), (e)(1) (1987).

101. 7 U.S.C. § 1631(c)(4) (1987).

*inter alia*, the debtor's social security number or tax identification number, the type of farm product, and a real estate description. Debtor is required to supply the secured creditor with a list of potential buyers. If the debtor sells to someone not on the list, the debtor is subject to a "fine." Congress seems to have made a conscious choice to treat this as a crime. This means that the United States Attorney must prosecute violations. Also, Congress does not define what constitutes receipt of notice, specifically leaving this to states to define.

If a state wants a central filing system, it must apply to the USDA to have its central filing system federally certified. The USDA is also directed to promulgate regulations detailing and defining what constitutes a "certifiable central system." The responsibility for this certification process is given to the Packers and Stockyards Administration section of the USDA. This writer and four other attorneys participated in two long conference calls with the government attorneys responsible for drafting these system regulations. The government attorneys were not very familiar with Article 9 and had no real understanding how the regulations would impact Article 9.<sup>102</sup>

Congress apparently hoped to simplify the law, make it more certain, reduce litigation, make the law more fair, and make it uniform. It failed miserably on all accounts. The statute itself is clear evidence that it was literally slapped together in a back room by people who did not have any expertise in Article 9 and did not understand the impact section 1324 would have.<sup>103</sup> It is replete with ambiguities, inconsistencies, omissions and confusion. As an illustration, the statute uses U.C.C. terminology that is, in most instances, given new and different meanings. Examples of changed meanings are found in such terms as: buyer in the ordinary course, central filing system, and an effective financing statement. A number of uncertainties exist for example: 1) whether a state can have both the written notice system as well as the central filing system; 2) whether a farmer who sells to someone not on the list is guilty of a federal crime; 3) whether the statute applies to unperfected security interests and statutory liens attaching to farm products; 4) whether a federal court rather than a state court must determine priority battles concerning farm products; (5) whether the law of the state where the farm product is produced controls when the farm product is sold in another state.

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102. It is, however, important to note that the government attorneys appreciated our suggestions, but clearly did not have any knowledge of Article 9 purpose or function.

103. Either the drafter had no expertise or Congress was deceived by those who wanted the bill to be doomed from the start and created a scheme that could not possibly work.

Section 1324 caused problems for the bank regulators because they did not know how to classify loans secured with interests in farm products. Initially, the Comptroller and the FDIC indicated they would instruct examiners to classify the loans as unsecured in a state with direct lender notification. Because, if the farm products were sold to a person not given notice, the bank had no collateral in as much as the farmer almost always will have used the proceeds. The regulators then recanted and said the loans would not be classified as unsecured if lenders made a good faith effort to comply with the federal legislation.

If this legislation is an illustration of how Congress would draft commercial law legislation, who needs it? Notwithstanding the monster created, certain trade associations think that Congress can provide answers to their priority problems under Section 9-312(2). For example, suppliers of production inputs such as seeds, fertilizers and chemicals want to change section 9-312(2), which deals with purchase money security interests in crop inputs, to give them a superior priority.

Congress has enacted other legislation affecting agriculture and Article 9 secured creditors. Unpaid sellers of livestock,<sup>104</sup> poultry<sup>105</sup> and perishable commodities,<sup>106</sup> for example, have priority over secured creditors having security interests in the inventory or accounts receivable of the buyer. This protection does not extend to the unpaid sellers of dairy products or grain, and they are seeking this priority protection from Congress.<sup>107</sup>

The USDA has also promulgated regulations directly impacting the U.C.C.<sup>108</sup> These regulations affect Commodity Certificates or Payment in Kind certificates (PIK's). During the last few years, the producer participating in the federal government farm price support programs for wheat, feed grains, and cotton has been paid in part with these certificates and part in cash.<sup>109</sup> The payments are significant because, for the years 1986 and 1987, as much as forty percent of some

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104. 7 U.S.C. § 196(b) (1987).

105. 7 U.S.C. § 197 (1987).

106. 7 U.S.C. § 499(a) (1987).

107. Congress' involvement in poultry, livestock and perishable commodities may in part be explained by the fact that it has long regulated livestock sales under the Packers and Stockyard Act. See 7 U.S.C. §§ 181-229 (1988) and 9 C.F.R. §§ 201.1-203.19 (1988).

