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An Agricultural Law Research Article

**The Making of Article 9 Section 9-312(2) Into  
Model Provision Section 9-324A: The  
Production Money Security Interest:  
Finally a Sensible “Superpriority”  
for Crop Finance**

by

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*Jason Finch\**

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I. INTRODUCTION

At its 1998 annual meeting, the National Conference of Commissioners on Uniform State Laws (“NCCUSL”) approved its final draft of the Revised Article 9 of the Uniform Commercial Code (“UCC”). The scope of changes to Article 9 are enormous, including vital changes affecting agriculture. Among the changes affecting agriculture are changes regarding the treatment of financing agricultural crop production. Article 9 section 9-312(2), which sets out very limited priority rules for lenders who finance crop production is eliminated.<sup>1</sup> In its place, revised Article 9 has proposed a model provision creating a Production Money Security Interest (“PrMSI”) and another model provision outlining PrMSIs’ priority status among competing security interests and agricultural liens.<sup>2</sup>

The objective of this Article is to explore financing issues in crop production with respect to security interests and priorities. Moreover, this Article serves to advocate the adoption of the model provision, creating the PrMSI as a necessary tool in the crop finance arsenal. This Article begins with a discussion of Article 9 section 9-312(2), its internal complexity, confusion, and ultimate failure in creating a

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1. Compare U.C.C. § 9-312 (1972) with U.C.C. § 9-312(2) (revised 2000).

2. See U.C.C. MODEL PROVISION FOR PRODUCTION-MONEY PRIORITY app. II (July 1998). Appendix II is not an official part of the Revised Article 9. Rather it contains optional provisions that a state may choose to adopt.

“superpriority” with respect to crop production.<sup>3</sup> This Article then explores NCCUSL’s attempts to create a superpriority in crop finance. Lastly, the article introduces Revised Article 9 Model Provisions 9-103A and 9-324A, which creates the PrMSI, as a necessary tool for priority regulation in production crop finance.

Today, America’s farmers have become heavily dependent upon creditors to finance their operations.<sup>4</sup> In 1996, total farm production expenses for seed purchased was \$6,112,100,000.<sup>5</sup> The total bill for fertilizer and lime reached \$10,934,200.<sup>6</sup> Farmers spent a total of \$8,525,100 on pesticides, and \$5,736,300 on fuel and oil.<sup>7</sup> All this money was spent in the name of crop production. These figures serve to illustrate the capitalization that has become an integral part of crop production in the United States.

In 1996, the Farm Credit System (“FCS”) banks held a total of twenty-five percent of all non-real-estate farm loans, or an estimated \$14 billion.<sup>8</sup> Commercial banks, on the other hand, held fifty-two percent, or \$38.3 billion, in non-real estate farm loans.<sup>9</sup> Individuals and others, including input suppliers, held \$17.4 billion and the United States Department of Agriculture’s Farm Service Agency (“FSA”) held \$4.4 billion.<sup>10</sup> These figures serve to illustrate the investment, and therefore, the interest of lenders in payment priorities from crop production.

Each year before planting season, many farmers contact lending institutions to obtain credit necessary to purchase the seed and inputs required for crop production. At the time the lender makes the loan it will typically require the farmer to sign a security agreement. A security agreement is “an agreement that creates or provides for a security interest” in the crop produced from the seed and inputs

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3. “Superpriority” is a term used in commercial law to denote a special priority status, given to a creditor, for credit extended to a debtor, when the debtor uses such credit for a specific purchase that will become collateral for the creditor. In terms of this article “superpriority” simply means that a certain security interest (i.e., a PrMSI) will be reimbursed before any other security interest in the same collateral.

4. The background in agricultural finance and the scope of lender’s investment in agriculture will assist in understanding the importance of payment priorities in crop production. Once upon a time, American farmers simply tilled the land to sustain themselves. Later, they tilled more land to sustain themselves and to sell excess to others. Sometime later, American Agriculture became mechanized and technologically advanced. With mechanization and technology came the need for capital that many farmers did not possess.

5. See NATIONAL AGRIC. STATISTICS SERV., U.S. DEP’T OF AGRIC., AGRICULTURAL STATISTICS IX-40 (1998).

6. *Id.*

7. *Id.*

8. See OFFICE OF COMMUNICATIONS, U.S. DEP’T OF AGRIC., AGRICULTURAL FACT BOOK 31 (1998). Non-real estate loans are defined as those that have terms of less than ten years and those for “seasonal operating” purposes of one year or less. *Id.* Seasonal operating loans are generally repaid within one calendar year. *Id.*

9. *See id.*

10. *See id.*

purchased.<sup>11</sup> A security interest means an interest that secures payment of extended credit.<sup>12</sup> The credit in this context is a short-term loan (lasting approximately one year) called an operating loan. The security interest constitutes a “consensual lien” by the farmer on the growing crop. “Consensual” means that the farmer grants a voluntary lien (a legal interest) in the crop to be grown.

Carefully note that within the security agreement, the lender will typically not only list the crop to be grown as collateral, but also other items of value such as land, other crops, equipment, livestock, crop insurance, and government payments. Moreover, the security agreement may contain a clause extending the lender’s security interest to crop to be grown in the future. Thus, the crop at issue will merely be a percentage of the total collateral encumbered by the lender’s security interest.

Priority of payment is generally determined by perfection of the security interest. Perfection of an interest in crops occurs by filing a financing statement with the appropriate authority.<sup>13</sup> In the simplest terms, the lender who perfects its security interest first is entitled to first payment from the proceeds of the harvest, unless that lender is displaced by another lender or statutory lien holder possessing a superior prior interest in the same crop harvest. Any others who hold security interests in the farmer’s crops will be paid in order of their priority after the superior interest holder’s security interest has been satisfied.

## II. PRODUCTION MONEY SECURITY INTEREST

### A. Overview

As described above, under existing Article 9 when a lender makes an operating loan to a farmer, it generally requires him to grant a security interest in crops.<sup>14</sup> If the farmer is unable to repay the operating loan from proceeds of the current year’s crop, the lender’s security interest is likely to roll over into the next year’s crop proceeds to secure the outstanding balance for that loan (now past due).<sup>15</sup> The status quo of the first lender’s ongoing interest in crops to secure the farm operating loans reduces risk to the first lender. The problem occurs when the farmer tries to get a new operating loan. The first lender’s security interest may interfere with the farmer’s efforts to purchase seed and inputs. Moreover, the efforts of subsequent lenders to grant credit may be hampered by the prior security interest excessively encumbering the collateral.

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11. U.C.C. § 9-105(1)(h) (1972).

12. *See id.* § 1-201(37).

13. *See* U.C.C. § 9-310 (revised 2000).

14. *See* U.C.C. § 9-312 (1972).

15. In 1972, the one year limit on crop security interests in section 9-312(2) was eliminated. Since the elimination it is permissible for security interests in crops to cover all crops grown during the years the UCC filing is good, unless otherwise limited. *See id.* § 9-312(2). Thus, after-acquired property clauses are being used to extend the lender’s priority into future crops.

1. *Purchase-Money Security Interest: The Superpriority*

Currently Article 9 provides a measure of relief to subsequent lenders in the form of the purchase-money security interest ("PMSI"). The idea behind the PMSI is to open more lender doors to those needing financing in order to purchase.

Without the [PMSI], secondary sources of credit would be chilled out of the picture unless they were willing and able to obtain subordination agreements from the floating lienor. The purchase money priority, an outgrowth of the conditional sales financing, breaks up what would otherwise be a complete monopoly on the debtor's collateral.<sup>16</sup>

Section 9-107 provides for a purchase money security interest for goods or equipment.<sup>17</sup> A purchase-money security interest is one where a lender loans funds to the debtor to "secure all or part" of a specific item of equipment or items inventory's price.<sup>18</sup> From an agricultural standpoint, it allows agricultural lenders to lend farmers money to purchase tractors or other equipment, but only so long as the money lent is used to purchase the equipment specifically named in the security agreement. Under existing rules of Article 9, purchase-money security interests allow agricultural lenders to acquire priority over previously made security interests.<sup>19</sup>

To illustrate, suppose Lender One has a security interest in all of Farmer's equipment and farm supplies. Suppose also that Lender One's security interest contains an after-acquired property clause on Farmer's future acquired equipment. Subsequently, Farmer acquires a new tractor from Lender Two using a purchase-money security interest loan. Under current Article 9 rules of priority, Lender Two, as holder of the purchase-money security interest, can take priority over Lender One's after-acquired property clause.

Article 9 allows for a PMSI for inventory and non-inventory goods.<sup>20</sup> The PMSI thus provides protection to lenders with respect to equipment purchases. As for crop financiers, seed and inputs are not contemplated within the scope of the PMSI, even though in the hands of agricultural dealers they are considered

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16. BARKLEY CLARK, *THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE* § 3.09, at 3-100 (rev. ed. 1993).

17. *See* U.C.C. § 9-107 (1998).

A security interest is a "purchase money security interest" to the extent that it is (a) taken or retained by the seller of the collateral to secure all or part of its price; or (b) taken by a person who by making advance or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

*Id.*

18. *See id.*

19. *See* U.C.C. § 9-312(2) (1972).

20. *See id.* § 9-312.

inventory. This is due in part because seed and inputs cannot be used as the collateral for the credit in the hands of the farmer since they will become the crop.<sup>21</sup> Therefore, once seed and inputs pass from the supplier's hands to the farmer's hands, they are classified as farm products.<sup>22</sup> Because PMSI is not intended to cover farm products, Article 9 may appear to neglect an agricultural supplier's option for a superpriority similar to what equipment dealers enjoy.

## 2. *UCC Section 9-312(2): Superpriority For Crops?*

Section 9-312(2) creates a priority framework for security interests involving crops.<sup>23</sup> Moreover, it creates a superpriority in favor of subsequent lenders who finance crop production.<sup>24</sup> Presumably, section 9-312(2) should provide a measure of protection against prior loans to lenders who give new value to farmers for crop production purposes.<sup>25</sup> This is not meant to imply that section 9-312(2) does not provide any protection to subsequent lenders of crop production loans. To a certain extent section 9-312(2) does provide such protection; however, as will be explained later in the Article, its realm of protection is so limited as to make it of very limited value—almost worthless. Section 9-312(2) provides:

A perfected security interest in crops for new value given to enable the debtor to produce the crops during the production season and given not more than three months before the crops become growing crops by planting or otherwise takes priority over an earlier perfected security interest to the

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21. Generally speaking, the creditor knowingly finances debtor's purchase of a specific item. The debtor in fact uses the extended credit to purchase that item. The item purchased is then used as collateral. Section 9-107 provides the definition of purchase money security interest. *See id.* § 9-107. Subsection b of section 9-107, when read together with section 9-107's prelude, indicates "that a purchase money security interest to the extent that it is . . . taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is so used." *Id.* § 9-107(b). Section 9-107 comment 1 indicates: "Under this section a seller has a purchase money security interest if he retains a security interest in the goods . . ." *Id.* § 9-107 cmt. 1.

22. To illustrate, consider seeds. Seeds in the possession of the agricultural supplier are classified as inventory. *See id.* § 9-109. Once in the possession of the farmer, seeds are classified as farm products. *See id.* With current section 9-312, "farm products" are not classified for use with purchase-money security interests. *See id.* § 9-312.

23. *See* CLARK, *supra* note 16, ¶ 8.05, at 8-50.

24. *See id.* ¶ 8.05[2][c][ii], at 8-53 (discussing limited situations where a production lender was given priority over an earlier-filed long-term). Lenders who provide value toward crop production may include not only traditional lenders such as banks, it may also include agricultural suppliers who supply the farmer with seed and inputs to be paid for at the time the crop is harvested and sold. *See generally id.*, ¶ 8.05[2][c] (discussing cases involving non-traditional lenders).

25. *Id.* For cases that illustrate Section 9-312(2) as a successful superpriority, see *Production Credit Association of the Midlands v. Farm & Town Industries Inc.*, 518 N.W.2d 339 (Iowa 1994); *In re Cress*, 89 B.R. 163 (Bankr. D. Kan. 1988); and *Decatur Production Credit Association v. Murphy*, 456 N.E.2d 267 (Ill. App. Ct. 1983).

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.<sup>26</sup>

Under the circumstances stated in the UCC, section 9-312(2) trumps the more general first to file or perfect rule of UCC section 9-312(5).<sup>27</sup> Section 9-312(2)'s super priority will overcome an existing lender's perfected security interest in crops. Barkley Clark provides an excellent overview describing section 9-312(2)'s limitations.

1. New value must be given by the crop claimant, in the form of a loan or credit sale.
2. The purpose of the value must be to enable the farmer to produce the crops during the current production season, although there appears to be no requirement that the value actually has to be applied.
3. The value must be given not more than three months before the crops are planted even though there appears to be no requirement that the crop interest be perfected at any particular time, except insofar as priority is sought over lien creditors, purchasers, or a trustee in bankruptcy.
4. Obligations owing to the earlier secured party must have been due more than six months before the crops were planted.<sup>28</sup>

Unfortunately for potential new value lenders, and thanks to the courts, these circumstances are very narrow and limited.

### 3. *The Complex Web of Section 9-312(2)*

Some commentators have suggested that courts take a new look at section 9-312(2).<sup>29</sup> One has also suggested that "the best approach is to amend Article 9 to repeal section 9-312(2) and replace it with a truly effective 'production money security interest.'"<sup>30</sup> The reason for such comments is based upon the complex and useless web that courts have formed out of section 9-312(2). Professor Steve H. Nickles provides a good illustration of how courts allegedly misinterpreted key elements of section 9-312(2) and formed precedences, unintended by its original drafters, that destroy its usefulness.<sup>31</sup>

26. U.C.C. § 9-312(2) (1972).

27. *See id.* §§ 9-312(2), 9-312(5).

