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An Agricultural Law Research Article

**Recent Uniform Commercial Code Cases
Affecting Agricultural Lenders and Borrowers**

by

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I. INTRODUCTION

The following is a summary of recent cases reported on LEXIS and WESTLAW for the period from September 21, 1992, through October 21, 1993, which involve agricultural lenders and borrowers and issues under the Uniform Commercial Code (UCC). The summaries of the cases are organized generally by topic consistent with the approach of the UCC, moving from scope and classification issues, to validity and attachment questions, to perfection, to priorities, to default, and ending with some cases on related general topics.

The LEXIS and WESTLAW searches were done in the "All Federal" and "All States" databases and the UCC database provided by those services. The terms of the search were "ranch or farm or orchard or crop and security or mortgage or (deed of trust) and (commercial code)," except that "(commercial code)" was deleted in searching the UCC databases. Cases that involved agricultural issues or the Uniform Commercial Code in only a peripheral way have been omitted from this summary.

In each topical section below, the federal cases appear before the state cases, with decisions of higher courts before lower courts. The state cases are listed alphabetically by state. Some of the cases highlighted deal with more than one issue relevant to the UCC. Thus, twelve of the forty cases summarized appear more than once in the outline below. An alphabetical list of all forty cases discussed appears at the end of the outline.

II. GENERAL INTERPRETATION AND SCOPE

A. *In re Zweygardt*, 149 B.R. 673 (Bankr. D. Kan. 1992).

In Kansas, the federal district court has decided that Conservation Reserve Program (CRP) payments are rents, rather than contract rights, and thus are not subject to the UCC. A local bank (now FDIC) had taken UCC security interests in the proceeds of the CRP contracts

of the debtors. The Federal Land Bank had also made loans to the debtors secured by mortgages, which included assignments of rents from the property. The Court held that the bank's UCC financing statements did not perfect its interest in the debtor's CRP payments. With this decision, Kansas joins Colorado, and perhaps Iowa, in treating CRP payments as rents, in contrast to their treatment in Minnesota and South Dakota under the UCC.

B. *In re Temple Stephens Co.*, 156 B.R. 38 (Bankr. W.D. Mo. 1993).

Does real estate law or the UCC control competing creditors' claims to standing timber and growing soybeans? A bank holding a deed of trust claimed that its "rents and profits" clause gave it a first lien interest in the debtor's standing timber, growing soybeans, severed soybeans in the bin, and proceeds from the sale of the severed soybeans, prior to that of the bankruptcy trustee. The court declined to decide whether the standing timber on the land was subject to the UCC or the lien of the deed of trust, after reviewing the case law on the subject to date. The court's decision that Article 9 of the UCC governed the soybean crop and its proceeds is discussed in section IX.D. below.

Note: The task force working on amendments to UCC Article 9 is attempting to reduce the confusion over the application of real estate law or the UCC to growing crops and timber by suggesting that real estate law apply exclusively to property (like trees) affixed to the ground that is not intended for eventual harvest and sale, and that the UCC apply exclusively to property (whether or not affixed to the ground or buried in it or growing on it) that is intended for eventual harvest.

C. *Shields v. Equine Capital Corp.*, 607 So. 2d 468 (Fla. Dist. Ct. App. 1992).

Can a "stallion service certificate" be collateral? A stallion service certificate is evidence of the breeding of a thoroughbred stallion to a mare. Shields, the owner of a mare and her foal, sued Equine Capital Corporation (ECC) to get the stallion service certificate for the foal. ECC had lent money to the syndicate owner of the stallion's breeding rights and claimed that it had perfected its security interest in the stallion's breeding rights and stallion service certificates by filing UCC financing statements. Although ECC had consented to the breeding of the stallion to Shield's mare, ECC refused to deliver the stallion service certificate until it received the stud fee, which Shields had already paid to the stallion breeding syndicate. In remanding the case, the court questioned whether the stallion service certificate for a mare not owned by a secured party can be collateral under the UCC.

D. *Lake County Trust Co. v. Two Bar B, Inc.*, 606 N.E.2d 258 (Ill. App. Ct. 1992).

Like the *Temple Stevens Co.* case above, this case illustrates the confusion over whether, and to what extent, crops and their proceeds are governed by real estate law or the UCC. The landlord under a crop share lease prevailed over its foreclosing underlying land seller, and thus got the crop proceeds in dispute as "rent" under the lease, despite the foreclosing seller's claim to the proceeds under a mortgage and separate assignment of rents given by the landlord/buyer. A key fact seemed to be that the crops generating the proceeds/"rent" had already been harvested and sold before the seller started the foreclosure. The court held that the seller had no right to recover the proceeds because (1) neither the assignment of rents, nor the mortgage created a UCC security interest in those rents (crops and proceeds); and (2) the foreclosing seller could only obtain a right to the crops and proceeds of the crops grown on that property under the assignment of rents when it took possession of the property, and even then the right would only extend to those crops still on the property at the time of the takeover. In a footnote, the court said it would reject the seller's new argument that the assignment of rents was enforceable as a UCC security interest in the crops.

E. *Cook v. Hansen*, 499 N.W.2d 94 (N.D. 1993).

A lease of 2,000 acres of pasture land to the Hansens in exchange for care and feeding of cattle owned by their sister-in-law landlord was held not to be a contract covered by the UCC. Since there were no goods being sold or exchanged by merchants under the lease relationship, the court thought of the contract as a services contract to which Article 2 did not apply. The test of applicability of the UCC to a mixed contract of goods and services used by the court was whether the predominant factor, the thrust, or the purpose of the contract is the rendition of services with goods involved, or a transaction of sale with labor involved.

