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Farm Financing Under the Uniform Commercial Code

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FARM FINANCING UNDER THE UNIFORM COMMERCIAL CODE

Farming is a modern business operation which requires a continuing line of credit. Not only must a farmer finance land acquisitions and major farm improvements, but he must find ways to finance the purchase of sophisticated equipment and the acquisition of seed, fertilizer and livestock. The Uniform Commercial Code has formulated special rules governing farm collateral which have contributed a great deal toward the tailoring of a workable line of credit for the farmer.

Perhaps the primary reason why a farmer merits special consideration regarding finance regulations is due to the peculiar collateral used in his operations. The ordinary merchant deals in a stable commodity where supply and demand are relatively easy to determine and production can be controlled. He also possesses a variety of assets which are suitable as collateral and his income is relatively constant throughout the year. In contrast, supply and demand are geared to several uncontrollable factors for the farmer. His assets are limited and his income is generally determined by the success or failure of an annual commodity. Without special protection, a farmer is a greater financial risk to a creditor than is the ordinary businessman.

Because of the peculiar nature of his collateral, the farmer suffered a great deal more than the average businessman under pre-Code financing regulations. The farmer's land is his most inviting collateral. Real estate mortgages on land were best suited for the financing of land purchases and other major expenditures, but they certainly were not suitable for short-term loans. Crops to be grown on the farmer's land were generally prohibited from serving as collateral. Livestock was a permissible form of collateral but such mortgages covered only livestock in existence at the time the agreement was executed and use or disposition of the collateral invalidated the entire security interest. The secured party was required to

"police" the collateral under the doctrine set forth in *Benedict v. Ratner*.¹ If a farmer wished to make a change in his mortgaged herd or wanted to use a mortgaged crop for feed, he was required to obtain special permission from the creditor.

Under the Code, the classification given collateral has great significance when determining the rights of various parties to that collateral. Proper classification depends upon the nature of the collateral as held by the debtor.² In other words, if power tools having a purchase price less than \$2500 were purchased by a building contractor, they would be classified as "equipment."³ The same tools, purchased by a farmer, would be classified "farm equipment."⁴ If they were purchased by a consumer for his personal use, the tools would be "consumer goods."⁵ Finally, the same power tools in the hands of a dealer would be classified as "inventory."⁶ The methods of perfection and the filing requirements for equipment, farm equipment, consumer goods, and inventory vary considerably. Therefore, the protection of a security interest might very well hinge upon how the collateral is classified.⁷

The general rules of perfection related to securing an interest in collateral cannot be relied upon when the collateral is classified as either "farm products" or "farm equipment." This note will discuss those special rules applicable to farm collateral and will analyze their effect upon specific types of collateral.

FARM EQUIPMENT

Since a farmer's business is so diverse, goods which are normally considered consumer goods may not be so classified in the hands of a farmer. Consider a person who loans an individual mon-

1. 268 U.S. 353 (1925). Under pre-Code law of many states, a chattel mortgage or assignment of receivables which left the debtor free to use, commingle, collect or dispose of the collateral without any duty to account to the secured party was constructively fraudulent and held void.

2. *Matter of Leiby*, 58 *Lanc. Rev.* 39 (County Pa. 1962); 2 *U.C.C. Reporter-Digest* 2-1105. The test to be employed when determining the filing requirements of a security interest in a tractor is not the use to which a piece of equipment could be used, but the subjective and empirical test for which the equipment is purchased or the use actually made.

3. UNIFORM COMMERCIAL CODE § 9-109(2); N.D. CENT. CODE § 41-09-09(2) (Supp. 1966).

4. UNIFORM COMMERCIAL CODE § 9-401 (1)(a); N.D. CENT. CODE § 41-09-40 (1)(a) (Supp. 1966).

5. UNIFORM COMMERCIAL CODE § 9-109(1); N.D. CENT. CODE § 41-09-09(1) (Supp. 1966).

6. UNIFORM COMMERCIAL CODE § 9-109(4); N.D. CENT. CODE § 41-09-09(4) (Supp. 1966). Farm machinery, in the hands of a dealer of such goods, being held for resale is "inventory" as defined by Section 9-109(4) rather than "equipment" as defined by Section 9-109(2). *Matter of Shepler*, 58 *Lanc. Rev.* 43 (County Pa. 1962); 2 *U.C.C. Reporter-Digest* 2-954.

7. When perfection is accomplished by filing, the proper place to file is determined by the type of collateral being perfected and perfection is not accomplished until filing is made in all the required places. UNIFORM COMMERCIAL CODE § 9-303(1); N.D. CENT. CODE § 41-09-24(1) (Supp. 1966). In re *Babcock Box Co.*, 200 *F.Supp.* 80 (D.Mass. 1961); *Matter of Leiby*, *supra* note 2.

ey to purchase power tools. He might expect the debtor to use the tools in his household or as a hobby. For such purposes, the tools in his household or as a hobby. For such purposes, the tools would be "consumer goods." As lender, he would have a purchase money security interest⁸ that is automatically perfected.⁹ Such an interest would take priority over conflicting interests in the same collateral.¹⁰ Later, he discovers the individual is a farmer and is using the tools in his farming operations. The tools are then classified "farm equipment," not "consumer goods." Although purchase money security interests in consumer goods are perfected automatically, the same interests in equipment generally must be perfected by filing.¹¹ Under these circumstances, claiming an interest in consumer goods when the goods are actually equipment would leave your interest unperfected.

