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Farm Collateral Under the UCC: “Those Some Mighty Tall Silos, Ain’t They Fella?”

by

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FARM COLLATERAL UNDER THE UCC: "THOSE ARE SOME MIGHTY TALL SILOS, AIN'T THEY FELLA?"

By JOHN C. MILLER*

This article examines the Uniform Commercial Code's treatment of farm collateral. It discusses the categorization of this collateral as either farm equipment or farm products and identifies the special problems which are typical to each type of collateral. It also comments on special problems involving purchase money security interests. Finally, the cases in which there have been unauthorized sales of farm products are analyzed. Throughout the article, the author states practical means of avoiding the problems presented by the Code.

INTRODUCTION

The producers of agricultural products in the United States are a diversified group. The orange groves of Florida, the giant feeder cattle operations of Colorado and Texas, the Idaho and Maine potato plantings, the rich grain fields of the Dakotas and the dairy herds of Wisconsin all are part of the farming community. Some producers are giant corporations and some are one-man operations, but they all have the same hallmark: a need for borrowed capital. These credit needs are long, intermediate and short term credit needs. Long term credit is generally used for the purchase and substantial improvement of real estate; intermediate credit, one to seven years, is used to finance equipment, dairy herds and less substantial improvements; short term, one year or less, is used to finance the purchase of feed, feeder livestock, crop plantings and the like.¹

Because short and intermediate term credit often is secured by personal property collateral, Article Nine of the Uniform Commercial Code (hereinafter the Code or UCC) governs these credit transactions in the forty-nine states in which it has been adopted.² To

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1. Clark, *Some Problems in Agricultural Lending Under the UCC*, 39 U. COLO. L. REV. 352 (1967) [hereinafter cited as Clark].

2. J. WHITE & R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* 4 (1972) [hereinafter cited as WHITE & SUMMERS]. Citation shall be to the UNIFORM COMMERCIAL CODE (1962) [hereinafter U.C.C.]. Because the South Dakota Code Commission inexplicably decided to renumber the U.C.C., as enacted in South Dakota, this article provides parallel citation to the relevant South Dakota and U.C.C. sections.

Any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures, including goods, documents, general intangibles, chattel paper, accounts or contract rights is subject to the Code. S.D. COMPILED LAWS ANN. § 57-35-2 (1967); U.C.C. § 9-102. A security interest is defined as an interest in personal property or

facilitate application of the Code, its draftsmen applied uniform solutions to many problems as diverse and varied as the agricultural community itself. Many of these rules do not conform to the reality, needs or practices of modern agriculture.

The draftsmen gave the farmer special and supposedly needed protection against unscrupulous creditors. Not only is the farmer coddled under the Code, but also the farm lender is covered by a unique protective blanket. The Code approaches farming as an occupation peopled by simple, unsophisticated tillers of the soil who need the mantle of protective legislation to survive;³ it evidences a similar attitude toward the sophistication of the farm lender. The companies which market the farmer's products, on the other hand, are presumed not only to be sophisticated, but possessed of a "deep pocket" to bail out unwary lenders.

The reasons for the Code's special treatment of farmers and farm lenders are twofold. First, the original UCC was drafted by commercial financiers without detailed knowledge of farm financing.⁴ Second, the draftsmen of the UCC did not have much to work with because many of the various state laws were illogical and inconsistent.⁵

Today's agriculture is vastly different from that of 1951 when the first UCC official draft appeared. Dean Hawkland has stated it well:

Until well into the 20th century it would have been ludicrous to compare the farmer to a businessman, especially a large businessman. Isolated and alone, the early-day American farmer operated without substantial capital and frequently on a subsistence basis. In this economic context there was little need for financial capital expansion and aggressive agricultural development, but small-town banks were constantly called upon to make loans that would enable the necessitous farmer to survive a hard winter or a dry summer. These loans, often secured, generated a body of agricultural law quite different from its financial counterpart in urban areas. This corpus was modeled to a great extent on the real estate mortgage with all of its rigidities,

fixtures which secures payment or performance of an obligation. S.D. COMPILED LAWS ANN. § 57-1-10 (1967); U.C.C. § 1-201(37).

3. The misunderstanding of the farmer is well exemplified by the attitude of the city-slicker who, upon noticing a man, obviously of rural roots, looking at tall city buildings, states: "Those are some mighty tall silos, ain't they fella?"

4. "It so happens that the sponsors of the Code were unsuccessful in enlisting the aid of anyone with a technical knowledge of farm financing comparable to knowledge of other business financing supplied by some of the advisors to the draftsmen." Coogan & Mays, *Crop Financing and Article 9: A Dialogue with Particular Emphasis on the Problems of Florida Citrus Crop Financing*, in 1B P. COOGAN, W. HOGAN & D. VAGTS, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE § 27.08, at 2827 (1968) [hereinafter cited as COOGAN, HOGAN & VAGTS].

5. See COATES, LAW AND PRACTICE IN CHATTEL SECURED FARM CREDIT (1954) [hereinafter cited as COATES].

but it was seasoned by concessions to the favorite of the law, those who till the soil. These rigidities and concessions operated to make up a curious patchwork of law often at cross purposes with itself.

Some of these inconsistencies were resolved by the enactment of the Uniform Commercial Code, but its draftsmen continued to treat the farmer differently from businessmen, overlooking the fact that present-day farming is a business operation that is practically indistinguishable functionally and economically from other forms of industry. The failure to recognize the farmer as a businessman is a serious shortcoming in the present U.C.C. and it has caused difficulties and expense.⁶

As agriculture has evolved, so has the UCC. In 1972 a new official text was promulgated by the American Law Institute and the National Conference of Commissioners on Uniform State Laws which was recommended to the states for adoption. Several states have adopted this revised text;⁷ however, the vast majority of the states still have versions of the 1962 Code in effect. Because the 1962 Code is still the most prevalent version, this article was based primarily on the provisions of the 1962 Official Text of the UCC, although changes made by the 1972 Code to relevant 1962 Code sections will also be discussed. Citations to Code sections will be to the 1962 Code unless specifically identified as 1972 sections.

This article focuses on the various provisions of Article Nine of the UCC which relate directly to farm personal property collateral. UCC financing provisions which only incidentally relate to farm financing are not stressed. Thus the purpose of this article is to serve as a guide to solution of problems which the practitioner might confront in dealing with agricultural collateral and to discuss the unresolved issues in the field.

There are two major types of UCC collateral which are directly related to agriculture: farm equipment and farm products. Each is discussed separately, with farm products being subdivided into several further classifications.

FARM EQUIPMENT

With the average farm becoming larger each year,⁸ and with shortages of nonfamily farm labor developing, the farmer is be-

6. Hawkland, *The Proposed Amendment to Article 9 of the U.C.C.—Part 1: Financing the Farmer*, 76 COMM. L.J. 416-17 (1971) (footnotes omitted) [hereinafter cited as Hawkland].

7. The 1972 amendments have been adopted in Arkansas, Illinois, Nevada, North Dakota, Oregon, Texas, Virginia and Wisconsin.

8. As of March 1, 1973, the total value of farm land and buildings in South Dakota was \$4,439,000,000 and the value per acre was \$97.00; in 1960 the comparable figures were \$2,309,000,000 and \$51.00; in 1950 the comparable figures were \$1,402,000,000 and \$31.00. SOUTH DAKOTA DEP'T OF AGRICULTURE, SOUTH DAKOTA CROP AND LIVESTOCK REPORTING SERVICE, CROP REPORTING SERVICE BULLETIN 63 (1965).

coming even more dependent on sophisticated and expensive machinery. This machinery is categorized generally as "equipment" under the UCC.⁹ However, for some purposes, equipment is more specifically grouped as "farm equipment"¹⁰ and as "equipment used in farming operations."¹¹ These specialized terms are not defined, nor are they differentiated by the provisions of the UCC. For the purpose of this article, they will be considered synonymous and used interchangeably.

Filing

There are two basic ways in which the treatment of farm equipment differs from nonfarm equipment. They both relate to filing: one concerns the *necessity* of filing¹² and the other relates to the *place* of filing.¹³

A. Necessity of Filing

Ordinarily a financing statement must be filed to perfect a security interest in equipment.¹⁴ However, section 9-302(1)(c)¹⁵ provides that a purchase money security interest in farm equipment having a purchase price not in excess of 2,500 dollars (other than fixtures and motor vehicles) may be perfected without filing. The apparent purpose behind adoption of this provision was to reduce the clerical and filing expense of farm implement dealers and thus free farm credit on lower-priced farm equipment. Some agricultural states, such as Missouri and Kentucky, have questioned the wisdom of this reasoning and have reduced the purchase price limitation to 500 dollars.¹⁶ The effectiveness of the automatically perfected purchase money security interest is of limited value to a creditor as section 9-307(2) provides that a buyer of farm equipment, other than fixtures, having an original purchase price not

9. There are three basic types of U.C.C. collateral: documents, intangibles and goods. Each contains several subtypes: intangibles include accounts and contract rights, S.D. COMPILED LAWS ANN. § 57-35-24 (1967); U.C.C. § 9-106; documents include chattel paper, documents of title and instruments, *id.* § 57-35-20; U.C.C. 9-105; goods include consumer goods, equipment, fixtures, inventory and farm products, *id.* §§ 57-35-27 to -30; U.C.C. § 9-109. All goods are classified by the U.C.C. according to the purpose for which they are held except for farm products, which classification is based on the occupation of the holder of the collateral. If goods are farm products, they are neither equipment nor inventory. *Id.* § 57-35-29; U.C.C. § 9-109(3). If they are inventory, they are not equipment. *Id.* § 57-35-40; U.C.C. § 9-109(4). The classes of goods are mutually exclusive; the same property at the same time and as to the same person can be within but one classification. U.C.C. § 9-109 & Comment 2.

10. S.D. COMPILED LAWS ANN. §§ 57-35-28, 57-37-31 (1967); U.C.C. §§ 9-109, 307(2).

11. *Id.* § 57-38-1; U.C.C. § 9-401(1) (second and third alternatives).

12. *Id.* § 57-37-4(3); U.C.C. § 9-302(1)(c).

13. *Id.* § 57-38-1; U.C.C. § 9-401(1) (second and third alternatives).

14. *Id.* §§ 57-38-1 to -18; U.C.C. § 9-302.