III. ARTICLE 2 ISSUES

A. *Worm v. American Cyanamid Co.*, No. CIV.A.HAR90-1424, 1992 WL 368062 (D. Md. Nov. 30, 1992), *aff'd*, 5 F.3d 744 (4th Cir. 1993).

Labeling under the Federal Insecticide, Fungicide and Rodenticide Act (FIFRA) was enough to preempt a claim of breach of warranty under the UCC. The Worms purchased and used an herbicide which stated on the label that it was safe to plant corn eleven months after its application. In addition, after the Worms had purchased the herbicide, the herbicide manufacturer released advertising and promo-

tional materials warranting the eleven month advice regarding planting. However, the Worms' corn crop planted in accordance with these instructions was substandard. The court held that the Worms' claim for breach of warranty under section 2-313 was preempted by FIFRA because the Environmental Protection Agency (EPA) had approved the herbicide's label. In addition, since the promotional materials containing the advice to plant after eleven months were issued after the Worms purchased the herbicide, those materials could not be the basis of a breach of express warranty because they could not have induced the Worms to purchase the herbicide.

B. *Rudiger Charolais Ranches v. Van De Graaf Ranches*, 994 F.2d 670 (9th Cir. 1993).

Cattle sold through a dealer belonged to the unpaid seller and not to the buyer who, following industry custom, had paid the dealer without the required documentation. The court held that the buyer could not be a good faith purchaser for value under Article 2 of the UCC, despite honesty in fact and conformity with the custom of the trade, because that industry's practice of not requiring documentation on sale violated a specific state statute dealing with the transfer of livestock. The court noted that under section 2-103, an industry practice that violates a statute is not a reasonable commercial standard. The adoption of the UCC in Washington did not alter the general principle of contract law that a custom in conflict with an existing statute will not be enforced.

C. *Hilt v. Draper*, 836 P.2d 558 (Idaho 1992).

The delivery, negotiation, and payment of a check marked "deposit 400 ton hay" was not enough to create a purchase and sale agreement between the drawer and the payee when they had no other direct dealings. Draper, a farmer, agreed to sell Hartman, a hay hauler, all of his hay for sixty dollars per ton, payable when the hay was taken by Hartman. Hartman in turn agreed to sell Hilt, a dairy farmer, 400 tons of Draper's hay. Hilt wrote a \$3,000 check payable to Draper bearing the notation "deposit 400 ton hay," and gave it to Hartman. Hartman in turn gave the check to Draper, but failed to tell Draper any of the terms of the Hartman/Hilt deal. Draper cashed the check. Hartman failed to pay Draper for all of the hay he took, and Draper sold the hay to others. Hartman delivered no hay to Hilt, who sued both Hartman and Draper. The court held that Hilt's check payable to the order of Draper was insufficient to establish a contract between them under Article 2 of the UCC, since it was equally consistent with being a partial payment of Hartman's independent obligation to pay Draper for the hay Hartman took. Even if there had been such a contract, the court ruled that Draper did not breach that contract because

he allowed Hartman to take all of the hay for which Hilt had paid. In addition to rejecting Hilt's various agency and ratification theories, the court found that a document satisfying the Article 2 statute of frauds is not in itself enough to establish a contract. Hilt, as purchaser, bore the risk of nondelivery or misdelivery of the hay under section 2-509(1), which places the risk of loss upon the buyer.

D. *Tongish v. Thomas*, 840 P.2d 471 (Kan. 1992).

In considering the appropriate damages where a grower breached his contract to sell sunflower seeds to a seed cooperative, the court held that the measure of damages was governed by section 2-713. This section fixes damages as the difference between the market price and the contract price at the time of breach, unlike section 1-106, which fixes damages as the buyer's actual lost profits.

E. *Trinidad Bean & Elevator Co. v. Frosh*, 1 Neb. App. 1819, 494 N.W.2d 347 (1992).

In another measure of damages case, Trinidad entered into a contract to purchase beans from Frosh, which Frosh repudiated before performance was due. The contract price and the market price for beans were the same at the time of the repudiation. Four months later Trinidad purchased beans from other sources to cover those not delivered under the Trinidad contract at considerably higher prices than those in existence at the time of the repudiation. Trinidad then sued Frosh to recover the difference between the contract price and the price it actually paid for the cover beans. The court held that under section 2-713(1), Trinidad had to cover as soon as commercially reasonable after Frosh repudiated the contract, not when Frosh was supposed to deliver the beans. Therefore, the court interpreted the phrase "learned of the breach" as the date of the repudiation, rather than the date performance was due. Since the contract and market price for the beans were the same when Frosh repudiated, Trinidad was not entitled to any damages. In addition, the court held that assertion of a defense by Frosh that Trinidad failed to mitigate its damages was inappropriate since the common law doctrine of mitigation of damages is inconsistent with the statutory scheme of the UCC.

IV. TYPE OF COLLATERAL

A. *Lambert v. Kysar*, 983 F.2d 1110 (1st Cir. 1993).

In the course of an involved commercial law case interpreting a choice of law clause, the court found that Christmas trees are goods within the meaning of Article 2 of the UCC, and that the sale of Christmas trees is a "transaction in goods" governed by the UCC under the state law of both Massachusetts and Washington.

B. *Union Bank & Trust Co. v. United States*, 27 Cl. Ct. 403 (1992).

In deciding this case based on the contract terms between the parties, the court noted that the Eighth Circuit has held that payments under the federal Dairy Termination Program are "contract rights" rather than "proceeds" under the UCC. However, the court did not rule on this state law question under the UCC.

C. *Flores de New Mexico, Inc. v. Banda Negra International, Inc. (In re Flores de New Mexico, Inc.)*, 151 B.R. 571 (Bankr. D.N.M. 1993).

