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Insolvencies in Farming and Agribusiness

by

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Insolvencies in Farming and Agribusinesses

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INTRODUCTION

Gross income from farming and farm-related businesses totaled $162.2 billion in 1982,[1] approximately 22% of the year's Gross National Product.[2] Nevertheless, the farm economy finds itself in a prolonged and severe recession.[3] The United States produces more crops than can be consumed in the domestic market.[4] One-third of the nation's farm acreage is used to grow crops for export.[5] However, agricultural exports have been affected by aggressive export programs undertaken in the early

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[1] STATISTICAL ABSTRACT OF THE UNITED STATES 1984 U.S. DEP'T OF COMMERCE 449 (1982 is the most recent year for which statistics were available).

[2] *Id.* at 449 (GNP for 1982 was $3,073 billion).

[3] Wall Street Journal, Nov. 9, 1984, at 1, col. 6.

[4] S. REP. No. 699, 95th Cong., 2d Sess. 4, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 696, 699; S. REP. No. 1142, 95th Cong., 2d Sess. 3-5, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 3664, 3666-68.

[5] The Courier Journal, Oct. 7, 1984 at E3, col. 1 (1/3 of the nation's farm acreage used to grow crops that are exported).

1980's by Australia, Canada and debt-laden developing countries like Argentina and Brazil.[6]

The farmer's philosophy in the 1970's was growth and more growth. During this period farm land prices soared, resulting in an unprecedented buying binge of agricultural land and equipment, creating a "mountain of debt" nearly equal to one quarter the total debt of all developing nations.[7] Today the American farmer is confronted with overwhelming debt, faced with historically low prices for farm commodities and struggling with depressed land values. A legion of factors, many beyond the control of the farmer, have contributed to the agricultural recession which began in 1980. Those factors include liberal lending practices from 1975 through 1981, high interest rates (21.5% in 1980), borrowing based upon appreciated farm land values rather than upon the farmer's ability to generate sufficient income, increased competition in the world market, the grain embargo of 1980, severe drought in the crop year 1983, depressed farm commodity prices in 1984 and the dramatic increase in the cost of fuel, fertilizer, chemicals and equipment.

Government programs, such as the payment-in-kind (PIK) and the crop diversion program of 1983 which provided generous payments to farmers for idling productive land, did not produce the long-term solutions envisioned by their sponsors.[8] Conversely, these benefits received by the farmer created additional financial stress on farm-dependent businesses.

Factory output of farm equipment and implements fell to 42% of 1979 levels.[9] The depressed equipment market can be attributed to the reduced number of individual farming operations, economies of scale, the inability of farmers to finance equipment and the large market of used equipment. The effect on farm manufacturing is also evidenced by the decline in farm equipment dealerships.[10]

Many farmers are part of marketing and supply agricultural cooperative associations which, along with their members, are

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[6] Wall Street Journal, *supra* note 3, at 1.

[7] *Id.*

[8] *Id.*

[9] *Id.* at 18.

[10] *Id.* (In the past five years there has been a 21% decline in farm equipment dealerships.).

also experiencing the financially distressed times of the 1980's.[11] The farm co-ops suffer losses at the same rate as their members, in many instances resulting in mergers, takeovers and bankruptcy.

The ravages of the farm recession are evidenced by closed farm equipment dealerships, auction sales of farms and shuttered elevators. This Article will not treat the complex socio-economic ramifications of farm problems, but will discuss the legal consequences and responses that are available both to the farm lender and to the farmer confronted with insolvency problems.

I. "WORKOUTS" AND OTHER PRE-BANKRUPTCY RELIEF

A farmer faced with overwhelming debt can solve his problem either by negotiating an out-of-court settlement or "workout," or by seeking relief under federal or state insolvency laws. However, it is common for a farmer in financial difficulty to ignore the problem. Farmers are accustomed to "feast and famine" years. Many tend to sit on their obligations, hoping nature will provide the solution. Unfortunately for the financially overburdened farmer, his creditors seldom are optimistic and patient concerning the farmer's financial situation. The earlier the farmer recognizes and reacts to his financial difficulties by taking affirmative steps to seek solutions, the more likely his chances will be of resolving his financial problems. The least expensive, most expeditious and most flexible method of relief is the negotiated, out-of-court settlement or "workout." This form of financial settlement has the advantage of not being saddled with the rigid procedures and rules encountered in the courtroom. Because of this flexibility, the parties are given an opportunity to develop a realistic repayment schedule. The workout avoids financial disaster for the farmer and allows creditors to ultimately recover on their claims with minimum expenses.

Although experienced insolvency attorneys can greatly assist in these workout negotiations, legal counsel is not required. Counsel used in the settlement process should provide technical expertise, not create counterproductive adversarial confrontations.

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[11] *Id.*

The success of any negotiation depends on a sincere desire by all parties involved to find a workable solution. All sides must recognize the need to make concessions. Even a sincere effort on everyone's part will not necessarily result in a successful workout when the farmer comes to the table too late and with too little to offer. Once all parties recognize that a negotiated workout would be mutually beneficial, then it is essential that the workout become effective without delay.

Financial workouts can take many forms, each being structured to meet the individual requirements and abilities of the farmer and his creditors. However, out-of-court financial workouts usually will include some of the following: forbearance by the creditor for a specified period of time, during which payments are either interest-only payments or principal-only installments; partial liquidation of assets; reamortized, lowered payments with a final "balloon" payment at a later date; extension of payments; "sale-leasebacks" giving a deed in lieu of foreclosure, with the right to lease back the farm assets for a specified period of time and with or without an option to repurchase at a later specified date; orderly liquidation of all assets to avoid distress sales under court order; abandoning collateral to the creditor in exchange for forgiving any subsequent deficiency; repayment plans with defined defaults that obligate the debtor and/or the creditors to liquidate all of the farm assets according to an agreed upon schedule and method; and temporary creditor forbearance to allow the farmer-debtor to refinance with third parties.

As noted, many workouts can be accomplished directly between the debtor and his creditors without the assistance of counsel. In many cases attorneys are used only to draft the necessary documents after an agreement has been reached. A major obstacle to this type of settlement is that it requires unanimous creditor consent. One large recalcitrant creditor will usually prevent an out-of-court restructuring of the debtor's financial affairs.

Another nonbankruptcy remedy is a voluntary assignment for the benefit of creditors.[12] Generally, the debtor assigns, in

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[12] KY. REV. STAT. ANN. § 378.060 (Bobbs-Merrill 1984) [hereinafter cited as KRS].

writing, all of his nonexempt assets for sale and distribution by the assignee-creditor.

In the event that the farmer-debtor has successfully negotiated a repayment schedule with a majority of his creditors, but has been unable to reach an agreement with some creditors, the debtor can utilize bankruptcy to obtain ratification of a plan of repayment and force an uncooperative creditor or creditors to participate in the reorganization. In the absence of bankruptcy, a creditor has the power to defeat the financial workout. Of course, this type of tactic can only be used when the debtor has sufficient time to successfully negotiate with a majority of his creditors and reduce such negotiations to a written plan. An immediate foreclosure sale or sale of repossessed collateral precludes the formation of a prefiling committee and the preparation of a plan and disclosure statement. Absent a crisis, such as the immediate sale of property under a judgment of foreclosure, the debtor should prepare for bankruptcy by drafting a prepetition plan.

Forming and organizing the unsecured creditors' committee prior to the filing of a petition is an effective device for maintaining control of the reorganization process after the case is filed. The Bankruptcy Code (Code)[13] and its rules permit the prepetition unsecured creditors' committee to serve after commencement if its members are fairly chosen and are representative of each kind of claim.[14] Although the Code does not specify a procedure to obtain court approval of the committee, an application filed with the court by the committee setting forth compliance with all the requisite requirements should be sufficient to have the prefiling committee appointed as the official committee.

In addition to the formation of the committee, the debtor, with the assistance of supportive creditors, is permitted to solicit acceptances of the plan of reorganization prior to the actual commencement of the case. If it receives adequate information within the meaning of either nonbankruptcy law or the Code, a claimant who either accepts or rejects the plan prior to com-

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[13] 11 U.S.C.A. §§ 101, *et seq.* (1979).

[14] 11 U.S.C.A. § 1102(b)(1) (Supp. 1985); BANKR. RULE 2007(b).

mencement of the case will be deemed to have accepted or rejected the plan as filed with the court.[15]

The advantage to the debtor, as well as to his supportive creditors, in preparing a plan prior to commencement and obtaining acceptances is that the reorganization process can be expedited and the uncertainties as to confirmation significantly reduced. At the confirmation hearing the debtor can force the uncooperative creditor(s) to participate in the reorganization.[16]

Early acknowledgement of financial difficulty and willingness to realistically deal with the problem will greatly enhance the possibilities of a successful restructuring of the farmer's financial affairs. He can either pursue a negotiated out-of-court settlement or use Chapter 11 or 13 to force recalcitrant creditors to accept a workout.

II. BANKRUPTCY RELIEF

Farmers, like other individuals or business entities which find themselves with unmanageable debts, will attempt to avoid bankruptcy whenever possible. However, their abhorrence of the bankruptcy stigma and the public acknowledgement of financial difficulties are overcome by a need to protect their assets and to continue farming. After all other efforts have failed, a farmer who is unable to satisfy his obligations as they mature, who lacks sufficient equity to incur additional debt and who is persistently confronted by creditors, is left with little choice but to seek the protection of bankruptcy.

A farmer can elect to file bankruptcy under Chapter 7, Chapter 13 or Chapter 11 of Title 11 of the United States Code. In Chapter 7 bankruptcy[17] the farmer's nonexempt assets are liquidated and the proceeds resulting from the liquidation are distributed to creditors. In a Chapter 13[18] and Chapter 11,[19] the debtor's financial affairs are reorganized. Whichever chapter the farmer files bankruptcy under, all property of the farmer, including all legal and equitable interests, wherever located and by

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[15] *See* 11 U.S.C.A. §§ 1125(a)(1), 1126 (Supp. 1985).
[16] 11 U.S.C.A. § 1129(b)(1) (1978).
[17] 11 U.S.C.A. § 701-766 (1979).
[18] 11 U.S.C.A. § 1301-1330 *et seq.* (1979).
[19] 11 U.S.C.A. § 1101-1174 (1979).

whomever held, must be turned over to the trustee once the bankruptcy proceeding has been commenced. The property of the estate is vested in the trustee in trust for the creditors. In a Chapter 7[20] and Chapter 13,[21] a trustee is apppointed during the initial stages of the bankruptcy proceeding. However, in a Chapter 11,[22] the court appoints a trustee only for cause. The debtor serves as a debtor-in-possession, with the same general powers of the trustee.[23]

For purposes of the bankruptcy laws, a "farmer" is a person[24] who receives more than 80% of his gross income during a taxable year from a farming operation[25] which he owns or operates.[26] The farmer can own *or* operate the farming operation. For instance, a disabled debtor who hires others to *operate* the farm while he keeps the farm books and manages the farm, has farmer status.[27] It also includes a corporation which, during a taxable year preceding the filing of the bankruptcy petition, derives its entire gross income from processing, packaging and marketing a farm product.[28]

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[20] 11 U.S.C.A. § 701 (1979).

[21] 11 U.S.C.A. § 1302 (1979).

[22] 11 U.S.C.A. § 1104 (1979).

[23] 11 U.S.C.A. § 1107 (1979).

[24] A "person" includes a corporation, partnership and other business entities and governmental loan agencies. 11 U.S.C.A. § 101(30) (1979). *See also In re* Estate of Joseph L. Brown, 16 Bankr. 128 (Bankr. D.C. 1981) ("Person" does not include a probate estate).

[25] A "farming operation" is defined to include "tillage of the soil, dairy farming, ranching, production or raising of crops, poultry or livestock, and production of poultry or livestock products in an unmanufactured state." 11 U.S.C.A. § 101(18) (1979).

[26] 11 U.S.C.A. § 101(17) (1979). *See also In re* Johnson, 13 Bankr. 342, 346 (Bankr. D. Minn. 1981) (farmer-debtor must raise the defense of farmer before the order for relief is granted or be precluded from asserting the status subsequent to the entry of an order and debtor's status was not a jurisdictionsl defect). *But see* American Fire & Casualty Co. v. Finn, 341 U.S. 6 (1951); Louisville & N.R.R. v. Mottley, 211 U.S. 149 (1908); FED. R. CIV. P. 12(h)(2) (Subject-matter jurisdiction can be raised as an issue at any time by the parties or the court. "Farmer" status is not a question of personal jurisdiction, capable of being waived as a defense, and consequently, the debtor should be able to assert the status of farmer at any time during the case.).

There are bills currently before the legislature which may change the definition of a farmer to one who has over 80 percent of his debt arising out of a farming operation (rather than tied to amount of income), see H.R. 2211, 99th Cong., 1st Sess. (1985) or to one who earns 75 percent of his income from farming. H.R. 1397, 99th Cong., 1st Sess. (1985).

[27] *In re* Lipe, 36 Bankr. 597 (Bankr. W.D. Mo. 1983).

[28] *See In re* Blanton Smith Corp., 7 Bankr. 410, 413 (Bankr. M.D. Tenn. 1980).

The importance of establishing the status of being a farmer is that the Code provides special protection to the farmer. The laws of insolvency favor farmers due to the unique and uncertain nature of their business. Congress has extended protection to farmers due to the recognition that "one drought year or one year of low prices, as a result of which a farmer is temporarily unable to pay his creditors,"[29] should not submit the farmer to financial disaster.

One of the protections provided to a farmer is that a farmer cannot be involuntarily forced into bankruptcy.[30] This protection permits the farmer to determine *when* the petition will be filed. Choosing the date of commencement of the petition is important because it gives the farmer the opportunity to pre-plan his bankruptcy, form the unsecured creditors' committee, prepare and solicit acceptances of a pre-commencement plan of reorganization, and/or negotiate post-petition financing while avoiding any problems resulting from preferential payments[31] and the uncertainties of bankruptcy.

Another protection granted to farmers is the preclusion of creditors from involuntarily converting the bankruptcy to another form of bankruptcy. While a farmer-debtor may voluntarily convert a Chapter 13 bankruptcy to a case under Chapter 7,[32] or a Chapter 11 bankruptcy to a Chapter 7 or Chapter 13,[33] neither the court nor any creditor may involuntarily convert a farmer's Chapter 13 bankruptcy into a Chapter 7 or 11 bankruptcy,[34] or a farmer's Chapter 11 bankruptcy into a Chapter 7 bankruptcy.[35] Any waiver of the right to convert by the farmer is unenforceable; the farmer must request the conversion.[36]

Another special protection afforded debtors, including farmers, involves exempt property. Certain property of the farmer may be exempt from process once a farmer files a bankruptcy petition. Property is defined as exempt either under the Bankruptcy Code or under state statute. In 1980, Kentucky elected

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[29] H.R. REP. No. 595, 95th Cong., 1st Sess. 116, 322 (1977).
[30] 11 U.S.C.A. § 303(a) (1979).
[31] *See* 11 U.S.C.A. § 547 (1979).
[32] 11 U.S.C.A. § 1307 (1979).
[33] 11 U.S.C.A. § 1112 (1979).
[34] 11 U.S.C.A. § 1307(e) (1979).
[35] 11 U.S.C.A. § 1112(c) (1979).
[36] *Id.*

to "opt out" of the federal exemption statute and specified the property to be exempted upon the commencement of a bankruptcy proceeding.[37] In addition to the $3,000 household furnishing exemption, $2,500 automobile exemption,[38] $1,000 general exemption,[39] and $5,000 homestead exemption,[40] the farmer obtains a $3,000 exemption on all tools, equipment, and livestock, including poultry.[41] As with all other debtors, the farmer receives an exemption on part of his disposable earnings depending on his circumstances,[42] but said exemption does not include growing crops for the payment of debt.[43]

Exemptions on property do not automatically make valid liens on exempt property unenforceable.[44] However, the Bankruptcy Code provides the trustee with the authority to avoid certain types of liens on exempt property, making the liens unenforceable.[45] These liens include judicial liens and liens on nonpossessory, nonpurchase-money security interests in household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments or jewelry that are held primarly for *personal, family or household use*, and implements, professional books or *tools of the trade of the debtor*.[46] Since farmers usually give security interests in their farm equipment when borrowing money, the right to avoid liens on tools of the trade is of special significance to farmers. The determination of whether particular tools are "tools of the trade" depends on the factual situation and the nexus between the trade and the tools.

The question then becomes, what is the effect of the trustee's avoiding powers on liens on exempt property, when a state like Kentucky "opts out" of the federal exemption statutes and enacts its own exemptions? Commentators concur that when a

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[37] KRS Chapter 427. (Bobbs-Merrill Supp. 1984).

[38] KRS § 427.010.

[39] KRS § 427.160.

[40] KRS § 427.060.

[41] KRS § 427.010.