15. S.D. COMPILED LAWS ANN. § 57-37-4(3) (1967).

16. 5C F. HART & W. WILLIER, FORMS AND PROCEDURES UNDER THE UNIFORM COMMERCIAL CODE T 179-80 (1974) [hereinafter cited as HART & WILLIER].

in excess of 2,500 dollars takes free of an unfiled perfected security interest if he buys without knowledge of the security interest, for value, and for his own farming operation.¹⁷

The limit of 2,500 dollars on the automatic perfection provision has engendered considerable litigation. There is, for example, a conflict of opinion whether the purchase price could be the cash sale price of the equipment, or should include not only the cash sale price, but also the interest and carrying charges on a deferred payment sale.¹⁸ If the purchase price, including interest and carrying charges, will exceed 2,500 dollars, the wise purchase money creditor would file to insure that there is no question of his priority.

Furthermore, there has been a question not only as to what is included in the price, but also as to whether the price relates to each item of farm equipment sold or to the total sold in a single transaction. In a recent decision, the Florida Supreme Court has held that the 2,500 dollar exemption relates to each item of farm equipment and not to the total amount purchased. In *International Harvester Credit Corp. v. American National Bank*¹⁹ the court held that the intent of the legislature must be that each item be valued individually, otherwise the exception could be defeated by lumping together many small items. It is this writer's opinion that the decision is erroneous; such an interpretation is an untoward interference with the Code's system of requiring notice to conflicting creditors. The allowance of an exemption from the notice requirements should be construed strictly.

In addition, the courts should recognize that farm implement dealers are sophisticated commercial entities, fully aware of the Code's filing requirements. If such a purchase money seller elects to lump together several small items so that the purchase price exceeds 2,500 dollars, he should be held to have waived the automatic perfection protection.

Fortunately, the exemption from filing for purchase money security interests in farm equipment has been deleted from the 1972 Code as has the companion provision of section 9-307(2).²⁰ Dean Hawkland has referred to section 9-302(1)(c)²¹ of the 1962 Code as a "foolish monument of a foolish privilege and as a trap for the unwary."²² He reasons that the filing exemption was not used by farm implement dealers because the risk of the cutting off of their security interest under section 9-307(2)²³ was greater than the

17. S.D. COMPILED LAWS ANN. § 57-37-31 (1967).

18. *Compare* Mammouth Cave Production Credit Ass'n v. York, 429 S.W.2d 26 (Ky. 1968) (cash price), with *In re La Rose*, 7 UCC REP. SERV. 964 (D. Conn. 1970) (bankruptcy) (deferred payment price).

19. 296 So. 2d 32 (Fla. 1974).

20. U.C.C. §§ 9-302, 307(2) (1972 version).

21. S.D. COMPILED LAWS ANN. § 57-37-4(c) (1967).

22. Hawkland, *supra* note 6, at 417.

23. S.D. COMPILED LAWS ANN. § 57-37-31 (1967).

savings from not filing; the provision actually had a deleterious effect on the availability of farm credit because secured lenders were wary of advancing credit when unknown and unfiled security interests in items of a farmer's equipment would be prior to the filed interests.²⁴

B. Place of Filing

The correct place for filing a financing statement covering "equipment used in farming operations" is the county of residence of the debtor. In the ordinary transaction involving the individual farmer this is a good rule because the filing will be made in the same office, and presumably on the same financing statement, as a concomitant interest in farm products.²⁵ However, there are at least two problems with this local filing. The first problem shows the small-farmer myopia of the Code draftsmen; the Code language presumes that the farmer has a home for a residence, and it makes no provision for determining the residence of a farm corporation.²⁶ Residence could be in either the county of the principal office of the corporation, or if a foreign corporation, the county in which the registered agent is located. This oversight has been remedied in the 1972 Code which provides that the residence of an organization is its place of business, if it has only one, or its chief executive office, if it has more than one place of business.²⁷

Second, the Code provides for a different filing office for farm equipment than for nonfarm equipment. As noted previously, a farm equipment filing is made in a local office. On the other hand, depending on whether a state selected the second or third alternative to section 9-401(1), the filing for nonfarm equipment is made in the Secretary of State's office and a local office, or in the state office alone.²⁸

The place of filing requirements have aroused controversy over whether the collateral is farm or nonfarm equipment. The cases decided on this point require that the equipment be classified as farm or nonfarm according to the use to which such equipment is put. In *Sequoia Machinery, Inc. v. Jarrett*²⁹ a custom harvester who owned no land was the debtor. The secured party filed his financing statement covering the debtor's combines in the state

24. Hawkland, *supra* note 6, at 417. See also U.C.C. § 9-302, Reasons for 1972 Change (1972 version).

25. S.D. COMPILED LAWS ANN. § 57-38-1 (1967); U.C.C. § 9-401(1) (second and third alternatives). Note that if the other collateral was crops, the interest in crops would be perfected not by filing in the county of the debtor's residence, but the county in which the crops were grown. *Id.*

26. Clark, *supra* note 1, at 359-60.

27. U.C.C. § 9-401(6) (1972 version).

28. South Dakota adopted the second alternative which requires filing in the state office alone for nonfarm equipment. S.D. COMPILED LAWS ANN. § 57-38-1 (1967).

29. 410 F.2d 1116 (9th Cir. 1969).

rather than the local office. The trustee of the bankrupt custom harvester sued to have the security interest declared unperfected on the grounds that the combines were "equipment used in farming operations." The court held for the trustee and ruled that the determinant was the actual use of the equipment, not the occupational status of the debtor. This decision conforms to the Code's method of classifying goods, except farm products, according to the use to which they are put or for which they are bought. A similar result was reached in a case in which an owner of a feed store purchased a haybine to use for commercial hay cutting; the haybine was held to be farm equipment.³⁰ This method of classification was logically extended in *In re Anderson*³¹ in which equipment used in a city egg production factory was held to be "equipment used in farming operations" because the equipment was used to produce eggs: a farm product. Because the secured party had filed in the local office, the farm equipment filing office, his perfected security interest prevailed over the trustee in bankruptcy.

These cases indicate that only the vigilant secured party can be certain of the validity of his interest. Farm equipment, unlike farm products, is defined by its principal use rather than by the status of its owners.³² Furthermore, in many situations, equipment designed for farm use, such as a farm tractor, may actually be used in a nonfarm capacity. For example, a farm tractor might be used to remove snow in a town. If in doubt as to the use of the equipment, the prudent creditor should file both in the local and the state offices.

Sufficiency of Description

The UCC provides that a description of collateral is sufficient if it reasonably identifies what is described.³³ Generally, the sufficiency of the description of farm equipment has not been an issue; however, two Kentucky cases have required a description of substantial specificity. In *Mammouth Cave Production Credit Association v. York*,³⁴ a description covering "all farm equipment" plus "replacements of, and additions to equipment" was held too vague and indefinite. The court reasoned that the description must identify the collateral so that it can be distinguished from property not covered. In *In re Anselm*³⁵ the security agreement purported to cover "all farm machinery and equipment, including but not limited to tractors, tanks, tilling and harvesting tools." The court held

30. *Citizens Nat'l Bank v. Sperry Rand Corp.*, 456 S.W.2d 273 (Tex. Civ. App. 1970).

31. 6 UCC REP. SERV. 1284 (S.D. Ohio 1969) (bankruptcy).

32. U.C.C. § 9-109, Comment 2; *In re La Rose*, 7 UCC REP. SERV. 964 (D. Conn. 1970) (bankruptcy).

33. S.D. COMPILED LAWS ANN. §§ 57-35-31, 57-36-3 (1967); U.C.C. §§ 9-110, 203.

34. 429 S.W.2d 26 (Ky. 1968).

35. 344 F. Supp. 544 (W.D. Ky. 1972).

that the security interest covered a tractor but not a spraying rig and tillage disc because these items were "machinery" and would not, because of their size and function, be considered "tools." In contrast to the Kentucky cases, the court in *Maryland National Bank v. Porter-Way Harvester Manufacturing Co.*³⁶ adopted an entirely different approach and held that the term "equipment" was adequate to describe "farm equipment" because it put third parties on notice that the secured party held a security interest in the debtor's equipment. Because the debtor was a farmer his equipment would be farm equipment and the notice was adequate. The last cited case is closer to the intent of the notice filing provision of the Code than are the Kentucky cases: "equipment" is a defined term under the UCC and the use of that description would give reasonable notice. However, the secured party should be well warned that lack of specificity invites litigation.

FARM PRODUCTS

Goods are farm products if they are crops or livestock or supplies used or produced in farming operations or if they are products of crops or livestock in their unmanufactured states (such as ginned cotton, wool-clip, maple syrup, milk and eggs), and if they are in the possession of a debtor engaged in raising, fattening, grazing or other farming operations.³⁷

Two categories of farm products are apparent from this definition: 1) crops, livestock or supplies used or produced in farming operations; and 2) products of crops or livestock in their unmanufactured states.

Both of these categories are subject to the additional provision that they be *in the possession* of a debtor engaged in farming operations. As long as they are in the hands of such a debtor acting in a capacity as a farmer, the purpose for which they are used is immaterial. This result is contrary to the basic classification of goods according to their use by the Code. The farmer who grows crops for use in feeding his herd is treated identically under the Code provisions to the cash crop farmer who grows crops for sale. Similarly, the large livestock feeding operations which constantly sell cattle are governed by the same rules as are dairy farmers whose livestock is used primarily for milk production and only incidentally for sale.

For products of crops or livestock to be included in the farm products definition, the Code requires that they be held in an "unmanufactured" state. The Code does not define the term but the Official Comments indicate that major processing of the prod-

36. — Del. —, 300 A.2d 8 (1972).

37. S.D. COMPILED LAWS ANN. § 57-35-29 (1967); U.C.C. § 9-109(3).

ucts must be performed by the farmer before the farm products become inventory.³⁸ There are, however, no recorded cases on the precise issue of what constitutes this major processing.

LIVESTOCK

Livestock as Collateral

The value of livestock as collateral varies depending upon the type of farm. In dairy operations, the dairy herd is very stable security because it depreciates slowly, if at all, and the herd itself produces steady income for the farmer. Because milk, not sale of livestock, is the primary source of income to the dairy farmer, the lender often may take a security interest not only in the livestock, but also in the milk products of the livestock and in the accounts arising from the sale of the milk products. The lender also knows and expects that the dairy farmer will sell the male young of the dairy herd and will cull and replace dairy cows to produce a better quality dairy herd.

In cattle feeding operations, on the other hand, the lender is looking to ultimate sale of the livestock for repayment. The lender's security is not as stable because it depends on lump sum payments, not the constant amortization of the loan from a monthly milk check. In both dairy and feeder operations the lender also must consider taking a security interest in crops, products of crops and purchased feed to insure, as much as possible, that feed would be available for the livestock.