Commercial rose bushes seem to be fixtures, and not miscellaneous equipment, at least in New Mexico. Banda Negra made a loan to Flores, a cut rose producer, intending to take all of Flores' assets as security. The security agreement and the UCC financing statements, however, did not specifically list Flores' rose bushes, nor did the security instruments list "crops" or "fixtures," although they very specifically listed most of Flores' other assets. The court found that the rose bushes were neither crops nor equipment, but were instead fixtures under section 9-313, as they were integrally related to the land and were not intended to be removed for seven to eight years. Banda Negra therefore needed to have filed a fixture filing under section 9-401 in order to perfect its security interest in the rose bushes. The court also held that a fixture filing was necessary to perfect Banda Negra's security interest in the rose bushes, despite the agreement between Flores and its landlord that the rose bushes would remain Flores' personal property and could be removed at the end of the lease term. The court finally held that even if the phrase "miscellaneous equipment" contained in the UCC financing statements was sufficient to describe a security interest in the rose bushes, that same description would not be sufficient to adequately describe the rose bush collateral in the security agreement. The lesson for a lender is to think about the collateral before you describe it, describe the most important collateral particularly, and use broad descriptions for other assets.

D. *Shields v. Equine Capital Corp.*, 607 So. 2d 468 (Fla. Dist. Ct. App. 1992).

If a "stallion service certificate" is collateral, how is it classified? Good? Farm product? General intangible? This case poses, but does not answer, this question. Refer to the facts of this case in Part II *supra*. The owner of a thoroughbred foal sought recovery of a stallion service certificate from ECC, the unpaid lender to the owner of the breeding rights. While not deciding whether these items were goods,

farm products, or general intangibles under the UCC, the court concluded that unless specifically reserved, ECC's obligation to provide the stallion service certificate was implicit in ECC's consent to the sale of the breeding right to Shields.

E. *Greenview Ag Center, Inc. v. Yetter Manufacturing Co.*, 615 N.E.2d 395 (Ill. App. Ct. 1993).

Yetter, a farm equipment manufacturer, offered Greenview, a farm equipment dealership, a ten percent discount if it purchased a minimum of 40,000 pounds of rotary hoes. Yetter subsequently refused to repurchase the remaining hoes when Greenview terminated the agreement, as was required by the state's Fair Dealership Law, on the grounds that there was no agreement that Greenview would maintain an inventory of hoes. The court held that the rotary hoes purchased pursuant to this contract were "inventory" under the Illinois Fair Dealership Law and under section 9-109(4) of the UCC because they were farm equipment or machinery (goods) held for immediate or ultimate sale "by a person who holds them for sale."

F. *Friedt v. Moseanko*, 498 N.W.2d 129 (N.D. 1993).

Milk is not a crop. A judgment creditor garnished the proceeds of a dairy farmer's milk production. The dairy farmer argued that the milk proceeds were either partially exempt earnings, or absolutely exempt crops, under state garnishment law. The court, however, held that the proceeds from the sale of the milk produced by the dairy farmer were business profits and not the kind of earnings partially exempted from garnishment. In addition, the court pointed out that although milk is a farm product under section 9-109, the UCC draws a distinction between two kinds of farm products: livestock and crops. The court held that milk products produced by livestock are therefore not crops, and thus are not exempt from garnishment or seizure from debt as crops under the state garnishment statute.

G. *National City Bank v. Golden Acre Turkeys, Inc.*, 604 N.E.2d 149 (Ohio 1992).

"It never hurts to file with the Secretary of State." That is the lesson learned by the bank in this case. The bank judicially foreclosed on turkey processing equipment used to manufacture turkey wieners. Another creditor with a perfected security interest in the same equipment filed a cross-claim. The bank had attempted to perfect its security interest in the equipment by filing its financing statement in the county of the debtor's residence as required under its version of section 9-401 of the UCC, thinking it was equipment used in farming operations. The court held that the turkey processing equipment was

used in a manufacturing process and was not equipment used in farming operations. Thus, the bank's security interest was not perfected by filing a UCC financing statement only in the county of the debtor's residence. The second-to-file creditor's security interest in the turkey processing equipment therefore had priority.

V. VALIDITY/ATTACHMENT OF SECURITY INTEREST

A. *Bank One v. Dettwiller (In re Dettwiller)*, 156 B.R. 540 (Bankr. S.D. Ohio 1993).

The security interest of a floor plan financing manufacturer, Kubota, attached to a tractor when the requirements of section 9-203 of the UCC were met, despite language in the security agreement that the interest covered only items sold to the dealership. Dettwiller, the owner of a farm tractor dealership, sold himself a Kubota tractor, and paid for it in part with the proceeds of a purchase money secured loan from the bank. Dettwiller deposited the proceeds in the dealership's account and did not pay or inform Kubota of the sale. The tractor, however, remained on the dealership's premises. Kubota later repossessed all of the dealership's inventory and equipment, including the subject tractor. The bank sued for possession of the tractor based on its purchase money security interest, arguing in part that the security interest of Kubota never attached because the tractor had never technically been sold by Kubota to the dealership. The court held that Kubota's security interest had property attached to the tractor under section 9-203 because (1) the dealership had signed the inventory financing agreement, which accurately described the tractor; (2) Kubota gave value by delivering the tractor to the dealership; and (3) the dealership obtained rights in the collateral by virtue of its right to resell the tractor. Discussion of the priority dispute in this case is at section IX.A. *infra*.

