Security Interests in Thoroughbred and Standardbred Horses: A Transactional Approach

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R. David Lester

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INTRODUCTION

The growth of the sport and industry of racing and breeding horses has created an increasing demand for the use of horses as collateral. Securing debt with horses presents unusually challenging problems, primarily because of the difficulty in characterizing the collateral within the molds provided by Article 9 of the Uniform Commercial Code (U.C.C. or Code). Other problems are created because horses differ from other types of property offered as security. Horses typically have different characteristics during their lives. For example, a horse which is first used for racing may later be used for breeding. The value and sex of the animal will have a great impact on the horse's characterization as collateral during the breeding stage; a valuable stallion is less likely to be moved for breeding purposes than a mare. Whether the animal is syndicated will play a role in its characterization as collateral. Further, some horses engaged in racing frequently move from state to state while others do not move at all. Special considerations also will be required if the collateral is or may be moved outside the United States.

Certain practices within the horse industry also affect the perfection and protection of security interests in horses. Illustrative is the fact that many races, particularly of thoroughbreds, are claiming races[1] in which title to the collateral may change hands in a somewhat involuntary fashion.

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* Partner in the Lexington, Kentucky law firm of Stoll, Keenon & Park. B.S. 1970, Western Kentucky University; J.D. 1975, University of Kentucky.

[1] A claiming race is a particular type of race in which entries may be purchased by eligible stable owners. The purchase price for the horse is specified prior to the race, and any stable owner wishing to enter a "claim" for the horse at the specified price does so before the race. Thus, by entering a thoroughbred in a claiming race, the owner is, in effect, offering the horse for sale.

These difficulties in characterizing horses as collateral under Article 9 of the Code will be the focus of this paper. We analyze both the 1962 and 1972 official versions of the Code, as well as the 1962 version as modified by the Kentucky General Assembly.[2] In addition, the impact of the rules and regulations of The Jockey Club[3] and the United States Trotting Association[4] must be, and will be, considered. Because a horse can become almost valueless if it cannot be registered by these organizations, the importance of their rules cannot be underestimated.

I. DOCUMENTATION

To perfect a security interest in a horse, it ordinarily is necessary to enter into a security agreement and file one or more financing statements.[5] Other documents which an informed lender may require in connection with the making of a loan secured by a horse include insurance documentation, an opinion of counsel (or some other analysis) as to ownership and pre-existing liens, delivery to the lender of the registration certificate issued by The Jockey Club or The United States Trotting Association and an assignment and power of attorney with respect to such certificate. Each of these documents will be given individual consideration below.

Other documents that a lender may find appropriate in some circumstances include a letter or agreement from a syndicate

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[2] If a reference is made to a section of the Uniform Commercial Code (U.C.C.) without stating which version is being considered, the reference will be to the 1962 version of the text and accompanying comments. Any discussion of the 1972 version or Kentucky's version will specifically state which version is being considered.

[3] The Jockey Club acts as the official breed registry for thoroughbreds in the United States and Canada. As such, The Jockey Club promulgates rules and regulations governing the breeding of thoroughbred horses.

[4] The United States Trotting Association is comprised of persons in the business of breeding, training and racing standardbred horses, officials of harness racing, track officers and other organizations which sponsor the racing of pacing and trotting horses. With a purpose of improving the breed of pacing and trotting horses, the association establishes rules regulating the standards and registration of such horses, among other functions.

[5] A security agreement is defined as "an agreement which creates or provides for a security interest." U.C.C. § 9-105 (1972). A financing statement is the document which must be filed to perfect a security interest in certain types of collateral. *See* U.C.C. § 9-302(1). For a discussion of these documents as they specifically relate to the use of horses as collateral, see the text accompanying notes 26-36 *infra*.

manager regarding transferability to the debtor and ownership (often called an "estoppel certificate") and letters regarding proof of payment from the persons providing board and stallion service for the horse.[6]

A. *The Jockey Club Certificate and The United States Trotting Association Registration Certificate*

The Jockey Club and The United States Trotting Association play a significant role in the registration of thoroughbred and standardbred horses respectively. These associations issue certificates needed to effectively sell, race or breed horses.