To avoid consequences similar to the one above, Section 9-302 (1) (c)¹² gives the same perfection to purchase money security interests in farm equipment valued at less than \$2,500 as given to consumer goods.

The distinction, therefore, between farm equipment and other equipment is that farm equipment, having a purchase price less than \$2500, can be automatically perfected when the interest is a purchase money security interest.¹³ A holder of a purchase money security interest must be cautioned that automatic perfection will not take priority over the interest of a person who buys the collateral:

1. without knowledge,
2. for value,
3. for his own personal, family or household purposes, or
4. for his own farming operations.¹⁴

To protect against this type of interest, one must file a financing statement.

The size of the loan or value of the collateral will likely determine whether a purchase money security interest is filed. If the loan is for only \$25, a person might risk a bona fide purchaser

8. UNIFORM COMMERCIAL CODE § 9-107; N.D. CENT. CODE § 41-09-07 (Supp. 1966).

9. UNIFORM COMMERCIAL CODE § 9-302(1)(d); N.D. CENT. CODE § 41-09-23(1)(d) (Supp. 1966).

10. UNIFORM COMMERCIAL CODE § 9-312(4); N.D. CENT. CODE § 41-09-33(4) (Supp. 1966).

11. *Stravell-Patterson Finance Co. v. May*, 77 N.M. 331, 422 P.2d 366 (1967). A guitar and amplifier used to entertain in a night club is equipment and not consumer goods. Consequently, perfection must be accomplished by filing a financing statement.

12. N.D. CENT. CODE § 41-09-23(1)(c) (Supp. 1966).

13. *Lonoke Production Credit Ass'n v. Bohannon*, 238 Ark. 206, 379 S.W.2d 17 (1964) (purchase money security interest in farm equipment).

14. UNIFORM COMMERCIAL CODE § 9-307(2); N.D. CENT. CODE § 41-09-28(2) (Supp. 1966). But, a dealer purchasing for resale does not come within the protection afforded by this section. *U.G.I. v. McFalls*, 18 Pa. D.&C.2d 713 (C.P. 1959).

taking priority over his interest rather than to incur the expense of filing. However, if the loan is for \$2490, the time and effort of filing may outweigh the risk of losing the priority of one's security interest.

Suppose Farmer A sold a used machine, valued at less than \$2500, to Farmer B. Further assume that a creditor, having no knowledge of the first transaction, lent Farmer B money for which Farmer B pledged the same machine as security. Farmer A's unfiled purchase money security interest would take priority over the creditor's interest in the machine.¹⁵

Creditors and used equipment dealers should be cautioned when using such collateral as security since no adequate method exists for obtaining notice of such unfiled, perfected, security interests.

If one, as a secured party, does not qualify as a purchase money security interest holder,¹⁶ he must either possess the collateral or file a financing statement to perfect his security interest. Since possession is an impractical method of perfecting farm equipment, filing is the only alternative. Filing under Section 9-401(1) (a)¹⁷ requires that consumer goods and farm equipment be filed in the same place.¹⁸ As a result, interested persons would have notice of a security interest in the collateral regardless of whether it is classified consumer goods or farm equipment.

Filing of a security agreement as a financing statement is permissible under the Code.¹⁹ Since a security agreement requires only the debtor's signature²⁰ and a financing statement requires the signature of both the debtor and secured party, the latter's signature also must be on the security agreement if it is to serve as a valid financing statement. The description of the collateral on these documents does not have to be a detailed or an entirely accurate

15. *Lonoke Production Credit Ass'n. v. Bohannon*, *supra* note 13.

16. *Supra* note 1.

17. N.D. CENT. CODE § 41-09-40(1)(a) (Supp. 1966).

18. UNIFORM COMMERCIAL CODE § 9-401(1)(a); N.D. CENT. CODE § 41-09-40(1)(a) (Supp. 1966). States adopting Alternative 1 to this section require security interests in both types of collateral to be filed centrally. States adopting either Alternative 2 or 3 would require filing in the county of the debtor's residence or if the debtor is not a resident of the state, then in the county where the goods are kept. North Dakota has adopted Alternative 2.

19. UNIFORM COMMERCIAL CODE § 9-402(1); N.D. CENT. CODE § 41-09-41(1) (Supp. 1966). In *re Mutual Board and Packaging Corp. v. Oneida Nat'l. Bank and Trust Co.*, 342 F.2d 294 (2d Cir. 1965) (conditional sale contract used as a security agreement and financing statement); *Stravell-Patterson Finance Co. v. May*, 77 N.M. 331, 422 P.2d 366 (1967) (chattel mortgage used as a security agreement and financing statement). But, a financing statement does not adequately serve as a security agreement, even though it contains the required information. *American Card Co. v. H.M.H. Co.*, 97 R.I. 59, 196 A.2d 150 (1963).

