An Agricultural Law Research Article

Current Article 9 Issues and Agricultural Credit

by

Keith G. Meyer

Originally published in DRAKE JOURNAL OF AGRICULTURAL LAW
10 DRAKE J. AGRIC. L. 105 (2005)

www.NationalAgLawCenter.org
CURRENT ARTICLE 9 ISSUES AND AGRICULTURAL CREDIT

Keith G. Meyer *

I. Introduction .................................................................................................................. 106

II. Scope of Article 9 ....................................................................................................... 107
A. Agricultural Liens ..................................................................................................... 110
B. Sale of Farm Products Subject to an Agricultural Lien or Security Interest ......... 127
   1. Proceeds from the Sale of Farm Products ......................................................... 130
   2. Recent Cases Dealing with Sale of Farm Products and Cash Leases ............... 131

III. Attachment ............................................................................................................. 135
A. In General .................................................................................................................. 135
B. Security Agreements and Bankruptcy Exception to Discharge ......................... 137
   1. Can a Security Agreement Create a Fiduciary Relationship for Purposes of Bankruptcy § 523 Exception to Discharge? ................................................................. 137
   2. Does Sale of Collateral Subject to a Security Interest Constitute Willful and Malicious Damage to Property under § 523? .................................................. 138
C. Security Agreements and Description Requirement ............................................ 142
D. Proceeds .................................................................................................................... 146
   1. Government Payments as Proceeds ................................................................. 148
E. Debtor Must Have Rights in the Collateral ......................................................... 152
   1. In General ........................................................................................................... 152
   2. When Does a Farmer Have Rights in Government Payments? .................... 159
F. Perfection .................................................................................................................... 164
   1. In General ........................................................................................................... 164
   2. Financing Statement and the Debtor's Name .................................................... 167
I. INTRODUCTION

Each year at the annual meeting of the American Agricultural Law Association I give what is called a Commercial Law Update that focuses on interesting cases that were decided during the year dealing with Article 9 of the Uniform Commercial Code ("U.C.C"). This paper is essentially the presentation given at the 2004 annual meeting in Des Moines, Iowa.

Article 9 is basically divided into five parts: scope, attachment, perfection, priorities, and default. This Article will be organized around the first three

---

1. See Keith G. Meyer, A Potpourri of Article 9 Issues, 8 DRAKE J. AGRIC. L. 323-80 (Summer 2003) (discussing 2002 update plus some general discussion of other Article 9 issues).

2. U.C.C. § 9-109 (2004). This section provides in part:

(a) [General scope of article.] Except as otherwise provided in subsections (c) and (d), this article applies to:
   (1) a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract;
   (2) an agricultural lien;
   (3) a sale of accounts, chattel paper, payment intangibles, or promissory notes;
   (4) a consignment;
   (5) a security interest arising under Section 2-401, 2-505, 2-711(3), or 2A-508(5), as provided in Section 9-110; and
   (6) a security interest arising under Section 4-210 or 5-118.

(b) [Security interest in secured obligation.] The application of this article to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this article does not apply.


Revised section 9-308 defines perfection:

(a) [Perfection of security interest.] Except as otherwise provided in this section and Section 9-309, a security interest is perfected if it has attached and all of the applicable requirements for perfection in Sections 9-310 through 9-316 have been satisfied. A security interest is perfected when it attaches if the applicable requirements are satisfied before the security interest attaches.
parts. The cases or issues discussed here will focus almost exclusively on Revised Article 9, (hereinafter R9), and cases decided since August, 2003. All references and cites are to R9 unless otherwise indicated.

II. SCOPE OF ARTICLE 9

When Article 9 was adopted in 2001, its scope was expanded. Scope is defined in § 9-109, which states that the rules of Article 9 apply to:

In general, depending on the type of collateral, perfection can occur in five different ways: (1) secured party files a financing statement in a public office; (2) secured party takes possession of the collateral; (3) secured party obtains control; (4) the security interest is noted on the certificate of title, and; (5) perfection can occur automatically upon attachment of the security interest under U.C.C. § 9-203(b). U.C.C. §§ 9-310--316 (2004).

7. As of July 1, 2001, all fifty states had enacted Revised Article 9. 2003-1 SECURED TRANSACTIONS GUIDE (CCH) ¶ 4991 (2003). In Alabama, Mississippi, and Florida, R9 became effective after July 1, 2001; R9 became effective in Connecticut on October 1, 2001. Id.
8. Since 1962 Article 9 has been changed twice. Substantial amendments were made in 1972, and in 1999 R9 was completely revised. The revision has produced controversy. Questions have been raised about the process followed by the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute (ALI) in revising Article 9. Moreover, only time will tell whether Revised 9 will produce results that justify the considerable resources devoted to its creation and the costs connected with the implementing of R9. Previous drafts of R9 may be found on the Internet at http://www.law.upenn.edu/library/ulc/ulc.htm U.C.C.
9. Both NCCUSL & ALI work on revisions and both approve changes, but the NCCUSL alone directs the effort to get states to adopt the new version of the U.C.C. The ALI revision process typically starts with a study committee and a group of advisors. If changes are needed, a drafting committee is appointed. The drafting committee typically contains academics, representatives of the various industries affected, and consumer advocates. An attempt is made to develop a code that has broad appeal so that special interest groups will not derail states from adopting it. It must also be noted that currently the American Bar Association plays an important role in the development process. For a thorough discussion of the revision process of Article 9 of the U.C.C., see generally Marianne B. Culhane, The UCC Revision Process: Legislation You Should See In the Making, 26 CREIGHTON L. REV. 29 (1992-93). Some have argued that the process is a closed society dominated by pro-business advocates and is too rigid in its approach to re-thinking uniform acts. See Kathleen Patchel, Interest Group Politics, Federalism, and the Uniform Laws Process: Some Lessons From the Uniform Commercial Code, 78 MINN. L. REV. 83, 120-23 (1993); Edward L. Rubin, Thinking Like a Lawyer, Acting Like a Lobbyist: Some Notes on the Process of Revising UCC Articles 3 and 4, 26 LOY. L.A. L. REV. 743, 787 (1993); see generally Alan Schwartz & Robert E. Scott, The Political Economy of Private Legislatures, 143 U. PA. L. REV. 595 (1995) (using “structure-induced equilibrium” theory to show the NCCUSL process is influenced by dominant interest groups). Other relevant articles include Peter A. Alces & David Frisch, On the UCC Revision Process: A Reply to Dean
(1) Any transaction, regardless of form, that creates a security interest in personal property or fixtures;\textsuperscript{9}

(2) An agricultural lien;\textsuperscript{10}

(3) Sale of accounts, chattel paper, payment intangibles, or promissory notes;\textsuperscript{11}

(4) Consignments;\textsuperscript{12} and

(5) Security interests arising under other sections of the U.C.C.\textsuperscript{13}

Article 9 of the U.C.C. now also applies to security interests granted by non-consumers in deposit accounts.\textsuperscript{14} U.C.C. sections 9-109(c) and (d) set forth a number of transactions that are not within the scope of Article 9.\textsuperscript{15} One of the major changes concerns statutory agriculture liens.

Scott, 37 WM. & MARY L. REV. 1217 (1996) (interest groups have not captured the drafting process); Edward J. Janger, Predicting When the Uniform Law Process Will Fail: Article 9, capture, and the Race to the Bottom, 83 IOWA L. REV. 569 (1998) (noting the effect of secured credit on societal concerns such as safety and the benefits and drawbacks of the uniform law creation process); Fred H. Miller, Realism Not Idealism in Uniform Laws—Observations From the Revision of the UCC, 39 S. TEX. L. REV. 707 (1998) (discusses the realities of the uniform drafting process).

The change process is slow. It generally takes years for changes to be made, approved by the NCCUSL and the ALI, and for all of the states to adopt the changes.

\textsuperscript{9} U.C.C. § 9-109(1) (2004) (no change from old Art. 9).

\textsuperscript{10} See id.§ 9-109(a)(2) (evidencing a major change that applies to nonpossessory statutory liens in farm products).

\textsuperscript{11} See id. compare R9, U.C.C. § 9-105 (1999) (showing the last two are new additions and the definition of accounts is expanded).


\textsuperscript{13} See U.C.C. §§ 9-110, 4-210, 5-118 (2004).

\textsuperscript{14} See id. § 9-109(d)(13) (providing that Article 9 does not apply to “an assignment of a deposit account in a consumer transaction, but Sections 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds”).

\textsuperscript{15} Id. § 9-109(c) states: This article does not apply to the extent that:

(1) a statute, regulation, or treaty of the United States preempts this article;

(2) another statute of this State expressly governs the creation, perfection, priority, or enforcement of a security interest created by this State or a governmental unit of this State;

(3) a statute of another State, a foreign country, or a governmental unit of another State or a foreign country, other than a statute generally applicable to security interests, expressly
governs creation, perfection, priority, or enforcement of a security interest created by the State, country, or governmental unit; or

(4) the rights of a transferee beneficiary or nominated person under a letter of credit are independent and superior under Section 5-114.

Id. 9-109(d) provides:

This article does not apply to:

(1) a landlord’s lien, other than an agricultural lien;
(2) a lien, other than an agricultural lien, given by statute or other rule of law for services or materials, but Section 9-333 applies with respect to priority of the lien;
(3) an assignment of a claim for wages, salary, or other compensation of an employee;
(4) a sale of accounts, chattel paper, payment intangibles, or promissory notes as part of a sale of the business out of which they arose;
(5) an assignment of accounts, chattel paper, payment intangibles, or promissory notes which is for the purpose of collection only;
(6) an assignment of a right to payment under a contract to an assignee that is also obligated to perform under the contract;
(7) an assignment of a single account, payment intangible, or promissory note to an assignee in full or partial satisfaction of a preexisting indebtedness;
(8) a transfer of an interest in or an assignment of a claim under a policy of insurance, other than an assignment by or to a health-care provider of a health-care-insurance receivable and any subsequent assignment of the right to payment, but Sections 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds;
(9) an assignment of a right represented by a judgment, other than a judgment taken on a right to payment that was collateral;
(10) a right of recoupment or set-off, but:
   (A) Section 9-340 applies with respect to the effectiveness of rights of recoupment or set-off against deposit accounts; and
   (B) Section 9-404 applies with respect to defenses or claims of an account debtor;
(11) the creation or transfer of an interest in or lien on real property, including a lease or rents thereunder, except to the extent that provision is made for:
   (A) liens on real property in Sections 9-203 and 9-308;
   (B) fixtures in Section 9-334;
   (C) fixture filings in Sections 9-501, 9-502, 9-512, 9-516, and 9-519; and
   (D) security agreements covering personal and real property in Section 9- 604;
A. Agricultural Liens

The drafters of R9 made nonpossessory statutory liens on farm products subject to the perfection, priority and enforcement rules of Article 9.\textsuperscript{16} Other state law determines how and when a statutory lien attaches to farm products and/or the proceeds of farm products.\textsuperscript{17} A statutory lien on farm products is defined as an "agricultural lien."\textsuperscript{18} Section 9-102(a)(5) defines an "agricultural lien" to mean:

"an interest in farm products:

(A) which secures payment or performance of an obligation for:

(i) goods or services furnished in connection with a debtor’s farming operation; or

(ii) rent on real property leased by a debtor in connection with its farming operation;

(B) which is created by statute in favor of a person that:

(i) in the ordinary course of its business furnished goods or services to a debtor in connection with a debtor’s farming operation; or

(ii) leased real property to a debtor in connection with the debtor’s farming operation; and

(C) whose effectiveness does not depend on the person’s possession of the personal property."\textsuperscript{19}

\textsuperscript{16} See id. § 9-109 (a)(2).
\textsuperscript{17} See id. § 9-109 (c)(2).
\textsuperscript{18} Id. § 9-102(a)(5).
\textsuperscript{19} Id. § 9-102(a)(34) defining farm products as:

\begin{itemize}
  \item goods, other than standing timber, with respect to which the debtor is engaged in a farming operation and which are:
    \begin{itemize}
      \item (A) crops grown, growing, or to be grown, including:
    \end{itemize}
\end{itemize}
Section 9-308(b) provides that an agricultural lien is perfected when the lien is effective under the statute that created it, and a proper financing statement has been filed centrally.\textsuperscript{20} It is clear that a financing statement may be filed before the agriculture lien becomes effective.\textsuperscript{21}

Article 9 now governs priority conflicts between a security interest and an agricultural lien.\textsuperscript{22} Section 9-322(g) states: “A perfected agricultural lien on collateral has priority over a conflicting security interest in or agricultural lien on the same collateral if the statute creating the agricultural lien so provides.”\textsuperscript{23} This means that if the state statute creating the agricultural lien does not state a priority rule, the normal priority rules of Article 9 apply.\textsuperscript{24} Thus, perfected security interests have priority according to time of filing or perfection, whichever occurs first, unless the statute creating the lien specifically provides otherwise.\textsuperscript{25} A perfected agricultural lien has priority over a conflicting unperfected security inter-

(i) crops produced on trees, vines, and bushes; and
(ii) aquatic goods produced in aquacultural operations;
(B) livestock, born or unborn, including aquatic goods produced in aquacultural operations;
(C) supplies used or produced in a farming operation; or
(D) products of crops or livestock in their unmanufactured states.

Farming operation is defined in id. § 9-102(a)(35).

\textsuperscript{20.} U.C.C. §§ 9-308(b); 9-310(a) (2003).

\textsuperscript{21.} Id. §§ 9-308(b); 9-310(a).

At what point in time a landlord’s lien has been properly filed can arise when a lien was created prior to the effective date of the R9. This issue was considered in Dean v. Hall, 2003 WL 21650145, 50 U.C.C. Rep. Serv.2d 618 (E.D. Va. 2003). Here landowners claimed crops produced on cash rented land when the rent was not paid. The lease was apparently created prior to the effective date of Revised 9. The controversy arose in 2002 when the landowner and a perfected secured creditor claimed the same crops. The court held that the landowner was asserting an agricultural lien under 9-102(a)(5) and landowner was required to file a UCC financing statement.

Virginia’s Revised 9 gave a one-year grace period to any holder of a valid statutory lien effective under the old law. Thus, as long as the holder filed before July 1, 2002, it was protected. Landowner did not file and her interest lapsed on July 1, 2002.

\textsuperscript{22.} U.C.C. § 9-322 (2001).

\textsuperscript{23.} See id. § 9-322(g) (emphasis added).

\textsuperscript{24.} See id. § 9-322(g) cmt. 12; id. § 9-322(g).

\textsuperscript{25.} Id. § 9-322(a)(1).
est or an unperfected agricultural lien. The first security interest or agricultural lien to attach or become effective has priority if a conflicting security interest or agricultural lien is unperfected. If a statute under which an agricultural lien is created provides that the agricultural lien has priority over a conflicting security interest or agricultural lien in the same collateral, that statute governs priority if the agricultural lien is perfected. Finally, in conflicts between a lien creditor and an unperfected agricultural lien, the lien creditor defeats the unperfected agricultural lien holder.

In summary, a state statute creating the nonpossessory lien must exist, must provide how the lien is created, and when it attaches. All statutory liens on farm products must be perfected by centrally filing a proper financing statement. This will be a change for many current statutory liens, as it eliminates secret liens. Under section 9-322(g), states are invited to determine which agricultural liens will have priority over prior perfected security interests. However, all such liens will be subject to the perfection and enforcement rules of Article 9. Again, if the statute creating the lien does not provide for a super-priority, the normal priority rules of section 9-322 will apply.

Perhaps the most significant impact of the coverage of agricultural liens is that a landlord lien for unpaid rent of land used in a farming operation is now covered by Article 9. The definition of an agricultural lien includes a statutory

26. Id. § 9-322(a)(2).
27. Id. § 9-322(a)(3).
28. Id. § 9-322(g), cmt. 12.
29. Id. § 9-102(a)(52). The definition of lien creditor includes a creditor who has obtained a judgment on an unpaid debt and levied execution on specific property as well as the Trustee in Bankruptcy [hereinafter TIB].
30. Id. § 9-317(a)(2).
31. See id. § 9-322(g).
32. See id. § 9-322 cmt. 12.
33. A number of good law review articles examine agricultural financing and liens. See, e.g. Donald W. Baker, Some Thoughts on Agricultural Liens under the New U.C.C. Article 9, 51 ALA. L. REV. 1417 (2000); Linda J. Rusch, Farm Financing Under Revised Article 9, 73 AM. BANKR. L.J. 211 (1999); Drew L. Kershen & Alvin C. Harrell, Agricultural Finance: Comparing the Current and Revised Article, 33 U.C.C.L.J. 169 (2000).
34. U.C.C. § 9-109(a)(2), § 9-102(a)(5)(A)(ii) (2001). In re Parks Planting Co. is a recent case rejecting a landlord’s claim that it had a landlord lien and holding it could only claim an interest in the specific crops if it had a perfected security interest. 2002 WL 1397250 at *4 (W.D. Tenn. June 5, 2002). A pre-revised Article 9 case made the clear, correct point that a landlord’s lien on crops for unpaid rent was not covered by former Article 9. Fratesi v. Fogelman, 32 S.W.3d 38, 41 (Ark. 2000).
nonpossessory lien created in farm products to secure the performance of an obligation for rent of real property leased in connection with debtor’s farming operation. Thus, a landlord lien on crops for unpaid rent for land upon which the crops are produced is now subject to the perfection, priority, and enforcement rules of Revised Article 9. This is an important issue because a number of states have landlord liens.

Remember that a security interest can be created in a farm lease. The security interest was and is subject to Article 9. Growing crops are personal property and a security interest in them is covered by Article 9.

36. Clearly, the drafters of Revised Article 9 intended that an agricultural lien must be filed. One of the main reasons for covering agricultural liens is to eliminate secret liens by requiring a public filing. It also makes the enforcement of agricultural liens subject to the same rules as all security interests. Some states have made non-uniform amendments to the Article 9’s treatment of agricultural liens. An example is Illinois. As of August 21, 2002, Illinois no longer requires landlord liens to be perfected by the filing of a financing statement, and has provided by statute that the landlord’s lien is prior to a prior perfected security interest in the same crops. See 810 ILL. COMP. STAT. 5/9-102(a)(5) and Pub. Act 92-0819, 92nd Gen. Assem. (Ill. 2002), available at http://www.ilga.gov (last visited Jan. 18, 2005).