Classification of Livestock as "Farm Products"

The term "livestock," although it is not defined in the UCC, has not been the subject of any reported controversy over its meaning. An Official Comment to the Code states that the term includes any useful farm animal such as poultry, sheep, hogs and cattle.³⁹ Further, consistent with the statutory definition of farm products, a court has held that after-acquired livestock covers after-acquired poultry.⁴⁰

There have been some cases, however, in which the issue was whether certain "livestock" were "farm products" as defined in the Code.⁴¹ Livestock are farm products if they are in the possession of a debtor engaged in fattening, raising, grazing or other farming operations. Simply put, livestock are farm products only if they are in the possession of a farmer, whether that farmer be an individ-

38. U.C.C. § 9-109, Comment 4.

39. The term clearly includes poultry. *Id.* But see INT. REV. CODE OF 1954, § 1231 (poultry specifically excluded).

40. *United States v. Pete Brown Enterprises, Inc.*, 328 F. Supp. 600 (N.D. Miss. 1971).

41. *E.g., Clovis Nat'l Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726 (1967).

ual or a large corporation. If they are in the possession of a stockyard and are held for resale, they are inventory, not farm products.⁴² However, the mere fact that an individual or entity is a farmer does not automatically assure the classification of livestock as a farm product. Additionally, the farmer must hold the livestock in his capacity as a farmer.

In *United States v. Mid-States Sales Co.*⁴³ for example, cattle in the possession of a farmer were held to be farm products, not inventory. However, in a case in which an individual was not only a farmer but also a cattle buyer and trader, the cattle which were purchased for resale were classified as inventory rather than farm products.⁴⁴

The classification of livestock as farm products has a fundamental effect on the buyer in the ordinary course of business. As explained in the section on the unauthorized sale of farm products,⁴⁵ such a buyer of inventory will take free of a security interest created by the seller but such a buyer of farm products will not.⁴⁶

Sufficiency of Description

As with farm equipment, description of livestock collateral is sufficient if it reasonably identifies what is described.⁴⁷ The problem of sufficient description of livestock as collateral has been the subject of litigation, but the courts have been lenient toward secured creditors and have found sufficient descriptions such as "all livestock" reasoning that creditors have been put on notice of a security interest.⁴⁸

Another description issue arises in connection with the young of livestock. Under the 1962 Code, a security interest can attach to the unborn young of livestock only after they are conceived.⁴⁹ It is arguable that if a secured party takes a security interest only in livestock and after-acquired livestock, the conceived but unborn are not includable in the collateral because they are not yet livestock. However, because the debtor has a present interest in them, they also are not after-acquired property. A lender should be certain to include not only after-acquired livestock but also increase in his description of collateral.⁵⁰ The 1972 Code obviates this prob-

42. S.D. COMPILED LAWS ANN. § 57-35-30 (1967); U.C.C. § 9-109(4).

43. 336 F. Supp. 1099 (D. Neb. 1971).

44. *First State Bank v. Maxfield*, 485 F.2d 71 (10th Cir. 1973).

45. See notes 119-166 *infra* and accompanying text.

46. S.D. COMPILED LAWS ANN. § 57-37-30 (1967); U.C.C. § 9-307(1).

47. *Id.* §§ 57-35-31, 57-36-3; U.C.C. §§ 9-110, 203.

48. *United States v. Pirnie*, 339 F. Supp. 702 (D. Neb. 1972), *aff'd*, 472 F.2d 712 (8th Cir. 1973); *In re Malzac*, 14 UCC REP. SERV. 1223 (D. Vt. 1974) (bankruptcy).

49. S.D. COMPILED LAWS ANN. § 57-36-6(1) (1967); U.C.C. § 9-204 (2) (a).

50. Coates, *Financing the Farmer*, 20 THE PRAC. LAW. 45, 50 (Nov. 1974) [hereinafter cited as Coates].

lem, because it no longer defines when a security interest attaches to livestock. The 1972 Code Official Comments indicate that the 1962 rules were arbitrary and that the determination of when the debtor acquired rights in the collateral should be left to the courts in individual cases.⁵¹

Another and more serious problem can arise in a dispute between lenders whose descriptions do not adequately identify their respective collateral. For example, a description of collateral as "51 head of Holstein heifers with increase" was found not to fail for insufficiency, but the court held that the description was uncertain enough to impose a substantial burden to identify the collateral securing his interest on a purchase money secured party claiming priority.⁵² This case points out the wisdom of the old saw that it is foolish to have more than one lender in "the same barn." Unless livestock can be physically segregated or permanently marked, a purchase money lender attempting to obtain priority over a previously filed interest in after-acquired property faces a substantial proof burden. If the purchase money lender desires to make a loan secured by unsegregated livestock, it should obtain a subordination agreement from the previously filed lender and should not depend on its purchase money priority.⁵³ Subordination is especially important because of the inherent priority limitations on purchase money interests as they relate to herd increase.⁵⁴

Purchase Money Security Interest in Livestock

A purchase money security interest in livestock, if it is a farm product, is generally given priority over conflicting security interests in the same collateral if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within ten days thereafter.⁵⁵ Furthermore, a purchase money secured party is protected against certain lien creditors who acquire a lien within the ten day period if the secured party perfects its interest within that time.⁵⁶ Because priority is dependent upon

51. S.D. COMPILED LAWS ANN. §§ 57-36-3, to -10 (1967); U.C.C. §§ 9-203, 204; U.C.C. § 9-204, Reasons for 1972 Change (1972 version).

52. *United States v. Mid-States Sales Co.*, 336 F. Supp. 1099, 1102 (D. Neb. 1971); see S.D. COMPILED LAWS ANN. § 57-37-39 (1967); U.C.C. § 9-312(4).

53. S.D. COMPILED LAWS ANN. § 57-37-53 (1967); U.C.C. § 9-316.

54. The lender also should recognize an obvious but sometimes misunderstood fact: the financing statement itself does not give an interest in the collateral. This is done by the security agreement. The financing statement only gives notice. In *Tri-County Livestock Auction Co. v. Bank of Madison*, 228 Ga. 325, 185 S.E.2d 393 (1971), the security agreement granted an interest in 800 cattle, and the financing statement covered not only the 800 cattle but also the increase. The court held that the security interest was limited to the 800 cattle described on the security agreement and did not flow to the increase. See also *Barth Bros. v. Billings*, — Wis. —, 227 N.W.2d 673 (1975).

55. S.D. COMPILED LAWS ANN. §§ 57-35-25, 57-37-39 (1967); U.C.C. §§ 9-107, 312(4).

56. *Id.* § 57-37-2; U.C.C. § 9-301(2); see *id.* § 57-37-1(3); U.C.C. § 9-

filing within the ten day period after the debtor acquires possession, courts have struggled with cases in which filing was not made within the ten day period after obtaining possession, but was made within ten days of the person becoming a debtor. In *North Platte State Bank v. Production Credit Association*⁵⁷ a farmer, in November of 1968, purchased cattle from a seller, taking actual possession of them. The Production Credit Association had at that time two filed perfected security interests which included after-acquired property clauses. On January 30, 1969, the bank executed a loan which enabled the farmer to pay for the cattle. The bank filed a financing statement on February 5, 1969, within ten days after the loan was made, thus acquiring a perfected security interest in the cattle. The farmer debtor subsequently defaulted and a priority battle ensued.

The bank argued that the livestock was not "collateral" until the farmer became a "debtor" to the bank through receipt of a loan from the bank. Under its reasoning, the farmer could only be considered to have received the collateral at the time he became a debtor to the bank. The court rejected this argument, finding that the farmer had become a "debtor" when he received, without payment, the possession of the cattle: the debtor status was not withheld until the bank made a loan. Therefore, the court held that the ten day period of the purchase money security interest section had begun to run at the time the farmer received possession of the cattle in November of 1968 and that the bank had failed to file to perfect its interest within the requisite ten days.⁵⁸ It therefore lost to the PCA in the priority battle.

Any lender who relies on a purchase money security interest must recognize its inherent limitations when conflicting with a prior perfected security interest in after-acquired property. Often a lender will advance funds to a farmer for the purchase of cattle based on the purchase money priority rules, only to find later that the cattle have been sold, traded or have otherwise disappeared. The 1962 Code is unclear regarding the relative priority rights in proceeds, be they cash or replacements, between a purchase money interest and a previously filed interest in after-acquired property.⁵⁹ This problem is eliminated by the 1972 Code which specifically states that a properly filed purchase money interest in collateral other than inventory also has a prior interest in the proceeds.⁶⁰

The purchase money priority relates only to the livestock in existence and to increase already conceived at the time the security interest attaches; the purchase money priority rules will not apply

301(1)(c) (certain good faith transfers). *But see id.* § 57-37-30; U.C.C. § 9-307(1).

57. 189 Neb. 44, 200 N.W.2d 1 (1972).

58. *Id.* at —, 200 N.W.2d at 6. *See also* James Talcott, Inc. v. Associates Capital Co., 491 F.2d 879 (6th Cir. 1974).

59. S.D. COMPILED LAWS ANN. § 57-37-39 (1967); U.C.C. § 9-312(4).

60. U.C.C. § 9-312(4) (1972 version).

to the after-conceived livestock.⁶¹ Instead, a prior filed security interest with an after-acquired property clause will attach first to the increase.⁶² Because the 1972 Code does not define when a debtor had rights in livestock, courts conceivably could hold that a debtor had rights not only in the livestock itself but also in future increase. This would give the purchase money secured party priority in the increase and would be a fair result because the prior filed party should not be able to benefit from the advances made by the purchase money secured party.

A secured lender relying on the purchase money priority also may get involved in a priority battle if it lends some of the purchase price and the seller of the cattle retains an interest as well. If the seller retains possession of the livestock after execution of the sale agreement, which gives the seller value and the debtor rights in the collateral, and files before the debtor receives possession, the seller would have a purchase money security interest initially perfected by possession.⁶³ The lender, by filing later, but within the ten day period, also obtains a purchase money security interest. Under the Code's priority rules, because the seller perfected by a method other than filing, priority would be determined by the time of perfection and not of filing, and the seller would have priority because he perfected by possession.⁶⁴

Priority of Breeding Lien

The priority of a perfected security interest may also be affected by liens arising by operation of law. Such liens may take precedence over a perfected security interest.⁶⁵ In some states, for example South Dakota and Wisconsin, the statute provides that an artificial inseminator or the owner of a breeding animal has a lien on the offspring prior to a perfected security interest.⁶⁶

PRODUCTS OF LIVESTOCK

Products of Livestock as Collateral

The products of livestock as a form of collateral are often taken as security along with livestock but are seldom considered by themselves as a primary source of collateral. Products of livestock include milk, eggs and sheep-clippings and also include some items not readily associated with the term "products," such as manure. If products are used as primary collateral, the secured party also should take an interest in the producing livestock to avoid possible

61. S.D. COMPILED LAWS ANN. § 57-35-25 (1967); U.C.C. § 9-107.

62. *Id.* § 57-37-40; U.C.C. § 9-312(5).