20. UNIFORM COMMERCIAL CODE § 9-203(1)(b); N.D. CENT. CODE § 41-09-16(1)(b) (Supp. 1966). *National Dime Bank v. Cleveland Bros. Equip. Co.*, 20 Pa. D.&C.2d 511 (County Pa. 1959); 2 U.C.C. Reporter-Digest 2-974.

one. As long as the description reasonably identifies the collateral it will be held sufficient.²¹

CROPS

Pre-Code laws afforded secured parties little protection when their interest was secured by crops not yet planted. Many jurisdictions, including North Dakota, prohibited mortgages on growing and unharvested crops,²² and crop production liens were only permissible when securing a government interest.²³ Even after crops were planted, most secured parties ran the risk of losing their preferred status. Whenever the secured party permitted a farmer to sell or even use the collateral, he ran the risk of invalidating the entire security interest under the doctrine established in *Benedict v. Ratner*.²⁴ Permissive use under this doctrine constituted a fraud on other creditors and for this reason the rights of the secured party were not sustained. If permission was not granted, however, the secured party retained his perfected security interest.²⁵

Under the Code, a security interest has no perfected status until it has attached.²⁶ Attachment takes place only when:

1. there is an agreement that the interest attach,
2. value is given, and
3. the debtor has rights in the collateral.²⁷

Farmers have no rights in crops until they are planted or otherwise become growing²⁸ and therefore attachment has not taken place until that time. When crops are being used as collateral, the agreement must also describe the land upon which the crops are to be grown.²⁹

21. UNIFORM COMMERCIAL CODE § 9-110; N.D. CENT. CODE § 41-09-10 (Supp. 1966). *Yancey Bros. Co. v. Dehco, Inc.*, 108 Ga.App. 875, 134 S.E.2d 828 (1964) (The recording of a wrong serial number still reasonably identified a security interest in a caterpillar tractor); *Barnesboro Fin. Co. v. Thompson*, 85 Pa. D.&C. 522 (1954) (An International Tractor described as "TD 40 TCC 5473" instead of "TD 40 TCB 5473" was held sufficient to reasonably describe the secured collateral.) But, "Seven acres of cotton" has been held an inadequate description of land on which cotton was to be grown. *Piggott State Bank v. Pollard Gin Co.*, 243 Ark. 159, 419 S.W.2d 120 (1967).

22. N.D. CENT. CODE § 35-05-01 (1960), repealed, N.D. SESSION LAWS 1965, ch. 296, § 32.

23. N.D. CENT. CODE § 35-08-01 (1960).

24. *Supra* note 1. *Carr v. Brawley*, 34 Okla. 500, 125 Pa. 1131 (1912) (cotton); *Partridge v. Minn. & D. Elevator Co.*, 75 Minn. 496, 78 N.W. 85 (1899) (wheat); *New England Mortgage Sec. Co. v. Great Western Elevator Co.*, 6 N.D. 412, 71 N.W. 130 (1897) (wheat).

25. *United States v. Union Livestock Sales Co.*, 298 F.2d 755 (1962) (against auctioneer); *Thomas v. Prairie Home Co-op Co.*, 121 Neb. 603, 237 N.W. 673 (1931) (against purchaser).

26. UNIFORM COMMERCIAL CODE § 9-303(1); N.D. CENT. CODE § 41-09-24(1) (Supp. 1966).

27. UNIFORM COMMERCIAL CODE § 9-204(1); N.D. CENT. CODE § 41-09-17(1) (Supp. 1966). *Evans v. Jorgenson*, 421 P.2d 978 (Or. 1966); *Lonoke Prod. Credit Ass'n. v. Bohannon*, 238 Ark. 206, 379 S.W.2d 17 (1964). But, mere possession by a bailee does not give him "rights" in the collateral. *Cain v. Country Club Delicatessen, Inc.*, 25 Conn. Supp. 327, 203 A.2d 441 (1964).

28. UNIFORM COMMERCIAL CODE § 9-204(2)(a); N.D. CENT. CODE §§ 41-09-17(2)(a) (1966), 35-01-05 (1965).

Once attachment has taken place, a security interest exists but its priority is relatively poor.³⁰ To obtain maximum security, a financing statement must be filed.³¹ In addition, when the financing statement covers crops, it must contain a description of the real estate concerned.³² Filing under Alternative 1 to Section 9-401(1)³³ requires central filing while Alternatives 2 and 3 require that the financing statement be filed with the Register of Deeds in the county where the crops are growing or are to be grown.³⁴

Under the Code, a secured party is not required to police his interest in collateral³⁵ and the security interest is not destroyed if the party does not exercise control over its sale. Section 9-205³⁶ of the Code abolishes the *Benedict v. Ratner* doctrine.³⁷ Comment 1 of that section states that the Code: ". . . repeals the rule of *Benedict v. Ratner* . . . and other cases which held such arrangements void as a matter of law because the debtor was given unfettered dominion or control over the collateral."