28. CLARK, *supra* note 16, ¶ 8.05[2][c], at 8-50.

29. *See generally id.* ¶ 8.05[2][c][i] (discussing the general ineffectiveness of the code section and how courts are now beginning to create limited situations in which it has more of an effect).

30. *Id.* ¶ 8.05[2][c], at 8-54.

31. *See* Steve H. Nickles, *Setting Farmers Free: Righting the Unintended Anomaly of UCC Section 9-312(2)*, 71 MINN. L. REV. 1135, 1190 (1987).



Nickles analyzes section 9-312(2) as three parts: (1) the general rule; (2) the exception; and (3) implication of knowledge.<sup>32</sup> The general rule provides, "a perfected security interest in crops for new value given to enable the debtor to produce the crops during the production season and given not more than three months before the crops become growing crops by planting or otherwise takes priority over an earlier perfected security interest . . . ."<sup>33</sup>

Nickles argues that the general rule should be interpreted as a superpriority similar to the PMSI.<sup>34</sup> In support of his position, he points out that section 9-312(2) closely resembles sections 9-312(3) and 9-312(4), both of which give superpriority status to purchase money security interests.<sup>35</sup> That is each subsection gives priority over conflicting interests in the same collateral when pertinent procedural requirements are satisfied.<sup>36</sup> He concludes that such resemblance is not accidental because prior versions of current 9-312(2) indicate that it was supposed to be a PMSI.<sup>37</sup> Nickles is not alone in his assertion. Courts, in applying section 9-312(2), apply it as though it were a superpriority.<sup>38</sup> Even so, courts apply it in an overly narrow manner as will be illustrated next by the exception.

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32. Nickles's third part of section 9-312(2) makes it clear that the general rule in part one is "unaffected if the holder of the crop production security interest knows of the earlier interest." *Id.* at 1192.

33. See U.C.C. § 9-312(2) (1972).

34. See Nickles, *supra* note 31, at 1190.

35. See *id.* Section 9-312(3) provides, "a perfected purchase money security interest in inventory has priority over a conflicting security interest in the same inventory and also has priority in identifiable cash proceeds received on or before the delivery of the inventory to the buyer if . . . ." U.C.C. § 9-312(3) (1972). Section 9-312(4) provides, "a purchase money security in collateral other than inventory has priority over a conflicting security interest in the same collateral or its proceeds if . . ." *Id.* § 9-312(4).

36. See Nickles, *supra* note 31, at 1191-92.

37. See *id.* Nickles argues that early versions of Article 9 equated section 9-312(2) with subsections explicitly labeled (i.e., existing subsections (3) and (4)) as purchase money security interests. See *id.* He reasons that because the language and structure of section 9-312(2) has remained materially identical throughout the evolution of Article 9, the comments applied to earlier versions of section 9-312(2) are equally applicable to existing section 9-312(2). See *id.*

Nickles then argues that language of those earlier comments suggest that section 9-312(2) was meant to be a purchase money interest. See *id.* As evidence Nickles quotes commentary from the 1952 Official Draft Text of the Uniform Commercial Code. See *id.* This commentary provides, "another (referring to section 9-312(6) the 1952 predecessor to existing section 9-312(2)) instance of the preferences which this Article gives a secured party who makes a present advance over one who takes security for an old debt." *Id.* Nickles indicates, "the other instances of preference which these descriptions refer to are the rules giving priority to purchase money security interests." *Id.*

38. See generally *In re Conner*, 733 F.2d 523 (8th. Cir. 1984) (holding appellee did not have superior interest over appellant because most of debtor's obligations to appellant had not come due and some of the obligations were not six months overdue); *McCoy v. Steffen*, 416 N.W.2d 16 (Neb. 1987) (prioritizing security interest of farmer's creditor over interest of farmer's landlord because farmer's creditor obligation was not more than six months overdue and they perfected the security interest); *Reilly v. First Nat'l Bank & Trust Co.*, 370 N.W.2d 163 (Neb. 1985) (deciding section 9-312(2) did not

Professor Nickles argues the exception in section 9-312(2) is the language that reads “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 before the crops become growing crops by planting or otherwise . . . .”<sup>39</sup> The exception, Nickles points out, is where the courts have erroneously interpreted section 9-312(2).<sup>40</sup> He says the courts have “construed [the exception] literally and broadly” thus making it a qualifier or prerequisite before reaching the “general rule.”<sup>41</sup> He contends that it was intended merely as an “occasional, narrow exception to the general rule of the provision,” rather than a “blanket” limitation on the entire section.<sup>42</sup> This is why section 9-312(2) cannot function—the prerequisite “swallows” the general rule.<sup>43</sup>

Nickles uses a historical analysis to show that the exception was intended only to benefit lenders who financed the farmer’s purchase, rent, or lease of land.<sup>44</sup> Moreover, the exception was only intended to benefit land financiers to a limited extent.<sup>45</sup> The extent to which land financiers were to be excepted from the superpriority was “limited to rent, interest, and amortized purchase money payments *due and unpaid during the six months before*” planting.<sup>46</sup> But not allowing the

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apply because the plaintiff agreed that the interest due to the defendant bank would be paid first and then the plaintiff could recover his investment).

39. U.C.C. § 9-312(2) (1972) (emphasis added). *See also* Nickles, *supra* note 31, at 1192.

40. *See* Nickles, *supra* note 31, at 1192.

41. *Id.*

42. *Id.* at 1193. *See generally In re Conner*, 733 F.2d 523 (8th Cir. 1984) (finding appellee did not have superior interest over appellant because most of debtors’ obligations to appellant had not come due and some of the obligations were not six months overdue); *United States v. Minster Farmers Coop. Exch., Inc.*, 430 F. Supp. 566 (N.D. Ohio 1977) (deciding the installments due to the plaintiff from the defendant were not more than six months overdue so the plaintiff was entitled to priority); *In re Piwowar Farms*, 66 B.R. 23 (Bankr. W.D. Pa. 1986) (holding loan was due within six months so could have obtained § 9-312(2) priority but subordination agreement was signed by parties and that was deemed superior).

43. *See* Nickles, *supra* note 31, at 1192.

44. *See id.* at 1193-1200. In his historical analysis, Professor Nickles’ outline presents past official and draft versions of section 9-312(2), together with their comments. *See id.* He indicates that a key part of understanding the exception is understanding why it was created. *See id.* Then he says:

The drafters created the exception because they reasoned that in financing the farmer’s purchase or use of the farmland, the land financier gave value that enabled the farmer to produce crops throughout the term of the mortgage, lease, or land sale contract. Allowing the land financier qua enabling lender to take an after-acquired interest in crops produced throughout the term of the land transaction, therefore, was consistent with limiting the use of crops as collateral to current production or enabling loans and credit. *Id.* at 1195 (footnote omitted).

45. *See id.* at 1197-98.

46. *Id.* at 1198 (emphasis added).

exception to apply to "rent or purchase money land obligations attributable to any period *after the six months*."<sup>47</sup>

Courts, on the other hand, interpret this section to say that only when prior lender's security interest is more than six months overdue, and planting has not begun, will section 9-312(2) grant a superpriority.<sup>48</sup> As a result, the exception has been converted into something of a prerequisite to the general rule providing the superpriority. Thus, "a supplier can never 'make a crop loan on the strength of [UCC Section] 9-312(2) with any certainty that he [will] end up with a clear priority' over the lender's earlier perfected interest."<sup>49</sup>

Courts' interpretation of section 9-312(2) has resulted in the "credit squeeze" problem. A "credit squeeze" is created when the prior lender refuses to subordinate to a new lender, because the prior year's crop did not generate sufficient income to pay off the prior loan, thus leaving the new lender reluctant to lend, leaving the farmer without financing, and any new crop already pledged to the unpaid lender.<sup>50</sup> This "credit squeeze" may give a lender that holds the prior loan power to force liquidation upon the farmer since the farmer will effectively have no access to credit with which to plant a new crop.

Prior to 1972, the limitations of section 9-312(2) were not such an intense problem. The 1972 amendments to Article 9 impacted section 9-312(2)'s limitations by eliminating the one-year limit on security interests in crops. This means that lenders are no longer required to file a new financing statement with respect to the security agreement each year in order to obtain a security interest in growing crops. Professor Nickles would argue that this change does not substantively change the intent or reasoning behind section 9-312(2).<sup>51</sup> He points out that the original intent of section 9-312(2) remains the same, because the 1972 revision committee opted not to make any changes to it.<sup>52</sup> Nevertheless, the practical effect is that the elimination

47. *Id.* (emphasis added). Any credit extended within this time frame did not enable the production of the current crop and was therefore not entitled to priority over current lenders, or those whose money was tied to the crops currently being produced.

48. See, e.g., *In re Connor*, 733 F.2d 523, 525 (8th Cir. 1984); *United States v. Minster Farmers Coop. Exch., Inc.*, 430 F. Supp. 566, 570 (N.D. Ohio 1977); *In re Smith*, 82 B.R. 62, 64 (Bankr. S.D. Ill. 1988) ("due" in article 9-312(2) interpreted to mean "overdue").

49. Nickles, *supra* note 31, at 1188 (quoting G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 32.5, at 870 (1965)).

50. See Memorandum from Gordon Tanner, Attorney, Stoel, Rives, Boley, Jones and Grey, L.L.P. to Steven Turner, Dick Brunette, and Keith Meyer, Attorneys and members of the Task Force 1 (May 26, 1992) (on file with author) [hereinafter Tanner Memo].

51. See Nickles, *supra* note 31, at 1199. Referring to the 1972 change, Nickles states, "this recent technical or housekeeping change regarding how a lender acquires an interest in future crops, however, in no way dilutes the interpretative force of intentions and reasoning originally behind section 9-312(2) regarding the priority of production money security interests in current crops." *Id.*

52. See *id.* at 1200.

of the one-year limit on security interest in crops, has created the “floating lien.”<sup>53</sup> Floating liens tie up a future crop’s value because, even before that crop comes into being, a perfected security interest is already attached to it. Floating liens have, in turn, devastated the effectiveness of section 9-312(2) because a crop with a floating lien attached to it is already considered collateral of an overdue perfected security interest before new value is ever given.

### III. AN ALTERNATIVE TO ARTICLE 9 SECURITY INTERESTS

Many states have bypassed the problems associated with section 9-312(2) using statutory agricultural liens.

#### A. *Agricultural Liens Generally*

Agricultural liens are statutory in nature because they are created by state legislative action. “Liens give a person who has provided goods or services on credit an interest in specific property to assure payment for the goods or services.”<sup>54</sup> Professor Meyer provides an excellent description of statutory liens.

Statutory liens are not consensual and do not depend upon judicial action by the creditor. They are status liens that arise by operation of law because of a particular creditor’s status. The statutory lien gives the creditor an interest in specific goods to assure payment for goods, services, land, labor, or whatever was provided by the person entitled to the lien. Statutory lien holders are, in effect, given the rights of secured creditors even though they did not bargain for security. Finally, these liens normally are given to creditors who sell goods on credit or who perform a service or otherwise give value that preserves or enhances the value of the property subject to the lien.<sup>55</sup>

Another important aspect of agricultural liens is that they are generally nonpossessory. Nonpossessory means that the holder of the lien does not need to have possession over the property in order to enforce the lien. Because agricultural liens are nonpossessory they are excluded from Article 9 coverage.<sup>56</sup> Because agricultural liens are outside of the scope of Article 9 and its priority rules, conflict between Article 9 secured creditors and agricultural liens holders may arise.

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53. “Floating lien” in this context refers to rolling over of a lenders security interest into the next years crop, thus tying the future crop as collateral for the past security interest.

54. Keith Meyer, *Should the Unique Treatment of Agricultural Liens Continue?*, 24 IND. L. REV. 1315, 1318 (1991).

55. *Id.*

56. See U.C.C. § 9-104(c) (1972).

### B. *Agricultural Liens vs. Article 9*

Professor Meyers provides another excellent illustration explaining the conflict between Article 9 secured parties and agricultural lien holders.

Agricultural liens not covered by the UCC are numerous and not uniform between the states or within one state(s). Examples include liens for stud service, for a commission merchant selling farm products, for a livestock feeder or stable keeper, for shoeing animals, for unpaid pasture rent, for unpaid rent of crop land (landlord lien), for veterinarian services, for labor and machines used to harvest farm products, for processing farm products, for production of supplies such as feed, fertilizer, seed and chemicals, and for bovine brucellosis treatment. Most of these liens are statutory and differ in substance, creation, perfection, enforcement, and priority relative to other creditors, or purchasers of farm products that might be subject to a statutory lien. No model or uniform lien exists, and it is often not clear how the lien is created, enforced, or what priority it is to receive. It is also difficult to determine what liens exist. These uncertainties cause a variety of problems. Creditors, and lawyers advising them, have no firm basis for making decisions. Both state and federal courts, particularly bankruptcy courts, have had difficulties resolving priority disputes involving agricultural liens.<sup>57</sup>

This "results in credit extension based upon two different collateral security systems,"<sup>58</sup> one based on Article 9 and the other based on statutory liens.<sup>59</sup> Given the dual system, "there exists an inherent conflict between the system of statutory liens and Article 9 security interests."<sup>60</sup> Even so, agricultural liens provide a tool for crop input creditors who would otherwise rely on section 9-312(2). Thus, because of section 9-312(2)'s failure to provide a superpriority for crop production creditors, in some states such creditors have relied on agricultural liens to protect their interests. Agricultural liens provide a safe harbor for otherwise subordinate Article 9 creditors in the face of prior secured creditors. Nevertheless, agricultural liens serve to create a legal uncertainty on the part of lenders in terms of whether their designated collateral is truly unencumbered enough to adequately cover the loan debt.