37. States with statutory landlord liens covering growing crops (listed alphabetically):
Alabama, ALA. CODE § 35-9-30 (2004); Arizona, ARIZ. REV. STAT. § 33-362 (2004); Arkansas, ARK. CODE ANN. § 18-41-101 (2004); Delaware, DEL. CODE ANN. tit. 25, § 6715 (2004); Florida, FLA. STAT. ANN. §83.10 (2004) (lien on crops for advances by landlord); Georgia, GA. CODE ANN. § 44.14-341 (2004); Illinois, 735 ILL. COMP. STAT. 5/9-316 (2004); Indiana, IND. CODE. ANN. § 32-31-1-19 (2004); Iowa, IOWA CODE § 570.1 (2003); Kansas, KAN. STAT. ANN. §58-2524 (2003); Kentucky, KY. REV. STAT. ANN. § 383.110 (2004); Louisiana, LA. CIV. CODE ANN. art. 2705 (2004); Maryland, Md. ANN. CODE, Real Property § 8-115 (2003); Minnesota, MINN. STAT. § 514.964 (2003); Mississippi, Miss. CODE ANN. § 89-7-51 (2004); Missouri, MO. REV. STAT. § 441.280 (2004); New Mexico, N.M. STAT. ANN. § 48-6-1 (2004); North Carolina, N.C. GEN. STAT. § 42-15 (2004); Oklahoma, OKLA. STAT. tit. 41, § 23 (2005); South Carolina, S.C. CODE ANN. § 29-13-10 (2003); South Dakota, S.D. CODIFIED LAWS § 38-17-3 (2004); Tennessee, TENN. CODE ANN. § 66-12-101 (2004); Texas, TEX. PROP. CODE ANN. §54.001 (2004); Utah, UTAH CODE ANN. § 38-3-1 (2004), (Ray v. Cox, 30 P.2d 1062, 1063-64 (Utah, 1934) (holding that alfalfa and hay seed were exempt from landlords lien under now repealed exemption law, but court infers that landlords lien would cover crops if not exempt); Virginia, VA. CODE ANN. § 43-29 (2004); Washington, WASH. REV. CODE ANN. § 60.11.020 (West 2004); West Virginia, W. VA. CODE § 37-6-12 (2004) (Landlord may have lien for distrain of rent of ‘goods’ on the property or removed from the property within 30 days).

States where statutory landlord lien do not extend to growing crops (includes only states where issue has actually been litigated): Oregon, OR. REV. STAT. § 87.162 (2003), In re Sabre Farms, Inc., 27 B.R. 532, 537 (Bankr. D. Or. 1982).
A few examples applying a specific state landlord statute will illustrate the basic rules and some of the potential issues concerning agricultural liens. Consider the following hypothetical:

3/1 O cash rents 80 acres of farmland to F for $100 acre; rent to be paid October 1.

4/1 O files a proper financing statement covering F’s farm products.

10/1 F harvests the crops and defaults on his lease.

11/1 F files a bankruptcy petition; F has possession of the crops; O asserts he has the right to the crops.

Generally, state law will govern conflicts concerning claims to crops in an action for bankruptcy. Assume for purposes of this hypothetical that Iowa law is the relevant law. Iowa has a statutory landlord lien for unpaid rent of farm land. Iowa Code section 570.1 states in part:

38. See Butner v. U.S., 440 U.S. 48, 55 (1979) (stating “[p]roperty interests are created and defined by state law . . . The justifications for application of state law are not limited to ownership interests; they apply with equal force to security interests. . . ”); see also Worthen Bank & Trust Co. v. Hilyard Drilling Co., 840 F.2d 596, 599 n.4 (8th Cir. 1988) (stating applicable state law determines the extent and validity of liens on property in bankruptcy); In re Cybernetic Servs., Inc., 239 B.R. 917, 919 (B.A.P. 9th Cir. 1999) (stating that perfection of a security interest in a patent would be governed by California’s Article 9, absent preemption under federal law); Trimarchi & Personal Dating Servs., Inc., v. Together Dev. Corp., 255 B.R. 606, 610 (Bankr. D. Mass. 2000) (holding that the Lanham Act section on national recording of assignment of trademarks did not preempt the state Article 9 law concerning perfection of a security interest in a trademark); Roman Cleanser Co. v. Nat’l Acceptance Co. of Am., 43 B.R. 940, 945 (Bankr. D. Mich. 1984) (the same holding as Trimarchi, “The Uniform Commercial Code provides a simple mechanism for obtaining and perfecting security interests in personal property. Understandably, the Code defers to federal legislation if such legislation accomplishes the same purpose. However, unless federal preemption is clearly established, the Code procedures should continue to apply”); Nef v. Ag. Servs. of Am., Inc., 86 S.W.3d 4, 11 (Ark. Ct. App., 2002) (discussing the Department of Agriculture Regulation governing assignment of cash payments did not preempt the state UCC laws governing perfection).

39. See IOWA CODE ANN. § 570.1 (West 2004). This provides in whole:

1. A landlord shall have a lien for the rent upon all crops grown upon the leased premises, and upon any other personal property of the tenant which has been used or kept thereon during the term and which is not exempt from execution.

2. In order to perfect a lien in farm products as defined in section 554.9102, which is created under this section, a landlord must file a financing statement as required by section 554.9308, subsection 2. Except as provided in chapters 571, 572, 579A, 579B, and 581,
1. A landlord shall have a lien for the rent upon all crops grown upon the leased premises, and upon any other personal property of the tenant which has been used or kept thereon during the term and which is not exempt from execution.

2. In order to perfect a lien in farm products as defined in section 554.9102, which is created under this section, a landlord must file a financing statement as required by section 554.9308, subsection 2. Except as provided in chapters 571, 572, 579A, 579B, and 581, a perfected lien in the farm products has priority over a conflicting security interest or lien, including a security interest or lien that was perfected prior to the creation of the lien under this section, if the lien created in this section is perfected on either of the following dates:


   b. When the debtor takes possession of the leased premises or within twenty days after the debtor takes possession of the leased premises. 40

3. A financing statement filed to perfect a lien in the farm products must include a statement that it is filed for the purpose of perfecting a landlord's lien. Notwithstanding section 554.9515, such financing statement shall continue to be effective until a termination statement is filed.

4. Within twenty days after a landlord who has filed a financing statement receives a written demand, authenticated as provided in article 9 of chapter 554, from a tenant, the landlord shall file a termination statement, if the lien in the farm products has expired or if the tenant is no longer in possession of the leased premises and has performed all obligations under the lease.

40. Iowa Code § 570.1 (2004). Iowa has a number of other agricultural liens such as:
   1) Custom Cattle Feedlot Lien, Chapter 579A; 2) Commodity Production Contract Lien, Chapter 579B; 3) Agricultural Supply Dealer's Lien, Chapter 570A; 4) Thresher's or Cornsheller's Lien, Chapter 571; 5) Lien for Services of Animals, Chapter 580; and 6) Veterinarian's Lien, Chapter 581. Iowa also has what is called an artisan's lien under Chapter 577 but this cannot be an agricultural lien under Article 9 because it can be effective only if the claimant has possession of the farm products.
Under Article 9 and Iowa Code section 570.1, O has a perfected agricultural lien. O has a perfected agricultural lien under Iowa law because the lien is effective and O filed a proper financing statement before the petition was filed.41 Thus, the lien has attached to the crops produced on the rented land. It is not clear, however, under Iowa Code section 570.1 whether the lien attached when the cash lease began or upon default on the lease by F.42 While this might present a problem for O in situations discussed later in this piece, it is clear at the date of the bankruptcy that O had an effective lien on the crops produced on the rented land. Furthermore, at the date of the bankruptcy, O had a proper financing statement; thus, O's lien is perfected. Section 570.1(2)(b) also has a requirement that land owner file within 20 days of the debtor taking possession of the lease land. This requirement appears to apply only to priority conflicts with a secured creditor or another lien holder.43

Yet another pressing issue emanates from this hypothetical: Is O insulated from avoidance powers of the trustee in bankruptcy (TIB)? The answer to this question requires an examination of the TIB avoidance powers under 11 U.S.C. sections 544(a)(1), 545 and 547. Under section 544(a)(1) the TIB is treated as having a judicial lien on all of the debtor’s property. The TIB has the powers of a hypothetical lien creditor at the moment the petition is filed. Thus, in the hypothetical presented, the TIB has a lien on F’s crops claimed by O. Now the question is if the TIB can defeat O’s claim under the Iowa landlord lien statute. Generally, this is determined by state law.44 U.C.C. Section 9-317 deals with priority conflicts between certain security interests and certain agriculture lien holders. It provides in part:

(a) A security interest or agriculture lien is subordinate to the rights of:

(1) a person entitled to priority under Section 9-322; and

(2) ... a person that becomes a lien creditor before ... the security interest or agricultural lien is perfected ... .45

---

41. Id. §§ 554.9310(1)-(2), 554.9308(1)-(2).
42. See id. § 570.1.
43. Id. § 570.1(2)(b).
Section 9-322 does not deal with a conflict between a holder of a perfected agriculture lien and a lien creditor, as the TIB is defined under Article 9. Section 9-322(g) deals with priority conflicts between a perfected agriculture lien and a security interest. The TIB has a judicial lien under section 544(a)(1) which makes him a lien creditor, not a perfected agriculture lien holder.

Under section 9-317(a)(2), O’s argument is that he had a perfected agriculture lien at the time the TIB became a lien creditor because the clear the negative inference of section 9-317(a)(2) is that a perfected agricultural lien holder wins this conflict. Yet, what is the impact of Iowa Code section 570.1(2)? Again, it states in relevant part that:

“[A] perfected lien in the farm products has priority over a conflicting security interest or lien, including a security interest or lien that was perfected prior to the creation of the lien under this section, if the lien created in this section is perfected.”

b. When the debtor takes possession of the leased premises or within twenty days after the debtor takes possession of the leased premises.

46. U.C.C. § 9-102(52)(A) & (C) define a lien creditor to include “a creditor that has acquired a lien on property involved by attachment, levy, or the like” or a trustee in bankruptcy.
47. See U.C.C. § 9-322(g) (2001).
48. See id. § 9-322(a)(1)-(3), (g), cmt. 12. The definition of lien creditor includes a creditor who has obtained a judgment on an unpaid debt and levied execution on specific property as well as the trustee in bankruptcy. Id. § 9-102(52). A number of good law review articles examine agricultural financing and liens. See, e.g. Donald W. Baker, Some Thoughts on Agricultural Liens Under the New U.C.C. Article 9, 51 ALA. L. REV. 1417 (2000); Linda J. Rusch, Farm Financing Under Revised Article 9, 73 AM. BANKR. L.J. 211 (1999); Drew L. Kershen & Alvin C. Harrell, Agricultural Financing—Comparing the Current and Revised Article 9, 33 UCC L.J. 169 (2000). U.C.C. § 9-109(a)(2), (5)(A)(ii). A recent case rejecting a landlord’s claim that it had a landlord lien and holding it could only claim an interest in the specific crops if it had a perfected security interest is In re Parks, No. CIV. A. 01-12467, 2002 WL 1397250 (W.D. Tenn. June 5, 2002). Fratesi v. Fogleman, 32 S.W.3d 38 (Ark. 2000), a pre-revised Article 9 case, made the clear, correct point that a landlord’s lien on crops for unpaid rent is not covered by former Article 9.

Remember that a security interest can be created in a farm lease. The security interest was and is subject to Article 9. Growing crops are personal property and a security interest in them is covered by Article 9. See U.C.C. §§ 9-102(a)(34), (35) (2004).
49. 11 U.S.C. § 544(a)(1) (2000); see also U.C.C. § 9-102(a)(52)(A), (C) (2001) (defining a lien creditor to include “a creditor that has acquired a lien on the property involved by attachment, levy, or the like” or a TIB).
52. Id. § 570.1(2)(b).
The TIB can argue that under Iowa Code section 570.1(2)(b), even though O is perfected, O does not have priority.\textsuperscript{53} Section 570 is specifically designed to deal with landlord liens on crops and conflicts among third parties claiming an interest in crops produced on leased land.\textsuperscript{54} In general, the statute provides priority to a holder of a perfected lien in farm products\textsuperscript{55} over other liens\textsuperscript{56} if the lien on farm products is perfected within twenty days after the debtor, F takes possession of the leased land.\textsuperscript{57} O did not perfect within twenty days and therefore does not have priority over a lien creditor. The twenty-day requirement is not restricted to security interests or liens on farm products arising before the landlord lien of O attaches.

When analyzing this factual situation under the statute, one should start by ignoring the clause: "including a security interest or lien that was perfected prior to the creation of the lien under this section."\textsuperscript{58} When one does this, it is clear that the statute states a perfected lien on farm products has priority if it was perfected within twenty days of the debtor obtaining possession of the farmland.\textsuperscript{59} Thus, under the statute, O can also get priority over a prior perfected security interest or lien on farm products if he files within the twenty day time period.\textsuperscript{60}

Unlike U.C.C. section 9-322(g), section 570.1.2 does not restrict the priority rule to conflicts between parties either having a security interest or an "agriculture lien."\textsuperscript{61} The statute simply refers to conflicts between a "security interest or lien."\textsuperscript{62} Moreover, it is interesting to note the twenty day perfection requirement is the same as for purchasing money security interests, but section

\begin{itemize}
\item \textsuperscript{53} See id.
\item \textsuperscript{54} See id. § 570 (1-10).
\item \textsuperscript{55} Id. § 570.1(2); see also id. § 570.1(1) (providing that "[a] landlord shall have a lien for the rent upon all crops grown upon the leased premises ..." (emphasis added)). These provisions are not inconsistent—"farm products" clearly includes crops. See U.C.C. § 9-102(a)(34) (2004).
\item \textsuperscript{56} Iowa has a number of other agricultural liens. Iowa has an artisan's lien under § 577, but this cannot be an agricultural lien under Article 9 because it can be effective only if the claimant has possession of the farm products. Also note that Iowa Code Ann. § 554.9322.7 states: "Priority under agricultural lien statute. A perfected agricultural lien on collateral has priority over a conflicting security interest in or agricultural lien on the same collateral if the statute creating the agricultural lien so provides."
\item \textsuperscript{57} Iowa CodE § 570.1.(2)(b) (2003).
\item \textsuperscript{58} Id. § 570.1.2.
\item \textsuperscript{59} Id. § 570.1.(2)(b).
\item \textsuperscript{60} See id. § 570.1.(2).
\item \textsuperscript{61} Compare U.C.C. § 9-322(g) (2003), with Iowa CodE § 570.1.(2) (2003).
\item \textsuperscript{62} Iowa CodE § 570.1.(2) (2003).
\end{itemize}
570.1(2)(b) does not restrict the priority to prior perfected security interests or agriculture lien holders. To avoid this problem, O should always file before a tenant is given possession.

The TIB is not restricted to just one method of attack. Another option available to a TIB is section 545. Section 545 provides:

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

(1) first becomes effective against the debtor

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

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

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

(D) when the debtor becomes insolvent;

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

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

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

(3) is for rent; or

(4) is a lien of distress for rent. 64

Thus, section 545 provides the TIB with four possible ways to avoid a claim based upon a statutory lien on property of the debtor. As can be seen

63. Compare id. § 570.1 (2003) (stating that a landlord shall have a lien for the rent upon all crops grown upon the leased premises and any other personal property with a perfected lien in from products having priority over a conflicting security interest or lien), with U.C.C. § 9-324(b) (2004) (stating a perfected PMSI has priority over conflicting interest, however, it does not state the interest be in crops); See also Keith G. Meyer, A Primer on Purchase Money Security Interests Under Revised Article 9 of the Uniform Commercial Code, 50 U. KAN. L. REV. 143, 149-77 (2001) (discussing the treatment of PMSI's under R9).

above, each subpart ends with a semi-colon and the last two are connected with "or." This clearly indicates they are separate and distinct methods. Thus, in our hypothetical, it is irrelevant that O's landlord's lien is perfected at the date of the petition. Subsections three and four empower the TIB to avoid a statutory lien that "(3) is for rent; or (4) is a lien for distress for rent." Scant legislative history exists for section 545. Nothing in section 545 indicates that residential leases, commercial leases, or agricultural leases were to be treated differently when the landowner relied upon a statutory lien for unpaid rent to claim property. Moreover, nothing indicates that a perfected statutory lien would be treated differently from one that had not been filed. Arguably, Congress, in 545(2), clearly used the term "not perfected" when determining effectiveness of a lien against a bona fide purchaser. Perfection is not mentioned in subsections three and four, and perfection is not made applicable to section 545 in its entirety. While no reported case has determined if a "for rent" perfected landlord


The Illinois approach is ineffective in providing the landlord with total priority protection. If the tenant that owes the unpaid rent files a bankruptcy petition, the trustee (TIB) most assuredly will attach the landlord's lien under 11 U.S.C. § 545(3-4) (2000) and should win.

Two examples of landlord liens when former Article 9 was in effect are In re Wedemeir, 239 B.R. 794 (Bankr. 8th Cir. 1999) and In re Marshall, 239 B.R. 193 (Bankr. S.D. Ill. 1999). In the Marshall case the landlords argued that a consensual security interest was created in the lease and therefore § 545 was not germane. Id. at 198. While the court recognized that a security interest can be created in a lease, the leases involved did not contain language which could be construed as creating a security interest. Id. at 195. Moreover, even if one was created, the landlords were unperfected because no financing statement was filed. In Wedemeir, landowners leased land to farmer who filed a bankruptcy petition. Wedemeier, 239 B.R. at 796. Unpaid landlords claimed a lien on the crops that were produced on their land. Id. The court held that the liens claimed by the landowners could be avoided by the trustee under 11 U.S.C. § 544(a)(1) if they were statutory landlord liens, or avoided under § 544(a)(1) if they were considered contractual liens because they were not perfected. Id. at 798.