A security interest in collateral shall continue in effect notwithstanding sale, exchange or other disposition by the debtor unless the secured party authorizes such action.³⁸ A secured party who permits the debtor to sell crops which are covered by a security agreement would lose his rights to the crops.³⁹ Permission by the secured party for the sale of such crops would not impair his right to the proceeds. If the original security interest in crops did not cover "proceeds" of those crops, the secured party has a perfected security interest in the proceeds for ten days following the receipt of the proceeds by the debtor.⁴⁰ The secured party must perfect

29. UNIFORM COMMERCIAL CODE § 9-203(1)(b); N.D. CENT. CODE § 41-09-16(1)(b) (Supp. 1967). *Piggott State Bank v. Pollard Gin Co.*, 243 Ark. 159, 419 S.W.2d 120 (1967).

30. UNIFORM COMMERCIAL CODE § 9-301; N.D. CENT. CODE § 41-09-22 (Supp. 1966).

31. UNIFORM COMMERCIAL CODE § 9-302; N.D. CENT. CODE § 41-09-23 (Supp. 1966).

32. UNIFORM COMMERCIAL CODE § 9-402(1); N.D. CENT. CODE § 41-09-41 (1966). "Seven acres of cotton" was held to be an inadequate description. *Piggott State Bank v. Pollard Gin Co.*, 243 Ark. 159, 419 S.W.2d 120 (1967).

33. N.D. CENT. CODE § 41-09-40(1) (Supp. 1966).

34. UNIFORM COMMERCIAL CODE § 9-401(1)(a); N.D. CENT. CODE § 41-09-40(1)(a) (Supp. 1966). North Dakota has adopted Alternative 2 and therefore requires local filing of security interests in crops.

35. *In re United Thrift Stores, Inc.*, 363 F.2d 11 (3d Cir. 1966).

36. N.D. CENT. CODE § 41-09-18 (Supp. 1966).

37. UNIFORM COMMERCIAL CODE §§ 9-107; N.D. CENT. CODE §§ 41-09-07 (Supp. 1966).

38. UNIFORM COMMERCIAL CODE § 9-306(2); N.D. CENT. CODE § 41-09-27(2) (Supp. 1966).

39. UNIFORM COMMERCIAL CODE § 9-307(1); N.D. CENT. CODE § 41-09-28(1) (Supp. 1966) states that a buyer in the ordinary course of business takes farm products subject to a security interest created by his seller if the seller is a person engaged in farming operations. Comment 2 to this section cautions that if the secured party has authorized (in the security agreement or otherwise) the sale of the goods, as provided by § 9-306(2); N.D. CENT. CODE § 41-09-27(2), the buyer takes free without regard to the limitations of this Section.

40. UNIFORM COMMERCIAL CODE § 9-306(3); N.D. CENT. CODE § 41-09-27(3) (Supp. 1966). The result would be the same if the collateral were accounts or livestock instead of crops. *In re Platt*, 257 F.Supp. 478 (D. Pa. 1966) (accounts); *Clovis Nat'l. Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726 (1967) (livestock).

his interest in the proceeds within the ten day period if he wishes to maintain a perfected security interest in the proceeds.⁴¹ If the original financing statement also covers the proceeds of the crops, the secured party automatically acquires a perfected security interest in the proceeds.⁴²

To avoid possible future conflicts, the secured party should check the proceeds and products of the collateral he is securing. He will not be penalized for doing so and he may avoid many future complications.

The Code expressly permits after-acquired property to serve as collateral.⁴³ However, when the after-acquired property is crops, they must become such within one year after the security agreement is executed if it is to be valid. Crops serving as collateral in conjunction with a lease or a land purchase or improvement transaction are exempt from this limitation.⁴⁴ Those agreements may attach to all crops to be grown during the period of the real estate transaction. In North Dakota, real estate transactions affecting crops of two or more crop years must be recorded by the Register of Deeds in a separate index of "continuing crop liens."⁴⁵

Assume that one lends a farmer money for the purchase of seed and fertilizer for spring planting. Also assume that he wants to secure his loan by attaching the crops that will be produced from the seed and fertilizer purchase. What is the best method of perfecting his interest?

Since the crops will be in existence within one year of the execution of the security agreement, the creditor knows that his interest comes within the limitation placed upon crops used as after-acquired property.⁴⁶ He also realizes that he will have no security interest in the crops until attachment has taken place.⁴⁷ He further realizes that as the debtor, the farmer has no rights in the crops until they are planted or otherwise become growing.⁴⁸ *But*, this farmer acquires rights in the seed and fertilizer the moment he purchases them.