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57. Meyer, *supra* note 54, at 1324.

58. ARTICLE 9 TASK FORCE OF THE SUBCOMMITTEE ON AGRICULTURAL AND AGRI-BUSINESS FINANCING OF THE COMMITTEE ON COMMERCIAL FINANCIAL SERVICES OF THE BUSINESS LAW SECTION OF THE AMERICAN BAR ASSOCIATION, REPORT ON AGRICULTURAL FINANCING UNDER ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE AND SUGGESTED CHANGES TO ARTICLE 9 (August 7, 1997) [hereinafter ABA TASK FORCE].

59. *See id.* at 5.

60. *Id.*

### C. Illustration

Given the nature of agricultural liens, they can create a superpriority in favor of non-Article 9 secured creditors. Consider, for example, Iowa Code chapter 570A, which creates a lien in favor of agricultural suppliers against a farmer's crop.<sup>61</sup> To illustrate how chapter 570A functions, assume Farmer secures an operating loan from Bank. Bank properly perfects a security interest to secure repayment of the loan pursuant Article 9. Bank's security interest includes, as collateral for the operating loan, Farmer's harvested crops.

Later that same year, Farmer purchases seed or services on credit from Agricultural Supplier. Pursuant to chapter 570A, Agricultural Supplier files a lien statement with the office of the Secretary of State at the time it delivers the seed or services to Farmer, thereby perfecting its interest in the harvested crop.<sup>62</sup> According to chapter 570A, even though Agricultural Supplier's lien was perfected after Bank's security interest was perfected, it is equal to the security interest for purposes of priority.<sup>63</sup>

This example illustrates how agricultural liens may create a superpriority in favor of the agricultural supplier. More importantly we can see how secured creditors who mistakenly rely on priority arising out of section 9-312(2) can bypass its unworkability.

## IV. ARTICLE 9 TASK FORCE DISAGREEMENT

In 1990, the Permanent Editorial Board for the UCC began a revision study of Article 9, and in late 1992, it was agreed that Article 9 needed to be revised. The Article 9 Task Force of the Subcommittee on Agricultural and Agri-Business Financing ("Task Force") undertook the study of revisions affecting agriculture.<sup>64</sup>

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61. See IOWA CODE § 570A.3(1) (1999).

62. See *id.* § 570A.4(1).

63. See *id.* § 570A.5(2). Subsection 570A.5(2) states, "a lien perfected under this chapter is equal to a lien or security interest which is of record or which is perfected prior to the time the lien statement is filed with the secretary of state except as provided in section 570A.2, subsection 3." *Id.* Section 570A.2(3) states:

Upon an action to enforce a lien secured under section 570A.3 against the interest of a financial institution secured to the same collateral as that of the lien, it shall be an affirmative defense to a financial institution and complete proof of the superior priority of the financial institution's lien that the financial institution either did not receive a certificate request and a waiver signed by the farmer, or received the request and a waiver signed by the farmer and provided the full and complete relevant financial history which it held on the farmer making the purchase from the agricultural supply dealer on which the lien is based and that financial history reasonably indicated that the farmer did not have a sufficient net worth or line of credit to assure payment of the purchase price.

*Id.* § 570A.2(3).

64. See generally ABA TASK FORCE, *supra* note 58 (Article 9 Task Force of the

As part of its responsibility, the Task Force was left to take action with respect to subsection 2 of section 9-312.<sup>65</sup> The Task Force's early focus became the issues of "credit squeeze" and "dilution."<sup>66</sup>

The possibility for dilution of existing security interests in the collateral by a new lender who, by qualifying under §9-312(2), lends more than is needed for the actual production of the current crops. The new money may be used to finance capital improvements or pay debt service on the theory that they somehow "enable the debtor to produce the crops," thereby diluting the security interests of the existing secured parties in the new crops.<sup>67</sup>

However, it recognized other deficiencies in section 9-312(2) also existed. For instance, the phrases "new value" and "becomes growing" have no clear definition or meaning under current Article 9, and thus contribute to the unworkability of section 9-312(2).<sup>68</sup> Another example of deficiency is that "it is unclear whether the interest must be perfected in the crops while they are growing and whether the special priority in favor of the new value crop financier extends to the crops upon harvesting."<sup>69</sup> The preceding represent the frustration many have suffered in attempting to utilize section 9-312(2).

#### A. *Task Force Disagreement*

Early on, the Task Force agreed that current 9-312(2) was unworkable. Yet, they could not come to an agreement on a workable alternative. In the words of one Task Force member, "we disagree with each other as to whether a workable production money security interest in farm products should exist at all."<sup>70</sup>

This effort led the Task Force to devise a plan of action. The first option was to do nothing, leaving 9-312(2) as is, "but available to anyone who can find a way to use it."<sup>71</sup> The second option was to repeal section 9-312(2). The Task Force noted that repeal would "leave the parties with no option other than to agree or not to subordination," thus leading to a "pure race approach to priority."<sup>72</sup> The third option was to revise section 9-312(2) so that it would be workable.

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Subcommittee on Agricultural and Agri-Business Financing released its suggested changes to Section 9-312 in a report in 1997).

65. *See id.*

66. *See id.* at 5.

67. *Id.*

68. *See Tanner Memo, supra* note 50, at 2.

69. 9 WILLIAM D. HAWKLAND ET AL., UNIFORM COMMERCIAL CODE SERIES § 9-312:3, at Art. 9-222 (1997).

70. *See Tanner Memo, supra* note 50, at 1.

71. *Id.* at 2.

72. *Id.*

Because elimination of section 9-312(2) seemed inevitable, the Task Force created six potential replacement alternatives.<sup>73</sup> The first alternative, called the "Gatekeeper for Crop Year Proposal,"<sup>74</sup> was described as follows:

The first crop lender primes all other security interest holders on the same collateral for a period of one calendar year or longer if the lender is willing to make a longer commitment to lend. Anyone wishing to lend to the farmer secured by the same crops once a production money security interest is in place on those crops must negotiate for priority with the holder of the PrMSI. This proposal harkens back to the 1962 code since it has a one year element.<sup>75</sup>

The second possible alternative was called the "Race-Notice / Pro Rata Proposal."<sup>76</sup> For this proposal the Task Force said,

The proposal is to separate creation and attachment from priority of the PrMSI. The existence of PrMSI status should depend on whether the funds or credit were actually used to "produce" the crop. That way the amount of the possible PrMSI is limited, thereby helping to alleviate the "dilution" problems.

Once established, a PrMSI holder should be given priority over all prior perfected and unperfected security interests and lien holders, if that PrMSI has given notice of its [production-money security interest] to such competing interest holders at least 21 days before the date of the first

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73. See *id.* at 2-4.

74. See *id.* at 2.

75. *Id.* at 3-4. For this version of 9-312(2), the task force proposed the following language:

A perfected production money security interest in crops or the proceeds thereof takes priority over an earlier perfected security interest in the same collateral. No production money security interest in crops applies to crops which become growing crops more than one year after the security agreement is executed; provided, however that the secured party may extend the application of the production money security interest to equal the term of the loan or lease the secured party is willing to commit to make the debtor. Such extension must appear in the loan agreement or lease executed at the same time as the security agreement giving rise to the production money security interest.

*Id.* at 3.

The Task Force proposed the following language for section 9-107(2):

A security interest is a production money security interest to the extent that it secures new value actually used by the debtor to produce crops.

*Id.*

76. See *id.* at 2.



advance of the loan for which the PrMSI is being claimed.<sup>77</sup> This deals with the “credit squeeze” problem.

Where there are multiple PrMSI holders in the same collateral, they share their security interests in the crops grown with their funds, and proceeds therefrom, pro rata based on the proportion of their loan they can prove was used to produce the crops in question bears to the total funds directly used to produce those crops. Payments of mortgage payments, living expenses of the farmer and other indirect costs are excluded from the base for determining the pro rata portion. The goal is to enable crop production, not to pay for household expenses or debt service. The use of the new value must be reasonably and directly related to the production of the crops over which the interest is claimed.<sup>78</sup>

The Task Force’s third alternative was called the “Race/Existing Debt Nut Proposal.”<sup>79</sup> The Task Force described this alternative as follows:

Current crop lender can prime all but that portion of the existing debt that is attributable to the “current crop year” – an arbitrary 12 month period. That “nut” (like cab drivers pay for the use of a cab) has priority over the new production lender to the extent it is a prior perfected security interest or lien.<sup>80</sup>

The Task Force’s fourth alternative was called the “New Debt/Existing Debt Nut All Pro Rata Proposal.”<sup>81</sup> The Task Force described this alternative as follows:

Same as Race/Existing Debt “Nut” proposal with the exception that the “nut” and the “current Crop loan” are combined and the proceeds of the crop are distributed pro rata according to the percentage each element bears to the whole.<sup>82</sup>

The Task Force’s fifth alternative was called the “Pure Reverse Race Proposal.”<sup>83</sup> The Task Force described this alternative as follows:

Under this approach the last lender has first priority and thus is the first paid. This approach should assure the farmer financing for the current crop since the farmer can always give first priority in that crop to the latest

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77. This notice allows the previous security interest holder the opportunity to lend money to the producer before the PrMSI-lender has a change to lend. This allows the previous holder to retain its priority.

78. *Id.* at 3, 4 (explanatory footnote added).

79. *See id.* at 4.

80. *Id.*

81. *See id.*

82. *Id.*

83. *See id.*

lender. However, if the current lender believes there is a chance it will not be repaid in full from the crop proceeds of the crop it finances, then the lender may be less likely to finance, thus defeating the advantage of this approach.<sup>84</sup>

The Task Force's final alternative was called the "Pure Pro Rata Proposal."<sup>85</sup> The task force described this alternative as follows:

This approach would require all lenders and other parties contributing to a crop in any way (i.e., capital improvements, inputs, long term loan for purchase of land) to share pro rata in the crops and proceeds based on the proportion their debt bears to the entire indebtedness of the farmer secured by such crops and proceeds.<sup>86</sup>

The Task Force could not unanimously agree on any one alternative for creating a production money security interest. Nevertheless, feeling compelled to make a recommendation, a majority of the Task Force recommended the Race/Notice Pro Rata alternative.<sup>87</sup> The probable motive behind the Task Force's selection of Race/Notice is because race/notice is Article 9's "default" position (i.e., the first to

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84. *Id.*

85. *See id.*

86. *Id.*

87. *See id.* at 5. The proposed alternative would also require that section 9-107 be amended because of the idea that a purchase money security interest and a production money security interest are similar. *See id.* Thus, below are the task forces initial recommended amendments to sections 9-107 and 9-312(2).

Section 9-107(2):

A security interest is a "production money security interest" to the extent that it secures new value actually used by the debtor to produce crops. "New value actually used by the debtor to produce crops" includes advances, credit extended and obligations incurred for purposes of planting, fertilizing, cultivating, husbanding or otherwise nurturing the crops through harvest.

*Id.*

Section 9-312(2):

A perfected production money security interest in crops or the proceeds thereof takes priority over an earlier perfected security interest in the same collateral if (a) such conflicting security interest is not a perfected production money security interest, and (b) the perfected production money secured party has given notice of its interest to the holder of the conflicting security interest at least 21 days before new value is first given by the perfected production money secured party. When there is more than one perfected production money security interest in the same crops or the proceeds thereof, the competing perfected production money security interests rank equally in priority, and the secured parties holding such competing interests share according to the ratio that the amount of each secured party's perfected production money security interest bears to the total amount of all perfected production money security interest in those crops and proceeds.

*Id.*

file rule).<sup>88</sup> Pro-Rata compensates for the biological forces at work in crop production, since nature determines when a crop is matured and ready for harvest.<sup>89</sup> The majority of the Task Force felt that this proposal would best solve problems of credit squeeze and dilution.<sup>90</sup> In 1992, despite the majority's decision, the group's final consensus was to conduct further study.<sup>91</sup>

### B. *Developing PrMSI: The Lenders' Reaction*

Further study led the Task Force to request information regarding a PrMSI from primary agricultural lenders.<sup>92</sup> The Task Force received responses from the California Bankers Association 9 ("CBA") and the Farm Credit Counsel.

#### 1. *California Bankers Association*

The CBA "has historically opposed any legislation which provides an agricultural trade supplier with a priority lien over other secured parties or with an unrecorded lien right [agricultural lien] that would not appear in a normal UCC search."<sup>93</sup> CBA's overriding concerns, with respect to providing a superpriority, appears to be that a superpriority "effectively takes away the conventional lender's ability to rely on crop proceeds as the primary source of repayment for the loans," and because "secured lenders will be forced to continually search records to be assured that no event giving rise to a superpriority lien has occurred."<sup>94</sup>

Moreover, CBA appears concerned that agricultural suppliers will use a superpriority to shift their risk of extending credit (i.e., selling seed to the farmer on credit) to the farmer back onto the lender.<sup>95</sup> Evidently agricultural suppliers in California have attempted to utilize agricultural liens (as discussed above) to bypass Article 9 secured creditors in the past.<sup>96</sup>

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88. See Interview with Gordon Tanner, Attorney, Stoel, Rives, Boley, Jones & Grey, L.L.P. in Seattle, Washington (October 15, 1999).

89. See *id.*

90. See *id.*

91. See Tanner Memo, *supra*, note 50, at 5. "[W]e must leave the search for a broadly supported solution that implements appropriate social and agricultural policy for further study." *Id.*

92. The task force requested information from other agricultural lenders but received no responses at the time of the Task Force's report. See *id.* This, however, should not suggest that other agricultural lenders are not interested in this issue. For example, observe the Agriculture Retailers Association's (ARA) website, which provides several essays advocating support of a production money security interest. See *Agriculture Retailers Association: UCC* (visited October 17, 2000) <<http://www.agretailerassn.org>>.