[42] KRS § 427.010(2).

[43] *In re* Markline, 16 Bankr. 729 (Bankr. W.D. Ky. 1982).

[44] *See* 3 COLLIER ON BANKRUPTCY ¶ 522.27 (15th ed. 1985) [hereinafter cited as COLLIER].

[45] 11 U.S.C.A. § 522(f) (1979).

[46] *Id.*

state "opts out" of the federal exemption scheme, the trustee's avoiding powers still apply, "but only to property that is exempt under state law that is of the same kind as the property allowed" under the Bankruptcy Code.[47] However, the Fifth and Sixth Circuit Courts limit the avoiding powers of the trustee further to the property which is similar to that allowed under the Code *and* which the state has specified is exempt.[48]

In 1982, the Kentucky legislature enacted section 4 of the personal property exemption statute, Ky. Rev. Stat. § 427.010, which provides:

> (4) Notwithstanding any other provision of law, no property upon which a debtor has voluntarily granted a lien shall, to the extent of the balance due on the debt secured thereby, be subject to the provisions of this chapter or be exempt from forced sale under process of law.

Section 4 further complicates the effect of the trustee's avoiding powers on state exemption statutes. The Eastern and Western Divisions of Kentucky's Bankruptcy Court have interpreted this section differently. The Western District has interpreted this section as nullifying the trustee's powers to avoid liens on non-possessory, nonpurchase-money security interests in personal items and as providing the states with unlimited control of the exemptions provided to debtors. The court also determined that this section is not violative of the Supremacy Clause of the United States Constitution.[49] The Eastern District, on the other hand, has found section 4 colliding directly with the lien avoidance provision of the Bankruptcy Code and as such, is unenforceable under the Supremacy Clause of the United States Constitution.[50]

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[47] 3 *Collier*, *supra* note 44, at ¶ 522.29.

[48] *In re* McManus, 681 F.2d 353 (5th Cir. 1982); *In re* Pine, 717 F.2d 281 (6th Cir. 1983), *cert. denied*, 104 S. Ct. 1711 (1984).

[49] *In re* Bennett, 36 Bankr. 893 (Bankr. W.D. Ky. 1984); *In re* Roehrig, 36 Bankr. 505 (Bankr. W.D. Ky. 1983) (following *In re* Pine, 717 F.2d 281); *In re* Wells, No. 3-82-01881 (Bankr. W.D. Ky. 1983) (unpublished).

[50] *In re* Lawson, 42 Bankr. 206 (Bankr. E.D. Ky. 1984).

The case was appealed to the U.S. District Court. As this article was going to press, the court rendered an order which reversed the Bankruptcy Code and upheld the validity of the statute. *See* Credithrift of America v. Lawson, Civil Action No. 84-68, *order* Aug. 9, 1985. The court expressly agreed with the Western District Bankruptcy Court's decision in In re Roehrig, 36 B.R. 505, *see* No. 84-68, slip op. at 1, and concluded that Sixth Circuit precedent controlled determination of the issue. *See* No. 84-68, slip op. at 1-2 (citing In re Pine, 717 F.2d 281 (6th Cir. 1983) and In re Spears, 744 F.2d 1225 (6th Cir. 1984)). The U.S. District Court's order is currently on appeal to the United States Sixth Circuit Court of Appeals.

Thus it would appear that a lien on a nonpossessory, nonpurchase-money security interest on an otherwise exempt item could be avoided in the Eastern District, but could not be avoided in the Western District. On appeal, the Sixth Circuit would affirm the Western District's decision.

All property of the debtor, including all legal and equitable interests, wherever located and by whomever held, must be turned over to the trustee once the bankruptcy proceeding has been commenced. In a farm reorganization, generally the property of the debtor may be used, sold or leased by the trustee in the ordinary course of business. Included within this property of the debtor which the trustee may use is what is commonly referred to as "cash collateral." Cash collateral is collateral in the form of cash, negotiable instruments, securities, deposit accounts and other cash equivalent.[51] The trustee can use the cash collateral only if (1) the party with a security interest consents or (2) upon notice, after a hearing and providing the creditor with adequate protection, the court enters an order authorizing the use of the cash collateral.[52] While this protection afforded to the creditor requiring its consent or a court order is offered in recognition of the unique character of cash collateral and the risk to the creditor from the consumption of the collateral in a reorganizational effort in bankruptcy, courts have recognized the equally demanding need of debtors to use cash collateral in the reorganizational process. If the creditor does not consent to the use of the cash collateral, the court shall hold a hearing "in accordance with the needs of the debtor."[53] Some circumstances, such as the imminent need to acquire financing of crops for the upcoming seasons, could warrant seventy-two hour notice of a hearing on the use of cash collateral in obtaining financing.[54]

Adequate protection must be provided to the non-consenting creditor before the court authorizes use of the cash collateral.[55] As a practical matter, adequate protection can be just about anything the parties agree upon. It can take various forms,

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[51] 11 U.S.C.A. § 363(a) (1979).
[52] 11 U.S.C.A. § 363 (1979).
[53] 11 U.S.C.A. § 363(c)(3) (1979).
[54] *In re* Sheehan, 38 Bankr. 859 (Bankr. D. S.D. 1984).
[55] 11 U.S.C.A. § 361 (1979).

including periodic cash payments,[56] providing additional or replacement liens,[57] the granting of an "undubitable equivalent" or granting such relief that will allow the creditor to realize the value of its interest.[58]

The creditor can voluntarily consent to the use of cash collateral. The creditor's consent will greatly aid in the financing of the reorganization. A farmer can obtain the consent of a creditor, such as the local Production Credit Association, to use the collateral to finance the reorganization or to purchase items which will produce proceeds that will provide the creditor with the realization of its security interest.

Transfers of property by the debtor within ninety days prior to the petition may be avoided by the trustee, as a "preferential transfer."[59] Preferences can be avoided if they are: "(1) to or for the benefit of a creditor; (2) for or on account of [the debtor's] antecedent debt. . .; (3) made while the debtor was insolvent; (4) made on or within 90 days before the date of the filing of the petition;" or within one year of the petition's filing if the creditor "was an insider; and had reasonable cause to believe the debtor was insolvent at the time of the transfer;" and (5) such transfer enabled the creditor to receive more than if the case were a Chapter 7 bankruptcy.[60] Some preferential transfers demonstrate good business practice because they enable the debtor to maintain his business at that point in time. Moreover, if the debtor files a Chapter 11 proceeding and becomes a debtor-in-possession, the debtor-in-possession is not as pressed to recover a preferential transfer as is a Chapter 7 trustee.[61]

However, not all preferential transfers are avoidable. For example, inventory "includ[es] farm products such as crops or livestock held for sale or lease."[62] A transfer of a perfected security interest in *inventory* (farm products) or proceeds cannot be avoided except when the amount transferred exceeds the value

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[56] 11 U.S.C.A. § 361(1) (1979).

[57] 11 U.S.C.A. § 361(2) (1979).

[58] 11 U.S.C.A. § 361(3) (1979).

[59] 11 U.S.C.A. § 547 (1979).

[60] 11 U.S.C.A. § 547(b) (1979). "Insiders" include relatives, general partners, persons in control of debtor, corporate directors, etc. 11 U.S.C.A. § 101(25) (Supp. 1985).

[61] *In re* One Marketing Co., 17 Bankr. 738 (Bankr. S.D. Tex. 1982).

[62] 11 U.S.C.A. § 547(a)(1) (1979).

of the secured interest and the creditor's position is improved.[63] Improvement in position does not automatically determine that the preferential transfer will be avoided.[64] For example, where the collateral was the farmer's livestock, and the livestock naturally increased, the creditor's position was improved, but such did not constitute a claim of preference.[65]

Preferential transfer problems can be litigated, but can also be dealt with in the disclosure statement and reorganization plan.[66] In any event, the court must find, either through litigation or agreement of the parties, that a transfer was preferential before adjustments in the distribution of the property of the estate occurs.

Reclamation rights of farmers also limit trustee avoiding powers.[67] This is important for a farmer who stores grain in a grain elevator which shortly thereafter enters bankruptcy.[68] The Bankruptcy Amendments and Federal Judgeship Act of 1984 ('84 Act)[69] preserves common law or statutory rights to reclaim if written demand is made within ten days after receipt of the goods.[70] At least one Kentucky case had reached that conclusion prior to the '84 Act.[71] As an alternative to reclamation, the court may grant a lien subordinate to any prior perfected security interest in the property.[72]

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[63] 11 U.S.C.A. § 547(c)(5) (1979); 4 COLLIER, *supra* note 44, at ¶ 547.41.

[64] *See In re* Fairchild, 31 Bankr. 789, 794 (Bankr. S.D. Ohio 1983). *Cf.* Clark, *Preferences Under the Old and New Bankruptcy Acts*, 12 U.C.C. L.J. 154, 180 (1979); Looney, *Bankruptcy Reform Act of 1978: A Survey of Applicable Provisions*, 25 S.D.L. REV. 509, 522-23 (1980). These Articles discuss the issue of growing livestock or crops. Although not resolved by all courts, the two authors conclude that such a fact pattern should not penalize the secured lender by creating a voidable preference.

[65] *In re* Fairchild, 31 Bankr. 789, 794 (Bankr. S.D. Ohio 1983).

[66] *In re* One Marketing Co., 17 Bankr. at 739 ("Chapter 11 debtor in possession is not as pressed to recover preferential transfers as is a Chapter 7 trustee" because preferential transfer problems could be dealt with in the disclosure statement and reorganization plan).

[67] *See* 11 U.S.C.A. § 546(c) (1979).

[68] *See* notes 393-95 *infra* and accompanying text.

[69] 11 U.S.C.A. § 546 (Supp. 1985) (effective Oct. 8, 1984).

[70] *See* 11 U.S.C.A. § 546(d) (1984) (effective Oct. 8, 1984).

[71] *See In re* Wathen's Elevators, Inc., 32 Bankr. 912, 921-22 (Bankr. W.D. Ky. 1983) (unpaid sellers of grain to bankrupt elevator may make reclamation demand in writing within 10 days of receipt).

[72] 11 U.S.C.A. § 546(c)(2)(B) (1979).

Property acquired postpetition generally is not subject to any lien granted prepetition.[73] This includes crops planted after commencement of the case.[74] While there is an exception for proceeds of prepetition collateral, it does not include "after-acquired property, other than proceeds, product, offspring, rents and profits, that would otherwise be collateral under the security agreement."[75] In particular, certain PIK payments will be unencumbered unless the prepetition security agreement covers general intangibles.[76]

In a Chapter 7 proceeding, the property of the estate is liquidated and distributed to the creditors in order of priority. In Chapters 11 and 13, the property is distributed in accordance with a confirmed plan.[77] With certain exceptions, the plans are similar in content.[78]

Chapters 11 and 13 both require that the court confirm a plan if the plan has been proposed in good faith and not by any means forbidden by law.[79] Good faith has not been defined by the Code. However, the references to good faith in the Code and the cases which interpret the term "disclose a common theme and objective: avoidance of the consequence of economic dismemberment and liquidation, and the preservation of ongoing values in a manner which does equity and is fair to the rights and interests of the parties affected."[80] For example, a farmer is not allowed to use the special provisions of the Bankruptcy Code for a purpose not intended by Congress;[81] or for an ulterior

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[73] 11 U.S.C.A. § 552 (1979 & Supp. 1985).

[74] *See In re* Hamilton, 18 Bankr. 868, 871 (Bankr. D. Colo. 1982) ("§ 552 applies only to crops which were in existence at the time of the filing of the Petition").

[75] 4 COLLIER, *supra* note 44, at ¶ 552.02. 11 U.S.C.A. § 552(b) (1979) creates the exception.

[76] *See In re* Kruse, 35 Bankr. 958, 966 (Bankr. D. Kan. 1983) (PIK contract with government in exchange for promise not to grow crops held not proceeds since the asset stems from no collateral).

[77] 11 U.S.C.A. §§ 1123, 1322 (1979 & Supp. 1985).

[78] A Chapter 13 plan cannot exceed three years, unless the court approves a longer period. However, the court may not approve a plan that extends beyond five years. Secured claims may be paid outside of the plan. 11 U.S.C.A. § 1322(c) (1979). Proposed H.R. 2211, 99th Cong., 1st Sess. (1985) (to extend the payment period to seven years).

[79] 11 U.S.C.A. §§ 1129(a)(3), 1325(a)(3) (1979 & Supp. 1985).

[80] *In re* Victory Construction Co., 9 Bankr. 549, 558 (Bankr. C.D. Cal. 1981), *vacated and remanded as moot*, 37 Bankr. 222, 229 (9th Cir. 1984).

[81] *See In re* Fullagar, 8 F. Supp. 602, 603 (W.D.N.Y. 1934) (transfer of property for the purpose of benefitting under bankruptcy law).

purpose;[82] or to accomplish delay while waiting for an upturn of the market;[83] or to defraud a wife;[84] or to permit milking of the assets.[85]

In defining "good faith," some courts have held that the debtor's best efforts are important.[86] One court has held that the "best efforts" test traditionally has been a stricter standard than good faith,[87] and that in Chapter 13 cases, best efforts is part of the broader duty of good faith and is required only as to the level of payments proposed.[88] The Bankruptcy Amendments and the Federal Judgeship Act of 1984[89] combined the best efforts and good faith tests. When all of the debtor's projected disposable income in the three-year period is included in the plan, the debtor's plan can be confirmed over objections by either the trustee or an allowed unsecured creditor.[90] Disposable income is income in excess of reasonable living expenses of the debtor and his dependants or, if the debtor is a business, income in excess of the necessary expenses for the operation and continuation of that business.[91] For example, a zero payment plan could be confirmed if all of the projected disposable income was included in the plan. This is extremely advantageous to the farmer whose regular income is generally projected regular income. A plan will be considered acceptable if based upon best efforts projections made in good faith.[92]

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[82] *See In re* Paul, 13 F. Supp. 645, 647 (S.D. Iowa 1936) (showing intent to take advantage of the law).

[83] *See In re* Cresap, 99 F.2d 722, 726 (7th Cir. 1938) (restraining orders obtained by debtor to delay mortgage foreclosure); *In re* Noble, 19 F. Supp. 504, 504-05 (D.N.J. 1937) (debtors who hoped for profit in real estate rather than income from farming found not to be farmers); *In re* Brewster, 20 F. Supp. 789, 792-95 (W.D. La. 1937) (debtor's proposal to pay debt dismissed because small farming income indicates lack of good faith).

[84] *See In re* Brown, 21 F. Supp. 935, 939 (S.D. Iowa 1938) (proceeding dismissed since no purpose could be found but to deny wife property she was awarded during divorce).

[85] *See In re* Olson, 21 F. Supp. 504, 508 (N.D. Iowa 1937) (debtor maximizing profit by neglecting farm).

[86] *See, e.g., In re* Schongalla, 4 Bankr. 360 (Bankr. D. Md. 1980).

[87] *See In re* Heard, 6 Bankr. 876, 883-84 (Bankr. W.D. Ky. 1980) (debtor's proposal to pay debts was found to be best efforts but still fell short of good faith).

[88] *See id.* at 884.

[89] 11 U.S.C.A. § 1325(b) (Supp. 1985).

[90] 11 U.S.C.A. § 1325(b)(1)(B) (Supp. 1985).

[91] 11 U.S.C.A. § 1325(b)(2) (Supp. 1985).

[92] 11 U.S.C.A. § 1325(a)(3) (Supp. 1985).

In both reorganization chapters, the debtor may modify the plan anytime before confirmation, provided the modified plan meets the requirements of the chapter and there is a meaningful change in the debtor's financial condition.[93] At any time after confirmation, the plan may be modified, but court approval of the modification may be granted only after notice and a hearing.[94] The plan may be modified to

> increase or reduce the amount of payments [of] . . . a particular class provided for by the plan; extend or reduce the time for such payments; or . . . [reallocate] the distribution to a creditor whose claim is provided for by the plan, to the extent necessary to take account of any . . . such claim[s] other than under the plan.[95]

A. Chapter 13

To be eligible for Chapter 13 bankruptcy, the farmer-debtor must be (1) an individual (not a corporation or partnership) with (2) regular income and (3) unsecured debts totaling less than $100,000 and secured debts amounting to less than $350,000.[96] Because of extensive leveraging, few farmers qualify for Chapter 13. While a Chapter 13 bankruptcy is limited to individuals, corporate debts guaranteed by the farmer may be included in the bankruptcy.[97]

The purpose of the "regular income" requirement is to insure the debtor will be able to make the payments under the plan.[98] Regular income does not necessarily require weekly or monthly income.[99] Many farmers can show regular income even if the income is derived from annual crop production. Knowing the speculative nature of farming and the farmer's uncertainty

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[93] *In re* Beasley, 34 Bankr. 51 (Bankr. S.D.N.Y. 1983) (no modification allowed when several unsecured creditors failed to file claims); 11 U.S.C.A. § 1127 (1979 & Supp. 1985); 11 U.S.C.A. § 1323 (1979).