41. UNIFORM COMMERCIAL CODE § 9-306(3)(b); N.D. CENT. CODE § 41-09-27(3)(b) (Supp. 1966). Perfection of proceeds not covered in the financing statement is automatically perfected for only ten days. *Clovis Nat'l. Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726 (1967).

42. UNIFORM COMMERCIAL CODE § 9-306(3)(a); N.D. CENT. CODE § 41-09-27(3)(a) (Supp. 1966).

43. UNIFORM COMMERCIAL CODE § 9-204(1) and (3); N.D. CENT. CODE § 41-09-17(1) and (3) (Supp. 1966). Section 9-204(3), N.D. CENT. CODE § 41-09-17(3) does not conflict with § 9-108, N.D. CENT. CODE § 41-09-08. New value need not be given at the time the debtor subsequently acquires the after-acquired property. *Rosenberg v. Rudnick*, 262 F.Supp. 635 (D.Mass. 1967); *Erb v. Stoner*, 19 Pa. D.&C.2d 25 (1958).

44. UNIFORM COMMERCIAL CODE § 9-204(4)(a); N.D. CENT. CODE § 41-09-17(4)(a) (Supp. 1966).

45. N.D. CENT. CODE § 35-05-05 (1965).

46. UNIFORM COMMERCIAL CODE § 9-204(4)(a); N.D. CENT. CODE § 41-09-17(4)(a) (Supp. 1966).

47. *Supra* note 27.

48. UNIFORM COMMERCIAL CODE § 9-204(2)(a); N.D. CENT. CODE § 41-09-17(2)(a) (Supp. 1966).

Therefore, the creditor's security interest will attach sooner if he claims as collateral not only the crops but the seed and fertilizer as well.

Since filing is required to perfect a security interest in crops,⁴⁹ the creditor must next determine when and where to file his financing statement. The cautious secured party will file as soon as possible. Although a binding security interest does not exist until attachment has taken place, the Code permits him to file his security interest before attachment.⁵⁰

Suppose one filed the security interest in crops April 1. Also assume that another person has filed a security interest in the same crops April 5, and that attachment did not take place until the crops were planted April 15. Section 9-303 provides that a security interest is perfected when it has attached and when all of the applicable steps required for perfection have been taken. Since both interests in this example were perfected at the same time, the one having filed first takes priority over the other.⁵¹ If the creditor would have deferred filing until attachment was completed, the person filing his interest April 5 would have taken priority over his security interest.

Assuming again that one wishes to secure an interest in a farmer's crops, this time further assume that another person has already secured an interest in the same crops. This prior interest was secured two years ago in conjunction with a land improvement transaction. Such a security interest represents an exception to the one year limitation on after-acquired interests in crops.⁵² Would the crops provide adequate security for his loan?

In many instances, the crops would be adequate security for the loan. Section 9-312(2)⁵³ of the Code provides that:

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

49. UNIFORM COMMERCIAL CODE § 9-302; N.D. CENT. CODE § 41-09-23 (Supp. 1966).

50. UNIFORM COMMERCIAL CODE § 9-303(1); N.D. CENT. CODE § 41-09-24(1). In re United Thrift Stores, Inc., 242 F.Supp. 714 (D. N.J. 1965).

51. UNIFORM COMMERCIAL CODE § 9-312(5)(a); N.D. CENT. CODE § 41-09-33(5)(a) (Supp. 1966).

52. UNIFORM COMMERCIAL CODE § 9-204(4)(a); N.D. CENT. CODE § 41-09-17(4)(a) (Supp. 1966).

53. N.D. CENT. CODE § 41-09-33(2) (Supp. 1966).

Under this section, one would have priority over the original secured party if:

1. he had given new value;⁵⁴
2. the value was given to produce the current year's crops; and
3. the value was given less than three months before the crops became crops.

Therefore, under the assumed facts, he would take priority over another interest in crops which were secured more than six months before the crops became growing, even though he might have known of the prior interests. The only interest that might take priority over the above is the right of the original secured party to installments due on the real estate mortgage within the last six months.

North Dakota has a statute which severely limits the situations in which growing and unharvested crops may be used as collateral. The only transactions in which growing and unharvested crops may serve as collateral are for debts owed to government agencies and for securing the purchase price, the rental, or the improvement of the land upon which the contracted crops are to be grown.⁵⁵ This statute takes priority over the Code provisions because Section 9-203(2) of the Code states that any conflict between Article 9 and the state statutes mentioned therein are to be resolved in favor of the state statute. The only way a private creditor in North Dakota might secure an interest in crops would be through one of the liens expressly provided by Title 35 of the *North Dakota Century Code*. Among the liens protected under that title is a seed lien⁵⁶ and a sugar beet production lien.⁵⁷ The sugar beet production lien not only covers seed, but also fertilizer, insecticide, labor, materials and cash advances incurred in the production of beets.