93. Memorandum from California Bankers Association to the Agricultural Lending Committee 1 (March 1, 1996) (on file with author).

94. *Id.* at 2.

95. See *id.*

96. See *id.* at 1. The CBA memo indicates that during the 1980s, agricultural suppliers attempted to persuade the California legislature to adopt agricultural liens that would have given

Specifically, CBA indicates concern that the PrMSI would “lead to split financing situations and cause collateral confusion” that would ultimately hinder the lenders’ ability to get paid.<sup>97</sup> CBA notes,

A financially distressed borrower will have access to a new credit without having to recognize the unpaid balance of the existing lender. While this may assist fertilizer and seed suppliers in selling more product, it undermines the secured lender who is trying [to] salvage a nonperforming loan. Notwithstanding the assertions of the fertilizer and seed industry, if a producer could grow his way out of a financial difficulty, it would be in the secured lender’s interest to subordinate under existing law and allow the new crop to be grown. Furthermore, how will priority be determined with respect to crops that have no clear break in production cycle?<sup>98</sup>

Finally, CBA is concerned that the Task Force is trying to use the same rationale in creating a PrMSI as is the foundation for a PMSI.<sup>99</sup> CBA argues that “you cannot compare a production money security interest in crops with a purchase money security interest in inventory or equipment.”<sup>100</sup> The common characteristic between inventory and equipment is that it is recoverable from the debtor.<sup>101</sup> Thus, it is realistic to provide a PMSI for these categories of goods. Seed, fertilizer, and water, each of which are used in crop production, are assimilated into the crop.<sup>102</sup> Individually, they cannot be recovered in the event the debtor fails to pay its loan.<sup>103</sup>

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suppliers priority over secured creditors. *See id.* As discussed previously in this Article, agricultural liens are not currently recorded with UCC filings. Therefore, the unwary lender can be trumped by an unknown lien holder. CBA indicates that the California legislature declined to “bless [agricultural suppliers’] disdain for Article 9” by refusing to enact such superpriority liens. *Id.* Instead, CBA, agricultural suppliers, and the California Legislature worked together to form a compromise whereby agricultural suppliers are permitted “to file a nonconsensual lien for product provided.” *Id.* (emphasis added). CBA notes,

This supplier lien takes priority with respect to time of filing and is treated, for filing purposes, as a financing statement (UCC-1) by the Secretary of State. The lien covers a limited amount of product. Since only *two* suppliers may have a valid nonconsensual lien in any one producer, suppliers who desire to use this statutory lien request a UCC-3 before delivering product. The practical effect of these laws has been to bring a commercial discipline to agricultural suppliers. Suppliers extending credit are forced to make the same decisions that any other commercial party makes when it determines whether to proceed on a secured or unsecured basis.

*Id.* at 2 (emphasis in original).

97. *Id.* at 2.

98. *Id.*

99. *See id.* at 3.

100. *Id.*

101. *See id.*

102. *See id.*

103. *See id.*

Therefore, unlike inventory or equipment that are physically recoverable, crop production only leaves the harvested product or its proceeds as recoverable.

## 2. *The Farm Credit Council Reaction*

The Farm Credit Council was the other institution that responded to the Task Force's request for issues regarding PrMSI. The Farm Credit Council requested each of its system banks to respond to a draft of revisions of Article 9, including the proposed production-money security interest.<sup>104</sup> The following are excerpts from the system bank comment letters on the proposed production money security interest, submitted in response to a request from the Task Force.

### a. *Farm Credit Bank of Springfield–Massachusetts*

Purchase money security interest on crops – we are generally in favor of a good system to accomplish this, but do not have any novel ideas to offer. We feel that there is a need to retain a way to protect lenders who are terminating an ongoing relationship with the borrower and don't get paid in a given year from getting trumped fully by a PMSI.<sup>105</sup>

### b. *Farm Credit Bank of Louisville–Kentucky*

The Fourth District institutions disagreed with the Task Force's recommendation to provide for a workable purchase money security interest in farm products. It was believed that a PMSI would initially allow a distressed borrower to finance several production seasons through different lenders without having to address necessary operational changes. In the long-term, it could make production financing more difficult as agricultural lenders adjusted their lending practices to counter the short-term effects. The consensus was that a PMSI works against a production lender who wants to be involved with a borrower on an on-going basis.<sup>106</sup>

### c. *Farm Credit Bank of St. Louis–Missouri*

First, we agree that this provision is a difficult provision due to the differences in agriculture across the nation. 9-312(2) was developed

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104. See Letter from Stephen T. Phelps, Senior Vice President and General Counsel, The Farm Credit Council, and John Gunderson, Senior Credit Specialist, The Farm Credit Council, to Larry M. Hultquist, Senior Vice President and General Counsel, Western Farm Credit Bank (February 21, 1992) (on file with author). Several letters from Systems banks were attached to the letter cited above.

105. Memorandum from Tim Moran, Farm Credit Bank of Springfield – Massachusetts, to Steve Phelps, Senior Vice President and General Counsel, The Farm Credit Council, and John Gunderson, Senior Credit Specialist, The Farm Credit Council 2 (Jan. 30, 1992) (on file with author).

106. Letter from Rebecca C. Reed, Associate General Counsel, Farm Credit Bank of Louisville – Kentucky, to Steve Phelps, Senior Vice President and General Counsel, The Farm Credit Council (January 27, 1992) (on file with author).

through extensive discussion with supplier groups. While review is appropriate, actual experience with 9-312(2) has been limited, it may be that the provision worked by eliminating the hidden benefit to previous lien holders under the scenario that their lien in after acquired crops was good, even though they contributed nothing to the most recent crop. The existence of 312(2) probably forced some creditors to finance some farmers that otherwise they would not, or if they chose not to finance, provided the legal basis so that the first creditor did not challenge the lien position of the "second crop" lender.<sup>107</sup>

d. *Farm Credit of St. Paul—Minnesota*

[B]ased on our experience in Minnesota, we urge the task force not to introduce the "crop year" concept that may be implied in the [production]-Money Security Interest in crops discussion if the intent is to use "crop year" as a security instrument descriptive device. In Minnesota, crop years must be specified on financing statements covering crops. Our experience has been that, just as there is little purpose served in requiring a real estate legal description, there appears to be no prudent reason to require that crop years covered by the financing statement be designated.<sup>108</sup>

e. *Farm Credit Service—Omaha, Nebraska*

"We support the Task Force intention of further review and study to formulate a workable purchase money security interest for all farm products. There is a definite need for such an option."<sup>109</sup>

f. *Farm Credit Bank of Wichita—Kansas*

"[We] believe that if the changes [to article 9 in general] are enacted by the various states, it should be an improvement."<sup>110</sup>

g. *Farm Credit Bank of Spokane—Washington*

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107. Memorandum from Ross B. Anderson, Farm Credit Bank of St. Louis – Missouri, to John Gunderson, Senior Credit Specialist, The Farm Credit Council 2 (Jan. 23, 1992) (on file with author).

108. Letter from Gary L. Hansen, Senior Credit Policy Officer, Farm Credit Bank of St. Paul – Minnesota, to John Gunderson, Senior Credit Specialist, The Farm Credit Council 2 (Jan. 24, 1992) (on file with author).

109. Memorandum from Don Shippy, Vice President – Credit Support Services, Farm Credit Bank of Omaha – Nebraska, to John Gunderson, Senior Credit Specialist, The Farm Credit Council 4 (Jan. 24, 1992) (on file with author).

110. Letter from Timothy G. Brown, Senior Attorney, Farm Credit Bank of Wichita, to Steve Phelps, Senior Vice President and General Counsel, The Farm Credit Council, and John Gunderson, Senior Credit Specialist, The Farm Credit Council (Jan. 7, 1992) (on file with author).

“PMSI status for secured crop financing – needed but should be studied until a workable solution is found. Need for PMSI status not shown – drafting problems, e.g., defining crop year, make pursuing amendments in this area inadvisable.”<sup>111</sup>

*h. Agriculture Bankers Division of the American Bankers Association*

On the issue of purchase money interest in farm products, the focus group saw little practical value in trying to change this section of Article 9. As a general rule, most of banks represented try to foster one-on-one relationships with their borrowers and tend to be the borrower’s sole source of credit. These lenders do not perceive PMSI based credit as being that significant in the agricultural context.<sup>112</sup>

Generally Farm Credit banks received PrMSI in a more favorable light than the CBA. They do, however, express concern that such a system must preserve their relationship with the borrower. Moreover, they recognize that a PrMSI should not allow troubling borrowers to continue status quo, rather it must force them to reevaluate their operations. The Farm Credit Council, similar to the CBA, recognizes that the lender must be protected.

V. 1994 PROPOSED 9-312(2)

With continuing effort to develop a PrMSI, in March of 1994 the Article 9 Task Force presented its report on agricultural financing under Article 9 to NCCUSL.<sup>113</sup> Contained in this report is a proposal for amending section 9-312(2) to create a PrMSI.<sup>114</sup> It is useful to compare the rationale of this proposed section 9-312(2) with the practical aspects of existing section 9-312(2) to appreciate the evolution of the PrMSI. Moreover, it provides a look at a foundational stone upon which the Model Provision section 9-324A PrMSI is built.

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111. Letter from Gregory J. Buene, General Counsel, Farm Credit Bank of Spokane – Washington, to Steve Phelps, Senior Vice President and General Counsel, The Farm Credit Council 2 (Jan. 27, 1992) (on file with author).

112. Letter from the Agricultural Bankers Division of the American Bankers Association to Steven C. Turner, Attorney, Baird, Holm, McEachen, Pederson, Hamann and Strasheim 2 (May 19, 1992) (on file with author).

113. See ARTICLE 9 TASK FORCE, EXCERPT FROM REPORT ON AGRICULTURAL FINANCING UNDER ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE AND SUGGESTED CHANGES TO ARTICLE 9, at 1 (1994) (educational materials on file with author) [hereinafter EXCERPT].

114. See *id.* at 3.

A. *Proposed 9-107(2): Creating The PrMSI*

Prior to analyzing proposed section 9-312(2) it is important to note the proposed changes necessary for section 9-107.<sup>115</sup> The Task Force proposed the addition of a new subsection 2 to be added to section 9-107. Proposed subsection 2 would have created the production-money security interest.<sup>116</sup> It provides:

A security interest is a “production money security interest” to the extent that it secures new value intended to be used by the debtor to produce crops. New value intended to be used by the debtor to produce crops means advances, credit extended and obligations incurred for purposes of planting, nurturing, harvesting, transporting or preparing the crops for sale.<sup>117</sup>

Subsection 2 exhibits the basic premise upon which the purchase money security interest is built. It requires that “new value” extended to the farmer by the lender be used for financing a specific crop’s production.<sup>118</sup> The accompanying draft official comment to subsection 2 indicates that the PrMSI scope is designed to be applied narrowly to direct expenses associated with the crop’s production.<sup>119</sup> Therefore, excluded from the PrMSI’s scope are “payment of living expenses, principal or interest on existing debt, and other indirect costs. . . .”<sup>120</sup>

The proposal remedies an ambiguity that exists in current Article 9. The definition of “new value” is not defined in current Article 9. In contrast, the proposal defines “new value” as “advances, credit extended and obligations incurred” in direct production of the crop.<sup>121</sup> The draft official comment to subsection 2 indicates that “the definition of [new value] is intended to limit the total

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115. *See id.* at 2.

116. *See id.*

117. *Id.*

118. *See id.*

119. *See id.* The Draft Comment says,

Payment of living expense, principal or interest on existing debt, and other indirect costs associated with the production of crops do *not* fall within the definition of a production money security interest. The costs of capital improvements, if they are both intended and likely to enable or enhance crop production, are within the definition. The definition of “new value actually used by the debtor to produce crops,” is intended to limit the total amount of money that can qualify for PrMSI status to that necessary and intended to be directly used in the production of a current or new crop. The costs of capital improvements intended to enhance crop production are within the definition of a production money security interest. The burden of proving the existence of a PrMSI and the amount entitled to PrMSI status is on the party asserting priority.

*Id.*

120. *Id.*

121. *Id.*



amount of money that can qualify for PrMSI status to that necessary and intended to be directly used in the production of a current or new crop."<sup>122</sup>

While subsection 2 limits the scope of PrMSI's applicability and defines "new value," it still leaves some areas necessitating further interpretation.<sup>123</sup> For instance, costs incurred because of capital improvements are permissible as PrMSI debt, if they are both intended for and likely to enhance crop production.<sup>124</sup> Left for interpretation is the direct relationship to the crop's production that such capital improvements would generate. Moreover, it is unclear how the intent and likelihood of enhancing crop production should be defined under the limited scope of the PrMSI. "The burden of proving the existence of a PrMSI and the amount entitled to PrMSI status is on the party asserting the priority."<sup>125</sup>

Proposed section 9-107's limited scope provides a framework for targeting loans to crop production only. Such a framework focuses the value extended strictly to crop production, thereby avoiding dilution of the loan among indirect operating expenses.

#### B. *Proposed 9-312(2)*

The Task Force proposed the 1994 section 9-312(2) to administer its priority in relation to other security interests.<sup>126</sup> The 1994 Proposed 9-312(2) provides

A perfected production money security interest in crops or their proceeds takes priority over prior perfected security interest in the same collateral if:

(a) The production money security interest is perfected at the time new value is first given for such crops; and

(b) The perfected production money secured party has sent written notice of its interest to the holder of the conflicting security interest at least 10 but not more than 30 days before new value is first given by the perfected production money secured party, if that holder of the conflicting security interest filed a financing statement covering the crops which was filed before the date of filing by the production money secured party; and

(c) Such conflicting security interest is not a prior perfected production money security interest in the same crops or their proceeds.