B. *Lyon v. May*, 424 S.E.2d 655 (N.C. Ct. App. 1993).

Without a right to crop insurance proceeds under its security agreement, Lyon, a lessor of farm land, was liable to his tenant, May, for interfering with May's crop insurance contract when Lyon demanded payment of the crop insurance proceeds. Lyon sued May to get the crop insurance proceeds May had assigned to Farmers Home Administration (FmHA), a junior lienholder in those crops. The trial court held that the proceeds belonged to FmHA. Lyon appealed on the basis that he was entitled to the insurance proceeds under section 9-306(1). The court held that under North Carolina law, Lyon had no claim against the insurer for the crop insurance proceeds because (1) he was not named as a loss payee or co-insured on the policy; (2) May had not assigned the policy to Lyon, but had rather assigned it to

FmHA; and (3) Lyon's security agreement merely required May to maintain such insurance as Lyon required, and Lyon never required May to get such insurance. Thus, no priority issue between Lyon and FmHA had yet matured. Discussion of the priority issue in this case is at section IX.A. *infra*.

C. *Friedt v. Moseanko*, 498 N.W.2d 129 (N.D. 1993).

Even though the FmHA's UCC financing statement on Moseanko's livestock and proceeds and products thereof had lapsed, FmHA still had a valid security interest, enforceable against the unencumbered interest of Mrs. Moseanko in the livestock products. The FmHA's security interest had, however, become subordinate to the claim of a judgment lienholder against Mr. Moseanko.

VI. CONVERSION OF COLLATERAL

A. *United States v. Currituck Grain, Inc.*, 6 F.3d 200 (4th Cir. 1993).

The United States had no conversion claim against the buyer of grain since its security interest became unperfected before the conversion claim was made. Curiously, there is no mention by the court of the federal preemption of the farm products exception of section 9-307(1) of the UCC by 7 U.S.C. § 1631. In this case, the FmHA made a farm operating loan secured by a properly perfected security interest in the farmers' grain crop. The farmers sold the grain to Currituck, a grain dealer, without FmHA's consent. Currituck had no knowledge of FmHA's security interest. FmHA sued Currituck for conversion more than five years after the last sale. The court held that Currituck did not initially take the grain free of FmHA's security interest due to the farm products exception. However, the court reasoned that under a special North Carolina law, the FmHA's security interest was extinguished eighteen months after Currituck purchased the grain. (Note that this "hidden" provision of North Carolina law affects not merely the perfection, but the very existence of liens on selected agricultural products.) The case is silent on the impact of the federal Food Security Act's elimination of the so called "farm products" exception, possibly since the facts of the case occurred in 1985, before the Act became effective on December 23, 1986. Also, the court found that under section 9-403(2), the lapse of FmHA's security interest related back with the effect that the FmHA's security interest was unperfected as against Currituck, who purchased before the lapse. This case is also mentioned in Parts VII and VIII *infra*.

B. *Seibert v. Noble*, 499 N.W.2d 3 (Iowa 1993).

Noble, a farm implement dealer, took possession of Siebert's farm implements, with Siebert's consent, to sell them in order to pay off the note secured by the farm implements. However, Noble failed to get Siebert's approval for the sale price of the farm implements. The court found that although Noble had wrongfully converted the equipment by failing to get Siebert's approval for the sale price, Noble could offset the damages for conversion by the amount of money Noble obtained from the sale of the equipment that was used to help satisfy Siebert's debt that was secured by the equipment. Additionally, the court held that Noble could also offset his costs of repairing and selling the implements against the conversion damages because he had held the equipment with Siebert's authority.

C. *Cook v. Hansen*, 499 N.W.2d 94 (N.D. 1993).

The common law of conversion has not been displaced by the UCC in North Dakota. The Cooks, executors of an estate, sued the Hansens to recover thirteen head of cattle that had been double branded with both the decedent's and Hansens' brands. The Hansens had leased pasture land from the decedent in exchange for their agreement to take care of and feed the decedent's cattle on the land. After the decedent passed away, some, but as was later discovered, not all of the cattle bearing the decedent's brand were sold, and the proceeds were paid to the estate. When the double branded cattle were discovered, the executors sued to recover. The court held that the action was governed by the common law of conversion and that Cook's executors were entitled to a jury trial on the issue of ownership.

D. *Michel v. Melgren*, 853 P.2d 940 (Wash. 1993).

The landlords had a statutory landlord's lien on the hay grown on leased land. The landlords sued a hay purchaser, Roos, for conversion and eloinment (removal or concealment of a chattel subject to a valid lien) when the tenant, Melgren, defaulted on the lease after selling the hay crop. The court found that there was an issue of material fact as to whether the landlords had waived their lien rights because they knew about Melgren's financial situation, but had specifically decided not to warn potential hay buyers. The court drew an analogy to section 9-302(2). The competing priority claim aspect of this case is mentioned in section IX.B. *infra*.

VII. WAIVER OF SECURITY INTEREST

A. *United States v. Currituck Grain, Inc.*, 6 F.3d 200, (4th Cir. 1993).

This case is discussed fully in Part VI *supra*. The issue of waiver in section 9-306(2) was mentioned by the court in support of the United States' right to sue in conversion when it did *not* consent to the sale of the collateral in this case. The court was merely restating a well-known rule.

B. *Eastern Idaho Production Credit Ass'n v. Idaho Gem, Inc.*, 842 P.2d 282 (Idaho 1992).

A conditional authorization to sell defeated a secured creditor's claim to proceeds under section 9-306(2). Eastern Idaho Production Credit Association (EIPCA) had a perfected security interest in Heinz's seed potato crop, and regularly allowed Heinz to sell his potatoes to third parties without EIPCA's consent, so long as Heinz turned over the proceeds to EIPCA. In this case, Heinz sold his seed potato crop to Baker who consigned the potatoes grown from Heinz's seed potatoes to Idaho Gem. Baker was in Chapter 11 reorganization when he bought the seed potatoes from Heinz. EIPCA sued to recover the proceeds of the crop sale from Idaho Gem, which had sold the potatoes. The court held that EIPCA had waived its security interest in the seed potato collateral, despite conditioning its consent on receipt of the proceeds. The reason was that section 9-306(2) does not distinguish between conditional and non-conditional authorization. In addition, the court held that under section 9-306(2), the creditor only retained a security interest in those proceeds of the potato sale actually received by the debtor, or at the very least, by one standing in the shoes of the debtor. Thus, EIPCA had no security interest in the proceeds received by Idaho Gem when it sold the potatoes.