67. See id. (lacking language indicating that landlords who relied on statutory liens are to be treated differently).

68. See id. (failing to distinguish status of perfected versus unfiled statutory liens).

69. Id.

70. Id.
lien can survive an attack under 11 U.S.C. § 545 (3), (4), a court can legiti-
mately conclude that the perfected lien for rent can be avoided. Unless a land-
lord is willing to deal with the uncertainty of litigation and pay the cost to litigate
the issue, the easiest and safest approach for the land owner is to require cash rent
up front. Presumably, this places the financial risk on lenders, who must evaluate
the trustworthiness of the tenant. The lender who has or is contemplating financ-
ing the tenant-operator has an incentive to provide the cash for the lease.

Another possibility for the landowner is to obtain a perfected security in-
terest in the crops grown on the rented land. While this protects the landowner
from the TIB, the option poses a problem if the farmer were to sell the farm
products produced on the rented land. For the landlord to prevail against the
buyer, he would have to comply with the Federal Farm Products Rule, 7 U.S.C. §
1631. This rule requires that a perfected secured party must give the appropriate
notice to the buyer of the farm products to have a remedy against the buyer.

Referring again to our hypothetical, even if O properly filed a finance
statement one month after F took possession of the rented land, a TIB may have
yet another attack through a preferential transfer. Under 11 U.S.C. section 547,
these preferential transfers can be avoided. Section 547(b) permits the TIB to

71. Remember that if the TIB could successfully attack a landlord’s lien under 11
U.S.C. § 545(3-4), it can be preserved for the benefit of the estate. This raises an interesting prob-
lem in bankruptcy. 11 U.S.C. § 551 states in relevant part: “Any transfer avoided under section... 544, 545, 547... is preserved for the benefit of the estate but only with respect to property of the
estate.” Utilizing this section, a TIB can avoid the landlord’s lien but preserve it for the benefit of
the bankruptcy estate and avoid a portion of the secured party’s secured claim. Iowa Code 570.1.2
can give the holder of a landlord’s lien priority over a prior perfected secured party. The following
situation illustrates this result. If landlord had a lien for unpaid rent of $20,000 on crops and per-
fected secured party who was owed $30,000 had a perfected security interest in the same crops, the
trustee could avoid $20,000 of secured creditor’s $30,000 perfected security interest. See e.g., In re

72. 11 U.S.C. § 547(b) (2000) in relevant part provides:

(a) In this section –
(1) “inventory” means personal property leased or furnished, held for sale
or lease, or to be furnished under a contract for service, raw materials,
work in process, or materials used or consumed in a business, including
farm products such as crops or livestock, held for sale or lease;
(2) “new value” means money or money’s worth in goods, services, or
new credit, or release by a transferee of property previously transferred to
such transferee in a transaction that is neither void nor voidable by the
debtor or the trustee under any applicable law, including proceeds of such
property, but does not include an obligation substituted for an existing ob-
plication;
"receivable" means right to payment, whether or not such right has been earned by performance; and

(4) a debt for a tax is incurred on the day when such tax is last payable without penalty, including any extension.

(b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property--

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made--

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if--

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

(c) The trustee may not avoid under this section a transfer--

(1) to the extent that such transfer was--

(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and

(B) in fact a substantially contemporaneous exchange;

(2) to the extent that such transfer was--

(A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;

(B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and

(C) made according to ordinary business terms;

(3) that creates a security interest in property acquired by the debtor--

(A) to the extent such security interest secures new value that was--

(i) given at or after the signing of a security agreement that contains a description of such property as collateral;

(ii) given by or on behalf of the secured party under such agreement;

(iii) given to enable the debtor to acquire such property; and

(iv) in fact used by the debtor to acquire such property; and

(B) that is perfected on or before 20 days after the debtor receives possession of such property;
avoid any transfer\(^{73}\) of an interest in property of the debtor made to a creditor for or on account of an antecedent debt existing before the transfer if made while the debtor was insolvent,\(^{74}\) if made within 90 days unless the transferee is an insider,\(^{75}\) and if the transfer enables the creditor to receive more than he would have

(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor—

(A) not secured by an otherwise unavoidable security interest; and

(B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;

(5) that creates a perfected security interest in inventory or a receivable or the proceeds of either, except to the extent that the aggregate of all such transfers to the transferee caused a reduction, as of the date of the filing of the petition and to the prejudice of other creditors holding unsecured claims, of any amount by which the debt secured by such security interest exceeded the value of all security interests for such debt on the later of—

(A)(i) with respect to a transfer to which subsection (b)(4)(A) of this section applies, 90 days before the date of the filing of the petition; or

(ii) with respect to a transfer to which subsection (b)(4)(B) of this section applies, one year before the date of the filing of the petition; or

(B) the date on which new value was first given under the security agreement creating such security interest;

(6) that is the fixing of a statutory lien that is not avoidable under section 545 of this title;

(7) to the extent such transfer was a bona fide payment of a debt to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation agreement, divorce decree or other order of a court of record, determination made in accordance with State or territorial law by a governmental unit, or property settlement agreement, but not to the extent that such debt—

(A) is assigned to another entity, voluntarily, by operation of law, or otherwise; or

(B) includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance or support; or

(8) if, in a case filed by an individual debtor whose debts are primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than $600.

\(^{73}\) Transfer is defined in id. § 101(54).

\(^{74}\) Id. § 547(f) (stating debtor presumed insolvent if transfer made within 90 days of bankruptcy).

\(^{75}\) Id. § 101(31) (stating the transfer can occur within one year of bankruptcy if the transfer is to an insider).
received in a Chapter 7 distribution. The question remains if the transfer did occur, when did the debt arise? For purposes of bankruptcy, debt is defined as "liability on a claim." 76 Claim is defined to include among other things the "right to payment, whether or not such right is reduced to judgment, fixed, contingent, matured, unmatured, disputed, secured, or unsecured . . . ." 77 Under this definition, signing a cash lease obligating F to pay $100 an acre on October 1, seems to satisfy the definition of "debt." Thus the actual debt was created on March 1.

Next, one must determine when a transfer of a property interest of the debtor occurred. The definition of transfer is incredibly broad; it may be voluntary, involuntary, direct, indirect, absolute or conditional. 78

In the hypothetical, O is claiming an interest in F's crops via the landlord lien statute. According to section 547(b), a transfer of interest of a debtor's crops cannot occur until the crops are actually planted; thus, O cannot obtain a transfer until after March 1. 79 The landlord lien statute itself supports the idea stating that a landlord shall have a lien on crops produced on rented land during the term of the lease. 80 Unless O is an insider, 81 the TIB will not be able to avoid this transfer because it did not occur within 90 days of the filing of the bankruptcy petition on 11/1.

76. Id. § 101(12); see also IOWA CODE ANN. § 579A.2(3) (West Supp. 2004) (dealing with Custom Cattle Feedlot Liens specifically states that the lien becomes effective when the cattle arrive at the custom feedlot).
78. Id. § 101(54).
79. See U.C.C. § 9-203(b)(2) cmt. 6 (2004); see also U.C.C. § 2-403(1) (2004); but see the entrustment rule under U.C.C. § 2-403(2) (2004). U.C.C. § 9-102(a)(20) (2004) defines a consignment to be a transaction, regardless of its form, where: 1) a person delivers goods for sale to a merchant who deals in goods of that kind under a name other than that of the person delivering; 2) the transaction does not create a security interest; 3) the merchant is not known by its creditors to be substantially engaged in selling the goods to others; 4) the aggregate value of the delivered goods is $1000 or more at the time of delivery; and 5) the goods were not consumer goods immediately before delivery. Unfortunately, R9 fails to provide any guidance as to how one determines when a consignment-like transaction secures an obligation of the merchant, i.e., a security interest is involved. This is surprising when one compares the elaborate provisions of § 1-201(37) (2004) defining when a lease creates a security interest.

Once the transaction is determined to be a consignment, the consignor (deliverer) is considered to have a PMSI in the inventory of the consignee (possessor) for purposes of R9. Accordingly, the conflicts between the consignor and a creditor having a perfected security interest in the consigner merchant's inventory are governed by § R 9-324(b) discussed infra in part B.3 dealing with PMSIs in inventory.

Remember that U.C.C. § 2-104 (2004) defines merchant and an issue exists as to whether a farmer is a merchant in some jurisdictions.
80. IOWA CODE ANN. § 570.1 (West 2003).
Another transfer issue exists under section 547 because the statute contains an additional definition of transfer applicable only to section 547. Subsections 547(e)(1)(A) and (2)(B-C) state:

For purposes of this section —

(B) a transfer of a fixture or property other than real property is perfected when a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee.

(2) For purposes of this section, except as provided in paragraph (3) of this subsection, a transfer is made—

(A) at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 10 days after, such time . . . ; [or]

(B) at the time such transfer is perfected, if such transfer is perfected after such 10 days . . . .

“insider” includes—

(A) if the debtor is an individual—

(i) relative of the debtor or of a general partner of the debtor;

(ii) partnership in which the debtor is a general partner;

(iii) general partner of the debtor; or

(iv) corporation of which the debtor is a director, officer, or person in control;

(B) if the debtor is a corporation—

(i) director of the debtor;

(ii) officer of the debtor;

(iii) person in control of the debtor;

(iv) partnership in which the debtor is a general partner;

(v) general partner of the debtor; or

(vi) relative of a general partner, director, officer, or person in control of the debtor;

(C) if the debtor is a partnership—

(i) general partner in the debtor;

(ii) relative of a general partner in, general partner of, or person in control of the debtor;

(iii) partnership in which the debtor is a general partner;

(iv) general partner of the debtor; or

(v) person in control of the debtor;

A relative is almost always as insider. See id. § 101 (45).
Under these subsections, the transfer is deemed to occur at the date of transfer of an interest in debtor property, if perfection occurred within 10 days of the transfer. If perfection is more than 10 days after the transfer of the interest in a debtor’s property, the transfer is deemed to occur when perfection occurs. For example, in the hypothetical, the perfection occurred on 4/1 if the crops were in the ground. The lien was both effective under 570.1 and the financing statement was filed. The debt was created on 3/1; thus we have a transfer for, or on account of, an antecedent debt. However, unless O is an insider, the TIB will not be able to avoid this transfer because it was not within 90 days of the filing of the petition on 11/1.

The result changes if O filed an effective financing statement on September 1 because the transfer is now deemed to occur on 9/1 and is now for or on account of an antecedent debt created before the transfer. The debt was created on 3/1 and the transfer occurs on 9/1; therefore, the transfer is within the 90 day requirement period. The TIB must then prove all of the other requirements of section 547(b). Assuming he can, O’s perfected agricultural lien may be avoided, but only if TIB cannot destroy the lien under § 545. Section 547(b) is subject to subsection (c). Section 547(c)(6) provides “[t]he trustee may not avoid under this section a transfer... that is the fixing of a statutory lien that is not avoidable under § 545 of this title.”

Another point worth mentioning about Iowa Code Section 570.1, is that a landlord’s lien can attach to more than just crops. “A landlord shall have a lien for the rent upon all crops grown upon the leased premises, and upon any other personal property of the tenant which has been used or kept thereon during the term and which is not exempt from execution.” Article 9, however, covers only nonpossessory statutory liens on farm products. Thus, if a landlord would try to

---

82. See U.C.C. § 9-308(b) (2004) (stating perfection of an agricultural lien occurs when it becomes effective and has satisfied all 9-310 requirements); see also IOWA CODE ANN. § 570.1.2.
84. 11 U.S.C. § 547(g) (2000).
86. See IOWA CODE § 570.1 (2003).
87. Id. § 570.1 (emphasis added).
88. See U.C.C. § 9-102(34) (2004) defines “farm products” as:

Goods, other than standing timber, with respect to which the debtor is engaged in a farming operation and which are:

(A) crops grown, growing, or to be grown, including:

(i) crops produced on trees, vines, and bushes; and
claim a statutory lien on personal property other than farm products, Article 9 would apply to the lien on farm products but does not apply to the lien on non-farm products.  

B. Sale of Farm Products Subject to an Agricultural Lien or Security Interest

Interesting scope questions arise when the debtor sells farm products subject to a security interest or an agricultural lien, and the secured party or agricultural lien holder claims to have priority over the purchaser from the farmer. Both the attachment and perfection rules apply to any conflict between the purchaser and the secured party, while the perfection rules also apply to the conflict between the lien holder and the purchaser. Article 9 priority rules, however, clearly do not control the conflict between the secured party and the purchaser, but they apply in part to the conflict between the purchaser and the holder of the agricultural lien.

While Article 9 contains a priority rule that applies to a priority conflict between a perfected secured party and a purchaser of the farm products, it is preempted by 7 U.S.C. § 1631. U.C.C. section 9-315(a) provides in part:

"Except as otherwise provided in this article and U.C.C. section 2-403(2):

(1) a security interest or agricultural lien continues in collateral notwithstanding sale . . . unless the secured party authorized the disposition free of the security interest or agricultural lien; and

(ii) aquatic goods produced in aquacultural operations;
(B) livestock, born or unborn, including aquatic goods produced in aquacultural operations;
(C) supplies used or produced in a farming operation; or
(D) products of crops or livestock in their unmanufactured states.

90. Id. § 9-109(d)(1).
91. See 7 U.S.C. § 1631(d) (2000) (providing that "a buyer who in the ordinary course of business buys a farm product from a seller engaged in farming operations shall take free of a security interest created by the seller").
(2) a security interest attaches to any identifiable proceeds of collateral.\(^93\)

One of the exceptions, covered by U.C.C. section 9-315(a), is found in U.C.C. section 9-320.\(^94\) It provides, “a buyer in the ordinary course of business, other than a person buying farm products from a person engaged in farming operations, takes free of a security interest created by the buyer’s seller, even if the security interest is perfected and the buyer knows of its existence.”\(^95\) But note that under U.C.C. section 9-320, the buyer of farm products does so while subject to perfected security interest, unless the secured party has authorized the sale free of the security interest.\(^96\) Thus, the secured party would normally prevail against a buyer of farm products under Article 9. Article 9, however, is pre-empted by 7 U.S.C. section 1631, the Federal Food Security Act of 1985. Under this section, the buyer is free of the perfected security interest unless the secured party has given the buyer appropriate statutory notice.\(^97\)

\(^93\) U.C.C. § 9-315(a) (2004).
\(^94\) See id. § 9-320.
\(^95\) Id. § 9-320(a).
\(^96\) Id. § 9-320, cmt. 4.
\(^97\) 7 U.S.C. § 1631(d) (1985) provides:

“Except as provided in subsection (e) of this section and notwithstanding any other provision of Federal, State, or local law, a buyer who in the ordinary course of business buys a farm product from a seller engaged in farming operations shall take free of a security interest created by the seller, even though the security interest is perfected; and the buyer knows of the existence of such interest”.

Under § 1631(e) two types of notice are possible: the so-called direct written notice or through a so-called central filing system. Both notice systems are in use. 7 U.S.C. § 1631(e) (2002). Section 1631(e) provides in part:

“A buyer of farm products takes subject to a security interest created by the seller if—

(1)(A) within 1 year before the sale of the farm products, the buyer has received from the secured party or the seller written notice of the security interest organized according to farm products that--[contains detailed information such as the name of the debtor and the secured party, a description of the farm products, social security or tax identification number]; or

(2) in the case of a farm product produced in a State that has established a central filing system—

(A) the buyer has failed to register with the Secretary of State of such State prior to the purchase of farm products; and

(B) the secured party has filed an effective financing statement or notice that covers the farm products being sold; or
Under Article 9, when a debtor sells farm products subject to an agricultural lien, the sale does not extinguish the agricultural lien—it continues in farm products, notwithstanding sale or lease of the collateral. Again, section 9-315(a)(1) specifically allows, except as otherwise provided in Article 9, an agricultural lien continues in a collateral upon sale, “unless the secured party authorized the disposition free of the . . . agricultural lien.” Unlike security interests, agriculture liens are not mentioned in U.C.C. section 9-320. Thus, the general rule is that an agricultural lien will follow the collateral upon sale.

This conclusion is also supported by U.C.C. section 9-317(b) that provides in part, “a buyer . . . of . . . goods . . . takes free of a security interest or agricultural lien if the buyer gives value and receives delivery of the collateral without knowledge of the security interest or agricultural lien and before it is perfected.” The negative inference is if an agricultural lien holder has perfected its lien, the buyer may take. Some states like Minnesota and Illinois have statutory provisions dealing with statutory liens. Illinois provides that a landlord’s lien is effective against a good faith purchaser, but only if within 6 months of the purchase the purchaser has received from the lien holder via registered or certified mail an appropriate written notice of the lien.

The Federal Farm Products rule does not apply to statutory liens, but to security interests created by agreement. Statutory liens are created by statute and not by agreement.

(3) in the case of a farm product produced in a State that has established a central filing system, the buyer--
(A) receives from the Secretary of State of such State written notice as provided in subsection (c)(2)(E) or (c)(2)(F) that specifies both the seller and the farm product being sold by such seller as being subject to an effective financing statement or notice.