63. *Id.* §§ 57-37-10, 41; U.C.C. §§ 9-303(2), 312(6).

64. *Id.* § 57-37-40; U.C.C. § 9-312(5); 5A HART & WILLIER, *supra* note 16, ¶ 93.25 (1968). The seller also may achieve a similar result by shipping under reservation and obtaining either a negotiable bill of lading or naming himself as consignee in a nonnegotiable bill of lading.

65. S.D. COMPILED LAWS ANN. § 57-37-34 (1967); U.C.C. § 9-310.

66. *Id.* § 40-27-3; WIS. STAT. ANN. § 289.49 (1971).

conflicts with other creditors who may subsequently obtain an interest in the livestock.

At least one prominent author recommends that products of livestock normally not be taken as security because these products are usually marketed on a daily or weekly basis and a security interest in them would place the farmer in a position in which he could not market regularly unless he had permission to sell. The author suggests instead that the secured party receive an interest in the account arising from the sale of the products.⁶⁷

This writer believes that the account is important as collateral. However, the security interest in the account should be further protected by taking a security interest in the products of livestock. Using an example with which this writer is familiar, a security interest should be taken not only in the milk account, but in the milk itself. This procedure could prevent a confrontation with another creditor who later takes a security interest in the milk and claims an interest in the proceeds from its sale. Because a farmer cannot sell farm products free of a security interest unless authorized to do so, a secured creditor with a security interest in the milk conceivably could sue the account financier for a declaration that his security interest is prior to that of the account financier. This might occur if the farmer defaults after the farmer makes a direct payment to the account financier. If the secured party does take a security interest in the relevant product of livestock, it should give the farmer permission to sell to a specified customer, such as a particular dairy, or in a particular manner. A provision of this nature will protect the creditor from unauthorized sales yet will not create possible conflicts with the purchaser.⁶⁸

The secured party who takes products of livestock as collateral should obtain rights only in the products with which it is concerned. A blanket security interest in all products of livestock should seldom be taken unless it is important to protect the secured party. For example, the term "products of livestock" with reference to cattle would include not only milk but also the manure produced by the cattle. If the manure was to be used by the farmer as fertilizer for crops to feed the cattle, the secured party should retain an interest. If, on the other hand, the manure was to be sold as fertilizer by the farmer and the secured party was not depending on this source of collateral for its loan, the secured party should not hamper the sales by taking a security interest in it. Moreover, another creditor may wish to take a security interest in the manure to fi-

67. Coates, *supra* note 50, at 53.

68. A thorough discussion of the priority conflict between the security interest in the milk account and the security interest in the proceeds is beyond the scope of this article. For a more detailed commentary see WHITE & SUMMERS, *supra* note 2, at 908-13.

nance the manure sale. By taking a security interest in more products than it needs, a creditor may unfairly prevent a farmer from obtaining further credit. Blanket coverage also may cause a court to accept arguments contending that the secured party waived his security interest by overreaching.

Accounts Arising from the Sale of Products of Livestock

Accounts arising from the sale of products of livestock will generally be a useful form of collateral when the farmer-debtor is in the business of daily or weekly marketing of a product such as milk or eggs. Accounts arising from the sale of products of crops, however, are generally not useful for this type of financing because proceeds result from only a single, yearly sale. The receipts from the periodic marketing of products provide a way for the debtor to amortize his loan directly from the proceeds of the sale of his farm products. For example, security interests in milk accounts with direct assignment of the proceeds are very common in dairy states, and are commonly but erringly referred to as "milk check assignments."

The delivery of milk to the dairy creates an account.⁶⁹ The "milk check assignment" is the taking of a security interest in accounts by the secured party in conjunction with an assignment to the secured party of the farmer's rights to receive direct payment on the account.⁷⁰ This security interest in the account can be enhanced by taking a security interest in livestock, the underlying product of livestock, the milk, and in the contract right arising from the farmer's marketing contract. In connection with the security interest in contract rights arising from the marketing agreement with the dairy, the secured party can agree with the farmer-debtor that the contract will not be modified without the consent of the secured party.⁷¹ Although the term "contract right" has been removed from the 1972 Code as unnecessary,⁷² parties may continue to agree that a contract will not be modified without the secured party's consent.

A farmer has the right to assign the benefits of his accounts and contract rights as collateral, but the dairy or other account debtor would have the right to continue to pay the farmer-assignor until it receives notice that the account has been assigned and that payment is to be made to the secured party.⁷³ Section 9-318⁷⁴ makes it clear that the farmer-debtor and the secured party can agree to have account payments made directly to the secured party

69. S.D. COMPILED LAWS ANN. § 57-35-24 (1967); U.C.C. § 9-106. For a discussion of the pre-U.C.C. effects of a milk check assignment, see COATES, *supra* note 5, at 25-26, 49-53.

70. Coates, *supra* note 50, at 51-54.

71. S.D. COMPILED LAWS ANN. § 57-37-56 (1967); U.C.C. § 9-318(2).

72. See U.C.C. § 9-106 (1972 version).

73. S.D. COMPILED LAWS ANN. §§ 57-37-56, 57 (1967); U.C.C. § 9-318(2), (3).

74. *Id.* §§ 57-37-56 to -58; U.C.C. § 9-318.

and that the account debtor (the dairy) must remit directly to the secured party upon receipt of the requisite notice.⁷⁵ Although the UCC uses the term "assignment" of accounts and contract rights in section 9-318, evidently that language is interchangeable with the term "security interest" when used regarding these forms of collateral.⁷⁶ One author, Coates, notes that if only part of the milk account is to be paid directly to the creditor, "it may be argued that the milk purchaser should agree to the transfer because Section 2-210(2) prohibits an assignment of rights under a sales agreement where the duty of the other party is materially increased"⁷⁷ Because a partial direct payment means the additional administrative expense of sending at least two checks, the dairy has a strong argument that its duties are materially increased. It is this writer's opinion, however, consistent with that of Coates, that section 2-210(2) on the rights under a sales contract does not apply when the farmer has already delivered the milk and the only remaining obligation of the purchaser is to make payment.⁷⁸

Because the "milk check assignment" has strong pre-Code roots, it is the experience of this writer that secured parties generally are not familiar with the operation of an assignment under the Code. Often a milk account assignment is used to amortize a farm real estate mortgage without the lender realizing that the assignment is a Code security interest which requires Code filing to establish priority. Without such a filing the mortgagee-secured party would not have a perfected security interest in the account and would be subject to a priority created by another secured party who had perfected its interest in the accounts.

Another area in which lenders have shown less than adequate sophistication is in the ascertaining of the relative priority of multiple assignments to various creditors by the same farmer. In the experience of this writer, it is common in the dairy states for one milk account to be paid in percentages or absolute dollar amounts to several different creditors regardless of the relative priorities of the many secured parties in the one basic milk account. A potential secured party should check the filed financing statements to determine whether any prior account filings are on record against the debtor; another creditor may have obtained, and often does obtain, a security interest in all the present and future accounts of a farmer-debtor but has notified the account debtor to pay only a certain percentage or amount of the account directly to him. If the interest of a prior secured party is perfected in all the accounts, he will be prior to a later security interest even if the prior secured party is not actually receiving a direct assignment of the whole

75. See also *id.* §§ 57-39-6, 7; U.C.C. § 9-502.

76. 5A HART & WILLIER, *supra* note 16, ¶ 95.04 (1968).

77. COOGAN, HOGAN & VAGTS, *supra* note 4, ¶ 27.04(2).

78. Cf. *id.* ¶ 27.04(2) (1968). See also U.C.C. § 2-210, Comment 3.

account. If the debtor granted a security interest in the entire account the prior lender would have the right to obtain it when he desired to do so, and the subsequent lender would have no basis upon which to object.⁷⁹ To prevent this problem from arising when the debtor gets into financial difficulty, the subsequent lender should attempt to obtain a release or subordination agreement from the prior lender at the time of the advance of credit.⁸⁰

CROPS AND PRODUCTS OF CROPS

Crops as Collateral

Crops can be either the primary or an important secondary collateral for a secured party. If the crops are grown in anticipation of sale, they are often the primary collateral for a production lender. Even if crops are not the actual focus of the extension of credit, a security interest in them may be very valuable. For example, a security interest in crops complements a security interest in livestock because it will give the lender some control over the disposition of livestock feed. Crops are defined by the UCC as farm products if they are in the possession of a farmer and used or produced in farming operations.⁸¹ No differentiation is made in the Code regarding the use of crops; the same rules apply whether the crops are grown for feed or whether they are grown for sale as long as they are in the possession of a farmer.

When a lender takes a security interest in a crop, the products of the crop also should be included. Although they are included in the definition of "farm products," "crops" and "products of crops" are neither defined nor distinguished by the UCC.⁸² The law is not clear concerning when a crop becomes a product of that crop. Is the harvested hay or corn in a storage facility a crop or a product of the crop? For a product of a crop to be a farm product, the product must be in its unmanufactured state, and it must be in the possession of a farmer.⁸³ "Manufacturing" also is not defined by the Code, but an Official Comment states that processes clearly connected with farming such as pasteurizing milk would not be manufacturing but that canning peas would be.⁸⁴ Consequently, upon a debtor's default, the nondefinition of crops and their products may cause a secured party without an interest in products of crops to find a gap in his protection.

Like personalty lenders, a real estate mortgagee or a lessor seeking a security interest in crops must comply with article nine to obtain priority. The reason for this is that the Code defines

79. S.D. COMPILED LAWS ANN. § 57-37-40 (1967); U.C.C. § 9-312(5).

80. *Id.* § 57-37-53; U.C.C. § 9-316.

81. *Id.* § 57-35-29; U.C.C. § 9-109(3).

82. *Id.*

83. *Id.*

84. U.C.C. § 9-109, Comment 4.

growing crops as "goods"⁸⁵ and the UCC covers any transaction intended to create a security interest in goods.⁸⁶ To comply with the UCC a mortgagee or lessor would have to comply with the filing requirements of the Code.⁸⁷ This would require a double filing, one with the real estate records for the mortgage and one with the UCC records for the crops.⁸⁸ Further, the UCC filing would only be valid for a maximum period of five years without refileing regardless of the length of the real estate mortgage. Personalty and realty lenders relying on a security interest in a crop must be certain that they have complied with all the technical requirements of the UCC. No other type of Code collateral has so many impediments to its effectiveness. These impediments run the gamut of the Code rules from description to filing.