It is particularly difficult for a creditor to obtain the necessary documents for racing horses. The Jockey Club certificates must be held by the owner before any horse may be entered in any thoroughbred race.[7] Similarly, the United States Trotting Association Registration certificate is required to enter standardbred races which are designated as claiming races.[8] Many of the thoroughbred races also are claiming races, a type of race which presents special problems to a creditor holding a security interest in a horse.[9] Horses entered in such races may be "claimed" by third parties, resulting in title to the horse and the certificate being transferred to the claiming party. Thus, a creditor who accepts racing horses as security may take a chance that the horse will be entered in a claiming race and be claimed.

If a horse subject to a security interest is claimed, or if the creditor otherwise fails to obtain the certificate, it may be possible for a court to find the creditor's security interest was waived.[10] Because a failure to obtain the certificate might result in a waiver, there is a possibility that the certificates might be treated as property separate from the horse.[11] The difficulty in

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[6] The importance of getting proof of payment from these persons relates to liens which may arise in their favor under Kentucky law. A discussion of these liens and their relation to security interests under Article 9 can be found in the text accompanying notes 131-51 *infra*.

[7] THE JOCKEY CLUB RULE OF RACING 73 (1982).

[8] THE UNITED STATES TROTTING ASS'N Rule 10, § 9 (1982).

[9] For a discussion of claiming races, see note 1 *supra*.

[10] For a discussion of the possibility of such a waiver, see the text accompanying notes 161-66 *infra*.

[11] *See* Lee v. Cox, 18 U.C.C. REP. SERV. 807, 809-10 (M.D. Tenn. 1976), discussed in the text accompanying notes 14-21 *infra*.

controlling collateral separate from the certificate suggests that the well-advised lender will likely reject a loan which cannot be made without reliance upon the horse as collateral. While it may be possible to limit this risk to some extent when the value of the horse is so great the horse would be unlikely to enter a claiming race or when the debtor contractually agrees not to enter the horse in a claiming race, the loan would still be risky since horses often are traded or sold at tracks with many buyers believing the certificate to be an adequate indication of the right to transfer.

In addition to these problems, both The Jockey Club and The United States Trotting Association would likely be concerned about a creditor trying to impose upon those who would claim at tracks a duty to check for any financing statement filings. As discussed below, the cooperation of The Jockey Club and The United States Trotting Association can be helpful to creditors.

Possession of the certificates has importance apart from transfers at race tracks. Even though it is doubtful that a purchaser could successfully argue that a certificate is an "instrument" which must be perfected by possession,[12] the possession of the certificate by a creditor may avoid problems. Even in the case of sales away from the track, title to horses is frequently transferred by merely endorsing and delivering the certificate. This could be considered a trade custom, and it might be argued that the lender has waived a continued claim to its security interest by allowing the debtor to retain the certificate in light of such a custom.[13]

Moreover, in *Lee v. Cox*,[14] a United States district court surprisingly held that while the registration certificate of an Arabian horse was not an instrument by which a security interest in a horse must be perfected by possession, the registration certificate may itself be property in which a security interest could be perfected by possession or to which the legal title could be sold. If the legal title to the certificate was sold as separate property, the debtor in possession of the horses would have to sell them "at the best price possible without the registration papers."[15]

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[12] *See id.* at 810-11.

[13] Waiver is discussed in the text accompanying notes 161-66 *infra*.

[14] 18 U.C.C. REP. SERV. at 807.