When there is more than one perfected production money security interest in the same crop or the proceeds thereof, the competing perfected production money security interest rank.

[Alt 1: Pro rata.] equally in priority, and the secured parties holding such competing interest share according to the ratio that the amount of each

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122. *Id.*

123. *See id.*

124. *See id.*

125. *Id.*

126. *See id.* at 3.

secured party's perfected production money secured interest bears to the total amount of all perfected production money security interest in those crops and proceeds.

[Alt 2: 1<sup>st</sup> in Time.] in priority according to the time of filing or perfection, as described in Section 9-312(5) and (6).<sup>127</sup>

A comparison of proposed section 9-312(2) and existing section 9-312(2) reveals important transformations. Both sections require the basic foundation of perfection of the interest it claims for priority status. Additionally, naming the interest the "Production-Money Security Interest," clarifies its intended use as a "superpriority." Finally, the scope of the PrMSI priority includes both the crop produced and its proceeds.<sup>128</sup>

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127. *Id.* at 3, 4. The Draft Official Comment says

Once established, the PrMSI holder should be given priority over all prior non-PrMSI perfected and unperfected security interest in the same collateral, if that PrMSI has given notice of its PrMSI to such competing interest holders at least 10 but not more than 30 days before the date of the first advance of the loan or other new value is first given for which the PrMSI is being claimed. This deals with the "credit squeeze" problem by giving the floating lienor the opportunity to provide the credit on comparable terms. *Id.* at 3.

[Paragraph if Alternative 1 is used:]

Where there are multiple PrMSI holders in the same collateral, they share their security interests in the crops grown with their funds, and proceeds therefrom, pro rata based on the proportion of their loan they prove qualifies for PrMSI status bears to the sum of funds proven by all PrMSI holders in the crops to qualify for PrMSI status. *Id.*

[Paragraph if Alternative 2 is used:]

Competing PrMSI rank in priority based on the first to file or perfect. This recognizes long standing customers in the industry whereby those contributing new value later in the production process must look to prior production lenders for payment, or take their chances to be paid from crop proceeds. *Id.* at 4.

[Final paragraph in all cases:]

Payments of mortgage indebtedness, living expenses, and other indirect costs are excluded from the base when determining the amount qualifying for PrMSI status. The costs of capital improvements, if they are both intended and likely to enable or enhance crop production, do qualify for PrMSI status. The goal is to enable crop production, not to pay for household expenses or debt service even though those expenses are important farm family expenses. The use of the new value must be reasonably and directly related to the production of crops over which the interest is claimed. This is necessary to avoid cries of "unfair" from prior security interest holders being primed, but not being repaid with the new loan. PrMSI priority is established by proof that the new value was *intended* to be used to produce the crops so as not to penalize the PrSI party for fraud by the farmer in use of the advances or other new value for other things. *Id.*

128. *See id.* at 3.

Proposed section 9-312(2) allows a PrMSI to take priority over prior conflicting security interests when three conditions are met.<sup>129</sup> First, subsection a requires that the PrMSI be perfected at the time new value is given.<sup>130</sup> Second, subsection b requires that existing secured creditors be given notice.<sup>131</sup> Third subsection c mandates that any conflicting security interests are not perfected PrMSIs.<sup>132</sup> This provision allows all PrMSIs to be treated separately from other perfected security interests. It does not prevent more than one PrMSI from being taken in the same crops.

The proposal eliminates the "due more than six month" phrase,<sup>133</sup> thus removing the Achilles heel of 9-312(2). It adds a notice requirement in subsection (b) similar to what is used for the Purchase Money Security Interest for Inventory.<sup>134</sup> Notice must be given to any conflicting security interest holders at least 10 days but not more than 30 days before new value is given.<sup>135</sup>

The notice period is designed to combat the "credit squeeze" problem articulated by Professor Nickles, because it puts the floating lien holder on notice that the debtor has found more favorable terms with another lender.<sup>136</sup> Thus, it gives the prior lender an opportunity to compete with the new lender, if that lender so chooses.<sup>137</sup>

The drafters provide a choice of alternative sections in the last part of the proposal.<sup>138</sup> These alternatives address conflicts when competing PrMSIs exist in the same crop.<sup>139</sup> The first alternative offers a pro rata solution, similar to that offered in the 1992 task force memo.<sup>140</sup> It treats the conflicting PrMSIs as equal in priority, despite different times of perfection.<sup>141</sup> However, it allocates the crop or its proceeds pro rata between the holders, according to the percentage of their interest to the total of all other PrMSIs in the same collateral.<sup>142</sup> Alternative 1's comment suggests each PrMSI holder must prove first its qualification as a PrMSI holder, and second its percentage interest with respect to any competitor's interest in the collateral.<sup>143</sup>

129. *See id.*

130. *See id.*

131. *See id.*

132. *See id.*

133. Compare U.C.C. § 9-312(2) (1972) with EXCERPT, *supra* note 113, at 1, 3.

134. *See* EXCERPT, *supra* note 113, at 1, 3; U.C.C. §§ 9-312(2), 9-312(3) (1972).

135. *See* EXCERPT, *supra* note 113, at 3, 4 (setting out the 1994 proposed 9-312(2) and its draft official comments).

136. *Id.* at cmt.

137. *See id.*

138. *See id.*

139. *See id.*

140. *See id.* *See also* Tanner Memo, *supra* note 50.

141. *See* EXCERPT, *supra* note 113, at 3, 4.

142. *See id.*

143. *See id.* at cmt.

Alternative two rewards the winner of the race to file.<sup>144</sup> Its draft official comment suggests “this recognizes long standing custom in the industry whereby those contributing new value later in the production process must look to prior production lenders for payment, or take their chances to be paid from crop proceeds.”<sup>145</sup>

## VI. FINAL RESULT: MODEL SECTIONS 9-103A AND 9-324A

### A. *Overview of the Model Provisions*

The 1994 proposal merely represents an important step in the evolution away from the unusable section 9-312(2) toward the Model Provision sections. In 1998 the Task Force recommended a final PrMSI proposal to the Drafting Committee. The Drafting Committee, in turn, designed sections 9-103A and 9-324A based upon the Task Force’s proposal.<sup>146</sup>

Yet, while the proposed PrMSI is workable, “neither the Drafting Committee nor the agricultural financing community [have] been able to reach a [unanimous] consensus on the desirability of including a special production-money priority rule in Article 9.”<sup>147</sup> Thus, sections 9-103A and 9-324A appear as model sections, not as “uniform, optional provision[s] for each State to consider during the legislative process.”<sup>148</sup>

It seems quite clear from the Drafting Committee’s comments that it is satisfied that a workable superpriority in crops has in fact been designed. However, despite its workability, an apparent inability of interested parties to reach a unanimous consensus on its existence has prohibited PrMSI’s complete adoption into the code. Thus, since PrMSI is optional, we find it buried in Appendix II of Revised Article 9.<sup>149</sup> Moreover, the “Sponsors of the UCC have taken no [official] position on [9-324A as a] priority rule.”<sup>150</sup>

### B. *Revised Model Section 9-103A: Defining Production-Money Security Interest*

Model Provision 9-103A is patterned after the same premise as a purchase money security interest.<sup>151</sup> Production-money security interest itself is an attempt “to

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144. *See id.*

145. *Id.*

146. *See id.*

147. U.C.C. § 9-324A app. II cmt. (amended 2000).

148. *Id.*

149. *See id.* § 9-324A app. II.

150. *Id.* § 9-324A app. II cmt.

151. *See id.* § 9-103A app. II cmt. 2.

balance the interests of the production money secured party with those of a secured party who has previously filed a financing statement covering the crops that are to be produced."<sup>152</sup>

### 1. *Subsection a*

Model Provision 9-103A(a) sets out the basic framework of the PrMSI. It indicates "a security interest in crops is a production-money security interest to the extent that the crops are production-money crops."<sup>153</sup> "Production money crops" are defined in the Model Definitions as "crops that secure a production-money obligation incurred with respect to production of those crops."<sup>154</sup> "Production-money obligation" is defined in the Model Definitions as "an obligation of an obligor"<sup>155</sup>

"Production-Money Crops"; "Production-Money Obligation"; Production-Money Security Interest; Burden of Establishing.

(a) A security interest in crops is a production-money security interest to the extent that the crops are production-money crops.

(b) If the extent to which a security interest is a production-money security interest depends on the application of a payment to a particular obligation, the payment must be applied:

(1) in accordance with any reasonable method of application to which the parties agree;

(2) in the absence of the parties' agreement to a reasonable method, in accordance with any intention of the obligor manifested at or before the time of payment; or

(3) in the absence of an agreement to a reasonable method and timely manifestation of the obligor's intention, in the following order:

(A) to obligations that are not secured; and

(B) if more than one obligation is secured, to obligations secured by production-money security interests in the order in which those obligations were incurred.

(c) A production-money security interest does not lose its status as such, even if:

(1) the production-money crops also secure an obligation that is not a production-money obligation;

(2) collateral that is not production-money crops also secures the production-money obligation; or

(3) the production-money obligation has been renewed, refinanced, or restructured.

(d) A secured party claiming a production-money security interest has the burden of establishing the extent to which the security interest is a production-money security interest.

*Id.*

152. *Id.* § 9-324A app. II cmt. 2.

153. *Id.* § 9-103(a).

154. MODEL PROVISIONS FOR PRODUCTION-MONEY PRIORITY app. II (July 1998) ("Legislative Note: States that enact these model provisions should add the following definitions to Section 9-102(a)") (on file with author).

155. "'Obligor' means a person that, with respect to an obligation secured by a security interest in or an agricultural lien on the collateral, (i) owes payment or other performance of the

incurred for new value<sup>156</sup> given to enable the debtor<sup>157</sup> to produce crops *if the value is in fact used* for the production of crops.”<sup>158</sup> “Production of crops,” in the model provision is defined to include “tilling and otherwise preparing land for growing, planting, cultivating, fertilizing, irrigating, harvesting, and gathering crops, and protecting them from damage or disease.”<sup>159</sup>

## 2. Subsection b

Model Provision 9-103A(b) provides:

If the extent to which a security interest in a production-money security interest depends on the application of a payment to a particular obligation, the payment must be applied:

(1) in accordance with any reasonable method of application to which the parties agree;

(2) in the absence of the parties’ agreement to a reasonable method, in accordance with any intention of the obligor manifested at or before the time of payment; or

(3) in the absence of an agreement to a reasonable method and a timely manifestation of the obligor’s intention, in the following order:

(A) to obligations that are not secured; and

(B) if more than one obligation is secured, to obligations secured by production-money security interest in order in which those obligations were incurred.<sup>160</sup>

The official comment to 9-103A indicates

Subsection (b) makes clear that a security interest can obtain production-money status only to the extent that it secures value that actually can be traced to the direct production of crops. To the extent that a security interest secures indirect costs of production, such as general living

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obligation, (ii) has provided property other than the collateral to secure payment or other performance of the obligation, or (iii) is otherwise accountable in whole or in part for payment or other performance of the obligation. The term does not include issuers or nominated persons under a letter of credit.” U.C.C. 9-102(a)(59) (revised 2000).

156. “‘New Value’ means (i) money, (ii) money’s worth in property, services, or new credit, or (iii) release by a transferee of an interest in property previously transferred to the transferee. The term does not include an obligation substituted for another obligation.” U.C.C. § 9-102(a)(57) (revised 2000).

157. “‘Debtor’ means: (A) a person having an interest, other than a security interest or other lien, in the collateral, whether or not the person is an obligor; (B) a seller of accounts, chattel paper, payment intangibles, or promissory notes; or (C) a consignee.” U.C.C. § 9-102(a)(28) (revised 2000).

158. *Id.*

159. *Id.*

160. U.C.C. § 9-103A(b) app. II (amended 2000).

expenses, the security interest is not entitled to production-money treatment.<sup>161</sup>

The comment suggests that section 9-103A(b) continues the limitations proposed in the 1994 PrMSI proposal. In addition to limiting the PrMSI to the direct cost of producing the crop, subsection b possesses the same payment framework as found in revised section 9-103(e).<sup>162</sup> Section 9-103(e) is the PMSI application of payment in non-consumer goods transactions.<sup>163</sup> Comment 7 to section 9-103(e) indicates that a security interest may be a "purchase-money security interest to some extent and a non-purchase-money security interest to some extent."<sup>164</sup> Given that subsection (b) and section 9-103(e) are the same it follows that a PrMSI will also possess this dual status."

Comment 7 provides an illustrative model of how section 9-103(e) and by extension subsection b functions.

Consider, for example, what happens when a \$10,000 loan secured by a purchase-money security interest is refinanced by the original lender, and, as part of the transaction, the debtor borrows an additional \$2,000 secured by the collateral. Subsection (f) [Subsection (c) in Section 9-103A] resolves any doubt that the security interest remains a purchase-money security interest [PrMSI under 9-103A]. Under subsection (b) [9-103A(a)], however, in enjoys purchase-money status [PrMSI status] only to the extent of \$10,000.

[I]f the debtor makes a \$1,000 payment on the \$12,000 obligation, then one must determine the extent to which the security interest remains a purchase-money security interest [PrMSI]- \$9,000 or \$10,000. Subsection (e)(1) [Subsection (b)(1)] expresses the overriding principle, applicable in cases other than consumer-goods transactions, for determining the extent to which

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161. *Id.* § 9-103A app. II cmt. 2.

162. *See id.* § 9-103(e).