Sufficiency of Description

A security interest in crops is not enforceable against the debtor or a third person unless the security agreement and filed financing statement⁸⁹ contain a description of the land concerned.⁹⁰ The official UCC text provides that any description of personal property or real estate is sufficient whether or not it is specific if it reasonably identifies what is described.⁹¹ Thus these rules give the secured party a significant chance for error in that he must include a real estate description on the security agreement for the security interest itself to be effective and he also must include it on the financing statement to perfect his interest.

In interpreting disputes relating to the reasonableness of the description in the financing statement under the official UCC text, the courts have applied the general rule that some sort of a description purporting to identify the real estate is mandatory.⁹² The description generally is adequate if a person searching the records could locate the property from the description given. In *United States v. Big Z Warehouse*⁹³ the court held that "crops growing or to be grown on the farm of Oscar B. Chauncey located one mile north of Offerman, Georgia," was an adequate description. In *Chanute Producton Credit Association v. Weir Grain Supply, Inc.*,⁹⁴ the court held that "land owned or leased by the debtor in Cherokee County, Kansas," was an insufficient description because third persons could not easily find records relating to lands leased

85. S.D. COMPILED LAWS ANN. § 57-35-20(6) (1967); U.C.C. § 9-105(f).

86. *Id.* § 57-35-2(1); U.C.C. § 9-102(1)(a).

87. *Id.* §§ 57-38-7 to -11; U.C.C. § 9-402.

88. 1A COOGAN, HOGAN & VAGTS, *supra* note 4, ¶ 16.05 (1964).

89. S.D. COMPILED LAWS ANN. § 57-38-7 (1967); U.C.C. § 9-402(1).

90. *Id.* §§ 57-36-3, 4; U.C.C. § 9-203.

91. *Id.* § 57-35-31; U.C.C. § 9-110.

92. See, e.g., *In re Mount*, 5 UCC REP. SERV. 653 (S.D. Ohio 1968) (bankruptcy). But see *First Nat'l Bank v. Calvin Pickle Co.*, 11 UCC REP. SERV. 1245 (Okla. Ct. App. 1973).

93. 311 F. Supp. 283 (S.D. Ga. 1970).

94. 210 Kan. 181, 499 P.2d 517 (1972).

by the debtor.⁹⁵ In *Pigott State Bank v. Pollard Gin Co.*⁹⁶ the Arkansas Supreme Court dismissed the secured party's action for conversion of a cotton crop. The bank's financing statement and security agreements described the collateral as:

All of the following crops to be planted or growing within one year from the date hereof on the lands hereinafter described: 7 acres of cotton and 53 acres of soybeans to be produced on the lands of S. E. Karnes; 11.6 acres of cotton and 50 acres of soybeans to be produced on the lands of Mary Gilbee . . . all of the above crops to be produced in Clay County, Arkansas during the year 1965.⁹⁷

The description was held inadequate because it failed to state whether the debtor grew more than seven acres of cotton on Karnes' land or whether anyone else was growing cotton on that land.⁹⁸ One court, however, has held that the sufficiency of the description should not be a consideration in a battle between two creditors when the one claiming that the other's description was inadequate was, in fact, knowledgeable about the crop description because he had obtained a subordination agreement from the first lender for the crops.⁹⁹ Because a misdescription may result in the loss of the entire security interest, the lender should be extremely careful in describing the real estate.

Some states, including South Dakota,¹⁰⁰ have modified the official text to require the lender to describe the land by legal description. This appears to be a better solution than it actually is for two reasons. The first is that many crop production loans will not be large enough to justify the expense of obtaining legal counsel to provide services in connection with the description. Second, unless the debtor stands the expense of a survey, he is effectively precluded from using as security crops located on separate tracts of land which are included in one legal description.

Filing

Under the second and third alternatives to the official text of section 9-401(1), a secured party wishing to perfect a security interest in crops must file a financing statement in the county in which the crops are grown.¹⁰¹ In *United Tobacco Warehouse*

95. Although the statute interpreted in *Chanute* varied from the official text of the U.C.C., the variance did not affect the result.

96. 243 Ark. 159, 419 S.W.2d 120 (1967).

97. *Id.* at —, 419 S.W.2d at 121.

98. *Id.* See also *People's Bank v. Pioneer Food Indus., Inc.*, 253 Ark. 277, 486 S.W.2d 24 (1972), in which the court ruled that a description, which included an accurate legal description of only some of the land involved, was inadequate except to the extent of the land actually described.

99. *First Security Bank v. Wright*, 521 P.2d 563 (Utah 1974).

100. S.D. COMPILED LAWS ANN. § 56-35-31 (Supp. 1974).

101. The second alternative has been adopted in South Dakota. The first alternative subsection 1 to section 9-401 requires central filing in all cases except fixtures.

*Co. v. Wells*¹⁰² a creditor was not able to assert his alleged priority in crops under section 9-312(2)¹⁰³ because he filed the financing statement in the county of the debtor's residence not in the county where the crops were grown. It is especially easy to run afoul of this rule if the security interest is obtained not only in crops, but also in other farm products because other farm product filings are made in the county of the debtor's residence.¹⁰⁴

Security Interest in After-Acquired Crops

Generally, a secured party may take a security interest in all the personal property owned by a debtor, both present and future, to secure all obligations, both present and future, owed by the debtor to the secured party. However, the scope of this general rule is restricted as it relates to crop collateral, both as to present and after-acquired interests. As to present interests, the Code specifically defines when a debtor has rights in a crop to which a security interest may attach. This right is acquired when the crop is planted or otherwise becomes growing.¹⁰⁵ The after-acquired interest is even more severely limited because no security interest can attach under an after-acquired property clause to crops which are planted more than one year after execution of a security agreement, unless it is given in connection with a real estate lease, purchase or improvement transaction.¹⁰⁶

An interesting although minor issue under the 1962 Code is the determination of whether the debtor has a present right in a perennial crop upon planting¹⁰⁷ or whether his interest would be after-acquired and thus limited to one year.¹⁰⁸ In other words, would a security interest in an alfalfa crop be limited to one year when the crop grew at least once within the year and then grew again for several more years without planting or did the interest attach to all growths of the perennial crop on planting?¹⁰⁹ Although this ambiguity has not been resolved by the courts, it seems that the intent of the statutory language would best be served by viewing each growth as a separate crop so that subsequent growths arising from the same planting would in turn be after-acquired. The reason for this view is that it would follow the statutory intent by preventing the farmer from unwittingly mortgaging his future source of feed and income.

The limitation on the debtor's rights to intentionally or unintentionally pledge future crops is an example of the paternalism with

102. 11 UCC REP. SERV. 1252 (Ky. 1973).

103. S.D. COMPILED LAWS ANN. § 57-37-37 (1967).

104. *Id.* § 57-38-1; U.C.C. § 9-401(a) (second and third alternatives).

105. *Id.* § 57-36-6(1); U.C.C. § 9-204(2)(a).

106. *Id.* § 57-36-8; U.C.C. § 9-204(4)(a).

107. *Id.* § 57-36-6(1); U.C.C. § 9-204(2)(a).

108. *Id.* § 57-36-8; U.C.C. § 9-204(4)(a).

109. 1A COOGAN, HOGAN & VAGTS, *supra* note 4, ¶ 16.02(2), at 1693 (1964).

which the UCC treats farmers. The Code does not limit the right of a farmer-debtor to pledge his equipment or his livestock, but it does limit his rights with respect to his crops, except in the case of certain land-related transactions. This inconsistency was recognized and all limitations on security interests in after-acquired crops were deleted from the 1972 Code as was the rule that a debtor has no rights in a crop until it is planted or otherwise becomes growing.¹¹⁰ One of the reasons that the limitation on after-acquired crops was deleted in the 1972 Code was a practical one: the 1962 rule did not work effectively to prevent a lender from encumbering a debtor's future crops because the one year requirements apply only to the security agreement, not to the financing statement. All that was needed each year was a new security agreement signed by the debtor; the old financing statement would retain the filing priority of the creditor under the first to file rule.¹¹¹

Priority of Crop Production Loans

In the view of the author, a lender cannot obtain a purchase money interest in a crop because his advance for the purchase of seed does not in itself enable the farmer to obtain rights in the crops but only in the seed.¹¹² The farmer obtains rights in the crops only by planting.¹¹³ This situation would discourage the use of crop production loans because the production lender would be subordinate to prior perfected interests in the crops.¹¹⁴ To remedy this the Code has included a special Alice-in-Wonderland priority rule for them. Section 9-312(2) provides:

A perfected security interest in crops for new value given to enable the debtor to produce the crops during the production season and given not more than three months before the crops become growing crops by planting or otherwise takes priority over an earlier perfected security interest to the extent that such earlier interest secures obligations due more than six months before the crops become growing crops by planting or otherwise, even though the person giving new value had knowledge of the earlier security interest.¹¹⁵

This provision has very limited application because of the many requirements placed on the production lender. Its only seeming advantage is that a lender may be able to take a purchase money security interest in equipment used for planting and also may be able to get priority on the crop under this section. The only prior-

110. U.C.C. § 9-204, Reasons for 1972 Change (1972 version).

111. S.D. COMPILED LAWS ANN. § 57-37-40 (1967); U.C.C. § 9-312(5); *cf.* United States v. Gleaners & Farmers Cooperative Elevator Co., 314 F. Supp. 1148 (N.D. Ind. 1970).

112. S.D. COMPILED LAWS ANN. § 57-35-25 (1967); U.C.C. § 9-107.

113. *Id.* § 57-36-6(1); U.C.C. § 9-204(2) (a).

114. *Id.* § 57-37-40; U.C.C. § 9-312(5).