99. Id.
100. See generally id. § 9-320.
101. Id. § 9-317(b).
102. See id.
103. MINN. STAT. ANN. § 514.05 (West 2004).
106. See, e.g., 735 ILL. COMP. STAT. 5/9-316 (2003) (providing that a landlord’s lien is effective against a good faith purchaser, but only if, within six months of the purchase, the purchaser has received an appropriate written notice of the lien via registered or certified mail from the...
A debtor's sale of crops subject to an agricultural lien or security interest may also make a debtor subject to criminal prosecution. Some states, like Iowa, have statutes that make it a crime for the debtor to sell or dispose of grain that is subject to a landlord's lien or a security interest.107

1. **Proceeds from the Sale of Farm Products**

What law determines whether the lien holder has a claim to the proceeds generated from the sale of the farm products?108 As noted earlier, U.C.C. section 9-315(a)(1) specifically refers to agricultural liens and provides that (unless the secured party waives)109 security interests or agriculture liens continue in the collateral notwithstanding sale or disposition. U.C.C. section 9-315(a)(2) provides only that the "security interest attaches to any identifiable proceeds of the collateral." Agricultural liens are not mentioned. The negative inference is that proceeds of collateral matters to an agriculture lien are not covered by Article 9. Also, U.C.C. section 9-302 (2004), comment 2 provides in part, "[I]nasmuch as no agricultural lien on proceeds arises under this Article, this section does not expressly apply to proceeds of agricultural liens. However, if another statute creates an agricultural lien on proceeds, it may be appropriate for courts to apply the choice-of-law rule in this section to determine priority in the proceeds.” However, it is interesting to note that comment 9 to 9-315 states:

This Article does not determine whether a lien extends to proceeds of farm products encumbered by an agricultural lien. If, however, the proceeds are themselves farm products on which an “agricultural lien”... arises under other law, then the agricultural-lien provisions of this Article apply to the agricultural lien on the proceeds in the same way in which they would apply had the farm products not been proceeds.110

---

2. Recent Cases Dealing with Sale of Farm Products and Cash Leases

Agriliance, L.L.C. v. Runnells Grain Elevator, Inc., an Iowa case, involved the sale of farm products subject to claims of unpaid creditors.\(^\text{111}\) In this case, multiple landowners had cash-leased land to a producer, ("M"), who gave them a security interest but no ownership interest in the crops to be produced.\(^\text{112}\) Moreover, none of the landowners filed a normal UCC-1, but one, ("S"), perfected its landlord's lien by filing.\(^\text{113}\)

M obtained input financing for the 2001 crop year from Agriliance, ("A"), and granted A a perfected security interest in his 2001 crops.\(^\text{114}\) A sent a written notice of its security interest in crops to Runnells Grain Elevator ("R") pursuant to 7 U.S.C. § 1631.\(^\text{115}\) The notice provided that if M sold grain to R, any payment check was to include A as a payee.\(^\text{116}\)

In November and December of 2001, M sold crops grown on leased lands to R.\(^\text{117}\) M directed R to "draw on [M]'s account to issue checks directly to the landowners."\(^\text{118}\) Without explanation, R issued checks payable to landowners despite of the written notice to issue joint checks.\(^\text{119}\) Included with the checks to the landowners was information indicating how the amount of the check was determined.\(^\text{120}\)

M subsequently filed a bankruptcy petition.\(^\text{121}\) A sued R and the landowners seeking to recover the amount of the checks issued by R to the landowners.\(^\text{122}\) In making its determination, the court first considered whether A had a conversion claim against R.\(^\text{123}\) After analyzing the Iowa conversion law, the court concluded that R had received, before payment, a proper U.S.C. § 1631

---

112. Id. at 803.
113. Id.
114. Id.
115. Id.
116. Id.
117. Id.
118. Id.
119. Id.
120. Id.
121. Id. at 804.
122. Id.
123. Id. at 805-807.
notice of A's perfected security interest. Thus, R took the crop subject to A's security interest. While R acted contrary to A's interest, the court noted that conversion requires wrongful intent and bad faith. In concluding that these requirements were satisfied, the court made some interesting statements. For example, the court notes that R's lack of actual knowledge that the crops purchased were subject to A's security interest does not shield it from liability. Because R had received an appropriate section 1631 notice, it was obligated to implement procedures designed to protect the secured party's interest. Here, R failed to make inquires of M and the landowners as to who owned the crops. Rather, R solely relied on the word of A's debtor, M. In fact, because of cash leases, the landowners had no ownership interest in the crops that were sold. Finally, R asserted the affirmative defenses estoppel and waiver. The court rejected these, concluding no facts existed to justify these defenses. In short, R was held liable for conversion.

The court then considered whether the landowners had any liability for accepting checks that were proceeds of A's collateral. Two defenses were asserted by the landowners: 1) they were holders in due course of the checks and took the checks free of A's security interest; and 2) their statutory landlord liens were superior to A's security interest in the crops. The court held that the landowners were holders in due course and took R's checks free of A's prior perfected security interest. To be a holder in due course under Article 3 of the U.C.C., the landowners had to establish all of the requirements of section 3-302, which provide that a holder took the check for value, in good faith, and without

124. Id. at 806.
125. Id.
126. Id. at 807.
127. Id. at 806.
128. Id.
129. Id. at 807.
130. Id.
131. Remember that under U.C.C. § 9-315(a)(1) a secured party relinquishes its security interest if it authorizes the disposition of the collateral free of the security interest. "Authorizes" is not defined. Thus, 1-103 applies and common law rules such as estoppel and consent are relevant. See U.C.C. § 9-315, cmt. 1 (2004); Agriliance, 272 F. Supp. 2d at 807.
133. A security interest attaches to identifiable proceeds obtain from the disposition of the collateral. See U.C.C. § 9-315(a)(2) (2004); Agriliance, 272 F. Supp. 2d at 810.
135. Id. at 811.
notice of claim to the instrument under section 3-306.136 Good faith, as defined in section 3-103(a)(4) "means honesty in fact and the observance of reasonable commercial standards of fair dealing."137 Here, there was no evidence that the landowners had actual knowledge of A’s security interest in the crops and thus the proceeds of the crop.138 A argued that the standards of fair dealing required the landowners to conduct a search of the public records.139 The court concluded the fair dealing standard does not include a duty of inquiry under these facts.140 Also, the duty to exercise ordinary care does not include the duty of inquiry.141 Thus, the court concluded that landlords are not subject to “reasonable commercial standards of fairness.”142

Next, the court turned to the issue of whether the landowners had notice of A’s claim.143 Notice is defined in pre-revised Article I in section 1-201(25) and Revised section 1-202 to include actual notice or receipt of notice or reason to know it exists.144 The only evidence that might have indicated notice of competing claims were the stubs accompanying the checks that showed how the amount of the check was calculated.145 The court held that no reasonable jury could conclude that receipt of a tenant’s rent payments in the form of a check (plus explanatory attachments) issued by the R (Elevator) would alarm a reasonable landlord that someone might have a claim to the checks.146

It is important to note that the court’s conclusion is supported by U.C.C. section 9-332(b).147 Suppose that R had issued a single payee check to M for the

136. Id. at 810.
139. Id.
140. Id.
141. Id.
142. Id. at 813; see U.C.C. §§ 3-103(a)(4), (a)(7); cmt. 4 (2004) (defining good faith and ordinary care).
144. U.C.C. § 1-202(a) (2004).
146. Id.
147. U.C.C. § 9-332 (2004) provides:

(a) A transferee of money takes the money free of a security interest unless the transferee acts in collusion with the debtor in violating the rights of the secured party.

(b) A transferee of funds from a deposit account takes the funds free of a security interest unless the transferee acts in collusion with the debtor in violating the rights of the secured party.
sale of the 2001 crop, M deposited the check in his checking account and then issued checks on his checking account to the landowners. Under 9-332(b), "a transferee [landowner] of funds from a deposit account takes the funds free of a security interest in the deposit account unless the transferee acts in collusion with the debtor [M]." 148

Finally, the court noted that one landowner had perfected its landlord lien in crops and proceeds of the crops by filing an appropriate financing statement. 149 Without thorough discussion, the court stated the perfected landlord lien gave the landowner priority over A’s competing security interest. 150 Iowa Code section 570.1(2) provides in part: "a perfected lien in the farm products has priority over a conflicting security interest or lien, including a security interest or lien that was perfected prior to the creation of the lien under this section, if the lien created in this section is perfected... when the debtor takes possession of the leased premises or within twenty days after the debtor takes possession of the leased premises." 151 Furthermore, Iowa Code section 554.9322(7) provides: "A perfected agricultural lien on collateral has priority over a conflicting security interest in or agricultural lien on the same collateral if the statute creating the agricultural lien so provides." 152 Also, Article 9 now controls conflicts dealing with an agricultural landlord lien. 153

Once it is determined that Article 9 applies to a transaction, the next question is what is the status of the parties. 154 This normally focuses on whether a creditor has a security interest. 155 For a secured party to have an enforceable security interest, attachment must occur. 156

Collusion is discussed in § 9-332 cmt. 4.

148. Id. § 9-332(b).
149. Agrilineance, 272 F. Supp. 2d at 803 (noting that defendant Scheltebaum Farms had filed a U.C.C. financing statement pursuant to Chapters 554 and 570 of the Iowa Code).
150. Id. at 814.
151. Iowa Code § 570.1(2) (2003) Remember that a landlord, who files its agricultural lien more than twenty days after the tenant gets possession of the rented land has a potential problem if Iowa Code § 570.1(2) is applied literally.
152. Id. § 554.9322(7).
155. Id.
156. Id. (citing U.C.C. § 9-203(a) (2004)).
III. ATTACHMENT

A. *In General*

R9, unlike Former 9 (F9), no longer requires a signed written security agreement when the *debtor has possession of the collateral*. R9 provides the debtor must execute an "authenticated . . . security agreement that provides a description of the collateral and, if the security interest covers timber to be cut, a description of the land concerned . . . ." \(^{158}\) "Authenticate" is defined in section 9-102(a)(7): "to sign; or to execute or otherwise adopt a symbol, or encrypt or similarly process a record in whole or in part, with the present intent of the authenticating person to identify the person and adopt or accept a record." \(^{159}\) "Record" means "information that is inscribed on a tangible medium or which is stored in an electronic or other medium and is retrievable in perceivable form." \(^{160}\) Thus, a debtor who signs a writing constituting a security agreement and identifying itself as the debtor has "authenticated" the agreement. \(^{161}\) This is also the

---

157. An "authenticated" agreement is required unless: (1) The collateral is "in the possession of the secured party . . . pursuant to the *debtor's security agreement*" and the collateral is not a certificated security; (2) the collateral is a "certificated security in registered form and the security certificate has been delivered to the secured party . . . pursuant to the *debtor's security agreement*"; or (3) the collateral is "deposit accounts, electronic chattel paper, investment property, or letter-of-credit rights, and the secured party has control under U.C.C. §§ 9-104, 9-105, 9-106 or 9-107 pursuant to the *debtor's security agreement*." U.C.C. § 9-203 (3)(B) (D)(2004) (emphasis added).

159. Id. § 9-102(a)(7).
160. Id. § 9-102(a)(69).
161. See id. § 9-102(a)(7)(A). For an interesting case dealing with who is the debtor, see Firstar Bank Burlington, N.A. v. Stark Agric. Farms (*In re Kevin W. Emerick Farms, Inc.*), 201 B.R. 790 (Bankr. C.D. Ill. 1996). The creditor was sloppy as to signatures of the debtor on the security agreement, listing the debtor as a corporation. The corporate debtor security agreement was signed by the *individual* producer without any indication of a representative capacity. The court refused to consider parol evidence showing the individual was signing on behalf of the corporation. For decisions holding to the contrary, see Valmont Equip. Co. v. Great Basin Transp. (*In re Great Basin Transp.*), 32 B.R. 365 (Bankr. C.D. Ill. 1983) (stating "evidence established that corporate officers intended to bind debtor as corporate debtor when they signed security agreement"); Mitchell v. Rock Hill Nat'l Bank (*In re Mid-Atlantic Piping Products of Charlotte*) 24 B.R. 314 (Bankr. W.D.N.C. 1982) (stating "description of collateral and security agreements was sufficient to satisfy requirements of South Carolina law"). Interestingly, this decision as to parol evidence runs counter to the rule found in U.C.C. § 3-402 (2004) which, in certain circumstances, permits a
case with a debtor who sends an electronic message containing a security agreement in an encrypted form that identifies the debtor as the sender. The definition of "authentication" does not in fact require the execution of a separate symbol, but only that the record itself be produced or adopted with the present intent to authenticate the record. The presence of a symbol will help show the present intent needed.

The authenticated agreement must contain an appropriate description of the collateral. R9, like F9, provides that the description is sufficient if it reasonably identifies what is described. But unlike F9, R9 provides some guidance as to what descriptions satisfy the reasonable identification standard. Section 9-108(b) gives examples of reasonable identification. Descriptions that are sufficient include a specific listing by category or by type of collateral as defined in the U.C.C. Section 9-108 also sets forth descriptions that are not acceptable.

creditor to use parole evidence to show a negotiable instrument was signed by an individual in her representative capacity.


163. Id. § 9-108(a). This section provides: (a) [Sufficiency of description.] Except as otherwise provided in subsections (c), (d), and (e), a description of personal or real property is sufficient, whether or not it is specific, if it reasonably identifies what is described.
164. Id. §§ 9-108(b), (d) provide:

(b) [Examples of reasonable identification.] Except as otherwise provided in subsection (d), a description of collateral reasonably identifies the collateral if it identifies the collateral by:

(1) specific listing;
(2) category;
(3) except as otherwise provided in subsection (e), a type of collateral defined in [the Uniform Commercial Code];
(4) quantity;
(5) computational or allocational formula or procedure; or
(6) except as otherwise provided in subsection (c), any other method, if the identity of the collateral is objectively determinable.

(d) [Investment property.] Except as otherwise provided in subsection (e), a description of a security entitlement, securities account, or commodity account is sufficient if it describes:
Several recent cases considered the security agreement requirement. Some of them are considered here.

B. Security Agreements and Bankruptcy Exception to Discharge

1. Can a Security Agreement Create a Fiduciary Relationship for Purposes of Bankruptcy § 523 Exception to Discharge?

This question of whether a security agreement could create a fiduciary relationship between the debtor and the secured party was raised in In re Ellis.¹⁶⁶ In Ellis, Bank loaned money to Debtor, who signed a security agreement purporting to grant Bank a security interest in crops, but it contained no real estate description.¹⁶⁷ Debtor sold the crops without Bank’s consent and did not remit the proceeds to Bank.¹⁶⁸ Subsequently, Debtor filed a Chapter 7 petition.¹⁶⁹ Bank sought an exception to discharge for its debt under 11 U.S.C. §§ 523 (a)(4) & (a)(6) (2002).¹⁷⁰ Section 523(a)(4) prohibits discharge for “fraud or defalcation while acting in a fiduciary capacity” and section 523(a)(6) prevents discharge “for willful and malicious injury by the debtor to another entity or to the property of another entity.”¹⁷¹ With regard to the fiduciary status, the court rejected the Bank’s argument that the security agreement language “... all proceeds from disposition of the collateral ... shall be held in trust for the Lender and shall not be commingled with any other funds”¹⁷² was sufficient to create a fiduciary relationship. The court concluded the language was “insufficient as a matter of law to create a fiduciary relationship” for purposes of keeping its debt from being ex-

---

¹⁶⁵ See, e.g., id. §§ 9-108(c)-(e).
¹⁶⁶ In re Ellis, 310 B.R. 762 (W.D. Okla. 2004).
¹⁶⁷ Id. at 765.
¹⁶⁸ Id.
¹⁶⁹ Id. at 762-763.
¹⁷⁰ Id. at 764-772.
¹⁷² Ellis, 310 B.R. at 764.
cepted from discharge under section 523(a)(4). Would it have made any dif­ference if it is a crime for a debtor to dispose of collateral subject to a security interest? It is unclear whether the fiduciary relationship conclusion was affected by the fact that the court also found that no effective security agreement had been executed by the Debtors. This finding is discussed next.

2. **Does Sale of Collateral Subject to a Security Interest Constitute Willful and Malicious Damage to Property under § 523?**

As to the willful and malicious damage to Bank’s collateral or its proceeds, the *Ellis* court accepts Debtors’ argument that Debtors did not cause any damage to Bank’s property. Bank had no property interest in the crops because it did not have a security interest in the crops. The document specially delineated “Security Agreement” did not contain a real estate description.

173. *Id.* It appears under § 523(a)(4) that the existence of a fiduciary relationship is determined under federal law 11 U.S.C. § 523(a)(4) (2004). To find that a fiduciary relationship existed under § 523(a)(4), the court must find that the money or property on which the debt at issue was based was entrusted to the debtor (older standard, more recent language calls for an express or technical trust). Neither a general fiduciary duty of confidence, trust, loyalty, and good faith, nor an inequality between the parties’ knowledge or bargaining power, is sufficient to establish a fiduciary relationship for purposes of dischargeability. See *Evans v. Pollard (In re Evans)*, 161 B.R. 474, 477 (B.A.P. 9th Cir. 1993) (citing *In re Baird*, 114 B.R. 198, 202 (B.A.P. 9th Cir. 1990)); *Kayes v. Klippel (In re Klippel)*, 183 B.R. 252, 260 (Bankr. D. Kan. 1995). “Further, the fiduciary relationship must be shown to exist prior to the creation of the debt in controversy.” *Allen v. Romero (In re Romero)*, 535 F.2d 618, 621 (10th Cir. 1976); *see also Evans*, 161 B.R. at 477; *cf.* *Fowler Bros. v. Young (In re Young)*, 91 F.3d 1367 (10th Cir. 1996) (federal law determines if fiduciary relationship exists).

174. 11 U.S.C. § 523(a)(4) (2004) provides that a “discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt . . . (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny . . . .” An interesting question is whether the sale of property subject to a security interest could constitute embezzlement or larceny for purposes of this exception to discharge. Some states like Iowa and Kansas make it a crime to impair a security interest or agricultural lien. *See, e.g.*, *Iowa Code* § 570.9 (2004); *Kan. Stat. Ann.* § 21-3734 (1995). It is interesting to speculate whether that might qualify as larceny or embezzlement.

175. *See generally Ellis*, 310 B.R. at 762.