[15] *Id.* at 811. The district court explained its reasoning as follows:

Although the registration papers could not give appellant [Cox] a right to the

In this particular case, Cox sold eight Arabian horses at an auction to Lee and retained the registration papers as security for the unpaid portion of the purchase price. Subsequently, Lee, as a "debtor in possession" under Chapter XI of the Bankruptcy Code, filed a complaint to recover the papers. The bankruptcy judge determined that no financing statement had been filed and that the retention of the certificates did not create a security interest pursuant to U.C.C. Article 9. The judge ordered Cox to turn the registration certificates over to Lee and ordered Lee to sell the horses so that the parties could subsequently litigate who would be entitled to the proceeds.[16] The District Court for the Middle District of Tennessee agreed that possession of the certificates did not perfect a security interest in the horses.[17] However, the district court decided that there was either an effective pledge and perfection of a security interest in the papers (either under Article 9 or by common law) or, even if there had not been a pledge, the seller's rights under the contract of sale should otherwise be enforced.[18]

Although the case may reach an equitable result, *Lee v. Cox* establishes a bad precedent without a clear analysis of the legal

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> horses, the question remains as to whether their possession gave the appellants [sic] a security interest in the papers themselves . . . . It is quite normal to assume, as apparently the Bankruptcy Judge did, that these papers have no value without the horses. It is, however, indisputable that the horses will sell at a much higher price with the certificates than without; therefore, an industrious holder could presumably seek to arrange their sale . . . . Given the conclusion that appellant successfully perfected a security interest in the papers themselves, and the fact that the debt was not paid in full as the contract required, the Bankruptcy Judge had no authority to require that the papers be turned over to the debtor's estate . . . .

Id. at 810-11.

[16] *Id.* at 807-08.

[17] *Id.* at 810.

[18] *Id.* The court stated:

> Even if the retention of the registration papers cannot be said to constitute an Article 9 or common law pledge, the appellant's right to those papers can still be sustained under the contract for sale on which there is apparently no disagreement. The contract provided that Cox would keep the papers until such time as he was paid in full. At most, Lee had only an equitable interest in the papers while Cox retained legal title. When the debt was not extinguished, the equities in favor of Lee should have dissolved, leaving Cox the right to the papers.

Id. at 811.

principles involved. The close relationship among the horse and certificate and the fact that the certificate is valueless without the horse indicates they should be treated as one item of property. Unfortunately, a lender who files a financing statement and otherwise properly perfects a security interest in a horse may be surprised to find that it may not be able to sell the horse as a registered horse. Even the district court conceded that "this sort of arrangement does not fit squarely within any of the categories of § 9-305."[19] The district court's reliance upon some sort of common law lien is clearly erroneous since Article 9 governs all consensual security interests and abrogates common law pledges.[20] Certainly, the district court's suggestion that the seller has retained legal title and thus may not be subject to the perfection provisions of Article 9 ignores the provisions of U.C.C. section 9-102(2) which clearly indicate that a seller's retention of title is within the scope of Article 9.[21] In any event, at least until other courts have analyzed this issue, lenders will want to make sure they perfect in both the horse and certificate.

In addition to the possible practice of the trade and other problems which can arise if a lender allows a debtor to retain possession of the certificate, The United States Trotting Association normally requires the certificate to be returned at the time of transfer.[22] The Jockey Club presently requires its certificate to be returned for breeding stock which is listed in the Ownership Registry.[23] If not listed, the animal would need to be listed and blood-typed after a change in ownership.[24] In any event, it may be more burdensome to sell the horse without the certificate.

In connection with receipt of the certificate, it is wise for a lender to obtain a written assignment of the certificate and a power of attorney. Of course, this document can be most impor-

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[19] *Id.*

[20] *See* U.C.C. §§ 1-201(37) and 9-102 comment 1.

[21] U.C.C. § 9-102(2) (1972) provides: "This Article applies to security interests created by . . . title retention contract . . . ." Other provisions to the same effect include U.C.C. §§ 1-201(37), 9-102(1) and 9-107. *See generally* J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 22-2 (2d ed. 1980) [hereinafter cited as WHITE & SUMMERS].

[22] THE UNITED STATES TROTTING ASS'N Rule 26, § 15 (1982).

[23] THE JOCKEY CLUB REGISTRATION Rule 7 (1982).

[24] *Id.* at Rule 5.

tant in transferring title if a default sale under U.C.C. section 9-504 is necessary.[25]

A lender normally should notify The Jockey Club or The United States Trotting Association of its security interest in a horse. Perhaps the most significant reason for such notification is that it is possible to obtain a duplicate registration certificate for a horse in which a second party has a security interest. Thus, the notification, together with the creditor's possession of the certificate, may make it difficult for the owner to transfer ownership of the horse without the lender's consent.