[94] 11 U.S.C.A. § 1127(b) (Supp. 1985).

[95] 11 U.S.C.A. § 1329(a) (Supp. 1985).

[96] 11 U.S.C.A. § 109(e) (1979). H.R. 2211, 99th Cong., 1st Sess. (1985), proposes the debt ceiling for Chapter 13 debtor/farmers to be raised to total for secured and unsecured debts of $1 million.

[97] *See* Associates Commercial Corp. v. Stevenson, 28 Bankr. 39 (Bankr. S.D. Miss. 1983).

[98] 11 U.S.C.A. § 101(27) (Supp. 1985).

[99] 11 U.S.C.A. § 101(27) (Supp. 1985).

as to future personal income, Congress intended the bankruptcy courts to interpret the regular income requirement liberally.[100]

In a Chapter 13 bankruptcy, the automatic stay is effective against collection from co-debtors of consumer debts.[101] This is designed to insulate the debtor from indirect pressure by creditors through friends or relatives who may have co-signed for the debt.[102] This does not prevent the creditor from using favorable contract terms or collecting from the co-debtor. The creditor retains the right to collect all payments from the co-debtor to the extent they are not made by the debtor when due pursuant to the plan.[103]

If the debtor's plan does not propose to pay the claim, the creditor may file a motion for relief of the stay against the co-debtor.[104] The stay will be automatically lifted unless the debtor or co-debtor files a written objection within twenty days.[105] The lifting of the stay enables the creditor to proceed in the collection of the debt and protects the creditor from both reduction in value and delay in receipt of the secured interest.[106] This provision benefits the farmer-debtor and the creditor, but it is extremely detrimental to the co-debtor.

The automatic stay that protects a co-debtor applies to consumer debts[107] and to primarily personal, family or household debts,[108] making the stay virtually inapplicable to farmers. The co-debtor of non-consumer debts (for example, debts for equipment, livestock, and feed) would not be protected by the automatic stay, and the creditor could collect the secured interests against the co-debtor whenever he desires to do so.

In a Chapter 13 case, only the debtor may file a plan.[109] The plan may be filed with the Chapter 13 petition or within fifteen

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[100] *In re* Hines, 7 Bankr. 415, 417 (Bankr. D.S.D. 1980) (farmer qualifies as individual with regular income).

[101] 11 U.S.C.A. § 1301(a) (1979).

[102] H.R. REP. No. 595, *supra* note 29, at 121-23.

[103] S. REP. No. 989, 95th Cong., 2d Sess. 138 (1978).

[104] *See* 11 U.S.C.A. § 1301(d) (Supp. 1985). If the debtor's plan proposes to pay the creditor in full, a mere failure to make timely payments will not terminate the automatic stay. *See* Harris v. Fort Oglethorpe State Bank, 721 F.2d 1052, 1054 (6th Cir. 1983).

[105] 11 U.S.C. § 1301(d) (Supp. 1985).

[106] 721 F.2d at 1054.

[107] 11 U.S.C.A. § 1301(a) (1979).

[108] 11 U.S.C.A. § 101(7) (1979).

[109] 11 U.S.C.A. § 1321 (1979).

days after filing the petition.[110] Payments under the plan must commence within thirty days after filing the plan.[111] Failure to make timely payments is grounds for dismissal.[112] A Chapter 13 plan must include provisions for enough of the debtor's future income to be paid to the trustee to make the plan feasible,[113] provide for full payment of all priority claims (unless the holder of a particular claim agrees to a different treatment),[114] and treat equally all claims within the same class.[115]

A Chapter 13 plan may: (1) classify unsecured claims; (2) modify the rights of a holder of an unsecured claim or of a secured claim other than a claim secured by the debtor's principal residence; (3) provide for curing or waiving any default; (4) provide for concurrent payments on any unsecured claim with any secured or other unsecured claim; (5) notwithstanding item (2) above "provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any . . . claim on which the last payment is due after the date on which the final payment under the plan is due;" (6) provide for the satisfaction of all or part of any allowable postpetition claims; (7) provide for the assumption or rejection of any executory contract or unexpired lease; (8) provide for the payment of all or part of the claim from lien property; (9) provide for property of the estate to vest in the debtor or other entity on confirmation of the plan or at a later time; and (10) include other appropriate provisions consistent with the Code.[116]

A Chapter 13 plan allows, with some limitations, the modification of the rights of a holder of secured claims.[117] A distinctive feature of the Chapter 13 plan that is disadvantageous to a farmer-debtor is that the farmer-debtor cannot modify the rights of the holder of a claim secured only by a mortgage on the farmer-debtor's principal residence. Two variables that should be considered by the creditor (or farmer, especially when in-

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[110] BANKR. RULE 3015.
[111] 11 U.S.C.A. § 1326(a)(1) (Supp. 1985).
[112] 11 U.S.C.A. § 1307(c)(4) (Supp. 1985).
[113] 11 U.S.C.A. § 1322(a)(1) (1979).
[114] 11 U.S.C.A. § 1322(a)(2) (1979).
[115] 11 U.S.C.A. § 1322(a)(3) (Supp. 1985).
[116] 11 U.S.C.A. § 1322(b) (1979 & Supp. 1985).
[117] 11 U.S.C.A. § 1322(b)(2) (Supp. 1985).

volved in a small farming operation) in taking or giving a secured interest are that the interest be (1) in the debtor's residence *only* and (2) in the debtor's principal residence. Thus, a creditor could protect his interest to a greater extent by obtaining an interest in the farmer's principal residence (not other land owned by the farmer) and *only* in that property.

The Code provides that the court shall confirm a Chapter 13 plan if the stated requirements are satisfied.[118] Acceptance of the Chapter 13 plan by the unsecured creditors is not required for confirmation of the plan.[119] However, any party in interest may object to confirmation at a hearing on confirmation of the plan.[120] If an unsecured party objects, the court cannot confirm the plan unless either the plan includes all of the farmer's disposable income for the next three years beginning on the date the first payment under the plan is due, or the property distributed under the plan is not less than the amount of the claim.[121] Acceptance by the secured creditors is required.[122] However, confirmation is possible without their acceptance if the creditors retain the lien securing their claim, or if the allowed amount of their claim is more than the value of the property.[123]

B. Chapter 11

One of the greatest advantages to a farmer-debtor in a Chapter 11 bankruptcy is that he may maintain control over the estate and, as a debtor in possession, act in the shoes of the trustee.[124] A debtor in possession has all the rights (other than the right to compensation) and powers and performs all the functions and duties of a trustee.[125] The only duties the debtor in possession cannot perform are to "investigate the acts, conduct, assets, liabilities, and financial condition of the debtor,

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[118] 11 U.S.C.A. § 1325 (1979).

[119] *See* 11 U.S.C.A. § 1325(a)(5) (1979).

[120] 11 U.S.C.A. § 1324 (1979 & Supp. 1985).

[121] 11 U.S.C.A. § 1325(b)(1)(A)-(B) (Supp. 1985).

[122] 11 U.S.C.A. § 1325(a)(5)(A) (1979).

[123] 11 U.S.C.A. § 1325(a)(5)(B)-(C) (1979).

[124] 11 U.S.C.A. §§ 1101(1), 1107(9) (1979 & Supp. 1985).

[125] 11 U.S.C.A. § 1107(a) (Supp. 1985). The debtor in possession is also subject to the limitations imposed upon a Chapter 11 trustee, and such other limitations as a court may prescribe. *See* S. REP. No. 989, 95th Cong., 2d Sess. 116 (1978). *See also* H.R. REP. No. 595, *supra* note 29, at 404.

[or] the operation of the debtor's business,"[126] and to file a statement of the investigation and transmit a copy or summary of this statement to certain persons and committees.[127] The rights of a debtor in possession include the strong-arm power of the trustee to render unsecured an improperly perfected secured claim.[128]

The debtor in possession should be aware, however, that the court may order the appointment of a trustee "[a]t any time after the commencement of the case but before confirmation of a plan, on request of a party in interest, and after notice and a hearing," for cause or if such appointment is in the interest of creditors.[129] Cause includes "fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management."[130] The trustee can then manage the debtor's estate. The court will not hear objections to the trustee's actions if the actions were taken in good faith, based on sound business judgment and within the scope of his authority.[131] If the court does not order the appointment of a trustee, a party in interest may request the appointment of an examiner to investigate the debtor.[132]

Chapter 11 creditors may want to oust the debtor in possession and have a trustee appointed. However, a trustee generally will not be versed in farm management and may find it necessary to retain management personnel. This can result in significant costs in addition to already incurred fees for the trustee and for the trustee's attorney, accountant and other professionals.[133] In a Chapter 11 case, an active creditors' committee can accomplish what the trustee would normally do without this additional cost. Only where a debtor in possession is significantly harming the estate (for example, through waste, defalcation or incompetence)

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[126] 11 U.S.C.A. § 1106(a)(3) (1979).

[127] 11 U.S.C.A. § 1106(a)(4) (1979).

[128] *See* 11 U.S.C.A. § 544(a)(1) (1979). *See also In re* Midwestern Food Stores, Inc., 21 Bankr. 944, 947 (Bankr. S.D. Ohio 1982) (Chapter 11 vests trustee with avoiding powers).

[129] 11 U.S.C.A. § 1104(a) (1979).

[130] 11 U.S.C.A. § 1104(a)(1) (1979).

[131] *See In re* Curlew Valley Assocs., 14 Bankr. 506, 513-14 (Bankr. D. Utah 1981) (trustee's decision to change farming method was a business judgment).

[132] 11 U.S.C.A. § 1104(b) (1979).

[133] *See* Moller, *Chapter 11 of the 1978 Bankruptcy Code or Whatever Happened to Good Old Chapter XI?*, 11 ST. MARY'S L.J. 437, 458-60 (1979-80).

should a creditor seek to have a trustee appointed. Better results are usually achieved through close monitoring of the case by creditors, through imposing additional restrictions on the debtor, and by requiring more frequent and detailed reporting.[134]

Only the debtor may file a Chapter 11 plan for the first 120 days after the date of the order for relief.[135] Any party in interest may file a plan, if the debtor has not filed a plan before the 120 day period ends[136] or if the debtor has not filed a plan that has been accepted by each class of impaired claims within 180 days after the date of the order for relief.[137] The court may reduce or increase the 120 day period or the 180 day period for cause upon request of a party in interest.[138]

During the 120-day exclusive period the debtor is afforded the protection of the automatic stay order,[139] has the use and benefits of his assets,[140] receives the advantage of interest accrual ceasing on his secured claims,[141] may assume or reject executory contracts,[142] may obtain credit,[143] and generally may manage his business affairs without being required to satisfy prepetition debts.[144] Creditors' remedies during the exclusive period are limited to actions that are basically negative responses. A claimant, irrespective of its class, may move the court for an appointment of a trustee in order to have the exclusive period of time reduced.[145] In addition to these statutory protections, a secured claimant may seek to have the automatic stay order terminated so that it can proceed with its nonbankruptcy remedies,[146] or it may seek to have the court order the debtor to provide it with adequate protection of its claim.[147]

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[134] *Id. See also* 11 U.S.C.A. § 1104.

[135] 11 U.S.C.A. § 1121(b) (1979). Current unenacted legislation proposes to change § 1121(b). H.R. 2211, 99th Cong., 1st Sess. (1985) proposes to extend the time for filing to 240 days for the Chapter 11 farmer/debtor.

[136] 11 U.S.C.A. § 1121(c)(2) (1979).

[137] 11 U.S.C.A. § 1121(c)(3) (1979).

[138] 11 U.S.C.A. § 1121(d) (Supp. 1985).

[139] 11 U.S.C.A. § 362(a) (1979).

[140] 11 U.S.C.A. § 1107(a) (1979).

[141] *See* 11 U.S.C.A. § 362 (1979).

[142] 11 U.S.C.A. § 365(a) (1979).

[143] 11 U.S.C.A. § 364 (1979).

[144] 11 U.S.C.A. § 363 (1979).

[145] 11 U.S.C.A. § 1104(a) (1979).

[146] 11 U.S.C.A. § 362(d) (1979).

[147] 11 U.S.C.A. § 361 (1979).

Only under the most extraordinary circumstances will a bankruptcy court order the appointment of a trustee or dismiss a Chapter 11 case within 120 days after commencement. It is also unlikely that the court will reduce the exclusive period of time in which the debtor may file his plan. The additional remedies available to the secured claimant (termination of the automatic stay or adequate protection), even if successfully prosecuted, will not result in a complete resolution of the case. Consequently, creditors typically find themselves in a situation where they must simply monitor the case and hope that there is no dramatic deterioration of the estate.[148]

The farmer in Chapter 11 or 13 is granted the additional advantage under the Code of not being subject to a motion to convert to Chapter 7.[149] Prior to the enactment of the Code, creditors in a farm case found themselves with few viable alternatives other than moving for dismissal. However, Congress, in rewriting the bankruptcy laws, recognized the unfairness of the situation and enacted section 1121(c) which provides:

> (c) Any party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may file a plan if and only if—
>
> (1) a trustee has been appointed under this chapter;
>
> (2) the debtor has not filed a plan before 120 days after the date of the order for relief under this chapter; or
>
> (3) the debtor has not filed a plan that has been accepted, before 180 days after the date of the order for relief under this chapter. . . .[150]

As explained in the legislative history, "[t]he granting of authority to creditors to propose plans of reorganization and rehabilitation serves to eliminate the potential harm and disadvantages to creditors and democratizes the reorganization process."[151]

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[148] For more details on all these issues, see Moller, *supra* note 133, at 443-62.

[149] 11 U.S.C.A. §§ 1112(c), 1307(e) (1979).

[150] 11 U.S.C.A. § 1121(c). *See also* notes 136-37 *supra* and accompanying text.

[151] *Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong., 2d Sess. 1875 (1976). *See also* H.R. REP. NO. 595, *supra* note 29, at 231.

Courts are split on whether a plan that has been filed by someone other than the farmer-debtor and provides for liquidation of the farmer-debtor's estate may be confirmed.[152] In Kentucky, the issue of a secured creditor's liquidation plan was decided in *In re Tinsley*,[153] where the court confirmed a secured creditor's plan providing for the liquidation of all nonexempt farm assets. A farm partnership known as Tinsley & Groom commenced a voluntary petition for relief under Chapter 11 in the Western District of Kentucky. Subsequently, the individual partners and their spouses instituted voluntary cases.[154] Prior to the expiration of the 120-day exclusive period, during which the debtors were to file their plan, the court upon motion granted the debtors an extension of up to sixty days.[155]

Upon expiration of the exclusive period, the debtors had not filed a plan of reorganization. Consequently, West Kentucky Production Credit Association (PCA), a secured claimant, filed a plan of liquidation. Despite this offensive move, the debtors chose to fight the PCA plan rather than propose their own plan.[156]

The disclosure statement, as approved by the court after notice and a hearing, established that the only viable solution was the complete liquidation of the debtors' estate. The creditor had determined through discovery that the farm business had been consistently unprofitable. Projections for the present crop year established that the farm partnership would not generate sufficient income to pay input or operational costs and satisfy debt service.

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[152] *Compare In re* Button Hook Cattle Co., 747 F.2d 483, 484 (8th Cir. 1984) (bankruptcy court may confirm a party in interest's liquidation plan); *In re* Cassidy Land & Cattle Co., 747 F.2d 487, 488 (8th Cir. 1984) (same) *and* Jasik v. Conrad (*In re* Jasik), 727 F.2d 1379 (5th Cir. 1984) (farmers not exempt from Chapter 11 liquidation proceedings) *with In re* Kehn Ranch, Inc., 41 Bankr. 832 (Bankr. D.S.D. 1984) (creditor's liquidation plan amounts to involuntary conversion); *In re* Lange, 39 Bankr. 483 (Bankr. D. Kan. 1984) (Chapter 11 remedy of a creditor is not liquidation but dismissal) *and In re* Blanton Smith Corp., 7 Bankr. 410 (Bankr. M.D. Tenn. 1980) (a farm creditor cannot compel a liquidation under Chapter 11).

Current unenacted legislation proposes to decide this dilemma. S. 705, 99th Cong., 1st Sess. (1985) proposes to preclude imposition of liquidation plans by creditors on farmers.

[153] 36 Bankr. 807 (Bankr. W.D. Ky. 1984).

[154] *Id.* at 807.

[155] *See* 11 U.S.C.A. §§ 1121(c)(3) (Supp. 1985), 1129(a)(11) (1979).

[156] 36 Bankr. at 807.