176. *Id.*

177. *Id.*
While R9 does not require a real estate description, F9 did. Interestingly, even though the security agreements involved had been executed before the effective date of R9, the bankruptcy petition was filed in Oklahoma after R9 became effective. The court specifically notes that the parties agreed that F9, not R9 was the controlling law, and the court apparently agreed because it applied F9. This is questionable given R9's transition rules apply. The argument is that section 9-702(a) transformed the security agreement and makes the omission of the real estate description irrelevant. Section 9-702(a) provides: "Except as otherwise provided in this part, this [Act] applies to a transaction or lien within its scope, even if the transaction or lien was entered into or created before this [Act] takes effect." A compelling construction of the savings clause of section 9-702(a) is that it was intended to make R9 applicable to any action brought after the effective date of R9 unless a specific section of the 9-700's provided otherwise. The transaction involved in In re Ellis was an attempt to obtain a security

---

178. U.C.C. §§ 9-203 (b)(3)(A) (2004); 9-108 (2004); cf. U.C.C. §§ 9-203(1)(a); 9-402(1)(1996). For an interesting case under F9 dealing with the failure to include a real estate description and attempt to use the so-called composite document theory utilizing other documents to find the real estate description see In re Kevin W. Emerick Farms, Inc., 201 B.R. 790, 791 (Bankr. C.D. Ill. 1996) (discussing real estate description for crops). For a further discussion of this case see U.C.C. § 9-102(a)(7)(A) (2004). Here Lenders made loans to Kevin and Sherry Emerick who farmed land in Illinois under three different entities: as individuals, as one corporation where Kevin was the sole shareholder and one corporation where Sherry was the sole shareholder. Lender obtained a security agreement granting a security interest in a corn crop, livestock and equipment. The Emericks failed and filed a bankruptcy petition that raised a number of issues. One issue concerned the description of the crops in the security agreement that contained no real estate description of the relevant real estate which was required under U.C.C. § 9-203(1). The lender argued that the security agreement could be salvaged by the so-called "composite document rule" under which a security agreement can be pieced together by combining all of the loan documents including the promissory note, communications between the debtors and the lender, loan agreements, and the financing statement. The financing statement here contained the relevant real estate description. This argument was rejected on the ground that Illinois law prohibits parol evidence when a security agreement already in existence is unambiguous. The court said the security agreement was clear and unambiguous; it just omitted the real estate description, and the court would not bail the sloppy creditor out of its bad drafting. NOTE: Under R9 this security agreement will be proper because no real estate description is required for crops.

The composite document approach has been accepted in a number of cases. See In re Outboard Corp., 300 B.R. 308 (Bankr. E.D. Ill. 2003), and cases cited therein.

179. This is a bit odd. First, consider transition U.C.C. § 9-702(a) (2004). Most courts look to the date the petition is filed to determine whether Revised U.C.C. § 9 applies to a transaction entered into when former 9 was in effect. See, e.g., In re Outboard Marine Corp., 300 B.R. 308 (Bankr. N.D. Ill. 2003) (and cases cited therein).

interest in crops, and this is within the scope of Article 9.\textsuperscript{181} Section 9-109(a)(1) covers any transaction that creates a security interest in personal property.\textsuperscript{182} Crops are farm products, and this is a type of good that is personal property. In addition, no section specifically provides that a security agreement ineffective under F9 will also be considered ineffective under R9. Official comment 1 to § 9-705 seems to accept the proposition that an attachment under R9 relates back to transactions occurring before the effective date of R9.\textsuperscript{183} It provides, “this section addresses primarily the situation in which the perfection step is taken under former Article 9 or other applicable law before the effective date of this Article, but the security interest does not attach until after that date.”\textsuperscript{184} It should be noted that the bankruptcy court in \textit{In re Stout}\textsuperscript{185} seems to have rejected a similar argument.

The court in \textit{Stout} notes § 9-702(a) and the official comment could arguably be construed to make R9 applicable to this transaction that was entered into before July 1, 2001.\textsuperscript{186} The court rejects this possibility by noting all of the transition rules deal with faulty perfection scenarios and that all appear to assume that the security interest was enforceable under F9.\textsuperscript{187} The court also specifically points out that R9 does not specifically address the unenforceable (no attachment) possibility.\textsuperscript{188} The court says this omission “seals the Bank’s fate.”\textsuperscript{189}

The final security agreement issue the \textit{Ellis} court considered was whether a Debtor’s real estate mortgage gave Bank a security interest in crops.\textsuperscript{190} Bank’s argument appeared to be that Debtors’ traditional real estate mortgage was an adequate security agreement.\textsuperscript{191} The real estate mortgage contained a clause pledging collateral as all “appurtenances,” and this description was sufficient to cover debtor’s crops. The mortgage also specifically described the land where the crops were produced. The court rejects the Bank’s argument by saying Bank is trying to apply real estate law to a personal property issue.\textsuperscript{192}

\begin{flushleft}
\textsuperscript{181} Ellis, 310 B.R. at 767.
\textsuperscript{183} Id. § 9-705, cmt. n.1.
\textsuperscript{184} Id.
\textsuperscript{185} In re Stout, 284 B.R. 511, 513 (D. Kan. 2002).
\textsuperscript{186} Id.
\textsuperscript{187} Id.
\textsuperscript{188} Id.
\textsuperscript{189} Id.
\textsuperscript{190} In re Ellis, 310 B.R. 762, 772 (D. Okla. 2004).
\textsuperscript{191} See id.
\textsuperscript{192} See id.
\end{flushleft}
While it is clear crops are goods and are covered by Article 9 and not real estate law, it is also clear that a document entitled a real estate mortgage can be treated as a security agreement for Article 9 purposes. Article 9 is not rendered inapplicable simply because a document is entitled a real estate mortgage. No magic words or precise form are required for a security agreement under Article 9. The only requirement in § 9-203(b)(3)(A) is that an agreement creating a security interest must exist, and the agreement must reasonably identify the collateral. Section 9-102(a)(73) defines a security agreement to mean "an agreement that creates or provides for a security interest." R9 § 9-203(b)(3)(A) provides in relevant part: "the debtor has authenticated a security agreement that provides a description of the collateral . . . ." F9 § 9-203(2) provided in relevant part: "the debtor has authenticated a security agreement that provides a description of the collateral and, if the security interest covers timber to be cut, a description of the land concerned." Section 9-108 and former § 9-110 require that the agreement contain a description that reasonably identifies the collateral. Thus, even if F9 applied, the crucial question is whether "appurtenances" reasonably identify the Debtor's crops as the collateral. The court does not discuss this issue, even though it should have. Another possible way the security agreement could have been salvaged is to utilize the so-called "composite document" approach and look at all of the documents that Debtors signed to find that an effective security agreement existed.

194. Id. § 9-203(b)(3)(A).
195. Id. § 9-102(a)(73).
196. Id. § 9-203(b)(3)(A).
197. Id. § 9-203(b).
198. Id. § 9-108(a).
199. This approach was rejected in In re Kevin W. Emerick Farms, Inc., 201 B.R. 790, 795 (Bankr. C.D. Ill. 1996). Here lenders made loans to Kevin and Sherry Emerick who farmed land in Illinois under three different entities: as individuals, as one corporation where Kevin was the sole shareholder, and one corporation where Sherry was the sole shareholder. The lender obtained a security agreement granting a security interest in a corn crop, livestock, and equipment. The Emericks failed and filed a bankruptcy petition that raised a number of issues. One concerned the description of the crops in the security agreement that contained no real estate description of the relevant real estate which was required under 9-203(1). The lender argued the security agreement could be salvaged by the so-called "composite document rule" under which a security agreement can be pieced together by combining all of the loan documents including the promissory note, communications between the debtors and the lender, loan agreements, and the financing statement. The financing statement here contained the relevant real estate description. This argument was rejected on the ground that Illinois law prohibits parol evidence when a security agreement already in existence is unambiguous. The court said the security agreement was clear and unambiguous; it
C. Security Agreements and Description Requirement

As indicated above, when the debtor has possession of the collateral, the general rule is that the debtor must execute an authenticated agreement containing a description of the collateral. The description is sufficient if it reasonably identifies what is described.200 Also, as indicated earlier, § 9-108(b) provides examples of reasonable identification.201 These include: specific listing or category, or type of collateral as defined in the U.C.C.202 Types of collateral would be accounts, general intangibles, inventory, farm products, or equipment. A category would be crops, livestock, or chickens. Description by type is not acceptable for a commercial tort claim, consumer goods, a security entitlement, a securities account, or a commodity account.203 Supergeneric descriptions such as “all the debtor’s assets” or “all the debtor’s personal property” are not sufficient for a security agreement.204 However, these descriptions are sufficient for the financing statement.205

In Baldwin v. Castro County Feeders I, Ltd.,206 the South Dakota Supreme Court was confronted with a description issue. The security agreement

just omitted the real estate description and the court would not bail the sloppy creditor out of its bad drafting. Under R9 this security agreement will be proper because no real estate description is required for crops. The composite document approach has been accepted in a number of cases. See In re Outboard Marine Corp., 300 B.R. 308 (Bankr. E.D. Ill. 2003) and cases cited therein.

This case is also discussed in U.C.C. § 9-102(a)(7)(A). For an interesting case dealing with who is the debtor, see Emerick Farms, 201 B.R. at 790. The creditor was sloppy as to signatures of the debtor on the security agreement listing the debtor as a corporation. The corporate debtor security agreement was signed by the individual producer without any indication of a representative capacity. The court refused to consider parol evidence showing that the individual was signing on behalf of the corporation. For decisions holding differently, see In re Great Basin Transp., Inc., 32 B.R. 365 (Bankr. W.D. Okla. 1983) & In re Mid-Atlantic Piping Prod. of Charlotte, Inc., 24 B.R. 314 (Bankr. W.D.N.C. 1982). Interestingly, this decision as to parol evidence runs counter to the rule found in U.C.C. § 3-402. This permits a creditor to use parol evidence in certain circumstances to show a negotiable instrument was signed by an individual in her representative capacity.

201. Id. § 9-108(b).
202. Id.
203. Id. § 9-108(e).
204. Id. § 9-108(c).
205. Id. § 9-504(2).
described the collateral as "[A]ll of Feeder's interest in farm products, limited to livestock . . . with all proceeds and products of all or any of the foregoing, such livestock being specifically located in Lot(s) # ___ at Castro County Feeders, I, Ltd., Hart, Castro County, Texas."207 Castro County Feeders, the Creditor, failed to fill in the blank for the Lot number.208 In litigation between the debtor and creditor, debtor argued that the security agreement did not reasonably identify the specific cattle subject to a security interest because it did not specify the particular pens in which the cattle were located.209 The court concluded the description satisfied Article 9's test that the description must reasonably identify the collateral.210 The court recognizes that the term "livestock" is an example of collateral by "category" which is permitted under Article 9211 but also recognizes the security agreement does not simply cover "all livestock of debtor."212 It then goes on to conclude:

Here, the Agreement did not attempt to give Castro County a security interest in all of Baldwin's property as prohibited by 57A-9-108(c). Although the parties did not specify a particular lot or lots, the Agreement restricted the security interest to the cattle Baldwin delivered to Castro County's feedlot complex in the city of Hart, Texas. According to the Agreement, Baldwin [Debtor] also granted Castro County a security interest in the sale of these cattle. We believe this description was sufficient to make the collateral objectively determinable. A reasonable reading of the Agreement gave Castro County a security interest in only those cattle of Baldwin's to which it advanced feed and related services. It was not necessary for the agreement to list each individual head of livestock to which Castro County's security interest attached. Moreover, it was also reasonable for the Agreement to leave a specific lot number blank given the fact the cattle were not usually located in one of Castro County's lots when sold.213

Arguably, the South Dakota holding reflects R9's liberal attitude toward collateral descriptions in a security agreement. However, a security agreement is still a contract. Also, if a default occurs, the security agreement description is important for repossession. The description must provide adequate guidance for the person doing the repossessing.

207. Baldwin, 678 N.W.2d at 799.
208. Id. at 800.
209. Id.
211. Id. § 9-108(b)(2).
212. Baldwin, 678 N.W.2d at 800-801.
213. Id. at 801.
Baldwin involves a conflict between the debtor and the alleged secured party.214 It is not known whether the result would be the same if this description issue was raised in a bankruptcy proceeding where the trustee attacked the description or if another secured creditor claimed a security interest in debtor’s livestock, or if the collateral subject to the security interest had been sold by the feedlot without permission.

According to the court, “Baldwin and Castro County stipulated to most of the facts in the case and agreed that only a question of law was before the [trial] court.”215 Would the court apply the same approach, if the debtor asserted that it had intended to grant a security interest in certain animals and not all? Would parol evidence be able to be used? Would the court have treated a security agreement that contained an incorrect pen or lot number in the same way it did with a complete omission?

A security agreement containing a defective description can be reformed. A Colorado bankruptcy court in In re Ivenux, Inc.216 held that § 9-203 does not displace the common law right to reform a writing—here, the security agreement—on the basis of mutual mistake regarding the description of collateral.217 Moreover, the parol evidence rule does not bar the secured party from proffering extrinsic evidence supporting its claim of mutual mistake notwithstanding the “crystal clear” language of the security agreement.218 Specifically the court stated: “[w]here there is a claim of mutual mistake, the parol evidence rule simply has no application and a court may consider extrinsic evidence which goes to the question of exactly what the agreement of the parties was and whether that agreement was expressed in the written document.”219

214. See id. at 796.
215. Id. at 797.
217. Id. at 446.
218. See id. at 448.
219. Id.

For another case permitting reformation, see In re Shutz, 241 B.R. 646 (Bankr. W.D. Mo. 1999). However, a case rejecting this approach is In re Firstar Bank Burlington v. Stark Agric. Servs., 201 B.R. 790 (Bankr. C.D. Ill. 1996). In re Kevin W. Emerick Farms, Inc., 201 B.R. 790, 791 (Bankr. C.D. 111 1996) dealt with a security agreement that did not contain a real estate description required under former Article § 9-203 and the court would not let it be reformed. See also U.C.C. § 9-102(a)(7)(A). For an interesting case dealing with who is the debtor see Firstar Bank 201 B.R. at 790. The creditor was sloppy as to signatures of the debtor on the security agreement listing the debtor as a corporation. The corporate debtor security agreement was signed by the individual producer without any indication of a representative capacity. The court refused to consider parol evidence showing that the individual was signing on behalf of the corporation.
A final description issue concerns after-acquired property. R9 does not provide any guidelines as to what descriptions are sufficient for after-acquired property. Revised U.C.C. § 9-204(a) continues to broadly authorize these clauses by stating: "a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral." Revised V.C.c. § 9-204(a) continues to broadly authorize these clauses by stating: "a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral." Examples of these clauses include "all inventory now or hereafter acquired by Debtor," "all equipment now or hereafter acquired by debtor," or "all accounts now due or to become due to debtor." Specific after-acquired property clauses should be included to make clear that after-acquired property was intended as collateral. Thus, Article 9 authorizes after-acquired property clauses which permit the debtor to encumber all of its assets present and future. Questions arise concerning whether the debtor intended to grant a creditor a security interest in after-acquired property when the security agreement does not have a specific after-acquired clause but covers, for example, "all inventory and accounts" or "all equipment." Revised § 9-108 takes no position on the issue. Official comment 3 to 9-108 provides:

220. U.C.C. § 9-204(a) (2001). Under Article 9, certain types of collateral cannot be covered by after-acquired property clauses. For example, when the collateral is consumer goods, a secured party cannot obtain a security interest in after-acquired consumer goods unless the debtor acquires them within ten days after the secured party gives value. Id. § 9-204(b). Also, commercial tort claims are not subject to the after-acquired clause. Id.

Non-Article 9 limitations also exist. The Bankruptcy Code has limited the effectiveness of after-acquired clauses. 11 U.S.C. §§ 547(b), (c)(5), (e)(3) (2000).

Other Federal law limitations exist as well. An unfair act or practice is committed under the Federal Trade Act if a security agreement covering household goods "contains a nonpossessory security interest other than a purchase money security interest." 16 C.F.R. § 444.2(a)(4) (2002). Under other regulations, lenders are prohibited by federal law from obtaining a nonpossessory nonpurchase money security interest in household goods. Thus, after-acquired property clauses covering household goods are invalid. 12 C.F.R. § 227.13(d), § 535.2(a)(4) (2004). Finally, some states may have separate consumer credit protection legislation that regulates after-acquired collateral when consumer credit is involved. See e.g. KAN. STAT. ANN. 16a-3-301 - 16a-3-303 (2000). Kansas has adopted the Uniform Consumer Credit Code §§ 3.301-03 (1974).

221. U.C.C. § 9-204(a) (2004).

222. See U.C.C. § 9-204 (2004) After-acquired clauses may cover an increase in existing collateral or products of collateral. An example of increase is where a security agreement covers cattle and one of the cattle gives birth to a calf. A products example is where the security agreement covers raw materials and the materials are covered into a finished product. See also U.C.C. § 9-102(44) (providing in part: "Goods means all things that are movable when a security interest attaches." The term includes the unborn young of animals).

Much litigation has arisen over whether a description in a security agreement is sufficient to include after-acquired collateral if the agreement does not explicitly so provide. This question is one of contract interpretation and is not susceptible to a statutory rule (other than a rule to the effect that it is a question of contract interpretation). Accordingly, this section contains no reference to descriptions of after-acquired collateral.

Courts are split as to whether attachment occurs when no after-acquired clause exists. The type of collateral involved is generally determinative. In cases involving inventory and accounts where the trade expects inventory and accounts to be sold and collected and then replaced, courts find a rebuttable presumption. They base this on the nature of overturning assets: a security interest in inventory and accounts receivables includes after-acquired inventory and accounts. 224 Under this test, in cases where the collateral is equipment and the description was "all equipment" with no specific reference to after-acquired equipment, the presumption that collateral will turnover would not apply. Courts have specifically held that after-acquired equipment is not covered when a specific after-acquired property clause does not appear in the security agreement. 225 A description of "all farm products" might be held to be subject to the rebuttable presumption rule. Farm products including livestock are similar to inventory because they are in effect the farmer's inventory. Past course of dealing and custom may have an impact. For example, assume that the parties had executed security agreements in the past that contained an after-acquired property clause but a specific agreement at issue did not contain an after-acquired clause. 226 Finally, if an original security agreement did not contain an after-acquired clause, execution of a second security agreement containing a grant of a security interest in the new collateral would solve the problem. Normally, priority dates from the date of filing, not attachment. 227

D. Proceeds

Occasionally issues arise concerning whether proceeds of the original collateral are covered by the original security agreement. Proceeds are basically

224. See, e.g., In re Filtercorp, Inc., 163 F.3d 570 (9th Cir. 1998).
226. See U.C.C. § 1-205; Revised § 1-303 (2004).
227. See U.C.C. §§ 9-322 cmt. 5, 9-324 cmts. 2, 3, 10, 11 (2001) (note that 11 U.S.C. § 547 can cause the creditor some problems if the new security agreement is executed within 90 days of the petition and no new value is given).
the replacement or substitute for original collateral and are defined in part in § 9-102(a)(64) among other things to be “whatever is acquired upon sale, lease, license, exchange or other disposition of the collateral . . . .” They can be cash or noncash. Cash proceeds are defined in § 9-102(a)(9) to mean “money, checks, deposit accounts or the like.” Non cash are those that are not cash, such as trade-ins and tangible chattel paper. Must a security agreement specifically refer to or describe proceeds for attachment to occur? No specific reference to proceeds is required in the security agreement under § 9-203 if certain conditions are met. Section 9-203(f) provides that attachment of a security interest in collateral automatically gives the secured party an interest in the proceeds if they are identifiable.