In a transaction other than a consumer-goods transaction, if the extent to which a security interest is a purchase-money security interest depends on the application of payment to a particular obligation, the payment must be applied:

- (1) in accordance with any reasonable method of application to which the parties agree;
- (2) in the absence of the parties' agreement to a reasonable method, in accordance with any intention of the obligor manifested at or before the time of payment; or
- (3) in the absence of an agreement to a reasonable method and a timely manifestation of the obligor's intention, in the following order:
  - (A) to obligations that are not secured; and
  - (B) if more than one obligation is secured, to obligations secured by purchase-money security interests in the order in which those obligations were incurred.

*Id.*

163. *Id.*

164. *Id.* at cmt. 7(a).

a security interest is a purchase-money security interest [PrMSI] under these circumstances: freedom of contract, as limited by principle of reasonableness. An unconscionable method of application, for example, is not a reasonable one and so would not be given effect under subsection (e)(1) [(b)(1)]. In the absence of agreement, subsection (e)(2) [(b)(2)] permits the obligor to determine how payments should be allocated. If the obligor fails to manifest its intention, obligations that are not secured will be paid first. (As used in this Article, the concept of “obligations that are not secured” means obligations for which the debtor has not created a security interest. This concept is different from and should not be confused with the concept of an “unsecured claim” as it appears in Bankruptcy Code Section 506(a).) The obligor may prefer this approach, because unsecured debt is likely to carry a higher interest rate than secured debt. A creditor who would prefer to be secured rather than unsecured also would prefer this approach.

After the unsecured debt is paid, payments are to be applied first toward the obligations secured by the purchase-money security interest [PrMSI]. In the event that there is more than one such obligation, payments first received are to be applied to the obligations first incurred. See subsection (e)(3) [(b)(3)]. Once these obligations are paid, there are no purchase-money security interests [PrMSI] and no additional allocation rules are needed.<sup>165</sup>

### 3. *Subsection c*

Subsection c provides:

A production-money security interest does not lose its status as such, even if:

- (1) the production-money crops also secure an obligation that is not a production-money obligation;
- (2) collateral that is not production-money crops also secures the production-money obligation; or
- (3) the production-money obligation has been renewed, refinanced, or restructured.<sup>166</sup>

Note, as with subsection b above, subsection c and revised section 9-103(f) are designed with identical language.<sup>167</sup> Therefore, the official comment for subsection f is useful for interpreting subsection b.<sup>168</sup> The official comment accompanying subsection f suggest that the PMSI, or PrMSI in subsection b, may serve a dual status

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165. *Id.* at cmt. 7(a)-(b).

166. *Id.* § 9-103A(c) app. II.

167. *See id.* § 9-103(f).

168. *See id.* § 9-103(f) cmt. 7(b).



with respect to renewal, refinancing, or restructuring so long as there exists an identifiable portion of the PrMSI is traceable to the resulting commitment.<sup>169</sup>

#### 4. *Subsection d*

Subsection d provides, “a secured party claiming a production-money security interest has the burden of establishing the extent to which the security interest is a production-money security interest.”<sup>170</sup> Simply stated, subsection d places the burden of establishing whether the security interest retains its production-money status.<sup>171</sup>

### C. *Revised Model Section 9-324A: Priority of Production-Money Security Interests and Agricultural Liens*

Once a PrMSI is created pursuant to Model Section 9-103A it becomes subject to rules of priority established by Model Section 9-324A.<sup>172</sup> Model Section 9-324A is probably best introduced by its accompanying official comment when it states, “this section replaces the limited priority in crops afforded by former Section 9-312(2). . . . This section attempts to balance the interests of the production-money secured party with those of a secured party who has previously filed a financing statement covering the crops that are to be produced.”<sup>173</sup>

#### 1. *Subsection a*

Subsection a provides:

Except as otherwise provided in subsections (c), (d), and (e), if the requirements of subsection (b) are met, a perfected production-money security interest in production-money crops has priority over a conflicting

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169. *See id.*

Subsection (f) buttresses the dual-status rule by making it clear that (in a transaction other than a consumer-goods transaction) cross-collateralization and renewals, refinancing, and restructurings do not cause a purchase-money security interest to lose its status as such. The statutory terms “renewed,” “refinanced,” and “restructured” are not defined. Whether the terms encompass a particular transaction depends upon whether, under the particular facts, the purchase-money character of the security interest fairly can be said to survive. Each term contemplates that an identifiable portion of the purchase-money obligation could be traced to the new obligation resulting from a renewal, refinancing, or restructuring.  
*Id.*

170. *Id.* § 9-103A(d) app. II.

171. *See id.* §§ 9-103(g), 9-103 cmt. 7(c).

172. *See id.* § 9-324A app. II.

173. *Id.* § 9-324A cmt. 2.

security interest in the same crops and, except as otherwise provided in Section 9-327, also has priority in their identifiable proceeds.<sup>174</sup>

Subsection a provides the roadmap for ascertaining priority with respect to PrMSIs.<sup>175</sup> First, it clearly designates subsection b as the general rule for PrMSI priority.<sup>176</sup> Then, it designates subsections c, d, and e as exceptions to the general rule of subsection b.<sup>177</sup> Finally, it sets out that if subsection b is satisfied and no exceptions are applicable, a perfected PrMSI takes priority over conflicting security interests in the same crop.<sup>178</sup> Additionally, subsection a notes that such PrMSI will also have priority over identifiable proceeds, but subject to the rules of proceeds (revised section 9-327).<sup>179</sup>

Importantly, subsection a limits the priority of PrMSI to interest in the “same crops,”<sup>180</sup> thus limiting PrMSIs’ priority to the specific crop grown using the credit extended to produce that crop.<sup>181</sup> Moreover, the term “same crop” would include the production of a specific crop (i.e., corn) that is grown in separate fields so long as the crop is under the control (ownership) of the farming entity to which the credit was extended.<sup>182</sup>

## 2. *Subsection b*

Subsection b provides:

A production-money security interest has priority under subsection (a) if:

(1) the production-money security interest is perfected by filing when the production-money secured party first gives new value to enable the debtor to produce the crops;

(2) the production-money secured party sends an authenticated notification to the holder of the conflicting security interest not less than 10 or more than 30 days before the production-money secured party first gives new value to enable the debtor to produce the crops if the holder had filed a financing statement covering the crops before the date of the filing made by the production-money secured party; and

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174. *Id.* § 9-324A(a) app. II.

175. *See id.*

176. *See id.*

177. *See id.*

178. *See id.*

179. *See id.*

180. *See id.*

181. *See id.*

182. *See generally id.* (explaining priority of PrMSI and agricultural liens).

(3) the notification states that the production-money secured party has or expects to acquire the production-money security interest in the debtor's crops and provides a description of the crops.<sup>183</sup>

Subsection b allows lenders to acquire PrMSI priority in production-money crops if three conditions are satisfied.<sup>184</sup> First, the holder must perfect by filing on or before the date the secured party first gives new value for that crop, and the new value must enable the debtor to produce the crops.<sup>185</sup> For example, a lender providing production-money must either provide money or credit to the debtor thus allowing the debtor to produce crops.<sup>186</sup> On or before the date the lender provides that money or credit though, the lender must perfect by filing.<sup>187</sup>

The second requirement is the production money-secured party must notify any holder of a conflicting security interest.<sup>188</sup> Notification must be sent "not less than 10 or more than 30 days before the secured party gives new value."<sup>189</sup> However, such notification is necessary only when the holder of a conflicting security interest had filed a financing statement covering that crop, prior to the production-money party's filing of a financing statement covering the same crop.<sup>190</sup>

Section 9-324A's Official Comment clarifies the policy behind notification.<sup>191</sup> It states, "to qualify for priority under this section, the production-money secured party must notify the earlier-filed secured party prior to extending the production-money credit. The notification affords the earlier secured party the opportunity to prevent subordination by extending the credit itself."<sup>192</sup>

Lastly, the notification must state "that the production-money secured party has or expects to acquire the production-money security interest in the debtor's crops . . . ."<sup>193</sup> The notification must also provide a description of the applicable crops.<sup>194</sup>

Thus, if Lender 1 decides not to lend to a farmer and for whatever reason Lender 2 is willing to lend, the notification requirements must be fulfilled for Lender 2 to acquire priority in the new crop ahead of Lender 1. To fulfill the notification requirements of subsection b, Lender 2 will be obligated notify Lender 1 at least ten days in advance, but no more than thirty days prior to giving new value. However, if Lender 1 does not have current financing statement covering these crops, there is no

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183. *Id.* § 9-324A(b) app. II.

184. *See id.*

185. *See id.*

186. *See id.*

187. *See id.*

188. *See id.*

189. *Id.* § 9-324A(b)(2) app. II.

190. *See id.*

191. *See id.* at cmt. 2.

192. *Id.*

193. *Id.* § 9-324A(b)(3) app. II.

194. *See id.*

obligation to give Lender 1 notice since Lender 1 would be an unsecured creditor anyway.<sup>195</sup> If Lender 1 were an unsecured creditor, Lender 2 would merely need to perfect a security interest rather than secure a PrMSI.

### 3. *Subsection c*

Subsection c provides:

Except as otherwise provided in subsection (d) or (e), if more than one security interest qualifies for priority in the same collateral under subsection (a), the security interests rank according to priority in time of filing under Section 9-322(a).<sup>196</sup>

Subsection c is the rule of competitive PrMSIs. While, subsection c is itself subject to being trumped by subsections d and e it regulates conflict between competing PrMSIs (i.e., “more than one [production money] security interest [that] qualifies for priority in the same collateral under subsection (a) . . .”).<sup>197</sup> Subsection c resolves such conflicts between PrMSIs using the first to file rule under Section 9-322(a).<sup>198</sup> Since “only a security interest perfected by filing is entitled to production-money priority,” subsection c “does not adopt the first-to-file-or-perfection formulation.”<sup>199</sup>

An understanding of the mechanics in subsection c is necessary to appreciate its value to existing lenders and new lenders. Let us suppose that the overdue balance of Farmer’s note to Bank is fifty thousand dollars. Suppose also that this note is secured in the Farmer’s crops (not just PrMSI the crop). Due to sluggish prices or other events, the harvested crop did not generate enough cash to retire the balance of the note.

Suppose that Bank initially declines to lend Farmer the needed money for the next year’s crop production because Bank’s parent bank holding company is pulling in the reins on agricultural loans. Farmer approaches Agricultural Supplier (or another bank) to inquire whether it would be interested in lending the needed production money. Agricultural Supplier agrees to lend farmer eighty thousand dollars for production of the new crops.

If it wants PrMSI status, Agricultural Supplier, pursuant to model section 9-324A(b)(2), must notify Bank that it will lend farmer eighty thousand dollars for

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195. This example assumes that financing statements covering past year’s crops are not applicable to future crops unless the past year’s loan is outstanding, and the existing security agreement has no time, or other limitations on the crops provided as collateral. After acquired property clauses are not needed if the security interest is in “crops” or “crops grown, growing, to be grown” or “farm products.”

196. U.C.C. § 9-324A(c) app. II (amended 2000).

197. *Id.*

198. *See id.*

199. *Id.* § 9-324A app. II cmt. 3.

production of crops, secured a PrMSI in those new crops, and thereby gaining priority in those new crops over Bank's fifty thousand dollar past due note.<sup>200</sup> Bank does nothing and Agricultural Supplier makes its production money loan for the current crop.

Reconsidering its position midway through the production season, Bank offers to lend Farmer an additional twenty thousand dollars for production of crops also to be secured by the collateral.<sup>201</sup> Bank duly notifies Agricultural Supplier pursuant to model section 9-324A(b)(2), and it acquires a PrMSI.<sup>202</sup>

The result is more than one PrMSI in the same collateral. Subsection c says the first to file takes priority.<sup>203</sup> Thus Bank, because it had already filed to perfect its security interest granted for last year's note, has priority for the twenty thousand dollars<sup>204</sup> it lent Farmer despite the fact that it lent that money after the eighty thousand dollars by Agricultural Supplier.

The question then becomes how does this affect the Agricultural Supplier's eighty thousand dollar note? Bank's PrMSI of twenty thousand dollars has a super-priority over Agricultural Supplier's eighty thousand dollar PrMSI because its prior filing, thus giving it first priority. However, it only has priority as to the twenty thousand dollar note, not the outstanding fifty thousand dollar note. Therefore, assuming harvest income of one hundred and twenty thousand dollars, Bank takes the first twenty thousand dollars, Agricultural Supplier takes the next eighty thousand dollars, and Bank's security interest continues in the remaining twenty thousand dollars in partial payment of its outstanding fifty thousand dollar carryover debt.

Thus, subsection c provides a superpriority for the holder of the PrMSI who has filed first, but only to the extent of the new value it gave to produce the current crop. It provides protection for other production money security holders to the extent of their PrMSI, depending on the amount of the harvest income. Finally, it allocates any remaining funds to pay past due loans after all the PrMSIs have been paid.

#### 4. *Subsection d*

Subsection d provides:

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200. *See id.* § 9-324A(b)(2).

201. The collateral will be the same as for the original security agreement. Such collateral, however, is not limited only to the crop produced. As noted earlier in this article, collateral will likely include all crops the farmer is growing, livestock, equipment, land, government payments, crop insurance, and et cetera.

202. *See* U.C.C. § 9-324A(b)(2) app. II (amended 2000).

203. *See id.* § 9-324A(c) app. II.