VIII. PERFECTION AND FILING

A. *United States v. Currituck Grain, Inc.*, 6 F.3d 200, (4th Cir. 1993).

This case is more fully discussed in Part VI *supra*. The perfection issue in this case was the retroactive effect of a lapse of the financing statement under section 9-403(2). Under section 9-403(2), the lapse of FmHA's security interest related back to the date of its original filing, thus making FmHA's security interest unperfected as against Currituck. This was the result even though Currituck purchased the grain before the lapse, during a period when the FmHA security interest was perfected and, arguably, had priority over the rights of the buyer.

**B. *Jersey State Bank v. Isringhausen (In re Isringhausen)*,
151 B.R. 203 (Bankr. S.D. Ill. 1993).**

Filing four days too early for continuation of a financing statement proved the downfall of a first priority security interest in this case. The bank's subsequent claims of equitable estoppel, laches, and collateral estoppel could not redeem the bank. In this case, the debtors granted the bank a first position security interest in their farm machinery and equipment, which the bank perfected by filing a UCC financing statement on July 13, 1984. The bank, however, filed its continuation statement on January 9, 1989, just four days before the opening of the six-month window for filing continuation statements allowed by section 9-403(2). No subsequent continuation statement was filed by the bank. In a later Chapter 7 proceeding under the Bankruptcy Code, the bank and the FmHA both claimed a first position in the collateral. The court held that the bank's security interest was unperfected and that the FmHA's later security interest in the same collateral took priority. The court also held that the bank could not rely on the filing officer's ministerial act of accepting the premature continuation statement to retain its first position. In addition, the FmHA was not equitably estopped from asserting the priority of its security interest despite a previous communication to the debtor that FmHA believed the bank to be in the senior position, since the debtor and bank had the responsibility to make an independent investigation of the bank's status. Finally, the court held that neither the doctrine of laches nor collateral estoppel affected FmHA's priority interest in the collateral, even though the debtor entered a reaffirmation agreement with the bank based on a belief that the bank had the first priority security interest.

**C. *DuQuoin National Bank v. Vergennes Equipment, Inc.*,
599 N.E.2d 1367 (Ill. App. Ct. 1992).**

An error at the filing office did not prevent perfection of a bank's security interest, but a competing creditor's filing of its purchase money security interest (PMSI) financing statement in the wrong place did prevent it from prevailing. The bank presented a farm security agreement to the clerk's office of the county in which the debtor resided for recording. The farm security agreement expressly covered only equipment and livestock. The clerk's office, however, mistakenly recorded the security agreement only in the mortgage records of the county. Once the bank discovered that the security agreement did not appear in the UCC records of the county, it called the clerk's office, and the clerk made a notation in the UCC records referring to the document recorded in the mortgage records. A financing equipment seller later filed a PMSI financing statement initially in the wrong county, but two months later correctly filed in the county of the

debtor's residence. The court found that the bank had perfected a security interest in the equipment and livestock by such actions, and that it had priority over another creditor who had subsequently filed a financing statement on the debtor's equipment. The court declined to impute the clerk's error to the bank. The court also found that failure to timely file in the proper county deprived the purchase money secured party of the super-priority status afforded by section 9-312(4). The priority dispute in this case is also mentioned in section IX.A. *infra*.

D. *National City Bank v. Golden Acre Turkeys, Inc.*, 604 N.E.2d 149 (Ohio 1992).

Dual filing with the Secretary of State and in the county of the debtor's residence was needed in this case to protect the bank that was first to file. Sadly, the bank did not file with the Secretary of State. Thus, the security interest was unperfected and the bank lost to a later-filing secured creditor. For the facts of this case, see Part IV *supra*.

IX. PRIORITIES

A. Among Article 9 Security Interests

1. *J.I. Case Credit Corp. v. First National Bank*, 991 F.2d 1272 (7th Cir. 1993).

This was a dispute between a farm equipment floor plan financier, Case, and a car floor plan financier, First National Bank, which was paid by the debtor in the ordinary course of business. Case's practice of permitting commingling of farm equipment proceeds and payment of those proceeds to the bank "in the ordinary course of business" resulted in Case's loss of the security interest in the proceeds. A farm equipment dealer deposited the proceeds from its sales of farm equipment into its general checking account at the bank. The dealer used those funds to pay off its loans at the bank and other general creditors, instead of remitting the proceeds to Case. Case sued the bank to recover the proceeds from the sale of the farm equipment which the dealer had paid to the bank. The court held that under Indiana law, by operation of Comment 2c to section 9-306, the bank took the proceeds free and clear of Case's security interest because (1) the proceeds were paid into the debtor's general checking account and paid out in the operation of the debtor's business; and (2) the bank had no actual knowledge that the payments violated Case's superior secured interest in those funds, nor did it act with reckless disregard about whether the payment violated Case's security interest. The court stated that the bank's knowledge of Case's security interest did not necessarily mean that the bank knew the dealer's large prepayments

violated that interest, even if the bank knew about the downturn in the farm equipment market and had classified the dealer's loans.