Issues concerning whether proceeds are covered by a security agreement have arisen in a number of factual situations. For example, in Western Farm Service v. Olsen, a producer of potatoes, who had granted Key Bank a perfected security interest in the potatoes, contracted to sell the potatoes to Simplot. One of the terms of the contract was that Simplot would pay the producer, in addition to the payment for the potatoes, a separate amount for hauling the potatoes to the buyer’s place of business. The Washington Court of Appeals decision that Debtor's reimbursement for hauling the potatoes was not to be proceeds of the potatoes was reversed by the Washington Supreme Court. Stretcher the breadth of the term proceeds, a majority of the Supreme Court held the term is all encompassing and is to be given a flexible and broad interpretation. The hauling allowance was a proceed of the debtor’s potato crop because the allowance was collectible only after delivery of the potato crop and was part of the sale of the crop.

The proceeds issue can arise in bankruptcy cases under 11 U.S.C. § 552 when a pre-petition created security interest is asserted against crops planted post-petition. The court in In re Thacker confronted this problem. In that case,
the pre-petition perfected secured creditor successfully argued that crops planted post-petition were products of seeds and inventory that were purchased pre-petition and therefore were covered by 552(b),\(^{238}\) which provides in relevant part:

\[ \text{[I]f the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to amounts paid as rents of such property or the fees, charges, accounts, or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties, then such security interest extends to such rents and such fees, charges, accounts, or other payments acquired by the estate after the commencement of the case to the extent provided in such security agreement . . .} \]

1. Government Payments as Proceeds

A fertile area of litigation concerns whether federal farm payments are proceeds.\(^{240}\) The issues concerning government payments as proceeds can arise in a variety of situations.\(^{241}\) For example, a debtor can have a government check, and the creditor may claim to have a security interest in the check.\(^{242}\) More often the producer-debtor has entered into a contract with the government under which producer is eligible to receive payments but has not yet received them.\(^{243}\) The right to receive the government payments is almost always held to be a general intangible.\(^{244}\) The payments in this situation are proceeds of a general intangi-

---

238. See id.
241. See generally In re George, 78 B.R. 886 (Bankr. C.D. Ill. 1987) (holding that "sealing profits" were considered proceeds that follow creditor’s security interest); In re Sumner, 69 B.R. 758 (Bankr. D. Or. 1986) (holding deficiency program payments were proceeds of the debtor’s crop interest); In re Mahleres, 53 B.R. 86 (Bankr. D. Colo. 1985) (holding that wool was a product of sheep and check to debtor representing an incentive payment was not secured under security agreement).
243. See In re Kingsley, 865 F.2d 975, 976 (8th Cir. 1989) (holding that payments arising from contracts with the Federal Commodity Credit Corporation are not proceeds covered by security agreement).
244. See U.C.C. § 9-102(a)(42), (61). "General intangible" means any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals before extraction. The term includes payment intangibles and software.
"Payment intangible" is defined in §9-102(a)(61): "Payment intangible" means a general intangible under which the account debtor's principal obligation is a monetary obligation. If the government payment is classified as a payment intangible, the sale of it, as well as the transaction creating a security interest in it to secure a loan, is covered by R9. U.C.C. §§ 9-109(a)(1 & 3). The sale of accounts and payment intangibles are covered by Article 9 but the sale of general intangibles is not. U.C.C. §9-109(a)(3).

Remember that the official comments to Article 9 do not take a position as to what type of collateral under Article 9 government payments under entitlement programs are. U.C.C. §9-102 cmt. 5(i) provides:

This Article does not contain a defined term that encompasses specifically rights to payment or performance under the many and varied government entitlement programs. Depending on the nature of the right under a program, it could be an account, a payment intangible, a general intangible other than a payment intangible, or another type of collateral. The right also might be proceeds of collateral (e.g. crops).

Almost all courts that have considered the issue have determined that the right to receive the payments under the contract is a general intangible. Thus, the payments under this farmer's contract with the government are proceeds of a general intangible. In addition to In re Stevens discussed in the text, see In re Sunberg, 779 F.2d 561, 562-63 (8th Cir. 1984) and In re Schmidt, 38 B.R. 380, 383 (Bankr. D. N.D. 1984).

The issue of what type of collateral government payments are under the Conservation Reserve Program (CRP) arose in In re Isenbart, 252 B.R. 62 (D. Kan. 2000). The court held that CRP payments are personal property rather than rent of real estate. They are in the nature of contract rights or general intangibles or accounts under F9. This decision was decided when F9 was in effect. Clearly, R9 applies to any transaction creating a security interest in personal property which the CRP payments are under this decision. The question is how they are classified under R9. It would seem that the payments are not accounts. It is not for services rendered U.C.C. § 9-102(a) defines an account as:

"Account", except as used in "account for", means a right to payment of a monetary obligation, whether or not earned by performance, (i) for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of, (ii) for services rendered or to be rendered (iii) for a policy of insurance issued or to be issued, (iv) for a secondary obligation incurred or to be incurred, (v) for energy provided or to be provided, (vi) for the use or hire of a vessel under a charter or other contract, (vii) arising out of the use of a credit or charge card for information contained on or for use with the card, or (viii) as winnings in a lottery or other game of chance operated or sponsored by a State, governmental unit of a State, or person licensed or authorized to operate the game by a State or governmental unit of a State. The term includes health-care-insurance receivables. The term does not include (i) rights to payment evidenced by chattel paper or an instrument, (ii) commercial tort claims, (iii) deposit accounts, (iv) investment property, (v) letter-of-credit rights or letters of credit, or (vi) rights to payment for money or funds advanced or sold, other than rights arising out of the use of a credit or charge card or information contained on or for use with the card.
The question of whether government program payments are proceeds of farm products arises often.246

A few cases will illustrate some of these proceeds issues. In Conagra, Inc. v. Farmers State Bank,247 the court had to determine whether a security interest in soybeans included federal disaster payments made to the debtor when the bean crop was destroyed by bad weather. The issue turned on whether the payments were considered proceeds of the specific soybean crop. While this case involved F9, its discussion of whether government payments are proceeds of farm products is still relevant.

The court adopted the approach of In re Schmaling,248 which held for governmental agricultural payments to qualify as proceeds if three conditions are met: 1) the crop must have been planted; 2) the crop must have been lost or destroyed; and 3) the government payment being claimed must have been received by the producer for the lost or destroyed crop. The rationale appears to be that the government payments are simply a substitute for the payments the producer would have received had the crop not been destroyed.249 The facts in Conagra showed that the bean crop was planted, it was destroyed because of a weather disaster, and the payments were directly linked to the destroyed crop.250 Thus, the payments were proceeds and covered by the security agreement. Once it was concluded the payments were proceeds, the Conagra court had to determine whether the proceeds were reasonably identifiable.251 The debtor received a government check for $100,000, which included disaster payments for the soybeans ($17,284) as well as other lost crops.252 The court concluded that the cash proceeds do not lose their identity simply because they are commingled. While this case is different than commingling in a cash account, the basic equitable rules of tracing still apply. Here the check did not specify what part of the whole was payable for the soybeans, but it was clear from government documents that $17,284 of the $100,000 was for the destroyed soybeans.253 Thus, the $17,284

246. Id.
248. See generally In re Schmaling, 783 F.2d 680 (7th Cir. 1986).
249. Id.
250. See Conagra, 602 N.W. 2d at 390.
251. Id.
252. Id. at 394.
253. See id.
was proceeds and reasonably identified. Recall that the U.C.C. does not define the term "identifiable proceeds." U.C.C. § 9-315(b)(2) makes explicit that equitable tracing rules are to be used to determine whether proceeds are identifiable.254

Courts have struggled with government payments when a secured creditor had a security interest in farm products, but debtor did not plant a crop. For example, prior to the last two farm bills, set aside programs were common and farmers received payments for not planting. The payments would not be proceeds under the three-prong test of In re Schmaling. Other courts have held that these payments are not proceeds.255

---

254. See also U.C.C. § 9-315(b) (2004), providing:

b) [When commingled proceeds identifiable.] Proceeds that are commingled with other property are identifiable proceeds:

(1) If the proceeds are goods, to the extent provided by 9-336 and amendments thereto; and

(2) if the proceeds are not goods, to the extent that the secured party identifies the proceeds by a method of tracing, including application of equitable principles, that is permitted under law other than this article with respect to commingled property of the type involved"

See also id. § 9-315 cmt. 3, providing:

Secured Party's Right to Identifiable Proceeds. Under subsection (a)(2), which derives from former Section 9-306(2), a security interest attaches to any identifiable "proceeds," as defined in Section 9-102. See also Section 9-203(f). Subsection (b) is new. It indicates when proceeds commingled with other property are identifiable proceeds and permits the use of whatever methods of tracing other law permits with respect to the type of property involved. Among the "equitable principles" whose use other law may permit is the "lowest intermediate balance rule." See Restatement (2d), Trusts § 202.

255. See, e.g., In re Kruse, 35 B.R. 958, 965 (Bankr. D. Kan. 1983); First Nat'l Bank v. Milford, 718 P.2d 1291, 1297 (Kan. 1986) (accepting the holding of Kruse). These issues have also arisen when livestock are involved. For example, producers have received government payments for eliminating or reducing their capacity to produce milk and courts have held these payments constitute proceeds of a security interest in the livestock. See, e.g., FMB-First Mich. Bank v. Van Rhee, 681 F. Supp. 1264, 1267 (W.D. Mich. 1987); In re Hollie, 42 B.R. 111, 117 (Bankr. M.D. Ga. 1984).
E. Debtor Must Have Rights in the Collateral

1. In General

Another one of the requirements for attachment is that the debtor must have "rights in the collateral or the power to transfer rights in the collateral to a secured party." The term 'rights' is not defined. Rights in the collateral do not necessarily mean "title." Clearly an owner has rights in property, and a thief who has mere possession does not. It is also clear that the debtor does not have to be an owner to be able to create an enforceable security interest. However, it is not clear where rights arise on the continuum between actual ownership and mere possession. What relationship with collateral establishes rights sufficient to create a security interest in goods that the debtor does not own? In general, it appears that the debtor must have the "power" to create a security interest. Because the term "rights" is not defined, U.C.C. § 1-103 is relevant. It provides: "Unless displaced by the particular provisions of [this Act], the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions." Thus, the debtor can obtain the power to create a security interest through any of the bodies of law set out in § 1-103.

Many of the cases that have been litigated involve situations where the debtor has possession of someone else's property. The conflict arises when a secured party claims property in the possession of the debtor who has obtained the property in a transaction referred to as a bailment, lease, or a consignment. If the transaction is a true bailment, the ownership rights of the bailor are enforceable against most third parties including a secured party. If, on the other hand, the transaction under which the person in possession obtained the goods is not a true bailment but a credit sale where the transferor of possession retained a security interest, the person in possession is an Article 9 debtor, and the transferor is a secured party and must file a financing statement to be protected. Also, when the person in possession is a true lessee, U.C.C. Article 2A, not Article 9, controls issues concerning the lessor's ability to enforce its ownership rights against a

256. U.C.C. § 9-203(b)(2) cmt. 6 (2004).
257. U.C.C. § 1-103(b) (2004).
258. See id.
259. U.C.C. § 2-403(1) (2004); But see U.C.C. § 2-403(2) (2004).
third party. Finally, if a consignment as defined in § 9-102(a)(20)\textsuperscript{260} is involved, the transaction is treated as a purchase money security interest in inventory, and the transferor has to comply with Article 9 to be protected against third parties.

In the 2004 case of American Bank & Trust v. Shaull, the South Dakota Supreme Court considered this issue.\textsuperscript{261} Shaull owned and operated a livestock auction house in South Dakota through which he bought and sold cattle using the name H.S. Cattle.\textsuperscript{262} He also had separate land where he kept cows and other animals.\textsuperscript{263} On June 8, 2001, Shaull refinanced his operation and borrowed money from American to cover an existing line of credit from Fin-Ag and for "breeding livestock."\textsuperscript{264} Shaull granted American a security interest in all livestock owned or later acquired, all farm products owned or thereafter acquired, and all inventory owned or thereafter acquired.\textsuperscript{265} Shaull did not tell American that he bought and sold animals through H.S. Cattle and that he had animals in his possession that were owned by someone else.\textsuperscript{266} In June, 2001, American filed a financing statement in South Dakota that covered livestock and "all cows and 2001 future offspring, all increase, issue offspring, products and products from the livestock."\textsuperscript{267}

\begin{itemize}
\item \textsuperscript{260} U.C.C. § 9-102(a)(20) (2004) (This section defines a consignment to be a transaction, regardless of its form, where: 1) a person delivers goods for sale to a merchant who deals in goods of that kind under a name other than that of the person delivering; 2) the transaction does not create a security interest; 3) the merchant is not known by its creditors to be substantially engaged in selling the goods to others; 4) the aggregate value of the delivered goods is $1000 or more at the time of delivery; and 5) the goods were not consumer goods immediately before delivery.
\item \textsuperscript{261} Am. Bank & Trust v. Shaull, 678 N.W.2d 779 (S.D. 2004).
\item \textsuperscript{262} Id. at 780.
\item \textsuperscript{263} Id.
\item \textsuperscript{264} Id. at 781.
\item \textsuperscript{265} Id.
\item \textsuperscript{266} Id.
\item \textsuperscript{267} Id. at 782.
\end{itemize}
Feldman brothers (Feldman) operated a cattle-feeding operation in Minnesota. In 2000, Shaull and Feldman entered into a “bred cow agreement.” It appears that under this “bred cow agreement,” Shaull would buy cows and feed and care for them on his land in South Dakota. Both Feldman and Shaull were to have rights in the calves produced and share in the profit and losses from the sale of the calves. Ag-Finance financed Feldman’s cattle operation, had a security interest in all Feldman’s cows, and had filed a proper financing statement in Minnesota but not in South Dakota.

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

Shaull defaulted on his loan to American, who claimed all of the animals in Shaull’s possession including those belonging to Feldman. Feldman and AgStar claimed that Feldman owned the animals, and the “bred cow agreement,” establishing a bailment between Feldman and Shaull. Therefore, American did not have a security interest in its cows in Shaull’s possession because Shaull did not have the ability to grant a security interest in property in which he did not own. On the other hand, American claimed that Shaull had total control of the animals, and it neither had notice of Feldman or AgStar’s interests nor the ability

268. Id. at 781.
269. Id. at 782.
270. Id. at 790.
271. Id. at 782.
272. Id.
273. Id.
274. Id.
275. Id.
276. Id.
277. Id.
278. Id. at 787.
279. Id. at 785.
280. Id.
to discover their interests because neither had filed a prophylactic financing statement under § 9-505.\textsuperscript{281} Section 9-505 permits an informational filing indicating the filer is a bailor and has an interest in goods held by the named debtor.\textsuperscript{282}

The majority of the court held that Feldman and AgStar were estopped from claiming an interest in Feldman’s cows in Shaull’s possession.\textsuperscript{283} The court’s basic point is that control, not ownership, determines whether a debtor has sufficient rights to grant a security interest.\textsuperscript{284} Here, the owners clothed the debtor with apparent ownership putting the debtor in the position to mislead third parties.\textsuperscript{285} It appears the majority is saying a litmus test exists. Owners must file a § 9-505 filing, or owners will be estopped from asserting that the debtor does not have sufficient rights to create a security interest.\textsuperscript{286} Finally, it may be that the court was really saying that no bailment existed.

An older case that illustrates the issues that can arise when property purportedly belonging to an owner is placed in the hands of another is \textit{Rohweder v. Aberdeen Production Credit}.\textsuperscript{287} Here Rohweder placed cows in the hands of another who had granted a security interest in all cattle.\textsuperscript{288} In dealing with the rights issue, the court concluded it was a question of fact whether a bailment was involved.\textsuperscript{289} The court stated:

\textsuperscript{281}Id.

\textsuperscript{282}U.C.C. § 9-505 (2004) provides:

\begin{itemize}
  \item[(a)] Use of terms other than “debtor” and “secured party.” A consignor, lessor, or other bailor of goods, a licensor, or a buyer of a payment intangible or promissory note may file a financing statement, or may comply with a statute or treaty described in Section 9-311(a), using the terms “consignor,” “consignee,” “lessor,” “lessee,” “bailor,” “bailee,” “licensor,” “licensee,” “owner,” “registered owner,” “buyer,” “seller,” or words of similar import, instead of the terms “secured party” and “debtor.”

  \item[(b)] Effect of financing statement under subsection (a). This part applies to the filing of a financing statement under subsection (a) and, as appropriate, to compliance that is equivalent to filing a financing statement under Section 9-311(b), but the filing or compliance is not of itself a factor in determining whether the collateral secures an obligation. If it is determined for another reason that the collateral secures an obligation, a security interest held by the consignor, lessor, bailor, licensor, owner, or buyer which attaches to the collateral is perfected by the filing or compliance.
\end{itemize}

\textsuperscript{283}Shaull, 678 N.W.2d at 796.

\textsuperscript{284}See \textit{id.} at 795-797.

\textsuperscript{285}See \textit{id.} at 792.

\textsuperscript{286}See \textit{id.} at 792-793.

\textsuperscript{287}Rohweder v. Aberdeen Prod. Credit, 765 F.2d 109 (8th Cir. 1985).

\textsuperscript{288}See \textit{id.} at 110-111.