204. Note: the \$20,000 lent to the farmer must be to enable the farmer to produce the crops.

(d) To the extent that a person holding a perfected security interest in production-money crops that are the subject of a production-money security interest gives new value to enable the debtor to produce the production-money crops and the value is in fact used for the production of the production-money crops, the security interests rank according to priority in time of filing under 9-322(a).<sup>205</sup>

Model Section 9-324A's official comments suggest, of subsection d, "if the holder of a security interest in production-money crops which conflicts with a production-money security interest gives new value for the production of the crops, the security interests rank according to priority in time of filing under Section 9-322(a)." <sup>206</sup>

In light of this commentary, subsection d contemplates a situation where a perfected security interest and a PrMSI simultaneously exist on the same crop. <sup>207</sup> The perfected security interest might arise in a prior lender who still has outstanding debt secured by crops.<sup>208</sup> The PrMSI exists as a result of value given for production of the production money crops.<sup>209</sup>

If the holder of the perfected security interest gives new value to the debtor that is in fact used for production of production money crops, then the holders of the perfected security interest and PrMSI rank in priority according to time of filing. <sup>210</sup> Thus, the holder of the perfected security interest would prevail, to the extent of its new value given, over the holder of the PrMSI because it filed first.<sup>211</sup>

##### 5. *Subsection e*

Subsection e provides:

To the extent that a person holds both an agricultural lien and a production-money security interest in the same collateral securing obligations, the rules of priority applicable to agricultural liens govern priority.<sup>212</sup>

This is the last exception of section 9-322. It contemplates a situation where the same creditor holds both a PrMSI and an agricultural lien in the same collateral.<sup>213</sup> A major contrasting point of revised Article 9 with current Article 9 is its inclusion of

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205. U.C.C. § 9-324A(d) app. II (amended 2000).

206. *Id.* at cmt. 2.

207. *See id.* § 9-324A(d) app. II.

208. *See id.*

209. *See id.*

210. *See id.*

211. *See id.*

212. *Id.* § 9-324A(e) app. II.

213. *See id.*

agricultural liens within its authority.<sup>214</sup> Thus, agricultural liens are defined in revised Article 9 section 9-102(5).<sup>215</sup> Where it occurs that an agricultural lien and PrMSI exist in the same collateral, the PrMSI's priority is subject to the priority rules pertaining to agricultural liens.<sup>216</sup> Priority rules for agricultural liens are located in revised Article 9 section 9-322.<sup>217</sup> Agricultural liens and their priority will be more fully dealt with below.

A creditor may avoid a conflict between its agricultural lien and PrMSI by "waiving its agricultural lien."<sup>218</sup> Why should a creditor waive one for the other as suggested by 9-324A's official comment 4?<sup>219</sup> The answer is quite simply that a statutory agricultural lien may not provide as broad a scope of coverage as can a PrMSI. The agricultural lien is only valuable to the extent of the service rendered, whereas, a PrMSI, pursuant to the underlying security agreement, can be made broad enough in scope to cover principal, accrued interest, filing fees, attorney fees, and more. Thus, the scope of the PrMSI is limited only by its underlying security agreement's scope.

## VII. REVISITING AGRICULTURAL LIENS UNDER REVISED ARTICLE 9

### A. *Agricultural Liens Under Revised Article 9 and their Relationship to PrMSI*

The relationship between agricultural liens and revised Article 9 is important to understanding the need for a superpriority in crop production. Revised Article 9

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214. *See id.*

215. *See id.* § 9-102(5).

(5) "Agriculture Lien" means an interest, other than a security interest, in farm products:

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

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

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

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

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

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

(C) whose effectiveness does not depend on the person's possession of the personal property.

*Id.*

216. *See id.* § 9-322.

217. *See id.*

218. *Id.* § 9-324A app. II cmt. 4.

219. *See id.*

“will apply to liens which are not security interests.”<sup>220</sup> The scope of Revised Article 9 indicates that such liens include “agricultural liens.”<sup>221</sup> However such agricultural liens are limited to those created in the state that holds jurisdiction over where the commodity is presently located and not necessarily where it was grown.<sup>222</sup>

### 1. *Agricultural Liens Defined*

Under revised Article 9 an agricultural lien is not a security interest.<sup>223</sup> Revised Article 9 defines agricultural liens as having three essential attributes.<sup>224</sup> The first attribute is that agricultural liens are “an interest, other than a security interest, in farm products.”<sup>225</sup> Farm products (i.e., crops) will secure “payment or performance of an obligation for: (i) goods or services furnished”<sup>226</sup> to the farmer to

220. Linda J. Rusch, *Farm Financing Under Revised Article 9*, 73 AM. BANKR. L.J. 211, 219 (1999).

221. U.C.C. § 9-109(a)(2) (amended 2000).

222. *See id.* § 9-109(c)(1)-(4). Agricultural liens that are not covered by Revised Article 9 include those created: (1) by a “statute, regulation, or treaty of the United States.” *Id.*; (2) in another statute of the state holding jurisdiction where such statute expressly “governs the creation, perfection, priority, or enforcement of [the] security interest” of the state or one of its governmental units. *Id.*; (3) by “a statute of another State, a foreign country, or a governmental unit of another State or foreign country, other than a statute generally applicable to security interests, expressly governs creation, perfection, priority, or enforcement of a security interest created by the State, country, or governmental unit.” *Id.*; or (4) by a letter of credit. *See id.*

223. *See id.* § 9-322.

224. *See id.*

225. *Id.* *See also id.* § 9-102(34).

“Farm Products” means goods, other than standing timber, with respect to which the debtor is engaged in a farming operation and which are:

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

- (i) crops produced on trees, vines, and bushes; and
- (ii) aquatic goods produced in aquacultural operations;

(B) livestock, born or unborn, including aquatic goods produced in aquacultural operations;

(C) supplies used or produced in a farming operation; or

(D) products of crops or livestock in their unmanufactured states.

*Id.*

226. *Id.* § 9-102(a)(5)(A). Revised Article 9 defines “goods” in section § 9-102(44) as

all things that are movable when a security interest attaches. The term includes (i) fixtures, (ii) standing timber that is to be cut and removed under a conveyance or contract for sale, (iii) the unborn young of animals, (iv) crops grown, growing, or to be grown, even if the crops are produced on trees, vines, or bushes, and (v) manufactured homes. The term also includes a computer [program embedded in goods and any supporting information] provided in connection with a transaction relating to the program . . . if (i) the program is associated with the goods in such a manner that it customarily is considered part of the goods, or (ii) by becoming the owner of the goods, a person [acquires] a right to use the program in connection with the goods. The term does not include a computer program [embedded in]



aid in "raising, cultivating, propagating, fattening, grazing, or any other farming, livestock, or aquacultural operation."<sup>227</sup> Alternatively, an agricultural lien can secure an interest for "rent on real property leased by a debtor in connection with [the debtor's] farming operations."<sup>228</sup>

The second attribute is that the agricultural lien arises from a state statute creating an interest in favor of the person or entity who provided the goods or services in connection with the farming operation.<sup>229</sup> However, goods must be provided or services rendered in the "ordinary course of [that person's (entity's)] business."<sup>230</sup> Finally, the third attribute is that the agricultural lien is nonpossessory in that its effectiveness does not depend upon the interested person having possession of the personal property.<sup>231</sup>

An example of an agricultural lien that will be subject to revised Article 9 is supplied by Iowa Code Chapter 570A.<sup>232</sup> As noted earlier, chapter 570A creates a lien in favor of agricultural supply dealers.<sup>233</sup> Section 570A.3 outlines the applicability of the lien to agricultural supply dealers who supply "agricultural chemical, seed, or petroleum" to farmers.<sup>234</sup> It further states that "the lien attaches to all crops which are produced upon the land to which the agricultural chemical was applied, or produced from seed furnished, or produced using the petroleum product furnished, for a period of sixteen months following the date of perfection of the lien . . ."<sup>235</sup>

According to section 570A.4, perfection of the lien occurs when the "agricultural supply dealer entitled to the lien" files "a verified lien statement with the office of the Secretary of State."<sup>236</sup> Moreover, the lien "may be filed at the time the agricultural chemical, seed, feed, or petroleum product is purchased or delivered but not later than thirty-one days after the first date on which payment is due . . ."<sup>237</sup>

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goods that consist solely of the medium [in] which the program is [embedded]. The term also does not include accounts, chattel paper, commercial tort claims, deposit accounts, documents, general intangibles, instruments, investment property, letter-of-credit rights, letters of credit, money, or oil, gas, or other minerals before extraction.

*Id.* § 9-102(44).

227. See *id.* § 9-102(35) (defining farming operation as "raising, cultivating, propagating, fattening, grazing, or any other farming, livestock, or aquacultural operation").

228. *Id.* § 9-102 (a)(5)(A)(ii).

229. See *id.* § 9-102(a)(5)(B).

230. *Id.* § 9-102(a)(5)(B)(i).

231. See *id.* § 9-102(a)(5)(C).

232. See IOWA CODE § 570A.1-.8 (1999).

233. See *id.* § 570A.3 (1999).

234. *Id.*

235. *Id.*

236. *Id.* § 570A.4(1).

237. *Id.*

Suppose that Agricultural Supplier sells Farmer seed. After delivering the seed Agricultural Supplier perfects its lien in Farmer's crop. Subsequent to delivery, Farmer fails to make payment.

The question then is whether Agricultural Supplier's lien is an "agricultural lien" under revised Article 9. In accord with the Section 9-102(5)'s definition of "agricultural lien" an agricultural suppliers lien clearly secures an interest in farm products.<sup>238</sup> Agricultural Supplier's lien is created by Iowa Chapter 570A in favor of agricultural supply dealers (of which Agricultural Supplier is one). Moreover, supplying seed to farmers is within the ordinary course of business of Agricultural Supplier. Finally, the lien created by Chapter 570A is nonpossessory.<sup>239</sup> Therefore, Agricultural Supplier's lien is an "agricultural lien" under revised Article 9.

## 2. *Priority Among Conflicting Security Interests and Agricultural Liens*

Proper perfection of agricultural liens is an important and new concept introduced in revised Article 9.

### a. *Section 9-322*

The underlying purpose of subsection e of section 9-324A is to address creditors who hold both an agricultural lien and a PrMSI.<sup>240</sup> Therefore, it is appropriate to discuss the priority rules applicable to agricultural liens as set forth in Section 9-322. Section 9-322 outlines the rules of "Priority Among Conflicting Security Interests in and Agricultural Liens on [the] Same Collateral."<sup>241</sup> Focusing primarily on subsections a, f, and g, one can get a sense of how agricultural lien priority rules work in terms of conflicting security interests (i.e., PrMSI) and agricultural liens.

### b. *Subsection a: General Priority Rules*

Except as otherwise provided in this section, priority among conflicting security interests and agricultural liens in the same collateral is determined according to the following rules:

(1) Conflicting perfected security interests and agricultural liens rank according to priority in time of filing or perfection. Priority dates from the earlier of the time a filing covering the collateral is first made or the security interest or agricultural lien is first perfected, if there is no period thereafter when there is neither filing nor perfection.

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238. See U.C.C. §9-102(5) (amended 2000) (this section specifically states that an agricultural lien means farm products).

239. See IOWA CODE § 570A.3 (1999).

240. See U.C.C. § 9-322(a) (amended 2000).

241. See *id.* § 9-322.

(2) A perfected security interest or agricultural lien has priority over a conflicting unperfected security interest or agricultural lien.

(3) The first security interest or agricultural lien to attach or become effective has priority if conflicting security interests and agricultural liens are unperfected.<sup>242</sup>

Subsection a is the general rule and it provides for those exceptions set out in subsection f.<sup>243</sup> Comment three of section 9-322 provides an explanation for subsection a's mechanics. It states

Subsection (a) contains three general rules. Subsection (a)(1) governs the priority of competing perfected security interest. Subsection (a)(2) governs the priority of competing security interests if one is perfected and the other is not. Subsection (a)(3) governs the priority of competing unperfected security interests. The rules may be regarded as adaptations of the idea, deeply rooted at common law, of a race of diligence among creditors. The first two rules are based on precedence in the time as of which the competing secured parties either filed their financing statements or obtained perfected security interests. Under subsection (a)(1), the first secured party who files or perfects has priority. Under subsection (a)(2), which is new, a perfected security interest has priority over an unperfected one. Under subsection (a)(3), if both security interests are unperfected, the first to attach has priority.<sup>244</sup>

c. *Subsection f: Limitations on subsections a through e.*

Subsection a through e are subject to:

- (1) subsection (g) and the other provisions of this part;
- (2) Section 4-210 with respect to a security interest of a collecting bank;
- (3) Section 5-118 with respect to a security interest of an issuer or nominated person; and
- (4) Section 9-110 with respect to a security interest arising under Article 2 or 2A.<sup>245</sup>

Subsection f simply makes the general rule of priority in subsection a subject to analysis by the rule in subsection g.<sup>246</sup>

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242. *Id.* § 9-322(a).

243. *See id.*

244. *Id.* § 9-322 cmt. 3.

245. *Id.* § 9-322(f).

246. *See id.*

d. *Subsection g: Priority under agricultural lien statute*

A perfected agricultural lien on collateral has priority over a conflicting security interest or agricultural lien in the same collateral if the statute creating the agricultural lien so provides.<sup>247</sup>

This subsection is specifically designed to address agricultural liens created by non-Article 9 statutes that purport to “grant priority to an agricultural lien as against a conflicting security interest or agricultural lien.”<sup>248</sup> The comment to subsection g provides that to have priority over a perfected Article 9 security interest, the statute creating the agricultural lien must not merely grant priority, but must also create the lien.<sup>249</sup> Moreover, the comment explains that even though the statute creates the lien and gives it priority, the agricultural lien must be perfected.<sup>250</sup> Here, subsection g and its comment are silent as to how the agricultural lien must be perfected.<sup>251</sup>

Nevertheless, early Task Force reports indicate that the statute must provide for the agricultural lien’s perfection.<sup>252</sup> Otherwise, the agricultural lien must be perfected pursuant to Article 9 procedures.<sup>253</sup> Where perfection occurs in the statute it is probable that the lien statute will provide a procedure similar, if not exactly the same, as Article 9’s perfection procedure. Whatever the scenario, to have priority over a perfected security interest, the agricultural lien must be perfected prior to the security interest perfection. Otherwise, the agricultural lien will always be subordinate. Of course, the lien statute could specifically place the lien ahead of any security interests notwithstanding revised Article 9. However, almost all agricultural liens will predate revised Article 9 and will likely fail to establish this priority.