2. *Bank One v. Dettwiller (In re Dettwiller)*, 156 B.R. 540 (Bankr. S.D. Ohio 1993).

The prior perfected security interest of a floor plan financing manufacturer of a tractor, Kubota, was prior to a PMSI in the same tractor. The facts of this case are summarized in Part V *supra*. The court held that Kubota's floor plan security interest in the tractor was superior to the bank's PMSI because Kubota's security interest (1) was perfected before the bank's security interest, and (2) was not extinguished by the sale to the dealership's owner because Dettwiller was not a buyer in the ordinary course under section 1-201(9). Dettwiller failed the good faith requirement of the definition. The court also rejected the debtor's argument that Kubota consented to the sale and thus lost its interest under section 9-306(2). The court mentioned the superiority given a PMSI in inventory under section 9-312(3), but noted that no notice was given to Kubota as required under that section. No one raised the possible argument that the tractor became equipment of the debtor when purchased, and thus the more lenient rule of section 9-312(4) should have applied.

3. *Lyon v. May*, 424 S.E.2d 655 (N.C. Ct. App. 1993).

The assignee of a crop insurance policy had rights to proceeds of that policy ahead of a perfected security interest in those proceeds under section 9-306(1). The facts of this case are summarized in Part V *supra*. The court noted at the end of its opinion that if the insurance proceeds exceeded the debtor's debt to FmHA, the assignee of the policy, then the competing secured party could demand payment of those excess proceeds once they were in the debtor's possession. However, they could not require the insurer to pay the secured party directly.

4. *DuQuoin National Bank v. Vergennes Equipment, Inc.*, 599 N.E.2d 1367 (Ill. App. Ct. 1992).

In a battle between a prior-filed security interest and a later-filed PMSI, in which both parties made mistakes in filing to perfect their interests, the first to file prevailed. Both parties were found to hold valid perfected security interests, but due to the error of the purchase money secured party in filing in the wrong county within the twenty day automatic perfection period of section 9-312(4), the first to file rule of section 9-312(5)(a) controlled.

B. Between an Article 9 Security Interest and a Statutory Lien**1. *Horton Dairy, Inc. v. United States*, 986 F.2d 286 (8th Cir. 1993).**

A bank's failure to perfect a security interest under Article 9 of the UCC resulted in an Internal Revenue Service (IRS) tax lien prevailing over the security interest. A bank made several loans to Horton Dairy, Inc. secured by accounts receivable, cattle, and land, and took a direct assignment of the proceeds of the dairy's raw milk sales. The bank, however, failed to perfect its security interest in accordance with Article 9 of the UCC. The IRS subsequently levied upon the milk proceeds from the buyer and upon the dairy's checking account at the bank, in satisfaction of tax liens against the Hortons personally. The court held that since the dairy was merely an alter ego of the Hortons, the IRS's tax lien against the Hortons personally was superior to the bank's unperfected security interest in the dairy's corporate property, and that the IRS's levy to satisfy the Hortons' personal debts was therefore not wrongful.

2. *Calumet Farm, Inc. v. Northern Equine Thoroughbred Productions, Ltd. (In re Calumet Farm, Inc.)*, 150 B.R. 403 (Bankr. E.D. Ky. 1992).

Even though a security interest in a horse had been granted in 1988, the bankruptcy trustee defeated the perfected security interest in that horse as preferential under section 547 of the Bankruptcy Code because the financing statement was not filed until some sixty days before filing of the bankruptcy petition in 1991. The factual summary of this case is under the bankruptcy topic at Part XV *infra*. The point to remember for priority disputes between a secured creditor and the trustee in bankruptcy is that a trustee takes priority over an unperfected security interest under section 9-301(1). A security interest is not perfected under section 547(e) of the Bankruptcy Code until the action necessary for it to have priority over a judicial lien is taken. In this case, that action was the filing of a financing statement at the county recorder's office.

3. *Henry v. Pioneer Sweet Potato Co.*, 614 So. 2d 853 (La. Ct. App. 1993).

This is one of the last pre-UCC cases involving growing crops expected to be seen from Louisiana. After January 1, 1992, Article 9 of the UCC governs these cases. In this case, a "crop pledge" defeated an alleged "lessor's privilege." In 1990, Pioneer entered into a farm operating agreement with the owners of a farm in Louisiana. Pioneer subsequently obtained a loan from Capital secured by its farm equipment

and the 1990 cotton and sweet potato crops grown on the farm. Capital filed financing statements with the Secretary of State and a filed copy of the security agreement pledging Pioneer's crop with the Louisiana Central Registry. When Pioneer defaulted on the farm operating agreement, the farm owners claimed a landlord's lien on the crops, but failed to record a lien notice in the central registry, as required by state law. The court held that Capital's filed security agreement and financing statements met the notice requirements of the crop pledge statute and therefore took priority over the landlord's unrecorded lien on the crops.

4. *Michel v. Melgren*, 853 P.2d 940 (Wash. 1993).

In this case interpreting the Washington agricultural lien law, the court noted that while landlords do not have to file notice of their lien under the state statute before completion of the harvest to be valid, until such notice was filed the landlords did not obtain priority over other valid suppliers' liens and perfected security interests. The court held that since the landlords did not file lien claims against the hay in question until April 15, 1988, the landlords' lien was only effective as to persons purchasing the hay on and after that date. The conversion aspect of this case is summarized in Part VI *supra*.

C. Between an Article 9 Security Interest and a Buyer in the Ordinary Course

1. *Ashburn Bank v. Farr*, 426 S.E.2d 63 (Ga. Ct. App. 1992).