115. *Id.* § 57-37-37; U.C.C. § 9-312(2).

ity the section gives, however, is over obligations due more than six months before planting. For example, if a mortgage were in default prior to six months before planting, the production loan would take priority over those payments then due. It would not take priority over obligations due after the six month cutoff date. If a farmer were substantially delinquent on a mortgage, a lender could make a crop production loan and only be subordinated to the first lender to the extent of the default occurring within six months of planting. This time limitation gives the priority a very limited value even if the lender can make his loan in the three month period before the crops are planted. Finally, the secured party's priority may be subject to still another attack, this time from a lien creditor. Section 9-312(2) does not apply until the crops are planted. If a person becomes a lien creditor before the crop is planted, but after the secured party has filed, he may have priority as the security interest is perfected only on the latter of planting or filing.¹¹⁶

Priority of Threshermen's Liens

Another priority rule also may affect a security interest in crops. Section 9-310¹¹⁷ provides that certain liens arising by operation of law take precedence over a perfected security interest. In some states, for example South Dakota and Wisconsin, the statute provides that a thresherman would have a lien on the crops which would be prior to a perfected security interest.¹¹⁸

UNAUTHORIZED SALE OF FARM PRODUCTS

One of the most important and perplexing provisions of article nine relating to farm collateral reflects the strong conflict between the farmer's secured creditors and the purchasers of his farm products. The Code draftsmen have made a value judgment which places the interest of a farmer's creditors above that of the purchasers of his products, farm products, which are specially defined. The opposite rule applies to other goods held for sale, inventory.¹¹⁹ Thus corn in a farmer's hands is a farm product which may not be sold free of a security interest created by him, while corn in the hands of an elevator may be sold to a buyer in the ordinary course of business completely free of a security interest created by the elevator. This treatment was elected even though farm products have many characteristics of inventory,¹²⁰ the most important of which is

116. *Id.* § 57-37-1(2); U.C.C. § 9-301(1)(b). The security interest cannot attach until the debtor gets rights in the collateral. *Id.* § 57-36-5; U.C.C. § 9-204. The debtor does not get these rights until a crop is planted. *Id.* § 57-36-6(1); U.C.C. § 9-204. If filing is made before attachment, then the interest is perfected on attachment. *Id.* § 57-36-5; U.C.C. § 9-204.

117. *Id.* § 57-37-34.

118. *Id.* § 38-17-16; WIS. STAT. ANN. § 289.50 (1971).

119. *Id.* § 57-37-30; U.C.C. § 9-307(1).

120. *Id.* §§ 57-35-27 to -30; U.C.C. § 9-109.

that, like inventory, farm products are produced to be sold (unless crops are grown for feed and livestock are grown for their products such as milk or eggs).

The result of this Code treatment of purchasers is that a farm product marketing organization may well end up paying the secured lender for the farm products even though it remitted the sales proceeds to the farmer. This can occur if the marketing organization sells farm products for a farmer or purchases them from him and the farmer misappropriates the purchase price. This rule is applied even though the marketing organization is, practically speaking, often helpless to protect itself. The very size of the giant multi-state farm cooperatives and marketing organizations make it impossible in practice to check the local filings of financing statements. Moreover, a check of the filings would indicate only that a debt once was owing and does not inform the searcher as to whether credit presently is outstanding or, if it is, whether the sale of farm products is authorized. Yet, the secured creditor, usually either a local bank, production credit association, or a Farmers Home Administration branch, which has the capability of policing its collateral, is protected. There are at least two reasons which have been espoused for this favorable treatment of lenders. The usual one is that added security is necessary to encourage lenders to advance credit on farm product collateral.¹²¹ The other reason often given is that the farmer is not a merchant selling from inventory and should not be treated as one.¹²² The first reason does not appear to be particularly valid because much farm lending is done either by rural banks whose principal customers are farmers or by entities specifically designed for farm lending such as production credit associations and the Farmers Home Administration. Furthermore, if it is a sound reason, it acquired its validity recently as under pre-Code law loans often were made even where there really was no legal right to collect on the collateral.¹²³ The second argument appears to be more telling. It is difficult to argue persuasively that a present day farmer should not be a "merchant" under the Code as to the products he produces.¹²⁴

Nonetheless, there is a cogency to the argument that farm products really *are* different from inventory. Farm products, unlike

121. Cf. Comment, *Farm Products Under the U.C.C.—Is a Special Classification Desirable?*, 47 TEXAS L. REV. 309 (1969).

122. Cf. COATES, *supra* note 5.

123. Cf. Campbell v. Yokel, 20 Ill. App. 3d 702, 313 N.E.2d 628 (1974).
But see Sierens v. Clausen, 21 Ill. App. 3d 450, 315 N.E.2d 897 (1974).

124. A "merchant" is

a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill. S.D. COMPILED LAWS ANN. § 57-2-7 (1967); U.C.C. § 2-104(1).

inventory which is sold piecemeal, often are sold in bulk yet the sales are not subject to the creditor protecting strictures of the UCC bulk sales provisions.¹²⁵ The addition of farm product sales to the bulk sales provisions would not be appropriate because farm products are sold in bulk in the ordinary course of business. Furthermore this would not be a practical solution because of clerical work and notice requirements.¹²⁶ However, without some sort of protection, the lender may be left without a reasonable chance of collection. This lack of creditor protection justifies the concern of the draftsmen for the protection of the creditor. Thus the provision in section 9-307(1) which allows a seller to sell collateral to a buyer in the ordinary course of business free of a security interest created by the seller should not be applicable to farmers because the sales by a farmer would leave the lender without a practical method of protecting his interest.

Conversion

Commonly, farm credit disputes arise after the debtor-farmer has sold his farm products to a food processor through a marketing agent. Because crops and livestock are most often sold by the farmer through a marketing agency in a manner which leaves the purchaser unidentified and the collateral commingled and unidentifiable, possessory rights generally are ineffective. Also, because the ultimate purchaser's identity often is not known, the continuation of the security interest in the product or mass would be of little consolation if an action is not available against the immediate purchaser.¹²⁷ Since possession of the farm product is unobtain-

125. U.C.C. § 6-102, Comment 2.

126. Cf. S.D. COMPILED LAWS ANN. §§ 57-24-22 to -24 (1967); U.C.C. § 6-107.

The report of the Article 9 Review Committee in 1970 recommended that section 9-307(1) be amended to delete the restriction on sales of farm products free of a security interest; however, this recommendation was not adopted by the Permanent Editorial Board of the Uniform Commercial Code for the 1972 Code. Dean Hawkland indicates that the federal government fought the change and was the chief proponent for protecting the creditor. He stated that the federal government can threaten to enact its own legislation to protect creditors. Another reason for the deletion given by Dean Hawkland is that a change in the rule would result in many nonuniform amendments to the section. Hawkland, *supra* note 6, at 420.

127. S.D. COMPILED LAWS ANN. §§ 57-37-51, 52 (1967); U.C.C. § 9-315. However, this section generally creates more problems than it solves. One commentator has noted:

Farm products are often fungible goods, i.e., "any unit is, by nature or usage of trade, the equivalent of any other like unit" [sec. 1-201(17)]. Unless the security interest extends to all such goods, a very real conflict can develop when they are commingled. Further, if only a part of the goods are the debtor's, as where the debtor farms on a crop-sharing basis, commingling at least presents the problem of applying the proper fraction to the whole. . . . In the extreme case, debtor could grant a security interest in each of separate crops of the same kind to different secured parties; when harvested, the crops will usually be commingled and stored in the same facility.

able and the farmer is insolvent, the lender seeks another avenue of redress. Usually participation by the marketing company is the easiest to trace. Even though the marketing company has paid the farmer, it still may be liable to the lender for conversion of the farm product.¹²⁸ The rule in most states appears to be quite clear: An agent is guilty of conversion when he sells farm products for his principal even though he acts in good faith and without knowledge that another creditor holds a security interest in them.¹²⁹

Presumably, Section 9-315 could be applied, if only by analogy, to determine priorities among secured parties. That section provides that a perfected security interest in goods continues "in the . . . mass if the goods are so . . . commingled that their identity is lost in the . . . mass." Priorities are determined "according to the ratio that the cost of the goods to which each interest originally attached bears to the cost of the total . . . mass." In the case of crops which have been grown, "cost" is an unreal measurement; if "cost" means "price," it would be equally unreal. Further, any such test presents evidentiary difficulties. Of course, if the yield of each crop is provable, such a ratio based upon yield or the value of yield could be worked out, but the statute does not provide for this. In fact, the Official Comment does not discuss farm products as examples except insofar as they become lost in a product—milk and eggs which become part of cake mixes. In that example, they would be the manufacturer's inventory and not farm products. 5A HART & WILLER, *supra* note 16, ¶ 93.19 (1968).

For a discussion of the relative priorities when one secured party has a security interest in crops and another has an interest in livestock and the livestock eats the crops, see Clark, *supra* note 1, at 362-63.

128. One of the secured party's fundamental rights on default by the debtor is to take possession of the collateral, unless the debtor has sold the property free of the security interest. See S.D. COMPILED LAWS ANN. 57-39-8 (1967); U.C.C. § 9-503. See S.D. COMPILED LAWS ANN. §§ 57-37-1(3), 19, 30 (1967); U.C.C. §§ 9-301, 306(2), 307. The creditor may follow it into the hands of the purchaser or, in an appropriate case, maintain an action for conversion. U.C.C. § 9-306, Comment 3. Professor Gilmore has stated: "[T]he secured party . . . [has] the right to follow collateral into the hands of good faith purchasers for value and to have whatever recovery, by an action in replevin or conversion, the law of the relevant state may allow." 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 714-15 (1965). "Conversion" is defined in AM. JUR.2d as: "A conversion is a distinct act of dominion wrongfully exerted over another's personal property in denial of or inconsistent with his title or rights therein, or in derogation, exclusion, or defiance of such title or rights." 18 AM. JUR. 2d *Conversion*, §1 at 158. For further explanation, see *id.* § 30 at 174:

A person who purchases personal property from one not authorized to sell the same may be held liable for conversion thereof, regardless of the fact that the purchaser was honestly mistaken, or acted innocently, in good faith, and without knowledge of the seller's lack of right to make the sale.

See also RESTATEMENT (SECOND) OF TORTS § 229 (1965). In *United States v. Pete Brown Enterprises, Inc.*, 328 F. Supp. 600 (N.D. Miss. 1971), the court held that a secured party could proceed against the purchaser in conversion without exhausting his remedies against the debtor.

129. *E.g.*, *United States v. Big Z Warehouse*, 311 F. Supp. 283, 286 (S.D. Ga. 1970). The Georgia legislature reacted to this type of result by amending section 9-307 of the Georgia U.C.C. by adding a new subsection (3) relieving *livestock* commission merchants from liability in certain circumstances. See also *United States v. E. W. Savage & Son, Inc.*, 343 F. Supp. 123 (D.S.D. 1972), *aff'd*, 475 F.2d 305 (8th Cir. 1973); *Clovis Nat'l Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726 (1967); Annot., 96 A.L.R.2d 208, 212 (1964). Some conflict has arisen over the effect of the Packers and Stockyards Act, 7 U.S.C. § 181-229 (1970), on the ability of a secured party to recover in conversion from an entity covered by the Act. However, the United States Supreme Court recently decided that the Act was not intended to determine security rights between a seller and third parties. *Mahon v. Sowers*, 94 S. Ct. 1626 (1974).