Although the debtors objected to confirmation of the plan upon numerous grounds, the thrust of their argument was that a creditor should not be permitted to liquidate a farmer in Chapter 11 when it is precluded from converting a farmer-debtor from Chapter 11 to Chapter 7.[157] In rebuttal, PCA maintained that Congress, while specifically providing a farmer with certain specified protections, had also chosen to provide certain rights to creditors.[158]

Confirming the PCA plan, the court reasoned:

> By [filing a voluntary Chapter 11 petition] it must be assumed that the farmer, in evaluating a proper course of action at a time of financial stress, weighs not only the potential advantages but also the risks attendant thereto. By voluntarily placing himself before the court and its jurisdiction, he is subjected to all the provisions of the applicable law, those affording relief and protection as well as those rights of creditors expressly stated and not otherwise limited.[159]

The court further stated:

> The public policy of extending to the farmers a special status against involuntary liquidations is addressed in every respect with this sole exception. Extension of farmer protection against liquidation under the voluntarily filed Chapter 11 petition cannot be inferred based upon public policy elsewhere expressed as justification against the involuntary petitioner, especially where, as here, the farmer petitioner elects to invoke the benefits of Chapter 11 in a selective fashion while seeking to negate the rights of parties in interest expressly stated.[160]

In another decision the Fifth Circuit held that the lower courts were correct in finding that the Code did not preclude the court-appointed trustee from submitting a plan of liquidation and that such a plan was confirmable.[161] In support of its conclusion the court reasoned:

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[157] *Id.* at 809.
[158] *Id.*
[159] *Id.*
[160] *Id.*
[161] *See In re* Jasik, 727 F.2d at 1379.

> Congress did give farmers special defensive protections under the Bankruptcy Act. However, nowhere in the statutory language or in legislative history is there evidence of any congressional intent to confer on a farmer the offensive capability to initiate a Chapter 11 proceeding which both stays collection by his creditors and allows him, by refusing to file, to block the submission of a plan of liquidation. To the contrary, Congress has expressed the intent that debtors in voluntary bankruptcy should not be able, by merely withholding affirmative action, to suspend creditors' rights indefinitely.[162]

A contrary and minority result was reached in *In re Lange*,[163] where the court refused to confirm a creditor's plan providing for liquidation of the farmer's assets. The court predicated its decision upon the Frazier-Lemke Act,[164] several sections of the Bankruptcy Code,[165] and a liberal construction of the Code, resolving ambiguities in favor of the debtor.[166]

The Frazier-Lemke Act gave the farmer a choice between (1) having the case dismissed and facing state foreclosure remedies or (2) "renting" his property for three years with the option of purchasing it at its appraised value at the end of that time.[167] "In exchange the farmer had to *voluntarily* agree to be adjudged a bankrupt . . ., agree to allow the sale of non-exempt, unnecessary property if the court so ordered . . ., and agree to liquidation if the farmer could not comply with the rental and repurchase provisions. . . ."[168] Although this Act expresses a congressional policy that involuntary liquidations in bankruptcy were not to be permitted during the "Great Depression,"[169] there was also an alternative policy that the debtor consent to liquidation or face dismissal and foreclosure.

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[162] *Id.* at 1381.

[163] 39 Bankr. 483.

[164] Act of June 28, 1934, ch. 869, 48 Stat. 1289. This Act amended § 75 of the Bankruptcy Act enacted by Congress in 1933 (ch. 204, 47 Stat. 1467 (repealed 1949)) by adding subsection (s).

[165] 11 U.S.C.A. §§ 303(a), 1112(c), 1307(e) (1979) 1129(a)(1), (a)(3) (1985).

[166] *See* 39 Bankr. at 485 (relying on Wright v. Union Cent. Life Ins. Co., 311 U.S. 273 (1940)).

[167] *See* Act of June 28, 1934, ch. 869, § 75(s), 48 Stat. 1289 (repealed 1949).

[168] 39 Bankr. at 484.

[169] *Id.* at 485.

The *Lange* court placed its greatest weight on the view in *Wright v. Union Central Life Ins. Co.*[170] that the Code is to be liberally construed "to give the debtor the full measure of relief afforded by Congress,"[171] and on its inference that the Code requires plans to be filed in good faith and not by means forbidden by law.[172]

The *Lange* court rejected an "implied waiver" theory which it considered to be part of the rationale for opinions which hold that creditor liquidating plans may be confirmed under Chapter 11.[173] However, the court's characterization neglects the unmistakable change in Chapter 11 which permits the filing of a liquidating plan. Unlike all other protections accorded farmers by the Code, neither the right of a creditor to file a plan, nor the right of a plan to provide for liquidation of the estate's assets, is prohibited or restricted in the case of farmers under Chapter 11.[174]

In denying confirmation of the creditor's liquidating plan, the *Lange* court failed to observe that the filing of a plan by a creditor does not preclude the farmer-debtor from proposing his own plan. The court strained to reach its conclusion, perhaps because it found liquidation to be too harsh a result.[175] However, the court should have recognized that the debtor's remedy was to propose an alternative plan. If both plans satisfy confirmation requirements,[176] the court must choose between them.[177]

Where the debtor either will not or cannot propose a plan, reducing the creditor's remedies to dismissal imposes a result that was not intended by Congress. In a Chapter 11 case which has been pending for many months, or even years, a dismissal at such a late date can be prejudicial to the creditors.[178]

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[170] 311 U.S. 273, 278-79.

[171] 39 Bankr. at 485.

[172] 11 U.S.C.A. § 1129(a)(3) (1985).

[173] 39 Bankr. at 486. The cited opinions are Jasik v. Conrad (*In re* Jasik), 727 F.2d at 1379; *In re* Tinsley, 36 Bankr. at 807; *In re* Cassidy Land & Cattle Co., No. 82-1257 (Bankr. D. Neb. 1984).

[174] *See* notes 157-60 *supra* and accompanying text.

[175] *See* 39 Bankr. at 487.

[176] *See* 11 U.S.C.A. § 1129(a)-(b) (1985).

[177] 11 U.S.C.A. § 1129(c) (1985).

[178] It must be noted that the *Lange* court did recognize the problems caused by delays: "The Court believes that uncomplicated farm reorganizations should not sit dormant without a plan for extended periods of time . . . [t]he Court does not view delay by the farm-debtor as an ultimately beneficial strategy. . . ." 39 Bankr. at 487.

Although liquidation suggests the immediate sale of property via a public auction, such a method of sale is not mandated. In fact, a creditor secured by real property may obtain possession and then lease the property to the farmer-debtor for either cash shares or percent shares upon harvest and sale of the crop. The creditor can later market the property so as to realize the most recovery.

The better reasoned decisions permit a creditor to file its own plan when the debtor is unable to do so or is using the bankruptcy protection to forestall the inevitable. Certainly there is no statutory, equitable or rational reason why a recalcitrant debtor who has voluntarily selected a forum should not be subject to the totality of its provisions.[179]

Frequently, farmer-corporations have debts with the owner, management or insiders who may receive special treatment under the Code. Codifying the case law of *Pepper v. Litton*,[180] Congress provided in the Code that a court may subordinate these claims under principles of equitable subordination.[181]

Equitable subordination is a harsh measure and is not lightly invoked by courts.[182] In order to demonstrate that subordination of a claim is an appropriate remedy, the proponent must establish the following: "(i) The claimant must have engaged in some type of inequitable conduct. (ii) The misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant. (iii) Equitable subordination of the claim must not be inconsistent with the provisions of the Bankruptcy [Code]."[183] There must be specific findings by the court for each element.[184]

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[179] *See, e.g.*, Jasik v. Conrad (*In re* Jasik), 727 F.2d at 1379; *In re* Tinsley, 36 Bankr. at 807.

[180] 308 U.S. 295, 307-12 (1939).

[181] *See* 11 U.S.C.A. § 510(c) (1979). The principles of equitable subordination are determined by case law. *See* 3 COLLIER, *supra* note 44, at ¶ 510.04.

[182] *E.g.*, Tinsley & Groom v. West Ky. Prod. Credit Assoc. (*In re* Tinsley & Groom), 49 Bankr. 85, 90 (Bankr. W.D. Ky. 1984).

[183] *In re* All Products Co., 32 Bankr. 811, 815 (Bankr. E.D. Mich. 1983) (creditors claimed parent corporation creditor received inequitable tax benefits through dealings with debtor subsidiary).

[184] *See* Wilson v. Huffman (*In re* Missionary Baptist Found. of Am., Inc.), 712 F.2d 206, 212 (5th Cir. 1983) (trustee did not present sufficient findings to justify subordination of insider's claim).

Courts will closely scrutinize the conduct of claimants who bear a close relationship with the debtor (including officers, directors, shareholders and fiduciaries) to assess whether their transactions with the debtor would justify equitable subordination of their claims.[185] When the debtor (through parent-subsidiary relationship, or one person or family control) is controlled by a claimant, the court may determine whether the debtor can be described as a "mere instrumentality" of the claimant.[186] In cases where the insider's conduct involving the claim would prejudice other creditors, the court subordinates the insider's claim. However, subordination is not automatic and depends on the facts and circumstances of the particular case.[187]

The claimant has the initial burden of proof in providing some substantial basis for an allegation of impropriety. Upon that showing, the burden of proof shifts to the insider to show the fairness of the claims.[188]

Inequitable conduct does not include conduct that has been remedied or nullified by prior litigation. Equitable subordination of a claim in that instance would be punitive in nature and contrary to equitable principles.[189] Inequitable conduct is not established when the creditors fail to adequately resist the use of cash collateral by the debtor pursuant to court order.[190] Nor

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[185] *See* 3 COLLIER, *supra* note 44, at ¶ 510.04 (citing Pepper v. Litton, 308 U.S. at 295).

[186] See American Trading & Prod. Corp. v. Fischbach & Moore, Inc., 311 F. Supp. 412, 413-14 (N.D. Ill. 1970) where the court found that a subsidiary is not a "dummy" corporation but has separate identity from its parent. The court adds that the "mere instrumentality" rule is rarely applied "for it runs contrary to the established principle of corporate limited liability." *Id.* at 413.

[187] *See* Multiponics, Inc. v. Herpel (*In re* Multiponics, Inc.), 622 F.2d 709, 717 (5th Cir. 1980) ("While the mere fact of an insider loan may be insufficient to warrant subordination, . . . under all the facts and circumstances of this case, Multiponics' capital base was inadequate.").

[188] *See* Rego Crescent Corp. v. Tymon (*In re* Rego Crescent Corp.), 23 Bankr. 958, 967 (Bankr. E.D.N.Y. 1982) (unsecured creditors' committee failed to demonstrate that insider loans were capital contributions to undercapitalized corporation); *In re* Castillo, 7 Bankr. 1351, 138 (S.D.N.Y. 1980) (no equitable subordination of creditor claim in debtor's property without trustee demonstrating substantial factual basis to claim of creditor misconduct).

[189] *See* Trone v. Smith (*In re* Westgate-California Corp.), 642 F.2d 1174, 1178-79 (9th Cir. 1981) (punitive to subordinate money claims of creditor whose misconduct had been remedied in litigation).

[190] *See In re* Roamer Linen Supply, Inc., 30 Bankr 932, 937 (Bankr. S.D.N.Y. 1983) (no subordination of secured claims of Internal Revenue Service and mortgagee bank).

is inequitable conduct established by the submission of a debtor-claimant that the creditors had control over the approval or rejection of a full proceeds loan. The claimants in *In re Tinsley & Groom*[191] unsuccessfully argued that the creditors' position of unilateral control over the debtor-creditor relationship was inequitable and constituted reason for subordination of the debt.[192]

In rejecting the claimant's argument, the court noted that "[w]hile the 'full proceeds' loan arrangement ha[d] been widely used, and in some instances criticized for its retained control provisions, its usage [did] not mandate a result that all such loans will be equitably subordinated."[193] Each case must be governed by its circumstances. The court further stated that it was not the position of control that determined whether a claim should be equitably subordinated, but whether there was unreasonable, arbitrary, unwarranted exercise of such control in a given case.[194] The court stated:

> While the power to approve or reject a loan renewal application is a recognized element of control, exercise thereof in a prudent non-arbitrary manner cannot and does not as a matter of law thereafter impute liability for a loan default to the approving officer. This theory, if extended, would preclude any renewal approval lest the lender thereafter forfeit its remedies in event of default.[195]

The court must confirm a plan before the plan is binding on the creditors and debtors.[196] There are several requirements for confirmation,[197] including that each impaired claim accept the plan.[198] The court may waive this requirement and cram down the plan. This provision is commonly referred to as the "cram down" provision because it may be invoked to compel a creditor to be bound by an arrangement which the creditor is otherwise unwilling to accept. Important requirements for cram down are

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[191] No. 1-83-0053, slip op. at 1.
[192] *Id.*, slip op. at 6.
[193] *Id.*, slip op. at 8.
[194] *Id.*
[195] *Id.*, slip op. at 8-9.
[196] 11 U.S.C.A. § 1129 (1985).
[197] 11 U.S.C.A. § 1129(a) (1985).
[198] *See* 11 U.S.C.A. § 1129(a)(8) (1985).

that the plan be accepted by one class of impaired claims[199] and that it be fair and equitable to each class of claims or interests which are impaired and have not accepted the plan.[200]

A farmer was not allowed to cram down a Chapter 11 reorganization plan where the one class who had approved the plan was a class that included priority claims for administrative expenses.[201] Because they were to be paid in full, this class was not characterized as impaired.

The plan must be fair and equitable.[202] A farmer-debtor cannot create a separate class of unsecured claims "in order to allow gamesmanship in vote getting."[203] A debtor could not cram down a plan where the debtor treated differently a deficiency claim arising out of a security interest in real estate.[204] The farmer's reorganization plan proposed to deed over to the secured creditor land worth some $300,000 less than the value of the secured claim. It made no provision for the deficiency, which normally would have been considered an unsecured claim, while paying the class of unsecured trade creditors 100% of their claims.[205] The court held that the plan unfairly discriminated against the secured creditor and this precluded confirmation under the cram down provision.[206]

In summary, the farmer has several alternatives for voluntary relief under the Bankruptcy Code. The farmer should elect the Chapter of bankruptcy based upon the amount and nature of his assets and debts. Each Chapter has distinguishing features to relieve the farmer from unmanageable debt.

III. COMMERCIAL TRANSACTIONS AND AGRIBUSINESS

The second portion of this Article will review a few of the perplexing and frequently arising legal issues presently facing

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[199] *See* 11 U.S.C.A. § 1129(a)(10) (1985) (insiders are excluded from accepting plan).

[200] *See* 11 U.S.C.A. § 1129(b)(1) (1979).

[201] *In re* Lloyd, 31 Bankr. 283, 284-85 (Bankr. W.D. Ky. 1983).

[202] 11 U.S.C.A. § 1129(b)(2) (1985). The standards used for the fair and equitable requirement are those used in distribution of property in liquidation. *See* 11 U.S.C.A. § 726 (1985).

[203] *In re* Pine Lake Village Apartment Co., 19 Bankr. 819, 831 (Bankr. S.D.N.Y. 1982).

[204] *In re* Wieberg, 31 Bankr. 782, 785 (Bankr. E.D. Mo. 1983).

[205] *Id.* at 783-84.

[206] *Id.* at 785.

agribusiness. First, a cursory overview of agribusiness financing is provided. Second, security interests, how to properly acquire them, and the problems they may present are examined. Finally, developments in the law involving grain elevators, warehouse receipts, and the Packers and Stockyards Act are reviewed.

A. Agricultural Financing

Government involvement in the farming industry is extensive and includes numerous programs. Some of these programs provide financing to farmers and agribusinesses. However, even with extensive government involvement in financing the agricultural industry, private financial sources continue to play an important role in the farm economy. This discussion is intended to be an overview of the typical methods of financing encountered in the farming industry.

The Bank for Cooperatives (BC) provides a full range of credit needs for cooperatives including inventory loans, commodity loans and long-term loans to buy, construct or expand planned sites, buildings or equipment, as well as providing operating capital. Loans from BCs are generally secured by a purchase-money lien or a lien on other acceptable collateral. The BCs, therefore, provide a credit service comparable to that provided by the Federal Land Bank (FLB) through the Federal Land Bank Association (FLBA) and by the Federal Intermediate Credit Banks (FICBs) through the Production Credit Associations (PCAs).[207]

FLBs generally provide long-term loans to finance the acquisition or ownership of real estate. The loans are usually made through FLBAs. To be eligible the borrower must purchase stock in the FLBA equal to five to ten percent of the face amount of the loan.[208] FICBs make loans to PCAs and purchase notes or other obligations from the PCAs. PCAs are associated with FIBCs in much the same way the FLBA is associated with the FLB. The PCAs make short-term and intermediate-term loans

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[207] Banks for Cooperatives were organized under the Farm Credit Act of 1933, ch. 98, 48 Stat. 257 (1933) and continued under the Farm Credit Act of 1971, Pub. L. No. 92-181, 85 Stat. 583 (1971). *See* 12 C.F.R. §§ 600.10-.60, 614 (1984). *See generally* D. UCHTMANN, J. LOONEY, N. KRAUSZ, & H. HANNAH, AGRICULTURAL LAW PRINCIPLES AND CASES 358-59 (1981) [hereinafter cited as UCHTMANN & LOONEY].