\textsuperscript{289}\textit{id.} at 112-113; see also U.C.C. § 9-505 cmt. 3.
At trial, the burden is on Rohweder to show that he actually owned the cattle in question. Evidence that the cattle bore Rohweder's brand, or evidence of the Genre brand plus a bill of sale from Genre to Rohweder, would constitute prima facie proof of ownership. Once Rohweder makes his prima facie showing, the burden shifts to the PCA to demonstrate that Bellman possessed sufficient rights in the cattle for its security interest to attach. The crucial question in this regard is the parties' intent. If Rohweder intended to make a conditional sale when he delivered the cows to Bellman, he retained only a security interest and Bellman had sufficient rights for PCA's security interest to attach. On the other hand, if the parties intended to create a bailment, with Rohweder retaining complete ownership of the cows and relinquishing only possession, Bellman would not have sufficient rights for attachment of PCA's lien and, in the absence of an estoppel, Rohweder should prevail. While the factors of control over the cattle, including the right of sale, and the option to purchase do not necessarily constitute "rights in collateral," they are relevant evidence for the jury in determining the parties' intent to transfer an ownership interest to Bellman. 290

Students of Article 9 know that its application involves two different concepts: a planning strategy and a litigation strategy. Without doubt from a planning perspective, owners placing property in the hands of another and lenders having a security interest in owners' assets placed in the possession of another should file a prophylactic financing statement under § 9-505. 291 This option presents some unapparent issues. For example, where must the financing statement be filed? It would seem it is filed where the party considered the potential debtor is located. If more than one state is involved, §§ 9-301 and 9-305


The rights issue can arise when a feedlot operator seeks financing. The question is whether a feedlot operator has rights in all of the livestock it has in its possession. This issue has come up numerous times with feedlots. The lender to a feedlot must determine whether the debtor owns all of the cattle located in the lot. Often some of them will be owned by people who have hired the operator to fatten them. The debtor cannot create a security interest in animals it does not own and holds as bailee for a limited purpose of fattening. See e.g. Nat'l Livestock Credit Corp. v. First State Bank of Harrah, 503 P.2d 1283 (Okla. Ct. App. 1972). Other rights cases are Morton Booth Co. v. Tiara Furniture, Inc., 564 P.2d 210, 214 (Okla. 1977) (stating rights exist "where a debtor gains possession of collateral pursuant to agreement endowing him with any interest other than naked possession..." ); Chrysler Corp. v. Adamatic, Inc., 208 N.W.2d 97, 104 (1973) (finding bailee's possessory interest for limited purpose of repair not sufficient "rights in the collateral"); see also Kinetics Tech. Int'l Corp. v. Fourth Nat'l Bank, 705 F.2d 396 (10th Cir. 1983).

291. See South Dakota Secretary of State, Livestock Producers Protect Your Livestock, at http://www.sdsos.gov/ucc/livestock (describing and listing the needed filings required by the Shaull case).
Another issue concerns the authorization to file the financing statement. Today, the debtor does not have to sign the financing statement. Under § 9-505, when a purported bailment is involved, must the bailee authorize in an authenticated record the filing of the financing statement? Section 9-509(a)(1) provides that an initial financing statement may be filed only if "the debtor authorizes the filing in an authenticated record or pursuant to subsection (b) [description same as financing statement]." From a planning standpoint, the owner or owner's lender should include in the bailment agreement an authorization to file a financing statement.

From a litigation perspective, the owner can argue that filing should not be the only way a lender of the bailee (possessor) could be put on notice. For example, arguably the lender should be put on notice of the owner's interest if the owner has placed identifications such as ear tags or brands that indicate the owner's interest. The Shaull court seems to suggest that this notice approach does not exist, but it is not clear whether that was because Feldman had not sufficiently identified the animals or that only filing will suffice. Lastly, remember that if Article 9 applies, all parties must act in good faith, which now includes the "observance of reasonable commercial standards of fair dealing."

Finally, a protective § 9-505 filing will not protect the owner or the owner's lender in all situations. For example, suppose the owner transfers possession of cattle to a producer who has, prior to the transfer, granted a perfected security interest in all cattle and all inventory including after-acquired cattle to another creditor. If the owner is considered to have sold the cattle to a producer, the owner will have a purchase money security interest. Even if the owner files a § 9-505 financing statement, it appears that § 9-324(d) which deals with purchase money security interests in livestock would apply to this transaction. Under § 9-324(d), the owner will lose to the prior perfected secured party unless the owner filed the financing statement before the cattle were delivered to the producer and gave appropriate written notice to the prior perfected secured creditor before the delivery of the cattle to the producer. Also, if the transaction be-

---

293. Id. § 9-505.
295. See Shaull, 678 N.W.2d 779.
298. Id. § 9-324(d) (providing that a super priority to a purchase money security interest holder in livestock if the holder complies with § 9-324(d)).
tween the putative bailor and the person having the goods is considered not to be a bailment but a secured transaction, the filing of only an Article 9 financing statement will not protect the original owner if the producer sells the cattle. Section 7 U.S.C. § 1631 applies, and the original owner-secured creditor will not be able to seek redress from the buyer unless an appropriate § 1631 notice was given to the buyer.299


Except as provided in subsection (e) of this section and notwithstanding any other provision of Federal, State, or local law, a buyer who in the ordinary course of business buys a farm product from a seller engaged in farming operations shall take free of a security interest created by the seller, even though the security interest is perfected; and the buyer knows of the existence of such interest.

See also 7 U.S.C. § 1631(e) (2001). Under § 1631(e), the two types of notice possible are a so-called direct written notice or a so-called central filing system. Both notice systems are in use. 7 U.S.C. § 163(e)(1) provides in part:

A buyer of farm products takes subject to a security interest created by the seller if—
1) (A) within 1 year before the sale of the farm products, the buyer has received from the secured party or the seller written notice of the security interest organized according to farm products that—[contains detailed information such as the name of the debtor and the secured party, a description of the farm products, social security or tax identification number]; or
2) in the case of a farm product produced in a State that has established a central filing system—(A) the buyer has failed to register with the Secretary of State of such State prior to the purchase of farm products; and (B) the secured party has filed an effective financing statement or notice that covers the farm products being sold; or
3) in the case of a farm product produced in a State that has established a central filing system, the buyer—(A) receives from the Secretary of State of such State written notice as provided in subsection (c)(2)(E) or (c)(2)(F) that specifies both the seller and the farm product being sold by such seller as being subject to an effective financing statement or notice.

2. When Does a Farmer Have Rights in Government Payments?

As we know, a secured creditor's security interest cannot attach until the debtor has rights in the collateral.\textsuperscript{300} The issue of whether and when a farmer-debtor has rights in federal government farm payments arises in a variety of contexts. For example, does the producer obtain rights in the payments when the producer is eligible to receive the payments, or when the actual payments are made, or when a particular crop is planted? In general, the producer has rights when the debtor is eligible to participate in the particular program or eligible to receive the payments, not upon receipt or planting.

This issue was considered in \textit{In re Stevens}, a 2004 Arkansas bankruptcy case.\textsuperscript{301} Secured creditor, who had loaned money to Debtor for the 2002 crops but not the 2003 crops, claimed Debtor's 2003 government payments made after the bankruptcy petition was filed.\textsuperscript{302} Secured creditor's signed 2002 security agreement contained among other things the following language:

\begin{quote}
All crops and government payments: whether any of the foregoing is owned now or acquired later . . . including all entitlements, rights to payment, and payments, in whatever form received, including but not limited to, payments under any governmental agricultural diversion programs, governmental agricultural assistance programs, the Farm Services Agency . . . all proceeds relating to any of the foregoing . . .
\end{quote}

The government payments here consisted of direct and counter-cyclical payments for fiscal year 2003 that were made pursuant to the Farm Security and Rural Investment Act of 2002 (2002 Farm Bill).\textsuperscript{304} The sign-up period for payments to be made under the 2002 Farm Bill was from October 1, 2002, until June 2003.\textsuperscript{305} One major issue of the case is when did the debtor obtain the right to receive the 2003 payments.\textsuperscript{306} The court held that this occurred before the filing of the bankruptcy case and independent of the debtor's 2003 crop.\textsuperscript{307}

\begin{itemize}
\item [300.] U.C.C. § 9-203(b)(2) (2003).
\item [302.] \textit{Id.} at 127-128.
\item [303.] \textit{Id.} at 127.
\item [305.] \textit{Id.}
\item [306.] Stevens, 307 B.R. at 126.
\item [307.] \textit{Id.}
\end{itemize}
Under the 2002 Farm Bill, the debtor became eligible to receive direct and counter-cyclical payments for crop years 2002 through 2007 upon the completion of a proper application and upon the establishment of prior yields and base acres. Debtor completed the paperwork in October of 2002. Thus, the debtor’s right to receive direct and counter-cyclical payments under the 2002 Farm Bill including the 2003 payments was to be determined upon the prior yields and base acres of the debtor’s farmland, not the debtor’s planting of the 2003 crop. The secured party had a security interest in the 2003 payments. Attachment occurred when the debtor acquired the right to receive the 2003 payments. The 2002 security agreement covered the debtor’s right to receive future government payments and all general intangibles, which the 2003 payments were, and the value requirement of attachment was satisfied by the creditor’s original loan. Yet, the secured party was not perfected. In Arkansas, farm products and accounts generated from the sale of farm products had to be perfected locally. The right to receive government payments is a general intangible and a security interest in them must be perfected by filing centrally, which the secured party did not do. Thus, it was unperfected as to the 2003 payments.

308. Remember that attachment cannot occur until a proper security agreement exists, value has been given, and the debtor has rights in the collateral. U.C.C. § 9-203 (2001).

309. Value is defined to cover pre-existing debt. Id. §§ 1-201(44)(b), R 1-204(2). After-acquired property clauses are supported because of this.

310. General intangible and payment intangible are defined in id. § 9-102(a)(42),(61): “‘General intangible’ means any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals before extraction. The term includes payment intangibles and software.” Id. § 9-102(a)(42).

‘Payment intangible’ means a general intangible under which the account debtor’s principal obligation is a monetary obligation.” Id. §9-102(a)(61). If the government payment is classified as a payment intangible, the sale of it, as well as the transaction creating a security interest in it to secure a loan, is covered by R9. Id. § 9-109(a). The sale of accounts and payment intangibles are covered by Article 9, but the sale of general intangibles is not. Id. § 9-109(a)(3).

Remember that the official comments to Article 9 do not take a position as to what are the types of collateral under Article 9 government payments under entitlement programs:

This Article does not contain a defined term that encompasses specifically rights to payment or performance under the many and varied government entitlement programs. Depending on the nature of a right under a program, it could be an account, a payment intangible, a general intangible other than a payment intangible, or another type of collateral. The right also might be proceeds of collateral (e.g., crops).

Id. § 9-102 cmt. 5(i).

Almost all courts that have considered the issue have determined that the right to receive the payments under the contract is a general intangible. Thus, the payments under a
The issue of attachment arises with other types of farm payments. For example, in *In re Otto Farms, Inc.*, the issue was whether creditor had a perfected security interest in debtor's LDPs (Loan Deficiency Payments), which were received post-petition. LDPs are the payments a producer is entitled to receive from the Commodity Credit Corporation (CCC) based on the difference between market prices for the producers crop and the CCC loan rate.

The security agreement covered not only all of the debtor's crops and their proceeds but also "all general intangibles, including government payments, insurance payments and the like" and "all proceeds of any collateral." The court rejected debtor's argument that 11 U.S.C. § 552 prevented the security farmer's contract with the government are proceeds of a general intangible. In addition to *In re Stevens* discussed in the text, see, e.g., *In re Sunberg*, 729 F.2d 561, 562-63 (8th Cir. 1984); *In re Schmidt*, 38 B.R. 380, 383 (Bankr. D. N.D. 1984).

The issue of what type of collateral government payments under the Conservation Reserve Program (CRP) arose in *In re Isenbart*, 255 B.R. 62, 67 (Bankr. D. Kan. 2000), where the court held that CRP payments are personal property rather than rent of real estate. They are in the nature of contract rights or general intangibles or accounts under Former Article 9. (U.C.C. §9-106 (2000) (revised by U.C.C. § 9-102 (2001) and decided when Former Article 9 was in effect. (See U.C.C. app. S (2003)). Clearly, Article 9 applies to any transaction creating a security interest in personal property which the CRP payments are found to be under this decision. (See U.C.C. § 9-102 (2004); *In Re Isenbart*, 255 B.R. 62, 67 (Bankr. D. Kan 2000)). The question is how they are classified under Article 9. It would seem that the payments are not accounts, and they are not for services rendered. U.C.C. § 9-102(a) (2001) defines an account as:

"Account," except as used in "account for," means a right to payment of a monetary obligation, whether or not earned by performance, (i) for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of, (ii) for services rendered or to be rendered, (iii) for a policy of insurance issued or to be issued, (iv) for a secondary obligation incurred or to be incurred, (v) for energy provided or to be provided, (vi) for the use or hire of a vessel under a charter or other contract, (vii) arising out of the use of a credit or charge card or information contained on or for use with the card, or (viii) as winnings in a lottery or other game of chance operated or sponsored by a State, governmental unit of a State, or person licensed or authorized to operate the game by a State or governmental unit of a State. The term includes health-care-insurance receivables. The term does not include (i) rights to payment evidenced by chattel paper or an instrument, (ii) commercial tort claims, (iii) deposit accounts, (iv) investment property, (v) letter-of-credit rights or letters of credit, or (vi) rights to payment for money or funds advanced or sold, other than rights arising out of the use of a credit or charge card or information contained on or for use with the card.

313. Id. at 758.
314. Id.
interest from attaching because the payments became property of the debtor’s estate post-petition and therefore cannot be subject to a security interest created pre-petition. The security agreement description (general intangibles, including government payments) covered LDPs. As to when the debtor had rights in the LDPs, the date that debtor is eligible to participate in the program is the key, not when the actual payments are made.

Another case is In re Klaus, where the security agreement covered not only all of the debtor’s crops and their proceeds but also payments the debtor was entitled to “from any state or federal farm program.” Again, the court struggled with whether the security agreement covered the LDPs and when the debtor obtained rights in them. The court held the description covered the actual payments and the right to receive them. As to the rights issue, the court again concluded that it was the date on which the debtor was eligible to participate in the program that was the key, not when the actual payments were made.

Another issue that has surfaced is whether federal law or state law governs attachment and perfection of security interests in federal farm payments.

The court in In re Endicott considered this issue. On December 31, 1997, the debtor granted to the bank a valid security interest in all general intangibles or other government entitlements and present and future payments or payment rights in federal agriculture payments. The bank filed a proper financing statement in the proper place. The debtor’s 1998 crop was destroyed, and he applied to receive disaster payments under the Crop Loss Disaster Assistance Program (CLDAP). After the application, the debtor filed a bankruptcy petition. A trustee claimed that the bank did not have a perfected security interest in the disaster payments because it had failed to obtain an assignment from the debtor under federal regulations. The court rejected the argument. It concluded that the federal regulations, which permit a farmer to execute an assignment of proceeds from CLDAP, were designed to limit the federal government’s

315. Id. at 759.
316. Id. at 760.
320. Id. at 530.
321. Id. at 531.
322. Id.
323. Id.
liability if CLDAP payments were improperly made, not to establish a federal filing scheme for security interests in government payments.\textsuperscript{324}

\textit{In re Norville} is another bankruptcy case dealing with CLDAP.\textsuperscript{325} This court rejected the debtors' argument that 7 C.F.R. § 1437.18, which contains an anti-assignment clause, preempts the law of Illinois on secured transactions authorizing the creation of a security interest in federal government payments.\textsuperscript{326} It reasoned that a federal agency's power to preempt state laws must be clearly delegated to it.\textsuperscript{327} No evidence existed that Congress expressly empowered the Department of Agriculture to promulgate regulations preempts state secured transactions law.\textsuperscript{328} The court does cite 7 C.F.R. § 1437.17(b), which provides that the producer can assign payments pursuant to 7 C.F.R. § 1404.\textsuperscript{329} Regulation § 1404 controls the assignment of payments, which notifies the Federal Service Agency (FSA) or the Commodity Credit Corporation (CCC) concerning who is entitled to receive the payments.\textsuperscript{330} For an effective assignment, the appropriate government form must be executed.\textsuperscript{331} Three forms are in use: 36, 251 and 252.\textsuperscript{332} Form CCC-36 must be executed and filed in the county Farm Service Agency (FSA) office prior to the time the county committee approves the making of the payment covered by the assignment.\textsuperscript{333} Form CCC-251 or 252 must be filed in the relevant FSA or CCC prior to the making of the payments.\textsuperscript{334} Both the assignee and assignor must sign these forms.\textsuperscript{335} These forms do not affect attachment or perfection. As the above cases hold, Article 9 still determines attachment, perfection, and priority to government payments.\textsuperscript{336} However, note that the reverse side of Form CCC-36 does state that the first person to complete and return the form to the FSA will be entitled to the assignment first.\textsuperscript{337}

\begin{itemize}
  \item 324. \textit{Id. at 532}.
  \item 325. \textit{Norville, 248 B.R. at 127}.
  \item 326. \textit{Id. at 129}.
  \item 327. \textit{Id}.
  \item 328. \textit{Id}.
  \item 329. \textit{See 7 C.F.R. § 1404.1 (2004)}.
  \item 330. \textit{Id}.
  \item 331. \textit{7 C.F.R. § 1404.4 (2004)}.
  \item 332. \textit{Id}.
  \item 333. \textit{Id. § 1404.4(2)(i) (emphasis added).}
  \item 334. \textit{Id}.
  \item 335. \textit{Id}.
  \item 336. \textit{See, e.g., Norville, 248 B.R. at 129 (holding that federal law does not preempt the Illinois U.C.C. in determining perfection).}
  \item 337. \textit{See Ag. Acceptance Corp. v. Nelson, 103 F. Supp. 2d 1129 (D. Minn. 2000). The case also involved Federal Crop Loss Disaster Assistance. This court also held that the anti-
F. Perfection

1. In General

In general, attachment makes the security interest enforceable against the debtor, and it allows the secured party to pursue its remedies against the debtor on default as articulated in Part 6 of Article 9 whether or not the security interest is perfected.338 A security interest cannot be perfected until it has attached and all steps required for perfection are taken.339 Perfection is required to protect the security interest against third parties, such as purchasers of collateral subject to a security interest, other creditors, or a trustee in bankruptcy.340

However, perfection does not give protection against the whole world. For example, § 9-320(a) allows the buyer in the ordinary course of business to cut off a perfected security interest in inventory.341 A valid perfected security interest in after-acquired inventory, livestock, and software or equipment or other goods that are not inventory or livestock lose to a later perfected qualifying purchase money security (PMSI) interest in the same.342

Put another way, the “dragnet clause” that covers not only collateral for an immediate loan but also loans made in the past or the future will give the lender priority dating from the time the financing statement is filed unless a qualifying subsequent PMSI holder surfaces.343 However, perfection that occurs more than ten days after the creation of the security interest and within ninety days of bankruptcy will probably be set aside as a preferential transfer under § 547(b) of the Bankruptcy Act, unless a PMSI is involved.344

The key to determining how to perfect is correctly classifying the collateral. In general, five possible ways to perfect exist. The norm is filing a proper

---

assignment provisions of 7 C.F.R § 1437.17(a) were designed to insulate the government from conflicting claims to payments not to preempt state secured transactions law.