108. Under the Food Security Act of 1985, which is effective through 1989, government price support payments for wheat, feed grains and cotton are being made in two forms: cash and commodity certificates. The general authorization is found in 7 U.S.C. §§ 1445(b)(1)-(4)(b) and 16 U.S.C. § 590(h) (Supp. 1988).

109. Commodity Certificates are controlled by 7 C.F.R. § 770 (1988). Cash payments can be made subject to a security interest. See 7 C.F.R. §§ 713, 709 (1988).

farmers' cash flow constituted government payments.

The regulations affecting these certificates provide:

This certificate shall not be subject to any *state law* or regulation, including but not limited to state statutory and regulatory provisions with respect to commercial paper, security interests and negotiable instruments. This certificate shall not be encumbered by any lien or other claim, except that of an agency of the United States government.

Bankruptcy courts are split as to whether these regulations are valid.<sup>110</sup> The issue being whether Congress intended to give the USDA

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110. Two cases have held that the regulations prohibiting the farmer from creating a security interest in the commodity certificates under state law are valid and therefore secured parties cannot obtain a security interest in the certificates. *In re Lehl*, 79 Bankr. 880 (Bankr. D. Neb. 1987); *In re Halls*, 79 Bankr. 417 (Bankr. S.D. Iowa 1987). Neither case was appealed. A Federal District Court judge in *In re Mattice*, 81 Bankr. 504 (Bankr. S.D. Iowa 1987), decided a case applying the *Hall* analysis that commodity certificates cannot be subject to a security interest.

*In re George*, 85 Bankr. 133 (Bankr. D. Kan. 1988), held that the PIK regulations were not valid because Congress has not clearly indicated that it intended to preempt the application of state law, i.e. the U.C.C., to Commodity Certificates. Thus, whether the certificates could be made subject to a security interest was controlled by state law. The certificates were general intangibles. This case has been appealed. An Iowa bankruptcy case following *In re George* is *In re Arnold*, 88 Bankr. 917, 921 (Bankr. N.D. Iowa 1988). There is a split between the northern and the southern districts in Iowa.

Another federal program providing payments is the Conservation Reserve Program. Under this program the land owner agrees to take fragile land out of production for ten years and is paid so much an acre for doing so. All of the payments under this program have been made in Commodity Certificates. In *In re Harvie*, 84 Bankr. 197 (Bankr. D. Colo. 1988), the court made the following conclusions concerning the CRP payments which are all in certificates:

[The regulations are for] administrative convenience [of the federal agencies] and are not meant to eradicate valid security interests or other types of perfected encumbrances. . . .

Nowhere in the Act [16 U.S.C. § 3831] is there the avowed congressional purpose of providing cash flow support to farmers at the expense of secured creditors through the destruction of security interest or other encumbrances that might attach to the proceeds of CCC commodities certificates under consensual lien agreements . . . .

Therefore, in order not to invalidate [the federal regulations], this Court finds that once the commodity certificates are in the hands of a debtor, the *proceeds* thereof can become subject to private consensual liens.

*In re Harvie*, 84 Bankr. at 201. (emphasis in original).

If the USDA regulations are valid, federal law would prohibit them from being encumbered either under the U.C.C. or real estate law. One line of bankruptcy cases held that the CRP payments are rents, issues and profits. *In re Harvie*, 84 Bankr. 197, 202 (Bankr. D. Colo. 1988) held that the CRP payments are rent. Under the CRP program, the farmer is required to take land out of production to qualify for payments. The court treated this as a lease of the land to the government. Here the creditor had a deed of trust encumbering the real estate involved and it had an assignment of "all rents, issues and profits, income and revenue" from real estate. *Id.* at 198. The note secured by the deed of trust had not been executed in order to fund the debtor's current crop. The court also held that the proceeds of the commodity certificates are subject to the real

the power to preempt state law and prevent the farmer from voluntarily creating a security interest in some certificates. Interestingly, cash payments from the federal government are not affected.