[208] *See* UCHTMANN & LOONEY, *supra* note 207, at 358.

to members. Generally, working capital loans are for one year and term loans for equipment are for up to seven years. Each borrower must purchase stock at a rate which varies among PCAs.[209]

Postproduction credit is provided by the Commodity Credit Corporation (CCC).[210] The CCC is a wholly-owned governmental corporation within the U.S. Dep't of Agriculture. The purposes of the CCC are to stabilize, support and protect farm income and prices, to assist in the maintenance of balanced and adequate supplies of agricultural commodities and their products, and to facilitate the orderly distribution of commodities.[211] Consistent with the role of supporting farm income and prices, the CCC makes loans to farmers for commodities in storage and farm storage facilities, as well as for the purchase and construction of drying equipment.[212] Loans by the CCC for commodities in storage may be made without recourse, and if the commodity which secures a CCC loan does not sell for enough to pay the loan, the borrower is not liable for the balance. Thus, the CCC absorbs the loss caused by fluctuating commodity prices and the farmer benefits from any increase in price of the particular commodity. The CCC's loan and price support programs are administered by the Agricultural Stabilization and Conservation Service (ASCS).[213]

The Farmers Home Administration (FmHA)[214] has three categories of loans, each based upon the source of the funds used to make the loans. The first category of loans, FmHA insured loans, are funded by the sale of certificates of beneficial ownership to investors, primarily through the federal financing bank. The certificates are fully insured by the government, and the FmHA services all loans made from the proceeds of these certificates.[215] The second category is composed of loans made by

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[209] *Id.* at 359.

[210] *See* 7 C.F.R. §§ 1402-1480 (1984).

[211] Price support programs were authorized by the Agricultural Act of 1949, ch. 792, 63 Stat. 1054 (1949) (codified as amended at 7 U.S.C. §§ 1421-1447 (1982)).

[212] *See generally* 7 C.F.R. § 1474 (1984).

[213] *See* 7 C.F.R. §§ 700-799 (1984).

[214] The Farmers Home Administration (FmHA) was created by the Farmers Home Administration Act of 1946, ch. 964, 60 Stat. 1062 (1946) (codified as amended at 7 U.S.C. §§ 1981-1992 (1982)).

[215] *See generally* 7 C.F.R. § 1806 (1984).

commercial lending institutions and guaranteed by the FmHA.[216] The FmHA guarantees up to ninety percent of this type of loan. Third, the FmHA makes direct loans to farmers.[217] Additionally, the FmHA may participate with commercial lenders on certain farm loans.[218]

The FmHA makes loans for various purposes. Insured or guaranteed FmHA loans are limited to applicants with family-size operations.[219] The FmHA makes emergency loans to farmers suffering property damage or severe crop loss from a disaster,[220] to farmers for livestock,[221] and to farmers who are unable to obtain sufficient credit from commercial lenders because of temporary adverse economic conditions.[222] The FmHA also makes soil and water loans,[223] recreation loans,[224] irrigation and drainage association loans,[225] grazing association loans,[226] operating loans,[227] and limited resource loans.[228]

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[216] *See generally* 7 C.F.R. § 1841 (1984).

[217] *See generally* 7 C.F.R. § 1843 (1984).

[218] *See generally* 7 C.F.R. § 1841 (1984).

[219] *See generally* 7 C.F.R. § 1822 (1984).

[220] Area farmers are declared eligible for assistance by the President of the United States or the FmHA state directors. The loans may be emergency operating loans or real estate loans. The maximum amount of emergency loans is $500,000 or the amount of the actual loss caused by the disaster, whichever is less. Emergency operating loans must be repaid in seven years and emergency real estate loans may be amortized over a term of up to 40 years.

[221] *See generally* 7 C.F.R. § 1945 (1984).

[222] *See generally* 7 C.F.R. § 1845 (1984).

[223] *See* 7 C.F.R. §§ 1823.221-.238 (1984). Soil and water loans may be insured or guaranteed for farmers and nonoperator owners of land to promote conservation, development and better use of soil and water resources, as well as for energy conservation and pollution control measures.

[224] *See* 7 C.F.R. § 1823.51 (1984). Recreation loans are made to farmers or ranchers for the purpose of converting all or a portion of a farm or ranch to an outdoor income-producing recreation enterprise that will supplement or supplant farm or ranch income.

[225] *See* 7 C.F.R. § 1823.224 (1984). Irrigation and drainage association loans can be made to organizations of farmers and ranchers for projects that include the application or establishment of soil conservation practices; the construction, improvement or enlargement of facilities for drainage; and the conservation, development, use or control of water.

[226] *See* 7 C.F.R. § 1823.55 (1984). Grazing association loans are made to provide seasonal grazing for the livestock of members of farmer or rancher associations.

[227] 7 C.F.R. §§ 1945.116-.118 (1984). Operating loans typically are made for seven years to operators of family farms who are unable to obtain credit from conventional sources, and are limited to $100,000 for loans not guaranteed by the FmHA, and $200,000 for FmHA guaranteed loans.

[228] 7 C.F.R. § 1945.116-.118. Limited resource loans are made to low-income farmers regardless of whether the farm is leased or owned, and repayment may be in reduced installments during an initial repayment period.

To stimulate the economic growth of small businesses in deprived areas, to promote minority enterprise opportunities, and to promote small business contributions to economic growth,[229] the Small Business Administration (SBA)[230] makes loans to small businesses engaged in farming and related activities.[231] The SBA's loans include operating loans, intermediate-term loans and long-term loans for real estate and construction or improvements to real estate, crop loans and farm machinery loans. SBA loans are made to individuals who are unable to obtain adequate business financing through normal lending channels on reasonable terms. The SBA also has disaster loans for those sustaining losses as a direct result of a physical disaster declared by the President of the United States or the Administrator of the SBA.

Life insurance companies are also a source of agricultural financing and generally focus on making long-term farm mortgage loans. In addition, life insurance companies make agribusiness loans. A life insurance company has no limit on the size of the loan it may provide other than self-imposed minimums and maximums based upon the appraised value of the security. Many major insurance company lenders service the larger commercial farmer and agribusiness.

Commercial banks have a substantial volume of non-real-estate farm loans, as well as real estate loans. Local commercial banks are readily accessible, give prompt service and provide a full range of financial services. A small commercial bank may not be able to service the large loans required by some farmers because of regulatory limits on the size of individual loans, but may develop correspondent banking relationships with larger banks and request a larger bank to participate in making a loan.

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[229] *See* 15 U.S.C.A. § 631 (West Supp. 1985). The SBA may make guaranteed, immediate participation and direct loans for regular business purposes. *See* 13 C.F.R. § 122 (1984). Guaranteed loans are made by a commercial lending institution and the SBA agrees to guarantee up to 90% of the loan, not to exceed $350,000. *See* 13 C.F.R. §§ 122.5(a), .10 (1984). The SBA's portion of an immediate participation loan and direct loans made solely with SBA funds may not exceed $350,000. *See* 13 C.F.R. §§ 122.5(a), .7-.8 (1984).

[230] The Small Business Administration was created by the Small Business Act and Small Business Investment Act of 1958, Pub. L. No. 85-536, 72 Stat. 384 (1958) (codified at 15 U.S.C. §§ 631-649d (1982)).

[231] *See* Act of June 4, 1976, Pub. L. No. 94-305, 90 Stat. 663 (1976) (codified as amended at 15 U.S.C. §§ 634-696 (1982)).

Commercial banks may discount the loans with the FICBs on a recourse basis. In addition, commercial banks may enter into arrangements where PCAs participate in loans made by the commercial banks that exceed a rural bank's legal lending limit, or may make loans which are guaranteed by the FmHA. Commercial banks make all types of loans including loans for working capital, production loans, intermediate-term loans for machinery and equipment, and long-term real estate loans. The terms of commercial bank loans to farmers vary depending on the lending bank's policies and its evaluation of the risk involved.[232]

Finally, merchants, dealers and other suppliers in agribusiness and other farm-related businesses may provide short-term credit as well as intermediate-term loans on supplies and equipment.[233]

IV. U.C.C. ARTICLE NINE AND FARM RELATED COLLATERAL

A. Classification and Description of Collateral

Improper classification and description of collateral in a security agreement[234] and a financing statement[235] decrease the protection of a creditor's secured interest. The resulting problems

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[232] *See generally* UCHTMANN & LOONEY, *supra* note 207, at 357-58.

[233] *Id.* at 359.

[234] A "security agreement" is an agreement that "creates or provides for a security interest." U.C.C. § 9-105(*l*) (1972). A security interest is a lien created by an agreement. U.C.C. § 1-201(37). For a security interest to attach, there must be a valid security agreement, value given, and debtor rights in the collateral. *See* U.C.C. § 9-204 (1962); U.C.C. § 9-203 (1972). While both the 1962 and 1972 versions of the U.C.C. require that the debtor have rights in the collateral, each version is different concerning rights in crops to be grown and unborn livestock. Under the 1962 version, the debtor has no rights "in crops until they are planted or otherwise become growing crops, [or] in the young of livestock until they are conceived." U.C.C. § 9-204(2)(a) (1962). The 1972 U.C.C. eliminated the section entirely. "A security interest is 'perfected' when the secured party has taken whatever steps are necessary [pursuant to the U.C.C.] to give him such an interest." U.C.C. § 9-301 comment 1 (1972).

[235] The financing statement discloses to prospective creditors the encumbrances on a debtor's personal property or where relevant information may be obtained, 13 N. HARL, AGRICULTURAL LAW ¶ 120.05(5) (1984), and is filed in the appropriate public office pursuant to statutory provisions. A financing statement must have: (1) the signature of the debtor; (2) the name and address of the debtor and secured party; and (3) a statement indicating the type or description of the collateral. *See* U.C.C. § 9-402 (1962 & 1972).

and the suggested means of avoiding these problems are discussed below.

Collateral used in security agreements involving farmers and agribusiness primarily includes crops,[236] livestock, products[237] and equipment. Any description of the collateral is sufficient if it reasonably identifies what is described,[238] but courts differ in interpreting the reasonableness of a description. Some courts have given a broad interpretation of a "reasonable" description of the collateral.[239]

In one instance a description of collateral specifying "[a]ll farm equipment" and "[a]ll property similar to that listed above, which at any time may hereafter be acquired by the Debtor" was too vague and did not distinguish the collateral from other property.[240] But a description stating "all farm machinary [sic], including but not limited to tractor, plow and disc . . . plus all property similar to that listed above which at any time may hereafter be acquired by the debtor," was sufficient to enable a creditor to reasonably identify the covered collateral.[241] While a description of collateral as "[a]ll tobacco crops, including but not limited to . . . 1/2 of 5200 pounds on Dewey Allen," was held sufficient,[242] a security agreement providing an interest in "[a]ll crops of every kind grown or to be planted" was held not

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[236] *See* Mammoth Cave Prod. Credit Ass'n v. Oldham, 569 S.W.2d 833 (Tenn. Ct. App. 1977). Where fixtures, crops, timber or minerals are acquired as security, the description of the land must be included in the description of the collateral. *See* U.C.C. §§ 9-203(1), -402(1) (1962); U.C.C. §§ 9-203(1)(a), -402(1), (5) (1972). Most courts only require that the description reasonably identify what is described. *See* U.C.C. § 9-110 (1962 & 1972). The term "crops" is not defined in the U.C.C. and is given different treatment in each version of the Code. *Compare* U.C.C. § 9-203(1)(b) (1962) *with* U.C.C. § 9-203(1)(a) (1972). *See also* Meyer, *"Crops" as Collateral for Article 9 Security Interest and Related Problem*, 15 U.C.C. L.J. 3, 4-5 (1982-83).

[237] Farm products are goods if: (1) "they are crops or livestock . . . or products of crops or livestock in their unmanufactured state" used or produced in a farming operation; (2) they are "in the possession of a debtor;" and (3) the debtor is engaged in farming operations. U.C.C. § 9-109(3) (1972). If goods are farm products, they cannot be equipment or inventory under Article 9. *See* KRS § 355.9-109(3) Kentucky commentary (1984).

[238] U.C.C. § 9-110 (1962 & 1972).

[239] *See, e.g.*, Midkiff Implement Co. v. Worrall, 36 U.C.C. Rep. Serv. (Callaghan) 963 (Ill. App. Ct. 1983).

[240] Mammoth Cave Prod. Credit Ass'n v. York, 429 S.W.2d 26, 27 (Ky. 1968).

[241] Horse Cave State Bank v. Nolin Prod. Credit Ass'n, 672 S.W.2d 66 (Ky. Ct. App. 1984).

[242] 569 S.W.2d at 835.

to include subsequently designated crops, growing crops, crops to be grown, and documents of title.[243]

In a small number of cases, claims that the description of the collateral was inadequate have been upheld when the alleged insufficient description involved the omission of an after-acquired property clause or an error in stating a serial number.[244] In many instances the courts have resolved doubts in favor of the creditor or determined the description of the collateral by reference to other documentation,[245] especially where the inadequate description was ultimately held not to be seriously misleading.[246] One court required that the objecting party both show actual prejudice and demonstrate the insufficiency of the description.[247]

Proceeds[248] of secured interests are not automatically covered in the description of the collateral under the 1962 Uniform Commercial Code (U.C.C.) and must be explicitly stated.[249] Unless the security agreement specifically states otherwise, proceeds are automatically included in the description of collateral under the 1972 version of the U.C.C.[250] A security interest in proceeds

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[243] Peoples Bank v. Pioneer Food Industries, 486 S.W.2d 24, 26 (Ark. 1972).

[244] *See In re* California Pump & Mfg. Co., 588 F.2d 717 (9th Cir. 1978); *In re* Lockwood, 16 U.C.C. REP. SERV. (CALLAGHAN) 195 (D. Conn. 1974); GAC Creditor Corp. v. Small Business Admin., 323 F. Supp. 795 (W.D. Mo. 1971); *In re* Thibodeau, 6 U.C.C. REP. SERV. (CALLAGHAN) 873 (D. Me. 1969); Material Service Corp. v. Bogdajewicz, 387 N.E.2d 1057 (Ill. App. Ct. 1979); 429 S.W.2d 26.

[245] *See, e.g., In re* Middle Atlantic Stud Welding Co., 503 F.2d 1133 (3rd Cir. 1974); Freeman v. Decatur Loan & Finance Corp., 231 S.E.2d 409 (Ga. Ct. App. 1976); N. HARL, *supra* note 274, at ¶ 117.03(2). *But see In re* Vintage Press, 552 F.2d 1145 (5th Cir. 1977); *In re* Delta Molded Products, 416 F. Supp. 938 (N.D. Ala. 1976), *aff'd sub nom.*, Sterne v. Improved Machinery, Inc., 571 F.2d 957 (5th Cir. 1978); *In re* Fibre Glass Boat Corp., 324 F. Supp. 1054 (S.D. Fla.), *aff'd mem.*, 448 F.2d 781 (5th Cir. 1971); American Nat'l Bank & Trust v. National Cash Register Co., 473 P.2d 234 (Okla. 1970); McGehee v. Exchange Bank & Trust Co., 561 S.W.2d 926 (Tex. Civ. App. 1978).

[246] *See, e.g.*, 416 F. Supp. 938, 941-42.

[247] City Bank & Trust Co. v. Warthen Serv. Co., 535 P.2d 162, 165 (Nev. 1975). *See also* 13 N. HARL, *supra* note 235, at ¶ 117.03(2).

[248] " 'Proceeds'-includes whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds." U.C.C. § 9-306(1) (1962 & 1972). The means of perfection of the proceeds is governed by the type of collateral. A plaintiff who has a prior perfected security interest in a debtor's tobacco crop may be able to recover the proceeds of the sale of the tobacco crop from a secured creditor who had been paid. *See* Bank of Danville v. Farmers Nat'l Bank of Danville, 602 S.W.2d 160, 164 (Ky. 1980). *See also* U.C.C. § 9-306(3) (1962 & 1972).

[249] *See* § 9-203(2) (1972).