The harsh effect of these rules on agents and purchasers makes valuable a discussion of the statutory framework from which these results emanate. The fountainhead rule is contained in section 9-306(2) which provides:

Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof by the debtor unless his action 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.¹³⁰

Thus the general rule is that the security interest continues in UCC collateral in the hands of a purchaser or transferee. An Official Comment to the Code states the effect of this rule: “[S]ince the transferee takes subject to the security interest, the secured party may reposses the collateral from him or in an appropriate case maintain an action for conversion.”¹³¹

However, section 9-306(2) also contains two basic exceptions to the general rule: The security interest does not continue in the collateral if other provisions of article nine provide otherwise, nor does it continue if the secured party authorizes its disposition “in the security agreement or otherwise.”

Possible Statutory Exceptions

Four provisions in article nine seems relevant to the discussion of possible statutory exceptions to the rule that an unauthorized sale of farm products results in their conversion by the purchaser. These include: 1) An argument based on section 9-311 that the sale is a transfer of debtor's rights; 2) An argument that a transfer by a negotiable warehouse receipt may defeat a perfected security interest in farm products; 3) An argument that the sale is actually a sale to a buyer in the ordinary course of business; 4) An argument based on section 9-306(2) concerning disposition of farm products by one other than the debtor.

A. Transfer of Debtor's Rights

A statutory argument is sometimes based on section 9-311. The tenor of the argument is that the UCC permits the farmer to sell the collateral regardless of a prohibition in the security agreement and that because the sale was permissible, no conversion results. Section 9-311 provides:

The debtor's rights in collateral may be voluntarily or involuntarily transferred (by way of sale, creation of a security interest, attachment, levy, garnishment or other

130. S.D. COMPILED LAWS ANN. § 57-37-19 (1967).

131. U.C.C. § 9-306, Comment 3.

judicial process) notwithstanding a provision in the security agreement prohibiting any transfer or making the transfer constitute a default.¹³²

However, it appears clear that this rule will not protect the marketing house or the purchaser. For example, in *Royal Store Fixtures Co. v. New Jersey Butter Co.*¹³³ the court stated:

Under the Uniform Commercial Code, which has been adopted in Pennsylvania, a debtor's rights in collateral may be transferred. 12A PS Sec. 9-311. A transfer of the debtor's rights, however, can in no way affect the secured party's rights in the collateral unless authorized in the security agreement.¹³⁴

Thus a bare sale is permitted, but the sale becomes a conversion when it interferes with the rights of the secured party to possession.¹³⁵ Because the farm product is difficult to trace in most transactions, conversion is an appropriate remedy.

B. Negotiable Warehouse Receipts

Farm products produced by a farmer often are stored in a warehouse upon issuance to the farmer of a negotiable warehouse receipt.¹³⁶ A holder to whom a negotiable warehouse receipt has been duly negotiated can take priority over an earlier perfected security interest.¹³⁷ However, the warehouse receipt will not be prior to a perfected security interest in the goods unless the secured party either 1) delivered or entrusted the goods to the farmer with actual or apparent authority to sell or with power of disposition under the UCC¹³⁸ or 2) acquiesced in the procurement by the farmer of a warehouse receipt.

The first exception would apply, for example, when a bank authorized a farmer to deliver corn to a particular elevator and notified the elevator that it had taken this action. Under these circumstances if the elevator issued a negotiable warehouse receipt to the farmer and the farmer duly negotiated it, the purchaser of the receipt would take free of the bank's security interest. It should be noted that without actual authority no apparent authority could be imputed because of the restriction on sale of farm products free of a security interest.

132. S.D. COMPILED LAWS ANN. § 57-37-55 (1967).

133. 114 N.J. Super. 263, 276 A.2d 153 (1971).

134. *Id.* at —, 276 A.2d at 155.

135. *Citizens Bank v. Perrin & Son's, Inc.*, 253 Ark. 639, 488 S.W.2d 14 (1972).

136. S.D. COMPILED LAWS ANN. §§ 57-26-1, 2 (1967); U.C.C. § 7-201. Under defined circumstances a farmer may himself store the goods and issue a warehouse receipt. *Id.* § 57-26-2, U.C.C. § 7-201 (2).

137. *Id.* §§ 57-29-1 to -7, 57-37-33; U.C.C. §§ 7-501, 9-309.

138. *Cf. id.* §§ 57-5-9 to -12, 57-29-10, 31; U.C.C. §§ 2-403, 7-503.

Unlike the situation in which the secured party intentionally entrusts the farmer with actual or apparent authority to dispose of the goods, the acquiescence exception does comprehend circumstances in which the secured party does not actively consent. Knowledge of the likelihood of storage or shipment with no objection or effort to control by the secured party is sufficient.¹³⁹ A discussion of cases in which the courts have found implied acquiescence in article nine litigation will be found below.¹⁴⁰

C. Sale to a Buyer in the Ordinary Course of Business

The most common statutory exceptions to section 9-306(2) by its specific terms are not available to the seller of farm products. Section 9-307(1) provides:

A buyer in ordinary course of business (subsection (9) of Section 1-301) other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence.¹⁴¹

The clear import of the language, of course, is that the section does not create an exception to the general rule that a security interest in farm products continues when farm products are sold by a farmer. A further question involves the resale by one who has purchased from a farmer. The section has been interpreted to mean that a buyer in the ordinary course of business from the person who bought from the farmer does not buy free of a security interest because the security interest was not "created by his seller."¹⁴² Instead, it had been created by the farmer. The security interest therefore continues and remains effective against the buyer despite the sale in the ordinary course of business.

139. U.C.C. § 7-503, Comment 1.

140. See notes 150-166 and accompanying text *infra*. For a discussion of the implied acquiescence in an article 7 situation involving a warehouse receipt see *United States v. Hext*, 444 F.2d 804, 814 n.34 (5th Cir. 1971).

141. S.D. COMPILED LAWS ANN. § 57-37-30 (1967). A "buyer in the ordinary course of business" under section 1-201 is such only if he buys "from a person in the business of selling goods of that kind." This means that the exception applies basically only to inventory and not to equipment or other goods. Thus the sale by a farmer of farm equipment would not cut off the lien of a secured party. U.C.C. § 9-307, Comment 2. Other statutory exceptions relate to unperfected security interests, S.D. COMPILED LAWS ANN. §§ 57-37-1 to -3; U.C.C. § 9-301; negotiable instruments, documents and securities, *id.* § 57-37-33; U.C.C. § 9-309; *cf.* U.C.C. § 9-306, Comment 2. If the security interest is unperfected, it still is prior to the buyer of farm products in the ordinary course of business. Section 9-301(1)(c) provides that certain buyers *not* in the ordinary course of business are prior to an unperfected security interest but does not provide the same priority for those who are buyers in the ordinary course. This appears to be an oversight in the 1962 Code and is corrected in the 1972 Code. Section 9-301(1)(c) of the 1972 Official Text provides that an unperfected security interest is subordinate to a buyer of farm products in the ordinary course of business.

142. *Cf.* 1B COOGAN, HOGAN & VAGTS, *supra* note 4, ¶ 27.02(5) (1968).

D. *Disposition by One Other Than the Debtor*

Under the 1962 Code there is at least one additional statutory argument which would free the purchaser of a product which was inventory in the hands of a dealer. Section 9-306(2)¹⁴³ expresses the rule that unless otherwise provided, a security interest continues in collateral notwithstanding *sale by the debtor*. Dean Hawkland has argued that a court could hold that the security interest would follow the collateral only when the disposition is made *by the debtor* and not by the purchaser from the debtor.¹⁴⁴ This argument has been rendered obsolete in the 1972 Code; section 9-306(2) was revised to delete any reference to disposition *by the debtor* and to refer instead to any unauthorized disposition.¹⁴⁵ Unless the theorizing by Dean Hawkland under the 1962 Code is accepted by the courts, there really is no exception to the rule that a security interest continues in farm products sold by a farmer, unless the transfer was "authorized by the secured party in the security agreement or otherwise."

Authorized Sale of Farm Products

A. *Authority in the Security Agreement*

A security agreement may, of course, provide that a debtor be allowed to sell his farm products at any time. However, in this writer's experience most secured parties provide in their form security agreements that a farm debtor must obtain written consent from the secured party to sell the farm products which constitute its collateral. Furthermore, the secured lender also generally obtains a security interest in the "proceeds" from the sale of the farm products. Whether the security agreement in proceeds constitutes an authorization to dispose of the farm product collateral is a question of fact. Official Comment 3 to section 9-306 provides:

A claim to proceeds in a filed financing statement might be considered as impliedly authorizing sale or other disposition of the collateral, depending upon the circumstances of the parties, the nature of the collateral, the course of dealing of the parties and the usage of trade (see Section 1-205).

The decisions of the courts which have ruled on the matter indicate that the claiming of proceeds, without more, does not constitute a waiver. In *Vermillion County Production Credit Association v. Izzard*,¹⁴⁶ for example, the court held that the taking of a security interest in proceeds did not give the debtor permission to sell products free of a security interest; the secured party was merely exer-

143. S.D. COMPILED LAWS ANN § 57-37-19 (1967).

144. Hawkland, *supra* note 6, at 420.

145. U.C.C. § 9-203(3) (1972 version).

146. 111 Ill. App. 2d 190, 249 N.E.2d 352 (1969).

cising his rights under the UCC. No further inference was justifiable.¹⁴⁷

The argument regarding waiver by obtaining a security interest in proceeds is definitely not valid under the 1972 Code. First, the right to "proceeds" is automatic without reference to the term in the security agreement.¹⁴⁸ Second, an Official Comment to section 9-306 of the 1972 Code states: "The right to proceeds . . . does not in itself constitute an authorization of sale."¹⁴⁹ The inconsistency of language, however, is a minor issue compared with the problems which have arisen in actual practice.

B. Authority Otherwise

Apparently lenders to individual farmers depend more on the character of the farmer than on physical collateral listed in the security agreement. The cases often discuss testimony by lending officers that it was the policy of their institutions to trust the farmer to remit proceeds of the sale.¹⁵⁰ If a lender takes farm products as collateral, it often will expect the farmer to sell some or all of the farm products in the ordinary course of business. Nonetheless, the security agreement generally will prohibit disposition of the farm product without written consent. For example, a bank which lends to a dairy farmer expects the farmer to feed crops to his herd and to replace dairy cows with better stock, when available. The security agreement however often ignores actual practice and prohibits any disposition of livestock without the creditor's express permission. These practicalities underlie the much litigated waiver issue.