GRAIN

When grain serves as collateral for a secured debt, the secured party must determine whether the collateral will be held by a farmer as a farm product or by a merchant as inventory.⁵⁸ A buyer in the

54. UNIFORM COMMERCIAL CODE § 9-108; N.D. CENT. CODE § 41-09-08 (Supp. 1966). A security interest in the after-acquired collateral will be deemed to be taken for new value if the debtor acquires his rights in the collateral either in the ordinary course of his business or under a contract of purchase pursuant to the security agreement within a reasonable time after new value is given. *Rosenberg v. Rudnick*, 262 F.Supp. 635 (D. Mass. 1967); *Erb v. Stoner*, 19 Pa. D.&C.2d 25 (County Pa. 1959); 2 U.C.C. Reporter-Digest 2-984.

55. N.D. CENT. CODE § 35-05-01 (1965).

56. N.D. CENT. CODE, Chapter 35-09 (1960).

57. N.D. CENT. CODE, Chapter 35-10 (1960).

58. UNIFORM COMMERCIAL CODE § 9-109(3),(4); N.D. CENT. CODE § 41-09-09(3),(4) (Supp. 1966) and Comment thereto.

ordinary course of business acquires the grain subject to a perfected security interest if the grain is a farm product.⁵⁹ The same buyer in the ordinary course of business, however, takes priority over a perfected security interest in grain treated as inventory.⁶⁰ Grain held by a warehouseman, who is also in the business of buying and selling such goods, is also held as inventory.⁶¹ Whenever grain is entrusted to a merchant who deals in grain, that dealer is given the power to transfer all the rights of the grain to the buyer in the ordinary course of business.⁶²

When the grain is held by a farmer, the secured party can treat the grain as a farm product and perfect it by filing a financing statement in the appropriate place.⁶³ State statutes should be examined to determine whether other laws also govern this type of transaction. If the grain is stored "under a statute requiring a bond against withdrawal or a license for the issuance of receipts in the nature of warehouse receipts," a farmer may issue a receipt for the goods which has the effect of a warehouse receipt, even though he is not a warehouseman.⁶⁴ If such a receipt is required, attachment has taken place, and a valid security interest has been created upon transferring the receipt to the creditor.⁶⁵ Under most circumstances an oral agreement is all that is necessary to bind the parties,⁶⁶ but normally the secured party will want to have a written security agreement to evidence the contract.

. . . [T]he requirements of creation and perfection of the security interest are so easily satisfied under the Code by a written security agreement and a filed financing statement that it is foolish to risk legal invalidity by attempting to create and perfect the security interest in inventory by other means, and field warehousing should be regarded as a policing device and not as a security arrangement that can stand aloof of the standard rules of creation and perfection.⁶⁷

LIVESTOCK

Although livestock is a major form of collateral for many farm-

59. UNIFORM COMMERCIAL CODE § 9-307(1); N.D. CENT. § 41-09-28 (Supp. 1966).

60. *Cf. id.*

61. UNIFORM COMMERCIAL CODE § 7-205; N.D. CENT. CODE § 41-07-11 (Supp. 1966).

62. UNIFORM COMMERCIAL CODE § 2-403(2); N.D. CENT. CODE § 41-02-48(2) (Supp. 1966).

63. UNIFORM COMMERCIAL CODE § 9-401(1)(a); N.D. CENT. CODE § 41-09-40(1)(a) (Supp. 1966). North Dakota has adopted Alternative 2 and therefore requires local filing of security interests in crops.

64. UNIFORM COMMERCIAL CODE § 7-201(2); N.D. CENT. CODE § 41-07-07(2) (Supp. 1966).

65. *Supra* note 27. An agreement has been made, value given and the debtor has rights in the collateral.

66. UNIFORM COMMERCIAL CODE §§ 9-203(1)(a), 9-305; N.D. CENT. CODE §§ 41-09-16 (Supp. 1967), 41-09-26 (Supp. 1966).

67. 2W. D. HAWKLAND, A TRANSACTIONAL GUIDE TO THE UNIFORM COMMERCIAL CODE § 2.3604 (1964).

ers, pre-Code restrictions hampered the use of this form of collateral for security. Identification of livestock covered by the pre-Code mortgage had to be specific. The mortgage covered only the livestock presently in existence in some jurisdictions, like North Dakota, which permitted first generation cattle to be included.⁶⁸ Any additions to the herd by the secured party necessitated the execution of another mortgage. Also the creditor who permitted the debtor to use or sell the livestock ran the risk of invalidating his security interest under the doctrine of *Benedict v. Ratner*.⁶⁹

The Code makes livestock a more favorable form of collateral. The "policing" requirement established by *Benedict v. Ratner*⁷⁰ has been repealed so that now the farmer is permitted to comingle and dispose of cattle as he sees fit without destroying the secured party's interest.⁷¹ The after-acquired provision of the Code⁷² permits a creditor to secure an interest in a farmer's entire herd without specific identification⁷³ and that the offspring of the livestock attach to the security interest at conception.⁷⁴

Assume that a farmer secures a loan from a creditor, and his beef cattle, held in a feed lot for future marketing, are to be used to secure the loan. Although the livestock do not have to be specifically identified,⁷⁵ the security agreement should describe the livestock, the land on which they are located, and the brand, if they are branded. This description plus the reference to after acquired property and to increases in the herd by birth would assure adequate protection to the secured party.