[250] *See* U.C.C. § 9-203(3) (1972). However, see U.C.C. § 9-306(3) (1972) concerning perfection requirements for a security interest in proceeds.

continues in a right to payment pursuant to a contract for assignment,[251] and in milk produced by a debtor's cows and receipts from the sale of the milk.[252]

Products and offspring of livestock[253] are best specifically included in the description of the collateral in an after-acquired property clause. Where collateral was listed as 800 head of cattle, with no after-acquired property clause, it did not include an additional 40 head of cattle, even though the agreement had a description including "any increase thereof by birth or purchase."[254] But when hogs were included in an after-acquired property clause, the secured interest in the hogs continued notwithstanding the debtor's changing its operation from a hog "feeder" operation to a hog "breeder" operation. The change of operation was held to be within the ordinary course of business.[255] General descriptions of the after-acquired property may be acceptable.[256] However, because neither the 1962 nor the 1972 version of the Code automatically includes products of livestock as collateral, Professor Harl suggests that products of livestock be specifically mentioned in the description.[257]

The proper classification of collateral presents another major problem to farmers and agribusiness centers. The Bankruptcy Code allows the continuation of prepetition security interests in proceeds, products or offspring of any property subject to the security interest,[258] including payments-in-kind.[259] A perfected security interest in proceeds in a bankruptcy proceeding only applies to noncash proceeds (that is, all proceeds except checks

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[251] *In re* Pendleton, 38 U.C.C. Rep. Serv. (Callaghan) 1805 (Bankr. W.D. Ky. 1984).

[252] *In re* Hollie, 38 U.C.C. Rep. Serv. (Callaghan) 1772 (Bankr. M.D. Ga. 1984). However, if the secured party impliedly authorizes a sale of the milk, the secured party could waive his right to the proceeds of the milk sale. *See In re* Quaal, 38 U.C.C. Rep. Serv. (Callaghan) 1769 (Bankr. D. Minn. 1984); *In re* Thomas, 38 U.C.C. Rep. Serv. (Callaghan) 1766 (Bankr. D.N.D. 1983).

[253] Products and offspring of livestock are included in the definition of farm products. *See* U.C.C. § 9-109(3) (1962 & 1972).

[254] Tri-County Livestock Auction Co. v. Bank of Madison, 185 S.E.2d 393, 393 (Ga. 1971).

[255] Fairchild v. Lebanon Prod. Credit Assoc., 31 Bankr. 789 (Bankr. S.D. Ohio 1983).

[256] *In re* Sunberg, 729 F.2d 561 (8th Cir. 1984).

[257] 13 N. HARL, *supra* note 235, at ¶ 118.03(2).

[258] 11 U.S.C. § 552(b) (1979).

[259] 729 F.2d 561.

and deposit accounts), cash proceeds not commingled with other money, cash proceeds commingled but subject to set-off, or cash proceeds received by the debtor within ten days prior to the filing of the proceeding less any payments made to the secured creditor and other monies to which the creditor would otherwise be entitled.[260]

Determining the proper classification of the collateral is important because it defines the proper place for filing the financing statement to perfect the security interest.[261] Confusion as to the proper classification is created by the variables involved. For example, when a nonfarmer-debtor purchased horses for racing, the horses were "equipment" and not "farm products."[262] Only persons engaged in farming own livestock that are "farm products."[263]

The classification of equipment used in both farming operations and other business endeavors results in a substantial amount of litigation. Many states[264] have applied the "actual use" test to determine whether the equipment is primarily used in farming operations.[265] Courts examine the equipment's operation in order to classify the collateral as used primarily in either business or farming operations.[266]

When collateral is not in possession of the farmer, it may cease to be farm products and become inventory.[267] Recently, stored grain was deemed to be inventory instead of farm products.[268]

"Floating lien" is not defined in Article Nine, but the term denotes a lien which "floats over changing collateral, such as inventory or accounts receivable."[269] "The typical components of the floating lien are (1) after-acquired property, (2) proceeds,

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[260] U.C.C. § 9-306(4) (1962 & 1972).

[261] U.C.C. § 9-401 (1962 & 1972).

[262] *In re* Bob Schwermer & Assocs., 27 Bankr. 304 (Bankr. N.D. Ill. 1983).

[263] *Id.*

[264] *See, e.g., In re* Rahberg Farms, 8 Bankr. 244 (W.D. Wis. 1981); *In re* Blease, 24 U.C.C. Rep. Serv. (Callaghan) 450 (Bankr. D.N.J. 1978).

[265] *See* 8 Bankr. 244.

[266] *See, e.g.*, Sequoia Machinery, Inc. v. Jarrett, 410 F.2d 1116 (9th Cir. 1969); *In re* Butler, 3 Bankr. 182 (E.D. Tenn. 1980).

[267] U.C.C. § 9-109 comment 4 (1972).

[268] *In re* Tinsley & Groom, Nos. 1-83-0015(B), 5-83-00080(B), 5-83-00079(B) (Bankr. W.D. Ky. Nov. 2, 1984).

[269] Meyer, *supra* note 236, at 12 n.32.

(3) future advances, (4) ability of secured party to use and control collateral . . . and (5) simple notice filing."[270] Some have considered the 1962 version of the U.C.C. to be a significant limitation on the "floating lien" because it imposes the impractical requirement that a security agreement must be executed every year, even though the financing statement need only be filed every five years.

B. Perfection

Perfection of the security interest is the goal of every secured creditor because it "makes the creditor's position virtually—not absolutely—impregnable."[271] While attachment[272] protects a creditor's interest against the debtor, perfection is necessary to protect the interest from that of other creditors in the same collateral. Depending on the classification of the collateral, secured interests in collateral are perfected in one of three ways:

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[270] *Id.*

[271] 13 N. HARL, *supra* note 235, at ¶ 117.04.

[272] Attachment occurs as soon as events specified in U.C.C. § 9-203(1) have taken place unless an explicit agreement postpones the time of the attachment. *See* U.C.C. § 9-203(2) (1972). The time of attachment occurs at different times under the 1962 and 1972 U.C.C. versions. Under the 1962 text, in a written agreement, absent a pledge, the security interest is not *enforceable* until the debtor signs the security agreement. *See* U.C.C. § 9-203(1)(b) (1962). In the 1972 version, the drafters cured the anomaly that a security interest can attach, be perfected and still be unenforceable against anyone who has not signed a security agreement by explicitly stating that the agreement is enforceable if all the events have occurred. *See* U.C.C. § 9-203(2) (1972). Under both versions of Article 9, once the debtor signs the security agreement, the secured party has an attached security interest enforceable against the debtor irrespective of perfection. *See* U.C.C. § 9-203(1)(a) (1972); U.C.C. § 9-203(1)(b) (1962). *See also* Meyer, *supra* note 236, at 11.

In the 1962 version of the U.C.C., no security interest attaches under an after-acquired property clause to crops more than one year after the security agreement is executed except when a security interest in crops is given in conjunction with a lease, land purchase or land improvement transaction. *See* U.C.C. § 9-204(4)(a) (1962). This section was eliminated by the 1972 U.C.C., which provides that a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral, with certain exceptions listed in U.C.C. § 9-204(2). *See* U.C.C. § 9-204(1) (1972). General descriptions of the after-acquired property may be accepted. *See In re* Sunberg, 729 F.2d 561. Therefore, under the 1972 version, a security interest can be created in "crops . . . to be grown" and "products of . . . livestock." *See* U.C.C. §§ 9-203(1)(a), -109(3) (1972).

(1) automatic perfection;[273] (2) perfection by possession;[274] and (3) filing a financing statement.[275]

The financing statement is the appropriate method for perfecting a security interest in the kinds of collateral generally pledged by farmers,[276] namely crops, livestock or farm equipment.[277] However, sometimes problems arise with respect to the place of filing the financing statement. The 1962 and 1972 versions of the U.C.C., and the alternative provisions therein, offer

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[273] U.C.C. § 9-302(1) (1972). Instances where perfection of the security interest automatically accompanies the attachment are: (1) those "security interest[s] temporarily perfected in instruments or documents without delivery under Section 9-304 or in proceeds for a 10-day period under Section 9-306;" (2) "security interest[s] created by an assignment of a beneficial interest in a trust or a decedent's estate;" (3) "purchase money security interest[s] in consumer goods;" (4) "assignment[s] of accounts which do not alone or in conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts of the assignor;" (5) "security interest[s] of a collecting bank (Section 4-208) or arising under the Article on Sales (*see* Section 9-113)" or under U.C.C. § 9-302(3) (1972); and (6) "assignment[s] for the benefit of all the creditors of the transferor; and subsequent transfers by the assignee thereunder." U.C.C. § 9-302 (1972).

[274] U.C.C. § 9-305 (1972). Some interests can be perfected by the secured party taking possession of the collateral. *See* U.C.C. § 9-305 (1962 & 1972). However, possession is not required to perfect an interest in instruments or negotiable documents for a period of 21 days between the date of the agreement and secured creditor receiving possession. U.C.C. § 9-304(4) (1962 & 1972). The 21-day period was chosen to conform to § 60 of the Federal Bankruptcy Act. *See* U.C.C. § 9-304 comment 4 (1972). Secured interests in collateral that include letters of credit, advices of credit, goods, instruments (other than certified securities which are governed by U.C.C. § 8-321 (1972)), negotiable documents, chattel paper or money may be perfected by possession. U.C.C. § 9-305 (1962 & 1972). Accounts and general intangibles are excluded. *See* U.C.C. § 9-305 comment 1 (1972).

[275] *See* U.C.C. § 9-302(1) (1962 & 1972).

[276] U.C.C. § 9-302(1) (1962 & 1972). The 1962 version requires that the financing statement be signed by the debtor and the secured party to be effective against third parties. *See* U.C.C. § 9-402(1) (1962). *See also* Hutchison v. C.I.T. Corp., 576 F. Supp. 1 (W.D. Ky. 1982), *aff'd*, 726 F.2d 300 (6th Cir. 1984). The 1972 version dispenses with the requirement of the signature of the secured party. *See* U.C.C. § 9-402(1) (1972). The financing statement may be filed before the security agreement is made or attaches. U.C.C. § 9-402(1) (1962 & 1972). A copy of the security agreement will suffice as a financing statement providing it satisfies statutory requirements. *See* U.C.C. § 9-402(1) (1962 & 1972). *See also In re* Sunberg, 729 F.2d 561.

[277] The 1962 text requires that a financing statement be filed to perfect a purchase money security interest in farm equipment with a purchase price in excess of $2500. *See* U.C.C. § 9-302(1)(c) (1962). Kentucky requires a financing statement for farm equipment with a purchase price in excess of $500. *See* KRS § 355.9-302(1)(c) (1984). The purchase price of farm machinery is calculated as "the cash amount paid or agreed to be paid, plus the agreed value of any merchandise traded, but not including interest or finance charges." Mammoth Cave Prod. Credit Ass'n v. York, 429 S.W.2d 26, 28 (Ky. 1968).

or suggest different places to file the financing statement.[278] Depending on the description of the collateral, the financing statement is generally filed in the county where the collateral is located or with the Secretary of State.[279] The secured party *must* check the version of the U.C.C. adopted in the applicable jurisdiction, since filing in the wrong place will affect the secured party's priority in the collateral.

A secured creditor who improperly files a financing statement is not without redress. A good faith filing of a financing statement in an improper place, or not in all of the required places, may be effective if the competing party has knowledge of the filing.[280] For example, if, in good faith, secured party *A* misfiled a financing statement covering farm equipment and secured party *B* had knowledge of the contents of the financing statement, secured party *A*'s improperly filed financing statement would be effective against secured party *B*.[281]

A financing statement is generally effective for a period of five years from the date of filing.[282] A change in ownership of the collateral may be reflected by amendment of the financing statement,[283] and the financing statement remains effective upon the commencement and for the duration of insolvency proceedings.[284] However, upon lapse of the effective period, the security interest is deemed unperfected as against a creditor who subsequently became a purchaser or lien creditor prior to the lapse of the effective period.[285]

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[278] U.C.C. § 9-401(1) (1962 & 1972).

[279] *See id.* Kentucky requires a financing statement involving farming equipment, farm products, or contract rights or general intangibles relating to the sale of farm products by a farmer, to be filed in the county where the debtor resides, or if the debtor is a non-resident, where the goods are kept. *See* KRS § 355.9-401(1)(a) (1984). In addition, if the collateral is crops, the financing statement must be filed in the county where the crops are growing or are to be grown; when the collateral is goods, then the statement should be filed in the office where a mortgage on real estate is filed. *Id.*

[280] U.C.C. § 9-401(2) (1962 & 1972).

[281] *See In re* Johnson, 28 Bankr. 292 (N.D. Ill. 1983).

[282] U.C.C. § 9-403(2) (1962 & 1972). "Presentation for filing of a financing statement and tendering of the filing fee or acceptance of the statement by the filing officer constitutes filing under [Article 9]." U.C.C. § 9-403(1) (1962 & 1972).

[283] U.C.C. § 9-402 (1962 & 1972). *See also* 84 Ky. Op. Att'y Gen. 38 (1984).

[284] U.C.C. § 9-403(2) (1972). Once insolvency proceedings are commenced the security interest remains perfected for a period of 60 days after the termination of insolvency proceedings or until the expiration of the five year period, whichever occurs later. *See id. See also In re* Chaseley's Foods, Inc., 726 F.2d 303 (7th Cir. 1983).

[285] U.C.C. § 9-403(2) (1972).

Relocation of the debtor or the collateral may also affect the continuation of the perfected security interest in some states. If a Kentucky debtor moves or if collateral is relocated, the continuation of the perfected security interest will not be affected.[286] However, in many jurisdictions the financing statement must be refiled in the new county within four months after the debtor's residence changes or it becomes ineffective.[287] In the event refiling is required and the creditor files after four months, there is an impaired perfection and the perfection dates from the time of filing in the new county.[288]

A continuation statement filed within six months prior to the expiration of the five year period prevents a perfected interest from becoming unperfected and continues the effective period for another five years.[289] It may only continue the secured interests stated in the original financing statement; no additional collateral can be included in the continuation statement.[290] There may be as many continuation statements filed to continue the effectiveness of the original statement as the secured party desires.[291] Failure to file a continuation statement, thus allowing the financial statement to lapse, does not invalidate the security interest, but the security interest becomes unperfected.[292]

Although both the 1962 and the 1972 versions of the U.C.C. contain provisions for a termination statement,[293] filing such a statement is not compulsory,[294] except with respect to a perfected

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[286] KRS § 355.9-401(3) (1984).

[287] U.C.C. § 9-401 (1962 & 1972).

[288] U.C.C. § 9-401 (1962 & 1972).

[289] U.C.C. § 9-403(3) (1972).

> A continuation statement must be signed by the secured party, identify the original statement by file number, and state that the original statement is still effective. [If the] continuation statement [is] signed by a person other than the secured party of record it must be accompanied by a separate written statement of assignment signed by the secured party of record and comply . . . with the provisions of [U.C.C. § 9-405(2)], including payment of the required fee.

Id.

[290] *In re* Merrill, 29 Bankr. 531 (Bankr. D. Me. 1983).

[291] U.C.C. § 9-403(3) (1962 & 1972).

[292] U.C.C. § 9-403(2) (1962 & 1972). *See* Frank v. James Talcott, Inc., 692 F.2d 734 (11th Cir. 1982); *In re* Radcliff Door Co., 17 Bankr. 153 (Bankr. W.D. Ky. 1982); *In re* Pischke, 11 Bankr. 913 (Bankr. E.D. Va. 1981).

[293] *See* U.C.C. § 9-404(1) (1962 & 1972).

[294] *See* U.C.C. § 9-404(1) (1962 & 1972).

security interest in consumer goods under the 1972 version.[295] However, a secured party must send the debtor a termination statement if requested to do so.[296]

C. *Priority of Secured Interests*

Problems arise when it is necessary to determine the priority of several perfected interests. A perfected secured creditor has priority over the debtor, over unsecured creditors and over secured but unperfected creditors.[297] Moreover, a perfected secured creditor will prevail against a trustee in bankruptcy[298] and against other lien and perfected secured creditors with lesser priorities.[299] There are basically five groups of claimants to consider when evaluating priority problems: (1) perfected secured creditors; (2) unperfected secured creditors; (3) unsecured creditors, including lien creditors under U.C.C. section 9-301(4); (4) buyers in the ordinary course of business; and (5) the debtor's trustee in bankruptcy.[300] "[A] security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors,"[301] except for certain relationships and situations, including a contest between an unperfected secured creditor and a lien creditor,[302] an authorized disposition by the secured party,[303] a buyer in the ordinary course of business,[304] a purchaser of chattel paper,[305] a secured creditor and certain purchasers of documents of title and holders in due course of negotiable instruments,[306] a statutory lienholder in certain in-

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[295] U.C.C. § 9-404(1) (1972). *See also* N. HARL, *supra* note 235, at ¶ 117.043.

[296] U.C.C. § 9-404(1) (1962 & 1972).

[297] U.C.C. §§ 9-301, -312 (1972). *See also* Hutchison v. CIT Corp., 576 F. Supp. at 3 (Even though "CIT . . . had notice of . . . [secured party's] unrecorded security interest, . . . CIT's recorded security interest is superior to . . . [the] unrecorded security interst.").

[298] *See* N. HARL, *supra* note 235, at ¶ 117.04. *See also* 11 U.S.C.A. §§ 541, 544-547 (1979).