The bank made a loan to Lumpkin, a feed lot operator, secured by a perfected security interest in Lumpkin's cattle. Lumpkin subsequently sold the cattle to Farr and defaulted on the note owed to the bank. The bank sued the buyer, Farr, for the cattle in his possession, claiming a perfected security interest in them, since Farr had not acted in good faith and the cattle in question were not farm products. The court found that 7 U.S.C. § 1631 controlled this case, not the state UCC. The court then held that the cattle were farm products and that Lumpkin was engaged in a farming operation as a feed lot operator. The court also noted that the definition of "buyer in the ordinary course of business" under the Food Security Act did not contain a good faith requirement like the one in section 1-201(9) of the UCC. No evidence of bad faith or knowledge by Farr was in the record. Thus, Farr purchased the cattle free of the bank's perfected security interest.

2. *Deutz-Allis Corp. v. Hutt Carville*, Nos. 41-91CH, 23a-92L, 1992 WL 509900 (Va. Cir. Ct. Oct. 2, 1992).

In an action to determine ownership of two farm tractors, the court held that a knowledgeable and experienced equipment dealer, who bought several tractors at below cost from another dealer, in what were actually sham transactions, did not purchase the tractors in the "ordinary course of business" under section 1-201(9). Therefore the dealer did not take the tractors at issue free of the lender's perfected security interest; there was a failure to meet the good faith component of the definition.

3. *Deutz-Allis Corp. v. Salm*, No. 93-1144-FT, 1993 Wis. App. LEXIS 1307 (Wis. Ct. App. Oct. 20, 1993).

In a replevin action by a the holder of a secured interest in a tractor, Salm, the buyer of the tractor, asserted he was a "buyer in the ordinary course of business" and thus took free of the security interest. After reviewing the facts, the court found that the tractor had been loaned rather than sold to Salm, and thus, he could not be a buyer at all.

4. *Franklin v. First National Bank of Morrill, Nebraska*, 848 P.2d 775 (Wyo. 1993).

In a dispute between the floor plan financier of a car dealership and a partner of the dealership concerning which party had the right to the cars, both parties argued the farm products exception of section 9-307(1) to the court. This case has nothing to do with agriculture. It is interesting only because it is the second case in the past year where a court has not recognized the preemption of 7 U.S.C. § 1631 (the Food Security Act) in eliminating the farm products exception of section 9-307(1).

D. Between an Article 9 Security Interest and a Mortgage Holder

1. *In re Temple Stephens Co.*, 156 B.R. 38 (Bankr. W.D. Mo. 1993).

A bank made a claim, prior to that of the bankruptcy trustee, under the "rents and profits" clause of its deed of trust for the debtor's standing timber, growing soybeans, severed soybeans in the bin, and proceeds from the sale of the severed soybeans. The court held that Article 9 of the UCC governed the soybean crop and its proceeds, superseding previous state law that growing crops went with the real estate and could be secured by a deed of trust. The court also stated that the bank could not have a lien on the proceeds of the severed soybeans, because once the soybeans are severed they are no longer

crops, but rather are farm products. The bank did not argue that it had a security interest in the debtor's farm products.

X. REPOSSESSION AND FORECLOSURE

A. *First Brandon National Bank v. Kerwin (In re Kerwin)*, 996 F.2d 552 (2d Cir. 1993).

This case seems to involve involuntary strict foreclosure through a Chapter 12 bankruptcy plan. Under his plan, Kerwin, a Chapter 12 "family farmer," transferred only a portion of the bank's total collateral to the bank. The property Kerwin transferred to the bank was determined by the court to be approximately the same value as the outstanding balance owed to the bank. The court held that the transfer fully satisfied the bank's loan and that the bank's lien on the remaining collateral was therefore extinguished. The bank was not entitled to retain a security interest in the other collateral to secure against a possible deficiency when the bank sold the transferred property.

B. *Buffalo National Bank v. United States*, 26 Cl. Ct. 1436 (1992).

The bank lent a dairy farm spring planting money secured by two tractors, and obtained a subordination from FmHA of its first priority lien on the tractors. The dairy farm subsequently discussed sale of the tractors with the local FmHA supervisor. The dairy farm sold one of the tractors and received a joint payee check made out to the dairy farm and the FmHA, which bounced. The purchaser, however, had sold the tractor to another party and gone bankrupt. The bank was unable to recover the tractor or the proceeds from the tractor sale. The court found that the bank's claim that FmHA had violated the UCC was not a proper claim in this case. The court went on to say that if it were to consider the UCC claim, that FmHA's failure to inform the bank of the tractor's sale and the dishonored check did *not* create an obligation on the part of FmHA to notify the bank of the sale under section 9-504(3), because FmHA was not the party selling the tractor. The end result was an unhappy bank.

C. *Metropolitan Life Ins. Co. v. Castle (In re Castle)*, No. 93-20031-C-11, 1993 Bankr. LEXIS 1080 (Bankr. W.D. Mo. July 30, 1993).

Metropolitan held a mortgage on three farms owned by Castle and her ex-husband as security for a loan made to both of them. In their divorce settlement, Castle deeded her interest in the farms to her ex-husband, and he agreed to indemnify her from liability on the note. The ex-husband subsequently filed Chapter 11 bankruptcy and settled

with Metropolitan by surrendering one farm and purchasing a release of the other two pieces of farm land for less than the amount of the note. When Metropolitan sued Castle for the deficiency, she argued that her liability for Metropolitan's deficiency should be discharged under section 3-606(b) of the pre-revision UCC, because the amount which Metropolitan had accepted from her ex-husband in exchange for release of the two farms from Metropolitan's mortgage unjustifiably impaired the collateral securing the note. The court held that despite Castle's higher appraisal values for the two farms, a variation of fourteen percent from Metropolitan's appraisal did not constitute unjustifiable impairment, especially since Castle had notice and opportunity to object to the sale at the time if she felt the values were too low.