Once again, proper classification of the collateral is important. Even though these cattle are being held for marketing, the farmer holds them as "farm products"⁷⁶ and not as inventory. As a result, a buyer in the ordinary course of business⁷⁷ would take the cattle subject to a perfected security interest in farm products.⁷⁸ If the secured cattle were sold at an auction without the secured party's

68. N.D. CENT. CODE § 35-01-05 (1960), repealed N.D. SESSION LAWS 1965, ch. 296, § 16. This section was replaced by Section 35-01-05 (1965) which adopts the after-acquired property policy of the Code.

69. *Supra* note 1. *Abeville Livestock Co. v. Walden*, 209 Ala. 315, 96 So. 237 (1932).

70. *Id.*

71. UNIFORM COMMERCIAL CODE § 9-205; N.D. CENT. CODE 41-09-18 (Supp. 1966). *Erb v. Stoner*, 19 Pa. D.&C.2d 25 (County Pa. 1959); 2 U.C.C. Reporter-Digest 2-984.

72. *Supra* note 43.

73. *Warfel v. Lebanon Valley Livestock, Inc.*, 9 Lebanon 300 (County Pa. 1962).

74. UNIFORM COMMERCIAL CODE § 9-204(2)(a); N.D. CENT. CODE § 41-09-17(2)(a) (Supp. 1966).

75. UNIFORM COMMERCIAL CODE § 9-110; N.D. CENT. CODE § 41-09-10 (Supp. 1966). "Nine cows and five calves" was an adequate description for both the security agreement and financing statement. *Warfel v. Lebanon Valley Livestock, Inc.*, *supra* note 73.

76. UNIFORM COMMERCIAL CODE § 9-109(3); N.D. CENT. CODE § 41-09-09(3) (Supp. 1966). *Clovis Nat'l. Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726 (1967).

77. UNIFORM COMMERCIAL CODE § 1-201(9); N.D. CENT. CODE § 41-01-11(9) (Supp. 1966).

78. UNIFORM COMMERCIAL CODE § 9-307(1); N.D. CENT. CODE § 41-09-28 (Supp. 1966).

consent⁷⁹ a buyer would not only take them subject to the security interest, but the secured party would have a cause of action for conversion against the auctioneer and the marketing agency.⁸⁰ To subject buyers in the ordinary course of business to prior security interests might seem unfair when applied to the ordinary consumer, but the rule is designed primarily to protect secured parties from "truck load" buyers in the ordinary course of business who are covered by the same definition.⁸¹

Included with collateral-termed "Farm-products" are products of crops or livestock "in their unmanufactured states" if they are in the possession of a debtor engaged in raising, fattening, grazing or other farming operations.⁸² The Code makes no determination as to the definition of a manufacturing operation. Comment 4 to Section 9-109⁸³ states that ". . . the line is one for the courts to draw." Cotton, wool-clip, maple syrup, milk and eggs are examples of crop and livestock products mentioned in the Code.⁸⁴

To avoid any controversy in this area and to assure maximum protection of the security interest, a wise secured party would cover farm products and their "products" in his security agreement and financing statement. By securing the "products" of farm products, such goods as milk and eggs might serve as additional security for a loan.

A secured party is not required to police his interest in livestock. Neither is the security interest destroyed if the secured party fails to exercise control over their sale. The previous discussion concerning the policing of crops also applies to livestock.⁸⁵

If a secured party wishes to have certain farm products, such as milk and eggs, serve as a primary source of collateral, a more practical approach to securing his interest would be to perfect an interest in the accounts and contract rights created by the sale of these products.⁸⁶

79. *Clovis Nat'l. Bank v. Thomas*, *supra* note 76. Consent to a sale may be implied and such implied consent would waive the secured party's right to a possessory interest in the cattle.

80. *United States v. Sommerville*, 324 F.2d 712 (1962); *Clovis Nat'l. Bank v. Thomas*, *supra* note 76; *Erb v. Stoner*, 19 Pa. D.&C.2d 25 (County Pa. 1959), 2 U.C.C. Reporter-Digest 2-984.

81. UNIFORM COMMERCIAL CODE § 1-201(9); N.D. CENT. CODE § 41-01-11(9) (Supp. 1966).

82. UNIFORM COMMERCIAL CODE § 9-109(3); N.D. CENT. CODE § 41-09-09(3) (Supp. 1966).

83. N.D. CENT. CODE § 41-09-09 (Supp. 1966).

84. UNIFORM COMMERCIAL CODE § 9-109(3); N.D. CENT. CODE § 41-09-09(3) (Supp. 1966).

85. *Supra* notes 35 and 37 through 41. *Erb v. Stoner*, 19 Pa. D.&C.2d 25 (County Pa. 1959); 2 U.C.C. Reporter-Digest 2-984.