The most widely analyzed case which discusses the waiver issue is *Clovis National Bank v. Thomas*.¹⁵¹ In *Clovis* the bank loaned money to a farmer and obtained and perfected a security interest in his present and after-acquired livestock. The security agreement prohibited sales without written consent of the bank, but testimony indicated that it was not the bank's policy to forbid sales. The bank instead depended upon the farmer to remit the proceeds of the sales. When the farmer sold livestock to the defendant stockyards and did not remit the proceeds, but defaulted on his loan, the bank sued the stockyards for conversion of its collateral. The court noted that an auction house may be liable for conversion if it sells secured

147. See also *Overland Nat'l Bank v. Aurora Cooperative Elevator Co.*, 184 Neb. 843, 172 N.W.2d 786 (1969) (similar result).

148. U.C.C. § 9-203(3) (1972 version).

149. U.C.C. § 9-306, Comment 3.

150. Cf. *Clovis Nat'l Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726, 730 (1967).

151. *Id.* As a result of this case the New Mexico legislature amended section 9-306(2) of the New Mexico U.C.C. by adding: "A security interest in farm products and the proceeds thereof shall not be considered waived by the secured party by any course of dealing between the parties or by any trade usage."

cattle for a debtor, but held that the UCC provisions are supplemented by the law of waiver, especially waiver by implied acquiescence or consent. Because the bank did not forbid sales and did depend on the farmer to remit proceeds from the sales, the court held that these principles of waiver applied and that the bank waived the security rights in the farm products. Consequently, it could not maintain an action for conversion.¹⁵²

The problem considered by the court in *Clovis* has been the subject of numerous reported decisions. Because section 1-103 of the UCC specifically provides that supplementary principles of law are applicable to Code transactions, none of the courts deny that a security interest may be waived. The dispute concerns the type of conduct which constitutes waiver. Some accept the *Clovis* rationale of waiver by implied acquiescence while others hold that more than an implied acquiescence is necessary.

1. Acceptance of *Clovis*

In *United States v. Central Livestock Association, Inc.*,¹⁵³ the court considered a situation in which the Farmers Home Administration held a security interest in cattle and other chattel property. The financing statement contained a provision that "[d]isposition of such collateral is not hereby authorized."¹⁵⁴ The court found that the debtor had made several sales of such property "without prior specific approval" and thereafter accounted for the proceeds to the FHA.¹⁵⁵ According to the court, "[t]his was the customary procedure."¹⁵⁶ The court held that the regular sales without prior approval operated under section 9-306(2) to release the government's security interest. Thus the sale by the debtor to the defendant was an "authorized sale" and the government's suit for conversion failed.

Private parties have also been found to waive their security interest because of their course of dealing with the debtor. For

152. S.D. COMPILED LAWS ANN. § 57-1-18 (1967); U.C.C. § 1-205(4):

The express terms of an agreement and an applicable course of dealing or usage of trade shall be construed wherever reasonable as consistent with each other; but when such construction is unreasonable express terms control both course of dealing and usage of trade and course of dealing controls usage of trade.

153. 349 F. Supp. 1033 (D.N.D. 1972).

154. *Id.*

155. *Id.* at 1034.

156. *Id.* In *United States v. Central Livestock Association*, 349 F. Supp. 1033 (D.N.D. 1972), the court did not specifically consider whether the government agents had the power to waive a security interest. This issue was discussed by the Eighth Circuit in *United States v. E.W. Savage & Son, Inc.*, 475 F.2d 305 (8th Cir. 1973) in which the court held that a local FHA supervisor would not have the authority to waive government rights if prohibited by published regulations. Another issue which arises where the government is a party is the application of federal or state law. See *United States v. McCluskey Mills, Inc.*, 409 F.2d 1216 (6th Cir. 1969); see also *United States v. E.W. Savage & Son, Inc.*, *supra*.

example, in *Lisbon Bank & Trust Co. v. Murray*,¹⁵⁷ the Iowa Supreme Court held that the bank plaintiff had allowed the debtor-farmer, by a course of dealing, to sell secured heifers and to pay notes with the proceeds. The result was waiver of its security interest.¹⁵⁸

These cases indicate that some courts examine the course of dealing between the creditor and the debtor to determine whether the creditor relied on the express prohibition against sale. If the creditor is found to rely more on the proceeds than on the farm products themselves, these courts have found waiver by implied acquiescence.

2. *Limitation of Clovis*

A significant limitation of *Clovis* rejects its waiver by implied acquiescence or consent theory. Instead, this view requires a decisive act to negate the debtor's agreement.

In *Garden City Production Credit Association v. Lannan*¹⁵⁹ the debtor was a farmer who had given the Production Credit Association a security interest in his cattle and their proceeds and had agreed not to sell or dispose of the cattle without the permission of the association. The farmer, however, had frequently sold cattle without the Association's permission but regularly forwarded the proceeds to it. After obtaining a new loan and signing a new security agreement, the farmer sold the cattle to a stockyard which sold them to the defendant, an innocent purchaser. The purchaser paid the stockyards, but the stockyards did not pay the farmer. The Association sued the purchaser for possession.

The court first noted that a "failure to rebuke or object contemporaneous with a delivery by the debtor and acceptance of the proceeds . . . [could not] be construed as a voluntary and intelligent waiver"¹⁶⁰ Furthermore, the court was influenced by the fact that the security agreement itself provided a "specific means for obtaining such a waiver."¹⁶¹ The finding of no waiver, according to the court, was consistent with the "general rule that in order to establish a waiver of legal right there must be a clear, unequivocal, and decisive act of a party showing such a purpose, or acts amounting to an estoppel"¹⁶²

157. 206 N.W.2d 96 (Iowa 1973).

158. *Id.* at 97; accord *In re Cadwell*, Martin Meat Co., 10 UCC REP. SERV. 710 (E.D. Calif. 1970) (bankruptcy) (steers); Planters Production Credit Ass'n v. Bowles, — Ark. —, 511 S.W.2d 645 (1974) (cotton); Central Washington Production Credit Ass'n v. Baker, 11 Wash. App. 17, 521 P.2d 226 (1974) (cattle).

159. 186 Neb. 668, 186 N.W.2d 99 (1971).

160. *Id.* at —, 186 N.W.2d at 103.

161. *Id.*

162. *Id.* at —, 186 N.W.2d at 104; accord *Farmers State Bank v. Edison Non-stock Cooperative Ass'n*, 190 Neb. 789, 212 N.W.2d 625 (1973). See *United States v. Greenwich Mill & Elevator Co.*, 291 F. Supp. 609 (N.D. Ohio 1968).

The court then considered the argument that the course of conduct of trade might have been in conflict with the express written agreement. The court felt this conflict was resolved by UCC section 1-205(4) which states:

The express terms of an agreement and an applicable course of dealing or usage of the trade shall be construed wherever reasonable as consistent with each other; but when such construction is unreasonable *express terms control both course of dealing and usage of trade and course of dealing controls usage of trade*.¹⁶³

Thus the act of accepting the proceeds, if deemed inconsistent with the terms of the express agreement, could not be found to waive the agreement because the express agreement is given priority by the code over the course of dealing or usage of trade. *Lannan* can therefore be seen as a limitation on what the Nebraska Supreme Court viewed as the overbroad language of *Clovis* and the failure of that court to consider the effect of section 1-205(4).¹⁶⁴

Analysis of the Code and the cases stemming from *Clovis* leads this writer to the conclusion that the decisions limiting *Clovis* are correct. *Clovis* has been too readily accepted by courts interested in mollifying the harshness of the creditor's conversion suit against an innocent marketing agent or purchaser. This writer feels that the best argument against loose acceptance of the waiver argument is that it is contrary to the Code policy expressed in section 9-307(1)¹⁶⁵ that a farmer does not have the power to sell farm products free of a security interest. Unfortunately, the courts following *Clovis* disregard the clear language of this section and its policy implications when considering the waiver argument.

The courts should not subvert this expressed legislative intent. It is for the legislature, not the judiciary, to remedy any inequity which flows from the rules embodied in the Code. Thus absent express consent or an highly unusual circumstance, a creditor should not be considered to have waived his security interest.¹⁶⁶

CONCLUSION

The Uniform Commercial Code's treatment of farm collateral differs substantially from its treatment of other commercial collateral. This article has examined some of these differences and recommended means by which the attorney can avoid the pitfalls

163. 186 Neb. 668, 186 N.W.2d 103-04, *citing* U.C.C. § 1-205(4) (emphasis by court).

164. S.D. COMPILED LAWS ANN. § 57-1-18 (1967).

165. S.D. COMPILED LAWS ANN. § 57-37-30 (1967).

166. For a discussion of the effect of multiple and related parties on the waiver issue *compare* *United States v. Hext*, 444 F.2d 804 (5th Cir. 1971), *with* *Baker Production Credit Association v. Long Creek Meat Co.*, 97 Ore. 1372, 513 P.2d 1129 (1973).

which could cause a client to lose either his perfected security interest or his priority against other creditors.

The Code classifies farm collateral in two general categories: 1) farm equipment and 2) farm products. The Code specifically defines farm products and identifies their treatment in various Code provisions governing perfection of security interests. In contrast, the Code does not specifically define farm equipment, but it does contain special rules that a creditor must follow to perfect a security interest in such equipment. It is especially critical to remember that farm collateral, both farm equipment and farm products, is only defined and treated as such when it is in the hands of a person engaged in farming operations. The Code generally specifies that a financing statement covering farm collateral be filed in a local (county) office. This contrasts with many other types of collateral which are ordinarily secured by filing in a state office.

Purchase money security interests in farm collateral merit special consideration. The creditor must be aware of the ramifications resulting from the special exemption from filing certain purchase money interests in farm equipment. Also, the inherent limitations of the purchase money interest as they relate to livestock and their increase must constantly be considered. Moreover, the special rules relating to security interests in crops, present and after-acquired, require constant attention.

The final section of this article has examined the unauthorized sale of farm products. Unless a creditor expressly waives his security interest, the general rule is that a farmer cannot sell farm products free of it. However, some courts have found that a secured creditor can waive a security interest by his conduct. This writer believes that waiver should not be found without some decisive act or explicit statement of the creditor, but until the courts unanimously come to this conclusion, the wise creditor who wishes to retain his security interest should make only those arrangements with his debtor that will assure prevention of an unintended waiver.

The UCC provides special rules for farm collateral. An attorney advising a farmer must recognize that these rules exist and advise his clients, whether farmers or businessmen, on the special arrangements necessary to perfect and protect a security interest in such collateral. Careful attention to the Code will assure that the lawyer's advice is appropriate.