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247. *See id.* § 9-322(g).

248. *Id.* § 9-322 cmt. 12.

249. *See id.*

250. *See id.*

251. *See id.* The comment merely states “[u]nder subsection (g), if another statute grants priority to an agricultural lien, the agricultural lien has priority only if the same statute creates the agricultural lien and the agricultural lien is perfected.” *Id.* There is no firm indication as the how such agricultural lien is to be perfected. One could arguably read the comment as implying that the agricultural lien must be perfected pursuant to Article 9 procedures, even though some agricultural liens provide perfection procedures within the statute itself.

252. *See* ARTICLE 9 TASK FORCE OF THE SUBCOMMITTEE ON AGRICULTURAL AND AGRIBUSINESS FINANCING OF THE COMMITTEE ON COMMERCIAL FINANCIAL SERVICES OF THE BUSINESS LAW SECTION OF THE AMERICAN BAR ASSOCIATION, FINAL REPORT ON: AGRICULTURAL FINANCING UNDER ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE, WORKING DOCUMENT NO. 6-48, at 441 (June 13, 1992) [hereinafter TASK FORCE DOCUMENT NO. 6-48]. “As noted above, the creation and enforceability of the Ag Lien would be determined by the underlying Ag Lien statute. Article 9 would then govern perfection and the Ag Lienholder would be required to file a UCC financing statement in order to perfect.” *Id.*

253. *See id.*

If the statute fails to grant the agricultural lien priority within the statute, then priority of such agricultural lien will be determined pursuant to the general rule of subsection (a) of section 9-322.<sup>254</sup>

Going back to the above example will serve as an appropriate foundation for analyzing an agricultural lien statute in light of revised Article 9's rules of priority. Thus, the first priority question is whether, even though it qualifies as an "agricultural lien" under revised Article 9, is Agricultural Supplier's lien subject to the rules of priority of section 9-322?

Section 570A.5(1) provides "a lien perfected under this chapter is superior to a lien or security interest which attaches subsequent to the time the lien statement is filed with the secretary of state . . . ."<sup>255</sup> Additionally, section 570A(2) provides "a lien perfected under this chapter is equal to a lien or security interest which is of record or which is perfected prior to the time the lien statement is filed . . . ."<sup>256</sup> Thus, the agricultural lien created by Chapter 570A grants priority status under the same statute that creates the lien.<sup>257</sup>

As noted above section 570A.4 provides the procedure for perfecting this agricultural lien.<sup>258</sup> Thus, all of the criteria set out in subsection 9-322(g) are satisfied in terms avoiding the perfection rules of subsection 9-322(a).<sup>259</sup> However, this leads to the next question: under which statute, revised Article 9 or Iowa Code Chapter 570A, does proper perfection of the agricultural lien take place when the lien holder attempts to perfect?

Arguably, chapter 570A would control perfection of the agricultural lien because the lien itself was created within that chapter. However, because the lien created by chapter 570A is an "agricultural lien" under revised Article 9 should it be perfected according to Article 9 procedures if the perfection procedures set forth in chapter 570A conflict with the purposes of Article 9 perfection? To answer this question an explanation of why "agricultural liens" were brought under the umbrella of Article 9 is useful.

### B. *Why Agricultural Liens were Brought into Article 9*

Simply stated, the purpose for bringing agricultural liens within the scope of article 9 is to protect primary secured creditors' collateral from being diluted by creditors working outside the scope of Article 9.<sup>260</sup> Professor Meyer amply

254. See U.C.C. § 9-322(a) (amended 2000).

255. IOWA CODE § 570A.5(1) (1999).

256. *Id.* § 570A.5(2).

257. See *id.* § 570A.3, .5.

258. See *id.* § 570A.4.

259. See U.C.C. §§ 9-322(a), (g) (amended 2000).

260. See Robert E. Scott, *The Politics of Article 9*, 80 VA. L. REV. 1783, 1839 (1994).

illustrates the risk creditors face with respect to agricultural liens that are outside of the scope of Article 9.

There is neither intrastate nor interstate uniformity with regard to statutory agricultural liens. Such liens vary with respect to how the lien is created, perfected, and enforced. Likewise, they vary with respect to the priority of the statutory lienholder vis-à-vis other creditors and purchasers of the good subject to the lien. Moreover, they are not found in one place in the statutes nor are they cross referenced in Article 9. Some agricultural liens are common-law liens. Although liens give the creditor rights in specific property of the debtor that are equivalent to those of a secured party, Article 9 normally is inapplicable.

The economic difficulties of the late 1970s and 1980s produced record numbers of conflicts between creditors and between farmers and creditors. [] During this period, the use of archaic statutory liens increased dramatically, and state legislatures promulgated new ones. [] Secured creditors who diligently complied with Article 9 were not as protected as they thought. Many were junior to liens that, in many instances, were not recorded. Often the legal system does not provide any clear, easily discoverable rules governing competing claims to agricultural collateral upon the default of the debtor when one of the claimants has a lien not covered by Article 9. This is true whether questions of priority arise in state court or in a bankruptcy proceeding.<sup>261</sup>

Some agricultural liens do not require notice or filing. The lack of notice to primary lenders has been a contentious issue between agricultural liens and Article 9 security interests holders. Focusing on agricultural lien holders, one obvious consequence of bringing agricultural liens under Article 9's umbrella is that it subjects these holders to the same general priority rules as Article 9 security interest holders.<sup>262</sup> As discussed previously, under revised Article 9, an agricultural lien holder must properly perfect its lien in order to receive priority over Article 9 security interest holders. Thus, revised Article 9 may dash any hope that the agricultural lien holder may gain priority status over an Article 9 security interest holder. Such hope will hinge upon the agricultural lien statute's language. By extension, agricultural liens are subordinated to purchase money or production money priorities as well. This result will work to frustrate the proposed protection that agricultural liens were designed to provide.

Article 9 provides substantial protection to primary lenders. The rationale for such favoritism would be that they endure much of the risk associated with crop production (i.e., crop or market failure). Therefore, lenders would reason that the

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261. Meyer, *supra* note 54, at 1315-16 (citations omitted).

262. *See id.* at 1316.

inherent risks associated with farming provide a legitimate basis for receiving priority over proceeds generated by production crops.

Because agricultural lien holders are lenders themselves, agricultural liens provide a source of security to lien holders because lien holders endure the same risk that lenders face. The agricultural supplier is at risk because it may not recover for its services where the production crops are encumbered by multiple security interests and those security interests are connected to floating liens. Under the revised Article 9 agricultural lien provision, if payment default occurs the burden of risk is shifted from the lender to the agricultural supplier. As a result, the presumed objective underlying agricultural liens, to protect the agricultural supplier from assuming the risk of crop production, becomes frustrated.

From the point of view of the local economy, revised Article 9 appears to place agricultural suppliers in direct competition with institutional lenders. Yet, the agricultural suppliers are forced to play the game with rules that heavily favor the lender. Thus, the risk of crop production is shifted into the local economy, rather than being diversified through out a larger economic sphere.

Revised Article 9's swallowing of agricultural liens removes a tool from the agricultural suppliers' protection arsenal. Though this is necessary because of the need for a uniform notice filing system, it still works to eliminate the lien holder's potential priority status. Moreover, Revised Article 9's agricultural lien does not provide lien holders protection against prior perfected security interests that are floating.<sup>263</sup>

Because under revised Article 9 those entities holding agricultural liens are going to play by the primary lenders rules, they need to be given the proper tools in order to compete effectively. The drafters of revised Article 9 recognized this and developed such a tool in the form of the PrMSI.

### C. *The Genesis of Revised Article 9's Production Money Security Interest*

Professor Scott observes that "Article 9 secured creditors would obviously prefer to bring [agricultural] liens within Article 9."<sup>264</sup> The inclusion of agricultural liens into revised Article 9 creates the necessity of offering a superpriority for crop production. In fact, the Agricultural Task Force recognized that with the inclusion of agricultural lien into the scope of Article 9 would be the accompaniment of a superpriority.<sup>265</sup> The Task Force's Agricultural Report recommended "the creation

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263. See *supra* Part II.A.3.

264. Scott, *supra* note 260, at 1841 (alteration in original).

265. See TASK FORCE DOCUMENT NO. 6-48, *supra* note 252, at 443.

At this point, the suggested changes establish a first-to-file rule with respect to priority disputes between Ag Liens and Article 9 security interest and as between Ag Liens. The Task Force recommends, however, that some provision be made for the concept of a "purchase money" or "priority" Ag Lien. Agricultural supplies are different than purchase money inventory or purchase money equipment. The

of a production money ag lien that would allow farm suppliers to retain priority so long as they supplied prenotification to secured creditors.<sup>266</sup> “Indeed, the Agricultural Report said such a production money ag lien would be necessary because ‘[i]t will be a ‘hard sell’ to convince Ag liens to come into Article 9 given the basic first to file rule.’”<sup>267</sup>

Subsequently, however, the Task Force never recommended the production money agricultural lien; instead it appears to have recommended the production money security interest in its place.<sup>268</sup> Professor Scott explains “to blunt the opposition of suppliers and others who have already secured protected lien status through the legislative process in individual states, the [Agricultural Report] invites the Agricultural Committee to join with production money financiers in exploiting the expanded superpriority created by the PrMSI.”<sup>269</sup> Therefore, it seems clear that the PrMSI is intended to be the necessary superpriority contemplated as a result of the inclusion of agricultural liens into Article 9.

A PrMSI provides an agricultural supplier, whose agricultural lien may be subordinate to prior perfected security interests, with the tool necessary to compete with consensual lien holders. While the production money security interest requires that the agricultural supplier comply with the criteria of secured transactions, it allows such supplier to gain a superpriority position over an existing security interest.<sup>270</sup> The agricultural supplier, however, will still be required to anticipate a possible default on the part the farmer. The production money security interest requires notification to other security interest holders “not less than 10 days or more than 30 days” before giving value.<sup>271</sup> Nevertheless, unlike an agriculture lien, the production money security interest will trump any existing security interests.<sup>272</sup>

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supplies are consumed and may or may not become part of or directly incorporated into the final product as in the case of raw materials or parts supplied to a manufacturing concern. For example, fuel sold by a supplier to a farmer in order to operate a tractor or irrigation system is not directly incorporated into the farm product. However, the fuel is just as necessary as seed in order to produce the crop. In part because of this difference, it is probably more “correct” to view this proposed exception to the basic first to file rule as a “priority” or “priming” lien as distinct from a [purchase money security interest] in specific goods sold and delivered. The policy for such a priority is that although certain supplies may be consumed and not “incorporated” in the farm product the ag supplier does provide a value enhancement to the farm product.

*Id.*

266. Scott, *supra*, note 260, at 1840-41.

267. *Id.* at 1841 (quoting TASK FORCE DOCUMENT NO. 6-48, *supra* note 252, at 444).

268. *See id.* at 1841.

269. *Id.*

270. *See supra* Part VII.A.2.

271. U.C.C. § 9-324(A)(b)(2) app. II (amended 2000).

272. *See id.* § 9-324(A)(a) app. II.



## VIII. CONCLUSION

Early on in the exploration process of crop priorities, members of the Agricultural Financing Task Force "could report very little, if any, experience dealing with [section] 9-312(2)."<sup>273</sup> This "absence of demand or use" led to questioning whether a priority in crop production was really necessary.<sup>274</sup> Certainly, as illustrated in this Article, section 9-312(2) has very little practical use. However, this should not lead to the conclusion that there is not a demand for a workable priority system in crop finance. Rather, it illustrates how inadequate drafting, flawed judicial precedence, or both can render a statutory provision unusable.

Revised Article 9 brings agricultural liens under its umbrella of authority. Subjecting agricultural liens to Article 9 rules is certainly necessary to bring uniformity to the conflict between agricultural liens and Article 9 security interests. Such action also serves to illustrate the need for the PrMSI. The Task Force recognized the need to give some priority for agricultural lien holders, but opted "that priority should be first-to-file unless the lien statute specifically provides otherwise."<sup>275</sup> In so doing, it renders any agricultural lien statutes that do not self-perfect and grant priority useless. Nevertheless, rather than burdening state legislatures with the task of rewriting such agricultural lien statutes, state legislatures can simply adopt what the Task Force considered to be a necessary alternative, the PrMSI. The PrMSI provides both agricultural suppliers and lenders with a unique priority tool that can be used to further agricultural crop financing.

Finally, the PrMSI should not be view merely as a tool for the agricultural supplier. In today's world of agricultural finance several of the nation's largest banks seem to control much of the agricultural lending. Smaller local banks are subjected to a competitive disadvantage in that they often may not be able to offer competitive rates. However, the occasion does arise where the farmer will need additional financing during the year for purposes of replanting, additional planting, or some other such event. The local lender may be willing and eager to lend this smaller amount, whereas the larger lender would be hesitant. Instead of being locked out of an opportunity, the local lender can use the PrMSI to make this loan.

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273. TASK FORCE DOCUMENT NO. 6-48, *supra* note 252, at 460.

274. *Id.*

275. ABA TASK FORCE, *supra* note 58, at 6.