339. Id. § 9-308 (emphasis added).
340. See id. § 9-317; § 9-322.
341. Id. § 9-320(a).
343. Id. § 9-324(a-g); see id. § 9-322 cmt. 5; § 9-323 cmt. 3 (dealing with future advances). See generally Pride Hyundai, Inc. v. Chrysler Financial Co., 369 F.3d 603 (1st Cir. 2004) (upholding a “dragnet” clause in a non-agricultural setting).
financing statement in the proper public office.\textsuperscript{345} Possession by a secured party is another method.\textsuperscript{346} So-called automatic perfection applies where certain types of security interests are perfected upon attachment.\textsuperscript{347} Notation on a vehicle’s certificate of title is normally the only way to perfect a security interest in a vehicle subject to a state’s certificate of title law unless the vehicle is held as inventory.\textsuperscript{348} Control is a way to perfect when the collateral is a deposit account, letter of credit rights, electronic chattel paper, and investment property.\textsuperscript{349} Two other possibilities are temporary, which apply in limited situations,\textsuperscript{350} and when there is

\textsuperscript{345} See U.C.C. § 9-501; §§ 9-502-506 (2004). As to where to file, the filing must be centrally (normally the secretary of state’s office) for accounts, consumer goods, chattel paper, equipment, inventory, instruments, investment property, farm products, general intangibles, and negotiable documents. R9 changed the rule for consumer goods and instruments, and also under R9 security interests in promissory notes and payment intangibles may be perfected by filing. The filing is local which normally is in the register of deed’s office for as-extracted collateral, fixtures, and timber to be cut.

\textsuperscript{346} U.C.C. § 9-313 (2004). A secured party may perfect security interest in goods, instruments, money, negotiable documents of title, tangible chattel paper and certificated securities. Possession is the exclusive means for perfection of an interest in money. \textit{Id.} § 9-312(b)(3). R9 changes the perfection rules when a third party has possession of the collateral. Section 9-313(c) now requires that the third party must: receive notice \textit{and} acknowledge in an “authenticated record” that it is holding the collateral “for the secured party’s benefit.”

\textsuperscript{347} See U.C.C. § 9-309 (2004). Perfection is automatic upon attachment when a PMSI in consumer goods is involved. \textit{Id.} §§ 9-309(1), 9-103. Sales of promissory notes or payment intangibles are automatically perfected under § 9-309(3)-(4). Automatic perfection does not apply to security interests in payment intangibles or promissory notes. It does not provide total protection but it does provide protection against trustee in bankruptcy.

With respect to a promissory note that is an instrument, perfection by filing will not protect the buyer or secured party from a later buyer or secured creditor who gives value and takes possession of the instrument in good faith and without knowledge that the purchase or lien violates the rights of the original buyer or secured party. \textit{Id.} 9-330(d). R9 also provides that attachment of the security interest in the promissory note or other payment obligations automatically causes the security interest to attach to the “supporting obligation,” i.e., the mortgage. \textit{Id.} §9-203(g). The security interest in the obligation is automatically perfected in the supporting obligation. \textit{Id.} § 9-308(e). This provides protection against a trustee in bankruptcy, lien creditor or subsequent assignee of the real estate mortgage. However, the interest should be recorded in the real estate records as well. \textit{Id.} § 9-308 cmt. 6.

\textsuperscript{348} See U.C.C. §§ 9-311; 9-310(b) (2004).

\textsuperscript{349} \textit{Id.} §§ 9-104 to 9-107; 9-314, 9-312(b).

\textsuperscript{350} See U.C.C. § 9-312(e) (2001) (providing for a 20 day security interest in certificated securities, negotiable documents, or instruments when new value is given under an authenticated security agreement).
an assignment of a perfected security interest. Finally, note that many types of collateral can be perfected in more than one way with some notable exceptions being money and vehicles.

Filing is the most common form of perfection, and it merits more discussion than the other forms of perfection under R9. The filing system has been modernized. Under the uniform version of Article 9, nearly all filings are made with the secretary of state. The rules for the name of the debtor on the financing statement have been clarified. Trade names are legally insufficient. If the debtor is a registered organization, the name on the financing statement must show “the name of the debtor indicated on the public record of the debtor’s jurisdiction of organization.” A failure to provide the correct name of the debtor is a seriously misleading error unless “a search of the records of the filing office under the debtor’s correct name, using the filing office’s standard search logic, if any, would disclose a financing statement that fails sufficiently to provide the name of the debtor…” Perfection has now been made easier. Instruments can be perfected by filing. The requirement of the debtor’s signature is eliminated so long as the person filing is authorized, which automatically occurs if the description in the financing statement is the same as in an “authenticated” security

351. U.C.C. § 9-310(b) (2004) (providing that if a secured party assigns a perfected security interest or agricultural lien, a filing under this article is not required to continue the perfected status of the security interest against creditors of and transferees from the original. This is essentially the same rule as set forth in F9-302(2)). See also In re Field, 263 B.R. 323 (Bankr. D. Idaho 2001) (holding that under F9-302(2) a creditor as assignee of a perfected security interest was not required to file a financing statement to maintain the bank’s perfected security interest status as to the debtor’s cattle. Revised 9, like F9, encourages the public disclosure of the assignment).


353. Id. § 9-503(a). This section states:

“[Debtor’s trade name insufficient.] A financing statement that provides only the debtor’s trade name does not sufficiently provide the name of the debtor.” However, § R 9-506(a) continues the minor error rule. It provides that “a financing statement substantially satisfying the requirements of this part is effective, even if it has minor errors or omissions, unless the errors or omissions make the financing statement seriously misleading.” If the debtor’s name is incorrect § 9-506(c) provides:

If a search of the records of the filing office under the debtor’s correct name, using the filing office’s standard search logic, if any, would disclose a financing statement that fails sufficiently to provide the name of the debtor in accordance with Section 9-503(a), the name provided does not make the financing statement seriously misleading.


355. Id. § 9-506(c).

agreement. Super-generic descriptions such as "all assets of the debtor" are sufficient in the financing statement but not in the security agreement.

When dealing with filing, two general questions have to be answered: where to file and what to file. One of the hottest topics today concerns the debtor's name. The financing statement must contain the name of the debtor. The name of the debtor is the key to the notice system and priority. The financing statement is indexed under the name of the debtor and searches are done under the name of the debtor. Remember that a financing statement must be filed to perfect an agricultural lien as well as a security interest.

2. Financing Statement and the Debtor's Name

Section 9-102(28) defines the term debtor and § 9-503 states when the debtor's name is sufficient. The debtor can consist of a variety of persons. For example, the debtor can be a registered organization, non-registered organization, an individual, a trust, or decedent's estate.

The rules dealing with a registered organization are clear. The name used for the debtor must be an exact match of the registered name. Section 9-503(a) provides that if the debtor is a registered organization, the name used in the financing statement must be the one that is the registered name on the public record of the debtor's jurisdiction of organization. Under § 9-102(70), "[r]egistered organization' means an organization organized solely under the law of the single State or the United States and as to which the State or the United States must maintain a public record showing the organization to have been organized." Typically this includes a corporation, a limited liability company, a limited partnership, and a limited liability partnership.

358. Id. §§ 9-504, 9-108(c), 9-108 cmt. 2.
359. Id. § 9-502(a)(1).
360. Id. § 9-503 cmt. 2.
363. See id. § 9-503(a).
364. See id.
365. See id. § 9-503(a)(1).
366. See id.
367. Id. § 9-503(a).
368. Id. § 9-102(70).
369. Id. § 9-102 cmt. 11.
Recently, the issue of whether the exact match standard applies to federal tax liens was litigated.\textsuperscript{370} The Court of Appeals for the Sixth Circuit recently reversed the federal district court’s holding in \textit{In re Spearing Tool \& Manufacturing Co.} that the exact registered name must be used in a federal tax lien notice. The Sixth Circuit also noted that the government’s notice substituting “MFG.” for “Manufacturing” was not defective because federal tax liens are not subject to the Article 5 test.\textsuperscript{371}

U.C.C. § 9-503(a)(4) deals with non-registered organizations and provides that the name of the debtor is the name of the organization or if it has no name, the names of the partners, associates, or others making up the debtor.\textsuperscript{372} Section 9-503(a)(4) also purports to state the rule for individuals by stating if the debtor is an individual, the name of the individual is the key.\textsuperscript{373} What name of an individual is sufficient? The debtor’s legal name? Section 9-503 does not use the term “legal name” but simply requires the name of the individual.\textsuperscript{374} However, it must be noted that the Uniform Financing Statement form found in § 9-521 requires a “DEBTOR’S EXACT FULL NAME and ADDITIONAL DEBTOR’S EXACT FULL LEGAL NAME.”\textsuperscript{375} The only other section that deals with the debtor’s name is § 9-506, which deals with filed financing statements that contain minor errors.\textsuperscript{376} If a financing statement substantially satisfies the requirements, a financing statement that contains a minor error is adequate if the minor error does not make the financing statement seriously misleading.\textsuperscript{377} Section 9-503(b) provides that the use of a debtor’s name that does not comply with § 9-503(a) is seriously misleading unless a search under the debtor’s “correct name” would disclose a financing statement filed under a debtor’s name that does not comply with Section 9-503(a).\textsuperscript{378} Thus, the issue is whether the drafters intended “correct name” to mean the exact legal name.

If the legal name is required, what is the legal name of an individual, and how is it determined? Is it the name on a birth certificate, social security card, driver’s license, or a person’s passport? What about a married person who took

\begin{itemize}
\item \textsuperscript{371} See \textit{In re Spearing Tool and Mfg. Co.}, 412 F.3d 653 (6th Cir. 2005).
\item \textsuperscript{372} U.C.C. § 9-503(a)(4) (2001).
\item \textsuperscript{373} \textit{Id.}
\item \textsuperscript{374} \textit{Id.} § 9-503(a)(4)(A).
\item \textsuperscript{375} \textit{Id.} § 9-521.
\item \textsuperscript{376} \textit{Id.} § 9-506.
\item \textsuperscript{377} \textit{Id.} § 9-506(a).
\item \textsuperscript{378} \textit{Id.} § 9-506 (emphasis added).
\end{itemize}
the name of his or her spouse but never had a court order changing the name? Is the marriage certificate enough to show a new legal name? What about a correct surname but a nonlegal first name, such as a nickname? Can a person have more than one legal name? What about a trade name? As to the trade name, § 9-503(c) states: “A financing statement that provides only the debtor’s trade name does not sufficiently provide the name of the debtor.”

While the drafters did not explicitly say the legal name of an individual is required, the intent of the drafters with regard to “registered organizations” was to place the burden on the filing creditor to get the name of the debtor correct rather than putting the burden on the searching creditor to make multiple searches under various name possibilities. It is cloudy as to whether this policy was intended for individuals as well.

The correct name of the debtor, as indicated above, is important for the application of the minor error rule when the filed financing statement does not have the correct debtor’s name. Moreover, as indicated earlier, § 9-506 contains the so-called minor error rule. Again, it provides that a financing statement substantially complying with the requirements of the 9-500’s is effective “even if it has minor errors or omissions ‘unless those’ errors or omissions make the financing statement seriously misleading.” Except as provided in § 9-506(c), a financing statement containing an incorrect debtor’s name is seriously misleading. An incorrect debtor’s name is not seriously misleading under § 9-506(c) “if a search of the records of the filing office under the debtors’ correct name, using the filing office’s standard search logic,” if any, discloses the financing statement filed under the incorrect name. The key questions are: What is the debtor’s correct name, and what is the official search logic of the filing office?

As to the second question, many states’ filing offices are using exact match search logic. This means that a search under the correct name of an individual using the exact match logic will only produce a financing statement indexed under the identical name of the debtor. In effect, there is no minor error rule when exact match logic is used. If the correct name of the debtor is the

379. Id. § 9-503(c).
380. See id. § 9-503 cmt. 2.
381. U.C.C. § 9-506 (2001) The previous version was found in former U.C.C. § 9-408.
382. Id. § 9-506(a).
383. Id. § 9-506(b)-(c).
384. Id. § 9-506(c) (emphasis added).
385. See id.
debtor's legal name, financing statements filed under a non-legal name are misleading because an exact match search under the legal name would not find them. Some states, like Kansas, have promulgated regulations that define the search logic to be used.387 For example, § 7-17-22(a)(4) provides that “[p]unctuation marks, accents, and suffixes are disregarded.”388 “Words and abbreviations at the end of a name that indicate the existence or nature of an organization are disregarded.”389 Examples of words and abbreviations include association, company, corporation, incorporated, limited partnerships, LP, limited liability company, LLC, limited liability partnership, and LLP.390 “For middle names of individuals, initials are equated with all names that begin with these initials, and the absence of a middle name or initial is equated with all middle names or initials.”391

The Kansas bankruptcy courts, as well as state courts, have been struggling with the debtor’s name issue.392 The bankruptcy judge in In re Erwin,393 held that a UCC-1 filed under the name “Mike Erwin” rather than “Michael A. Erwin,” the debtor’s legal name, was not seriously misleading, notwithstanding the fact that a search under the legal name “Michael A. Erwin” using the official search logic requiring an exact match did not find the filing under “Mike Erwin.” The court had to decide what the debtor’s correct legal name was.394 The trustee argued that the correct name is the legal name, which was Michael A. Erwin.395 The bank argued that the correct name was Mike Erwin.396 At the outset of the discussion, the judge concluded that Revised Article 9 does not define the correct name for individuals as it does for registered organizations.397 He noted that Article 9 does not require that the individual name be the legal name, and the official form in § 9-521 does not require a legal name.398 Finally, until the legislature directs that the full name or the legal name of the debtor be provided, he “must give the term ‘name’ its common and ordinary meaning.”399 He points to

387. See id. 7-17-22.
388. See id. 7-17-22(a)(4).
389. Id. 7-17-22(a)(5).
390. Id.
391. Id. 7-17-22(a)(8).
393. Id. at *11.
394. Id. at *7.
395. Id.
396. Id.
397. Id. at *6.
398. Id. at *10.
399. Id. at *9.
the definition of name in Black's Law Dictionary as being very broad and including such things as nickname, full name, and trade name. The judge notes that Revised 9 § 9-503(c) specifically states that trade names are insufficient, and the use of a nickname as an individual debtor's first name on a financing statement is not insufficient as a matter of law.

Another Kansas bankruptcy judge in In re Kinderknecht concluded that nicknames are acceptable. The judge held that a financing statement that did not use the debtor's formal legal name but listed the debtor by his surname and a nickname rather than his legal first name was not "seriously misleading" and was sufficient to perfect a security interest. Again, the court noted that the name of the debtor was not restricted to the legal name of the debtor.

The Bankruptcy Panel of the Tenth Circuit reversed this decision in Clark v. Deere and Co. That court held that under Kansas law the financing statement must list the legal name of the individual, not a nickname. Clark would also seem to overrule the Erwin decision discussed above. It seems that there was no disagreement on the legal name of the debtor in Clark, but the question remains as to how creditors determine the legal name of the debtor.

From a planning standpoint, what should a creditor do? It seems appropriate to ask the prospective debtor to produce a social security card, a 1040 form, or a driver's license. If the names are all the same, it is easy. If there are differences, both names should be used. What about the prospective creditor? The same process should be followed and a search under one or multiple names can be done.

Certainty and predictability are important in commercial transactions. A rule should be fashioned that requires the name appearing on a social security card, passport, court order, or an I.R.S. 1040 must be used in a financing statement when the debtor is an individual. Some may be concerned about requiring a social security number to appear on the financing form. While identify theft is
a real issue these days, most credit checks are done by using a social security number, which means that most borrowers must have one. While some may argue that it is unconstitutional and bad policy to predicate loaning on the existence of a social security card, this may be a rational basis to deny that person credit if someone does not have a social security card or cannot get one.

Some debtor name errors are minor errors. Consider this hypo and the minor error rule of § 9-506(c) in Kansas. The debtor’s legal name is “ABC Co., Inc.” The filed financing statement lists the name of the debtor as “ABC Corp.” rather than “ABC Co., Inc.” A search under the legal name “ABC Co., Inc.” applying the exact match search logic would find any financing statement filed under the name ABC because the search logic ignores end name words like Corp., Co. and Inc. K.A.R. 7-17-22 (a)(1) (2001) provides that “[p]unctuation marks, accents, and suffixes are disregarded” and (a)(5) provides “[w]ords and abbreviations at the end of a name that indicate the existence or nature of an organization are disregarded.”406 In Kansas, the filed financing statement should be found. This set of facts is an illustration of a case that should be a minor error under § 9-506(a).401 Does this mean that the minor error rule can apply to situations where the debtor is a registered organization which § 9-503(a) declares must be a legal match?408

Can some of the debtor’s name problems be avoided by a broader official search logic? How difficult and expensive would it be to design a search logic that could cross reference or match with a debtor’s name and an address, tax identification number, or social security number? Today a prudent secured creditor loaning money to an individual should make every effort to determine what the legal name of the individual is and whether the debtor is using that name in business. Obviously, trade names are ineffective. If the individual normally uses a name different than one on a social security card or passport, the creditor should file under both names.

Likewise, the searching creditor must be vigilant with regard to names. And, if it learns of multiple names, the search must be done under all names. Clearly, computer searches can be designed to find nicknames as well as legal names. However, who is to pay for the search and the paper that is produced by a broad search?

408. Id. §§ 9-503(a), 9-506(c).