86. Coates, U.C.C. Brief No. 6: *Financing the Farmer*, 13 PRAC. LAW. 72 (May 1967).

ACCOUNTS

The use of accounts as collateral was limited under most pre-Code laws. In many jurisdictions an unsecured creditor would take priority over the interest of one who claimed the proceeds of future accounts when the security agreement was executed.⁸⁷ Future accounts were permitted to be assigned in North Dakota⁸⁸ and became perfected by noting the interest in the records where future accounts would be recorded.

A common form of farm account assignments is the milk check assignment. Delivery of the milk by the farmer to the dairy creates an account⁸⁹ which can be assigned. The Code removes pre-Code restrictions on the assignment of future accounts by providing that contract rights (any right to payment under a contract not yet earned by performance) are an acceptable form of collateral.⁹⁰ Courts have held that interests in after-acquired accounts are taken for new value and are effective from the time the security agreement is executed.⁹¹ They are divided, however, as to the adequacy of the terms "accounts" and "contract rights" in securing the money which is received from this form of collateral.⁹² A wise secured party will also cover proceeds of accounts and contract rights.

When securing crop and livestock products through perfection of the contract rights and accounts arising from such goods, perfection must be obtained by filing in the appropriate place.⁹³

The secured party usually must supplement this type of an arrangement with a letter to the purchaser of the collateral, giving him notice of the security interest and directing the purchaser to pay the agreed portion of the check to him.⁹⁴ A debtor is permitted

87. *In re Nelson's Estate*, 211 Ia. 168, 233 N.W. 105 (1930); *O'Neil v. Wm. B. Kerr Co.*, 124 Wis. 234, 102 N.W. 573 (1905).

88. N.D. CENT. CODE § 9-11-09 (1960).

89. UNIFORM COMMERCIAL CODE § 9-106; N.D. CENT. CODE § 41-09-06 (Supp. 1967).

90. The comment to Section 9-106, N.D. CENT. CODE § 41-09-06 (Supp. 1967), states: "The recognition of the 'contract right' as collateral in a security transaction makes clear that this Article rejects any lingering common law notion that only rights already earned can be assigned."

91. *In re Portland Newspaper Pub. Co.*, 271 F.Supp. 395 (D. Ore. 1967); *Rosenberg v. Rudnick*, 262 F.Supp. 635 (D.Mass. 1967). N.D. CENT. CODE § 35-01-05 (1965) expressly permits liens on future interests and states that the lien shall attach from the time the debtor acquires an interest in the item secured.

92. The description of the collateral must reasonably identify what is described. UNIFORM COMMERCIAL CODE § 9-110; N.D. CENT. CODE § 41-09-10 (Supp. 1966). *Middle Atlantic Credit Corp. v. First Pennsylvania Banking & Trust Co.*, 199 Pa.Supp. 456, 185 A.2d 818 (1962) ("proceeds" were checked); *Industrial Packaging Products Co. v. Fort Platt Packaging, Int'l. Inc.* 399 Pa. 643, 161 A.2d 19 (1960) ("all present and future accounts receivable submitted" was held a sufficient description to cover "proceeds"). But, merely the words "inventory and accounts" has been held insufficient to cover their proceeds. *In re Platt*, 257 F.Supp. 478 (D.Pa. 1966).

93. *Supra* note 18. A minor exception to the filing requirement is found in UNIFORM COMMERCIAL CODE § 9-302(1)(e); N.D. CENT. CODE § 41-09-23(1)(e) (Supp. 1963).

94. UNIFORM COMMERCIAL CODE § 9-318(3); N.D. CENT. CODE § 41-09-39(3) (Supp. 1966).

to hold the proceeds of the security interest for the secured party and can comingle the proceeds without invalidating the security interest.⁹⁵

The comments to Section 9-205⁹⁶ make it clear that the Code section establishes only a minimum standard for the protection of a secured party's interest. Additional terms may be established for the "policing" of the security interest.

. . . [B]usiness and not legal reasons will determine the extent to which strict accountability, segregation of collections, daily reports and the like will be employed.⁹⁷

SUMMARY

The Uniform Commercial Code has made more of the farmers' assets desirable collateral for business operations. Three factors appear most significant in this achievement.

First is the fact that future assets are a permissible form of collateral through the Code's after-acquired property provision. Second, the secured party is not required to "police" the collateral. A farmer may use or dispose of the collateral and the secured party can maintain at least an interest in the "proceeds."

Finally, the Code grants automatic perfection to security interests in "consumer goods" and "farm equipment" having a purchase price less than \$2500. It also grants the secured party priority over interests of buyers of farm products. This now encourages creditors to extend credit to farmers.

These special provisions of the Code give the farmer an opportunity to obtain a line of credit previously unavailable to him, but which has always been available to other businessmen.

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95. UNIFORM COMMERCIAL CODE § 9-205; N.D. CENT. CODE § 41-09-18 (Supp. 1966).

96. *Id.*

97. *Id.* at Comment 5.