[299] U.C.C. § 9-312 (1962 & 1972).

[300] *See* Meyer, *supra* note 236, at 31.

[301] U.C.C. § 9-201 (1962 & 1972).

[302] *See* U.C.C. § 9-301 (1962 & 1972).

[303] *See* U.C.C. § 9-306(2) (1962 & 1972).

[304] *See* U.C.C. § 9-307(1) (1962 & 1972).

[305] *See* U.C.C. § 9-308 (1962 & 1972).

[306] *See* U.C.C. § 9-309 (1962 & 1972).

stances,[307] conflicting security interests in the same collateral,[308] and proceeds.[309]

Commercial transactions involving farmers most frequently give rise to priority conflicts in farm products sold by farmers to third parties and in collateral held by farmers. The following discussion deals with these problems.

D. Buyers of Farm Products

Under the 1972 version of the U.C.C., an unperfected security interest is subordinate to the rights of a buyer of farm products in the ordinary course of business who is without knowledge of the security interest before it is perfected.[310] The 1962 version does not specifically provide the same protection to the buyer of farm products.[311]

A person buying farm products from one engaged in farming operations cannot avoid a perfected security interest created by his seller.[312] This places a burden on the buyer of farm products to determine prior to purchase whether the farm products are encumbered.[313] When purchasing encumbered farm products, the buyer can avoid a loss by making a joint payee check to the seller and the creditor.[314]

This provision provides substantial protection to the farm creditor with a perfected security interest.[315] Unless the farm creditor authorized disposition in the security agreement or otherwise, his collateral is protected notwithstanding sale, exchange or other disposition. The security interest "continues in any identifiable proceeds including collections received by the debtor."[316]

Under both the 1962 and the 1972 versions, the perfected security interest generally extends to one who purchases from a

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[307] *See* U.C.C. § 9-310 (1962 & 1972).

[308] *See* U.C.C. §§ 9-301, -312 (1962 & 1972).

[309] *See* U.C.C. § 9-306 (1962 & 1972).

[310] U.C.C. § 9-301(1)(c) and comment 4 (1972).

[311] *Compare* U.C.C. § 9-301(1)(c) (1972) *with* U.C.C. § 9-301(1)(c) (1962).

[312] U.C.C. § 9-307 (1962 & 1972).

[313] Note, *The Farm Creditor: Preserving Security Interests in Farm Products*, 33 DRAKE L. REV. 391, 393 (1983-84).

[314] *Id.*

[315] U.C.C. § 9-306 comment 3 (1972).

[316] U.C.C. § 9-306(2) (1962 & 1972).

buyer in the ordinary course of business.[317] For example, if the farmer has given to a bank a valid, enforceable and perfected security interest in his cattle, then a buyer in the ordinary course of business would *not* take free of the bank's perfected security interest.[318] The person who purchases the cattle from the buyer in the ordinary course of business also would not take free of the security interest.[319]

Two arguments are usually given to support the farm products exception to the priority rules. One is that "agriculture is a capital intensive industry which would not be able to obtain adequate financing without protecting the creditor's interest."[320] The other argument is "based on the theory that the farm products purchaser is better able to understand the . . . exception and protect himself against it, than are buyers of other goods."[321] The exception makes financing more feasible by easing the burden on the secured creditor to monitor easily sold collateral and encouraging all purchasers to protect other purchasers' interests.

The Kentucky legislature has eased the burden of the buyer in the ordinary course of business by enacting a statute expanding protection of buyers and sellers in the ordinary course of business to sales of tobacco, grain or soybean crops, livestock and race horses.[322] If the above-mentioned collateral is subject to a lien and is sold through a duly-licensed entity in the ordinary course of business, a buyer without written notice of the lien will take the product free of the lien and will not be liable for conversion.[323]

The Kentucky statute protects purchasers of tobacco, grain, soybeans, livestock and race horses by equating them with other buyers in the ordinary course of business.[324] The burden does not shift to the purchaser to protect the secured creditor's interest.[325] Often, the seller/auctioneer is deemed an agent for the

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[317] U.C.C. §§ 9-306(2), -307(1) (1962 & 1972).
[318] Note, *supra* note 313, at 393-94.
[319] *Id.*
[320] *Id.* at 394.
[321] *Id.* at 395.
[322] KRS § 355.9-307(2)-(4), (6) (1984).
[323] KRS § 355.9-307(2)-(4), (6).
[324] *See* KRS § 355.9-307 Kentucky commentary.
[325] KRS § 355.9-307(1).

farmer-debtor.[326] In one instance an agent of the debtor was subject to a security interest that had been properly perfected between a farmer and the secured creditor, and was liable for converting the collateral (cows) when he wrongfully sold them at auction.[327]

Kentucky places the primary burden of protecting secured interests by monitoring the collateral on the secured creditor. The secured creditor can notify the tobacco warehouses, grain warehouses and stockyards and can use these entities to police the secured interests.[328]

The secured farm creditor may defeat his own security interest in the collateral by authorizing disposition of the collateral.[329] The security interest continues "unless the disposition was authorized by the secured party in the security agreement *or otherwise*."[330] The term "or otherwise" has not been uniformly applied. Some courts have interpreted the language to include implied waivers by the secured party.[331] Other courts have ruled that the secured creditor has not waived rights in the collateral by allowing prior sales.[332]

One of the leading cases holding against an implied waiver of the security interest by the creditor is *Garden City Production Credit Association v. Lannan*.[333] The parties had a provision in the security agreement requiring the creditor's approval prior to

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[326] United States v. Sommerville, 211 F. Supp. 843, 847 (W.D. Pa. 1962), *aff'd*, 324 F.2d 712 (3d Cir. 1963), *cert. denied*, 376 U.S. 909 (1964).

[327] *Id.* at 848.

[328] *See, e.g.*, KRS § 355.9-307(2).

[329] U.C.C. § 9-306(2) (1962 & 1972).

[330] U.C.C. § 9-306(2) (1962 & 1972) (emphasis added).

[331] *See, e.g.*, Wabasso State Bank v. Caldwell Packing Co., 251 N.W.2d 321, 325 (Minn. 1976) ("or otherwise" means that authorization to sell collateral can be granted in a form other than the security agreement itself).

[332] *See, e.g.*, Duvall-Wheeler Livestock Barn v. United States, 415 F.2d 226, 228 (5th Cir. 1969) ("sale . . . at public auction . . . in disregard of the recorded bills of sale, was a violation of the government's title and security"); United States v. E.W. Savage & Son, Inc., 343 F. Supp. 123, 126 (D.S.D. 1972) ("absent an express consent, the United States cannot be said to have acquiesced to the sale"), *aff'd*, 475 F.2d 305 (8th Cir. 1973); Baker Prod. Credit Ass'n v. Long Creek Meat Co., 513 P.2d 1129, 1134 (Or. 1973) ("nothing in the Code . . . to prevent a secured party from attaching conditions or limitations to its consent to sales of collateral by a debtor"); Southwest Wash. Prod. Credit Ass'n v. Seattle-First Nat'l Bank, 593 P.2d 167, 169 (Wash. 1979) ("sale by the debtor in violation of . . . conditions is an unauthorized sale and the security interest . . . continues in the collateral").

[333] 186 N.W.2d 99 (Neb. 1971).

sale of the collateral and providing specific ways for the debtor to obtain a waiver.[334] The court held that the secured creditor's failure to review prior sales did not waive its rights in the collateral or in the proceeds of the collateral.[335]

In *Clovis National Bank v. Thomas*,[336] the security agreement likewise required the debtor to obtain prior written consent before the sale of the collateral (cattle).[337] In *Thomas*, the creditor did not know the debtor was selling the cattle, and the debtor did not remit the sale proceeds to the creditor.[338] In contrast to *Garden City*, the court ruled that, because the debtor had previously sold collateral with the creditor's consent and without the written permission required in the security agreement, the creditor had waived its right to insist that the debtor comply with the terms of the agreement and obtain written permission from the creditor to sell the collateral.[339]

Another issue of concern to buyers of farm products is the so-called "borrower's list." Many buyers contact lenders and ask them to furnish a list of borrowers in whose crops or livestock the lender claims an interest. A lender honoring this request is faced with problems such as confidentiality, reliance and estoppel.[340] With regard to reliance and estoppel, one court has held that the "borrower's list" was "a convenience, and was not necessarily complete," and that the buyer must still check the appropriate records to determine the existence of liens upon farm products.[341]

E. Conflicting Security Interests in the Same Collateral

Problems with conflicting security interests in crops, equipment and proceeds arise in farming operations.[342] Generally,

> [c]onflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is

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[334] *Id.* at 101.
[335] *Id.* at 104.
[336] 425 P.2d 726, 728 (N.M. 1967).
[337] *Id.*
[338] *Id.*
[339] *See id.* at 730-32.
[340] *See* Meyer, *supra* note 236, at 37.
[341] United States v. Riceland Foods, Inc., 504 F. Supp. 1258 (E.D. Ark. 1981).
[342] *Cf.* U.C.C. § 9-312 comment 1 (1977).

> first made covering the collateral or the time the security interest is first perfected, whichever is earlier, provided there is no period thereafter where there is neither filing nor perfection."[343]

Priority is not extended to "additional collateral" if there is no provision for "future advances" within the terms of the security agreement.[344]

When crops are involved, special priority rules are applied. A perfected security interest in crops, given within three months before the crops start growing to secure "new value given to enable the debtor to produce the crops during the production season," takes priority over an earlier perfected security interest securing obligations due more than six months before the crops start growing even if the later secured creditor had knowledge of the earlier security interest.[345] However, advances made to enable a farmer to plant crops with an intent to acquire an interest in the crops,[346] improper filing of the financing statement,[347] and giving "new value" by the same creditor within a specified period of time[348] are all insufficient claims for priority under this provision.[349]

Another item affecting priority of secured interests involves statutory liens. There are a number of statutory liens involving farmers, including the thresher's lien,[350] the lien for feed and care of livestock,[351] the seeding lien,[352] the agister's lien,[353] the

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[343] U.C.C. § 9-312(5)(a) (1962 & 1972).

[344] ITT Indus. Credit Co. v. Union Bank & Trust Co., 615 S.W.2d 2, 4-5 (Ky. Ct. App. 1981). *But see* Allis Chalmers Credit Corp. v. Cheney Inv., Inc., 605 P.2d 525 (Kan. 1980).

[345] U.C.C. § 9-312(2) (1962 & 1972).

[346] United States v. Busing, 7 U.C.C. Rep. Serv. (Callaghan) 1120, 1123 (E.D. Ill. 1970).

[347] United Tobacco Warehouse Co. v. Wells, 490 S.W.2d 152, 154 (Ky. 1973).

[348] United States v. Minster Farmers Coop. Exch., Inc., 430 F. Supp. 566, 570-71 (N.D. Ohio 1977).

[349] U.C.C. § 9-312(2) (1962 & 1972).

[350] *See, e.g.*, KRS § 376.135 (1984).

[351] *See, e.g.*, KRS § 376.410 (1984).

[352] *See, e.g.*, KRS § 376.135 (1984).

[353] *See* Mousel v. Daringer, 206 N.W.2d 579, 583-84 (Neb. 1973); Agristor Credit Corp. v. Unruh, 571 P.2d 1220, 1223-24 (Okla. 1977); Leger Mill Co. v. Kleen-Leen, Inc., 563 P.2d 132, 139 (Okla. 1977). *See also* Yeager & Sullivan, Inc. v. Farmers Bank, 317 N.E.2d 792 (Ind. Ct. App. 1974) (lien on livestock).

landlord's lien,[354] and the crop lien.[355] These liens can be either possessory or nonpossessory. Some of these liens can affect a security interest in crops. A statutory lien, unless the statute provides otherwise, takes priority over a perfected security interest, "[w]hen a person in the ordinary course of his business furnishes services or materials with respect to goods subject to a security interest."[356] The purpose of this provision is "[t]o provide that liens securing claims arising from work intended to enhance or preserve the value of the collateral take priority over an earlier security interest even though perfected."[357] For example, if a subcontractor acquires a mechanic's lien on improved property because of lack of payment from the contractor, the subcontractor's lien on proceeds due the contractor has priority over a secured creditor's lien arising from the security interest on the contractor's accounts receivable.[358]

The U.C.C. provides that a purchase money security interest (PMSI) in collateral *other than inventory* "has priority over a conflicting security interest in the same collateral . . . if the [PMSI] is perfected at the time the debtor receives possession of the collateral or within 10 days thereafter"[359] (twenty days in Kentucky[360]). The 1972 version extends the priority to the proceeds of the PMSI.[361] There is no requirement for notice, and the PMSI takes priority even if its holder knows of another interest in the collateral.[362]

F. Enforcing the Lien

When a debtor is in default, Part Five of Article Nine[363] provides the secured party with certain rights and remedies and,

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[354] *See, e.g.*, KRS §§ 383.070, .080 (1984).

[355] *See, e.g.*, KRS §§ 376.135, 383.110 (1984). For other examples see Meyer, *supra* note 236, at 39 n.118.

[356] U.C.C. § 9-310 (1972).

[357] U.C.C. § 9-310 comment 1 (1972).

[358] Citizens Fidelity Bank & Trust Co. v. Fenton Rigging Co., 522 S.W.2d 862, 864 (Ky. 1975).

[359] U.C.C. § 9-312(4) (1962, 1972 & 1977).

[360] KRS § 355.9-312(4) (1984).

[361] *Compare* U.C.C. § 9-312(4) (1972) *with* U.C.C. § 9-312(4) (1962).

[362] U.C.C. § 9-312 comment 3 (1972).

[363] U.C.C. § 9-501(1) (1962 & 1972).

except as limited therein,[364] with the rights and remedies in the security agreement. The secured party "may reduce his claim to judgment, foreclose or otherwise enforce the security interest by any available judicial procedure. If the collateral is documents the secured party may proceed either as to the documents or as to the goods covered thereby."[365] If the secured party is in possession of the collateral, U.C.C. section 9-207 applies.[366] If the loan is secured by equipment, the secured creditor's remedies include repossession and suit, and pursuit of one remedy does not prevent simultaneous pursuit of the other.[367]

The secured party's rights in the collateral following the debtor's default are the basis of a security interest.[368] Except as provided in the U.C.C., the security agreement is effective according to its terms against purchasers of the collateral and creditors.[369] Generally, the law of the state where the collateral is located is the governing law,[370] and extreme care should be taken in knowing the proper procedures when repossessing collateral. The creditor should be certain the collateral taken is the collateral designated in the security agreement.[371] A secured party who failed to note payment by the farmer-debtor on one tractor and elected to repossess, but could not locate the tractor and instead repossessed another piece of equipment (which was also financed by the secured party), was ordered to pay $843.74 in actual damages and $60,000 in punitive damages.[372]

V. BANKRUPTCIES OF GRAIN ELEVATORS

Farmers are directly harmed by grain elevator bankruptcies because the assets of an insolvent grain elevator seldom cover

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[364] U.C.C. § 9-501(3) (1962 & 1972).

[365] U.C.C. § 9-501(1) (1962 & 1972).

[366] U.C.C. § 9-501(1) (1972).

[367] Ingersoll-Rand Fin. Corp. v. Electro Coal, Inc., 496 F. Supp. 1289, 1291 (E.D. Ky. 1980).

[368] *See* U.C.C. § 9-501 comment 1 (1972).

[369] U.C.C. § 9-201 (1962 & 1972).

[370] U.C.C. § 9-102 comment 3 (1972); U.C.C. § 9-103(1)(b) (1977). This section is not in the 1962 version of the U.C.C.

[371] *See, e.g.*, Mitchell v. Ford Motor Credit Co., 38 U.C.C. Rep. Serv. (Callaghan) 1812, 1814 (Okla. 1984).

[372] *Id.* at 1813, 1817.

all claims.[373] With production of corn, wheat and soybeans at or near the highest levels in history, storage of grain is on the rise.[374] Grain warehousemen provide the facilities to store the grain until the farmer is ready to sell it on the market.[375] Although grain elevators, warehousemen and dealers are heavily regulated, the "measures have been inadequate to provide stability in the grain industry."[376]

General mismanagement and losses in the grain futures market have been the main causes of grain elevator bankruptcies.[377] The Bankruptcy Amendments and Federal Judgeship Act of 1984 has added several new provisions increasing the protection for farmers with unsecured claims against a debtor operating a grain storage facility. Each farmer has a priority up to $2,000.[378] This priority may enable the very small farmer to collect at least a portion of his claim. The 1984 Act also preserved the statutory and common law rights of the grain producer to reclaim grain sold to an insolvent grain storage facility.[379]

The 1984 Act also includes a provision expediting determination of the facility's interest in, abandonment of, or other disposition of grain.[380] The entire proceedings are not to exceed 120 days and the time period can only be extended for cause.[381] The trustee can receive reasonable and necessary costs and expenses from the proceeds of sale of the grain.[382] If the grain involves more than 10,000 bushels, the trustee must sell it.[383]

Another protective provision for farmers is that, to the extent not inconsistent with the United States Warehouse Act or applicable state law, a warehouse receipt (or its equivalent) is "prima facie evidence of the validity and amount of a claim of ownership of a quantity of grain."[384]

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[373] *See* Comment, *Grain Elevator Bankruptcy—Has Illinois Successfully Provided Security to Farmers?*, 1983 S. ILL. U.L.J. 337, 338 n.9.