XI. GOOD FAITH AND FAIR DEALING

A. *Ripplemeyer v. National Grape Cooperative Ass'n*, 807 F. Supp. 1439 (W.D. Ark. 1992).

Welch Foods, the parent corporation of National, a national agricultural marketing cooperative for concord grapes, closed its Springfield plant. The grape growers who were members of the cooperative sued for breach of their membership and marketing agreements with National, among other claims. The court, however, held that the contract agreement clearly allowed Welch the right to close the plant. The court also held that since Welch had the right to close the plant under the terms of the agreement, and had sent the required notices, it had not breached its general obligation of good faith and fair dealing imposed by section 1-203.

XII. PREEMPTION

A. *Town & Country Equipment, Inc. v. Massey-Ferguson, Inc.*, 808 F. Supp. 779 (D. Kan. 1992).

A specific state law requiring the repurchase of equipment at the end of a franchise preempted the measure of damage provision in section 2-703. The court denied a franchisee the right to be paid the difference between the price it obtained from selling its inventory of repair parts to a third party, and the statutory repurchase price under a Kansas statute that requires repurchase. The court held that because of the preemption, the franchisee was not obligated to mitigate its damages, and had no obligation to resell the repair parts to a third party. Once the franchisee elected to resell the parts, the wholesaler was relieved of its obligation to pay the eighty-five percent statutory repurchase price, and the franchisee had no right to a deficiency.

- B. *Worm v. American Cyanamid Co.*, CIV.A.HAR90-1424, 1992 WL 368062 (D. Md. Nov. 30, 1992), *aff'd*, 5 F.3d 744, (4th Cir. 1993).**

As noted in Part III *supra*, the court in this case held that the Worms' claim for breach of warranty under section 2-313 was preempted by FIFRA because the EPA had approved the herbicide's label.

XIII. BULK TRANSFER

- A. *Central Line Tractor & Equipment Co. v. Rapp*, 616 N.E.2d 585 (Ohio Ct. App. 1992).**

No bulk transfer occurred when Kubota, the owner of farm equipment and machinery inventory held by Davis, a defunct farm equipment dealership, transferred it to Central, a new dealer. Kubota had a floor plan financing relationship with its former dealer, Davis. Davis went to work for Central and essentially gave one of Central's tractors to an unpaid creditor of Davis. When challenged on this transaction, the unpaid creditor claimed it was merely exercising its rights against the collateral of the former dealership, since the bulk transfer provisions of Article 6 of the UCC had not been complied with in transferring the inventory. The court said the transfer did not constitute a bulk transfer under section 6-102(1). The creditor of Davis could not offset its claims against the price of a tractor purchased from Central under the theory that he was a creditor who did not receive adequate notice of the bulk transfer. Even if the bulk transfer rules were to apply, however, the creditor could not levy on the particular tractor purchased by the creditor because it had never been part of Davis' inventory.

XIV. PACA

- A. *Cossa & Sons v. Tani Farms (In re Altabon Foods, Inc.)*, 998 F.2d 718 (9th Cir. 1993).**

Cossa supplied vegetables to the debtor under contracts that allowed payment to be made within periods of forty-five to sixty days. When the debtor filed for bankruptcy, Cossa attempted to seek payment under the provisions of the Perishable Agricultural Commodities Act (PACA) statutory trust for unpaid deliveries of produce. The court held that under 7 C.F.R. § 46.46(f)(2), PACA mandated maximum payment periods of thirty days in order to qualify for trust protection. Therefore, the PACA statutory trust was not available to Cossa for unpaid deliveries of produce pursuant to contracts with payment periods of longer than thirty days.

XV. BANKRUPTCY

A. *Calumet Farm, Inc. v. Northern Equine Thoroughbred Productions, Ltd. (In re Calumet Farm, Inc.)*, 150 B.R. 403 (Bankr. E.D. Ky. 1992).

The bankruptcy trustee defeated a perfected security interest as preferential under section 547 of the Bankruptcy Code because the financing statement was filed within ninety days of the filing of the bankruptcy petition. In 1988, Northern Equine sold its half interest in a race horse to Calumet, and in the purchase and sale agreement retained a security interest in the horse to secure payment of the purchase price. Northern Equine, however, did not file a UCC financing statement with the county clerk until 1991. Calumet filed a petition under Chapter 11 of the Bankruptcy Code within ninety days after the filing of the financing statement. The court held that the bankruptcy trustee could avoid Northern Equine's security interest in the horse, despite the validity of the security interest between Calumet and Northern Equine. The priority aspect of this case is mentioned in section IX.B. *supra*.

B. *Bel-Bel International Corp. v. Barnett Bank*, 158 B.R. 252 (S.D. Fla. 1993).

Bel-Bel had made loans to the debtor secured by the debtor's 1988 and 1989 tomato crops and their proceeds. Instead of being paid into accounts designated by Bel-Bel, the proceeds of the secured crops were diverted by the bank, a junior creditor, to repay various loans made by the bank to the debtor and others. After filing for protection under Chapter 11 of the Bankruptcy Code, the debtor-in-possession obtained a judgment against the bank for recovery of the diverted funds, under preference and fraudulent conveyance claims, which the bank appealed. The court held that Bel-Bel's adversary action against the debtor-in-possession for repayment of its loans did not have to be stayed until resolution of the bank's appeal because (1) Bel-Bel's claims were for collection of secured and unsecured debt, rather than for recovery of preference payments or fraudulent conveyances; (2) Bel-Bel's claims were only a part of the total amounts diverted; and (3) the court had previously given Bel-Bel relief from the automatic stay in order to pursue its claims against the debtor-in-possession.

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