It is important to note that the significant changes made by the federal government to Article 9 discussed here have *all originated* in the Agriculture Committees and the USDA, not the banking committees or agencies regulating banks.<sup>111</sup>

This discussion of federalism would not be complete without some reference to what has been happening to Article 9 in states with a significant agricultural industry. The economic disaster that hit many rural areas during the last few years has had a substantial impact on laws relating to credit transactions. State legislatures have reacted to the agricultural crisis in a variety of ways. Some states have abolished deficiency judgments, some have imposed foreclosure moratoriums, others have imposed mandatory mediation before foreclosure, or developed new statutory liens to protect certain creditors against prior perfected secured creditors. The number of statutory liens involving agriculture that are not covered by Article 9 is staggering and continues to grow.<sup>112</sup> Furthermore none of these laws affecting Article 9 secured creditors are in the U.C.C. but are scattered throughout the appropriate state's

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estate mortgage. *Id.* at 202.

111. The Congressional Agricultural Credit Act of 1987 also impacts Article 9, but in a more limited way. The Act only applies to the Farmers Home Administration and the Farm Credit System when they foreclose on personal property and a distressed farm loan is involved. For example, the lender must give notice of the right to apply for restructuring.

The federal government has affected the U.C.C. in other areas. Pursuant to the Expedited Funds Availability, Title VI of the Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, 101 Stat. 552, codified at 12 U.S.C. §§ 4001-4010 (1988), the Federal Reserve Board promulgated regulations which gives the Federal Reserve plenary power over the check collection process. 53 Fed. Reg. 21, 983 (1988) (to be codified at 12 C.F.R. § 229) (proposed June 13, 1988). The Federal Trade Commission (FTC) has affected security interests by prohibiting certain nonpurchase money security interests in consumer goods and the FTC has also affected the holder in due course rule, to name a few such examples.

112. Article 9 deals with consensual security interests and accordingly, U.C.C. § 9-104(b) excludes landlord liens from the coverage of Article 9 because these are not consensual liens created either by statute or case law. The one exception to nonconsensual liens not being covered by Article 9 is found in 9-104(c) which provides: "This Article does not apply to a lien given by statute or other rule of law for services or materials except as provided in Section 9-310 on priority of such liens." J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE, § 21-5, at 171 n.29 (3d ed. 1988). *See id.* §§ 23-7, 23-8, at 278-81. U.C.C. § 9-310 states:

When a person in the ordinary course of his business furnishes services or materials with respect to goods subject to a security interest, a lien upon goods in the possession of such persons given by statute or rule of law for such materials or services takes priority over a perfected security interest unless the lien is statutory and the statute expressly provides otherwise.

*Id.* § 23-12, at 293 n.19.

statutory provisions.

Without analyzing the question, it is appropriate to ask whether the U.C.C. should remain a state statutory scheme with fifty different creators, being interpreted by fifty different courts applying many different judicial glosses to individual provisions. While the broad framework and fundamental concepts of the U.C.C. remain intact, the different treatment in various states makes it increasingly difficult for multi-state transactions to be put together. For example, different filing rules and state procedures are a source of some difficulty. With the computer age beginning to mature, one federal filing system with regional filing places and access at the local level is possible.<sup>113</sup>

It is time to seriously ponder why the U.C.C. should not be federalized. What are the costs of keeping the state system versus the costs of federalizing? Likewise, what are the benefits to be gained? Because Congress has already become involved in a piecemeal way, the relevant question is how, rather than when federalization should occur. The regulatory approach adopted in the check collection area has been touted by some as the appropriate model.<sup>114</sup> Whatever happens, changes should not be made by Congressional committees that have no understanding of the U.C.C., such as occurred with the federal farm products rule and the regulation of PIK certificates. Interestingly enough, the legal profession in general has not taken an active leadership role in this whole area, but rather has been basically reactive, waiting to respond to changes made in the Code.

Whether an organized thoughtful federalization occurs, or if changes are to be made in laws affecting the U.C.C. there is a need for input and participation by U.C.C. experts who are not "hired guns" and/or beholden to any client or group. Some general possibilities include a commission, the Permanent Editorial Board, the American Law Institute, an American Association of Law Schools committee, and an American Bar Committee, or some combination thereof that could have direct responsibility for drafting and input. For anything like this to work, though, a substantial time and monetary commitment would be needed.

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113. The state of Nebraska has such a system.

114. See *supra* note 94.