[374] *Id.* at 340.

[375] *Id.* at 340-41.

[376] *Id.* at 341.

[377] *Id.*

[378] 11 U.S.C.A. § 507(a) (effective Oct. 8, 1984).

[379] 11 U.S.C.A. § 546(d) (effective Oct. 8, 1984).

[380] 11 U.S.C.A. § 557 (effective Oct. 8, 1984).

[381] 11 U.S.C.A. § 557(c)(1) (effective Oct. 8, 1984).

[382] 11 U.S.C.A. § 557(h)-(i) (effective Oct. 8, 1984).

[383] 11 U.S.C.A. § 557(i) (effective Oct. 8, 1984).

[384] BANKR. RULE 3001(g).

It is important to note that these new provisions of the Act may deal with two separate situations. In one instance, the farmer stores his grain in a grain elevator or grain storage facility.[385] Grain storage facilities may engage in several different activities including warehousing or storage of grain,[386] storage of grain under a grain bank program,[387] entering into deferred pricing contracts,[388] and outright purchase of grain from farmers.[389]

Warehousing or storage of grain for farmers should be considered a bailment transaction.[390] Storage of grain in a grain bank may also be a bailment transaction. Grain banking is typically a service furnished by feed mills which may also be grain storage facilities or grain warehouses. Grain banking involves delivery by the farmer of grain to the storage facility where it is stored and later used in making feed for the farmer. The grain is returned to the farmer a little at a time as needed.

In the second instance, the farmer may sell his grain to the grain storage facility.[391] In the case of a sale transaction between a farmer and a grain storage facility, the farmer would have only two nonexclusive options in the event of nonpayment and bankruptcy by the grain storage facility. He can claim the $2,000 priority set forth in section 507(a)(5) of the Bankruptcy Code[392] or he can attempt to reclaim the grain pursuant to Code section 546(d).[393] Except to the extent they are modified by section 546(d), any statutory or common law rights of reclamation of producers are recognized. Specifically, the farmer's demand for reclamation must be made on the grain storage facility in writ-

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[385] *See, e.g.*, 11 U.S.C.A. § 557(b)(2) (effective Oct. 8, 1984).

[386] 11 U.S.C.A. § 557(b)(2) (effective Oct. 8, 1984).

[387] 11 U.S.C.A. § 557(b)(2) (effective Oct. 8, 1984).

[388] Deferred pricing contracts involve the purchase of grain by a grain merchant or grain storage facility where the seller of the grain has a contractual right to determine the selling price during a specified period of time after the grain is received by the buyer. These are also referred to as price-later contracts. *See* Comment, *supra* note 382, at 341-42.

[389] *See, e.g.*, 11 U.S.C.A. § 557(b)(2) (effective Oct. 8, 1984).

[390] *See, e.g.*, *In re* Bowling Green Milling Co., 132 F.2d 279, 284 (6th Cir. 1942) ("provision for storage . . . smacks not of sale, but of bailment"); Lyon v. Lenon, 7 N.E. 311, 314 (Ind. 1886) (transaction a bailment if depositor can get return of grain on demand); IND. CODE ANN. § 26-3-7-19(b) (Burns Supp. 1984).

[391] *See, e.g.*, 11 U.S.C.A. § 557(b)(2) (effective Oct. 8, 1984).

[392] 11 U.S.C.A. § 507(a)(5) (effective Oct. 8, 1984).

[393] 11 U.S.C.A. § 546(d) (effective Oct. 8, 1984).

ing.[394] Under the U.C.C. (outside of the bankruptcy context), a seller might reclaim the goods after the ten-day period if there had been a written misrepresentation of solvency made to the seller within three months before delivery.[395]

A bond must be posted by the warehouseman under federal grain warehousing law or applicable state law.[396] Because state laws regulating grain storage facilities are usually intended to provide protection only for persons storing grain in such facilities, the ability to make a claim against a bond may not be available to the producer in a sales transaction. Such laws do not regulate the mere buying and selling of grain.[397]

Finally, the farmer should request relief from the stay and/or adequate protection under section 362(d) of the Code by virtue of the farmer's property interest as a bailor in the grain.[398] In fact, the time period provided in section 362(e) is shorter than the time period set forth in section 557 for proceeding to determine the grain facility's interest in the grain.[399] Adequate protection of the farmer's property interest might include a request that insurance be maintained upon the grain,[400] that the grain stored in the facility be maintained at a level which would equal the total warehouse receipts and other storage obligations of the grain storage facility,[401] that periodic reports of the grain on hand be made,[402] and that the appropriate regulatory agency be allowed to inspect the grain storage facility on a periodic basis.[403]

By virtue of a farmer's property interest as a bailor in the grain, the farmer is entitled to have this property interest protected.[404] In the event the grain storage facility debtor is unable

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[394] 11 U.S.C.A. § 546(d) (effective Oct. 8, 1984).

[395] U.C.C. § 2-702 (1962 & 1972).

[396] *See, e.g.*, 7 U.S.C. §§ 247, 249; KRS §§ 359.060, 251.440, .670 (1982 & Cum. Supp. 1984); IND. CODE ANN. §§ 26-3-7-9 to -16.5 (Burns Supp. 1984).

[397] *See, e.g.*, KRS § 251.440. *But see* KRS § 251.670 (1984).

[398] 11 U.S.C. § 362(d) (1978).

[399] *Compare* 11 U.S.C.A. § 362(e) (effective Oct. 8, 1984) (30 days) *with* 11 U.S.C.A. § 557(c)(1) (effective Oct. 8, 1984) (120 days).

[400] KRS § 251.440 (1984).

[401] KRS § 251.490 (1984).

[402] KRS § 251.480 (1984).

[403] KRS § 251.490 (1984).

[404] *See* Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 589-90 (1935) (bankruptcy power subject to 5th Amendment); 132 F.2d at 285; U.S. CONST. amend. V; 11 U.S.C.A. § 361 (1979 & Supp. 1985).

to provide adequate protection for the farmer's property interest, then the farmer would be entitled to relief from the stay and would be able to obtain possession of his grain.[405] If the court finds the farmer's property interest can be adequately protected and the grain storage facility is subsequently unable to provide such adequate protection, then the farmer would be entitled to a super priority claim.[406] A super priority claim generally has priority over every other claim.[407]

VI. WAREHOUSE RECEIPTS AND SECURED CREDITOR PRIORITY

Many times after harvesting, the price for grain is at its lowest point, causing many farmers to store their grain in warehouses and obtain warehouse receipts. These receipts can be either negotiable or nonnegotiable.[408] The priority determination between warehouse receipts and other security interests in the grain depends primarily on the warehouse receipt's negotiability.[409] One author suggests that "the safest thing for a secured party to do [when crops are to be stored,] is to require the farmer to have a nonnegotiable receipt issued in the name of the secured party."[410] The security agreement should specify the issuance of a nonnegotiable receipt prior to harvest.[411] In the event the farmer subsequently transfers the warehouse receipt to a second secured creditor, then the provisions of U.C.C. sections 9-313(5) and 9-304(3) would give the first secured party, provided it had perfected regarding the crops, priority over the second party.[412] The first secured party may, however, lose priority if it has waived its rights.[413]

Another situation arises when a "double dealing" farmer is in financial trouble and is issued a negotiable warehouse receipt. Professor Clark provides an example:

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[405] 11 U.S.C.A. § 362(d) (1985).
[406] 11 U.S.C.A. § 507(b) (1979).
[407] 11 U.S.C.A. § 507(b) (1979).
[408] Meyer, *supra* note 236, at 6.
[409] *Id.* at 48.
[410] *Id.*
[411] *Id.*
[412] *Id.*
[413] *Id.* at 49. *See also* U.C.C. § 9-306(2) (1962 & 1972).

> On May 1, Country Bank *A* loans Farmer $20,000 and perfects a security interest in Farmer's growing wheat crop. After cutting the wheat in June, Farmer delivers the entire crop to Coop Elevator Company on July 1. Farmer intends to store the wheat in the elevator while waiting for prices to rise. Coop issues to Farmer a negotiable warehouse receipt covering the wheat in equivalent fungible bushels. Unknown to Country Bank *A*, Farmer pledges the warehouse receipt to Country Bank *B* as security for a new $15,000 loan.[414]

In the case of the farmer's double default, Professor Clark suggests Country Bank A would probably prevail:

> A security interest in goods is perfected by perfecting a security interest in the negotiable warehouse receipt only during the period which the goods are in possession of the issuer.[415] Since Country Bank *A* had perfected its security interest *before* the wheat was delivered to the elevator, the holder of the warehouse receipt obtained no rights to the wheat. Conversely, if Country Bank *A* had not perfected as to the wheat until after delivery to the elevator, by failing to file a financing statement or misdescribing the property, any interest in the wheat would depend on possession of the receipt, and Country Bank *B* would prevail.
>
> These results are supported by §§ 7-501, 7-502, 7-503 of the UCC, which provide that a holder to whom a negotiable document of title has been "duly negotiated" in the "regular course of business or financing" gets title to the goods as well as title to the document. The only exception is found in § 7-503(1), which provides that a document of title "confers no right in goods against a person who before issuance of the document had a legal interest or perfected security interest in them and who neither (a) delivered or entrusted them or any document of title covering them to the bailor or his nominee with actual or apparent authority to ship, store or sell . . . nor (b) acquiesced in the procurement by the bailor or his nominee of any document of title. . . ." Country Bank *A* had an interest in the wheat before issuance, and the facts don't indicate that the bank gave apparent

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[414] B. CLARK, THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE ¶ 8.5(2)(e) at 8-56 to 8-57 (1980).

[415] U.C.C. § 9-304(2) (1962 & 1977).

authority to Farmer to store the wheat or acquiesced in procurement of the warehouse receipt.[416]

However, Professor Clark notes that the crop lender's awareness that the farmers will store their crops in an elevator and obtain warehouse receipts allows Country Bank B to argue that "it has priority to the receipt and the wheat it represents under [Code section] 7-503, since Country Bank A has at least 'acquiesced' in the issuance of a warehouse receipt."[417]

The possibility of the issuance of a negotiable warehouse receipt to a second secured party requires the first secured party to monitor the debtor when the stored grains are covered by a security agreement.[418] The secured party should, within the security agreement, affirmatively object to the issuance of a negotiable warehouse receipt.[419] Although, it would be wise for the first secured party to require payment of the loan upon harvest, there is an obvious problem if prices are extremely low at that time.[420] One court upheld an action in conversion against the holders of warehouse receipts representing cotton on which the Farmers Home Administration had prior perfected security interests.[421] The holders were liable even though they were totally innocent.[422] Although the conversion was decided under the law of Louisiana, which has not adopted Article Nine, Professor Clark suggested the result would probably be the same under U.C.C. section 9-304(2).[423] Kentucky Revised Statutes section 355.9-309 prevents a similar conversion action in Kentucky if the warehouseman was licensed.[424]

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[416] B. CLARK, *supra* note 414, ¶ 8.5(2)(e) at 8-56 to 8-57.

[417] *Id.* at 8-58.

[418] Meyer, *supra* note 236, at 53.

[419] *Id.*

[420] *Id.*

[421] United States v. Weems, 680 F.2d 26, 28-29 (5th Cir. 1982).

[422] *Id.*

[423] B. CLARK, *supra* note 414, ¶ 8.5[1][a] at S8-18 (1984 Supp. no. 1.).

[424] KRS § 355.9-309 provides in pertinent part:

> Nothing in this article limits the rights of a holder in due course of a negotiable instrument (KRS § 355.3-302) or a holder to whom a negotiable document of title has been duly negotiated (KRS § 355.7-501) or a bona fide purchaser of a security (KRS § 355.8-301) and such holders or purchasers take priority over an earlier security interest even though perfected. Filing under this article does not constitute notice of the security interest to such holders or purchasers.

VII. PACKERS AND STOCKYARDS ACT AND ITS PROTECTION FOR FARMERS

Congress amended the Packers and Stockyards Act[425] in 1976 in response to the hardships incurred by livestock producers resulting from the bankruptcy of American Beef Packers.[426] The amendment requires packers to hold certain assets in trust until cash sellers of livestock, middlemen, market agencies and dealers are paid in full.[427]

The amendment requires packers whose average annual purchases exceed $500,000 to place in trust for the benefit of unpaid sellers the following assets: all livestock purchased by cash sales and any inventories, receivables, or proceeds "from meat, meat food products, or livestock products."[428] In the event it becomes infeasible to determine which assets of the packers had been derived from cash sales, all assets attributable to livestock sales are to be held in trust, with the burden of establishing which assets are attributable to livestock sales placed upon the claimant.[429]

To be eligible to assert a claim under the amendment, livestock producers must sell livestock to packers on a cash basis and give written notice to the packer and the Secretary of Agriculture within thirty days of the final day for making payment, or within fifteen business days after receipt of notice that the instrument presented for payment has been dishonored.[430] Sellers lose the benefit of the trust if no payment instrument is received within thirty days of the sale or within fifteen business days after notice of dishonor of an instrument.[431] A sale is a cash sale if the producer has not expressed a clear intent to extend credit to the packer.[432] A packer is defined to include buyers of livestock for purposes of slaughter, for purposes "of manufacturing or preparing meats or meat food products," or

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[425] 7 U.S.C.A. § 181 (1980). The Packers & Stockyards Act applies only to the transactions described above which are deemed in commerce. *See* 7 U.S.C.A. §§ 182(6), 183 (1980).

[426] *In re* Frosty Morn Meats, Inc., 7 Bankr. 988, 999 app. A (M.D. Tenn. 1980).

[427] 7 U.S.C.A. § 196(b) (1980).

[428] 7 U.S.C.A. § 196(b) (1980).

[429] 7 Bankr. at 997, 1012-13 app. A.

[430] 7 U.S.C.A. § 196(b) (1980).

[431] 7 U.S.C.A. § 196(b) (1980).

[432] 7 U.S.C.A. § 196(c) (1980).

for purposes "of marketing meats, meat food products, or livestock products in an unmanufactured form acting as a wholesale broker, dealer or distributor."[433] If a producer fails to make a timely claim or if the packer has not maintained the required assets in trust for cash sellers, the producer may either bring a claim against the bond which must be posted by a packer[434] or sue the packer for violating the Act.[435] If the producer sells to a packer, market agency or dealer, the Act requires payment before the close of the next business day after the date of sale and the transfer of possession of the livestock.[436] Market agencies and dealers as well as packers are required to post a bond.[437] A claim may be made against the bond[438] or suit may be brought if the market agency or dealer violates the Act or becomes insolvent.[439]

CONCLUSION

Unfortunately, the modern farmer is sometimes overwhelmed and left with no viable alternative except bankruptcy. Only the farmer may initiate bankruptcy proceedings, and he may choose either Chapter 7, 11 or 13 to accommodate his goals. The farmer who files under Chapter 11 or 13 cannot be involuntarily converted to Chapter 7. Some farmers who have initiated Chapter 11 proceedings, and have not submitted plans, have been involuntarily liquidated through creditor proposed Chapter 11 plans. The farmer may counter-propose plans and negotiate with creditors to achieve the plan he wants.

Farmers generally borrow from government-sponsored loan programs—including the Farm Credit System, Farmers Home Administration, Bank of Cooperatives and Commodity Credit Corporation—as well as commercial banks and insurance lenders.

The creditor may protect its interest against the debtor by obtaining a security agreement. By complying with the terms of

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[433] 7 U.S.C.A. § 191 (1980).
[434] 7 U.S.C.A. § 204 (1980).
[435] 7 U.S.C.A. § 209 (1980).
[436] 7 U.S.C.A. § 228b (1980).
[437] 7 U.S.C.A. § 204 (1980).
[438] 7 U.S.C.A. § 204 (1980).
[439] 7 U.S.C.A. § 209 (1980).

Article Nine, the creditor can, to some extent, protect its security interest in the collateral against other creditors. Protection against other creditors will depend on the nature of the security interest.

Congress continues to be aware of the problems of farmers. It has recently enacted new provisions in the Bankruptcy Code to protect grain farmers from grain elevator bankruptcies. It also has enacted protections for livestock farmers.

Farmers are not alone in the burdens of the cyclical nature of the business. Farmers, creditors, courts and consumers are feeling the impact of the indebtedness of the farmer, and each shares the burden of the fluctuation of the farm economy.