B. *Security Agreement and Financing Statements*

In addition to The Jockey Club certificate and the United States Trotting Association certificate, a creditor also should obtain a security agreement and financing statement. Assuming the lender adopts the policy of not making loans secured by horses engaged in racing, a standard "form" security agreement would normally be adequate for non-racing horses, although the lender may want to add provisions regarding: (1) whether the horses are "movables" within the meaning of U.C.C. section 9-103;[26] (2) what, if any, representations have been made regarding the location, residence and principal place of business of the owners;[27] (3) who would have possession of certificates of offspring if products are included in the security agreement, and (4) a power of attorney to transfer and an assignment with respect to The Jockey Club or The United States Trotting Association Registration certificate if a separate form is not used. Further, if the debtor intends to sell breeding rights to the horse or to sell its offspring, special provisions for the partial release of the security interest may be necessary. Special documentation should always be used in the cases of racing horses and syndicate shares because both of these types of collateral normally require special considerations.[28]

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[25] U.C.C. § 9-504 sets out the procedures to be followed when a secured lender repossesses and resells collateral upon a default by the debtor.

[26] For a discussion of U.C.C. § 9-103(2), see text accompanying notes 81-93 *infra*.

[27] These considerations are important in determining where to file within a particular state. See text accompanying notes 94-108 *infra*.

[28] Considerations as to racing horses are discussed in the text accompanying notes 7-11 *supra*, while those concerning syndicated horses are discussed in the text accompanying notes 37-46 *infra*.

In preparing the security agreement and financing statement, special attention should be given to describing the collateral. Section 9-110 of the Code states: "For the purposes of this Article any description of personal property or real estate is sufficient whether or not it is specific if it reasonably identifies what is described."[29] A normal description of a horse will include breed, sex, coloration, breeding, year foaled, registered name and certificate number. However, a much less detailed description such as "all horses or livestock and progeny thereof now owned or hereafter acquired" apparently will be sufficient.[30] One also may want to state a security interest is being taken in the certificate *in addition to* the horse.[31]

Special care should be used if a location of the collateral will be employed in the description because of the possibility that the animals will not be where the secured party believes them to be located. For example, the Ninth Circuit Court of Appeals has ruled that parol evidence is inadmissible to show that equipment intended to be covered was at a different location from that designated in the security agreement and financing statement.[32] The court rationalized its hardline stand against using parol evidence to determine what collateral was covered by the security agreement by stating that the admission of parol evidence "would prove detrimental not only to the goals of Section 9-203 but also to the fundamental goal" of Article 9 to simplify financing transactions.[33] While the movement of the collateral subsequent to the perfection of the security interest may not invalidate the lien,[34] the inclusion of a location is not required and may

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[29] U.C.C. § 9-110.

[30] *See* United States v. Southeast Miss. Livestock Farmers Ass'n, 619 F.2d 435 (5th Cir. 1980); United States v. Pirnie, 339 F. Supp. 702 (D. Neb. 1972), *aff'd*, 472 F.2d 712 (8th Cir. 1973); *In re* Charolais Breeding Ranches, Ltd., 20 U.C.C. REP. SERV. 193 (Bankr. W.D. Wis. 1976). *But see* Mammoth Cave Prod. Credit Ass'n v. York, 429 S.W.2d 26 (Ky. 1968) (description "all farm equipment" construed as too vague to be given effect in a security agreement).

[31] See text accompanying notes 7-25 *supra* for a discussion of why this action may be advisable.

[32] *In re* California Pump & Mfg. Co., 588 F.2d 717, 719-20 (9th Cir. 1978).

[33] *Id.* at 720.

[34] *See, e.g., In re* Page, 16 U.C.C. REP. SERV. 501, 506-07 (Bankr. M.D. Fla. 1974) (inventory and equipment properly described in chattle mortgage and financing statement are subject to security interest notwithstanding the collateral being moved from the location designated in the financing statement). *See generally* U.C.C. § 9-401(3).

create unnecessary problems, and thus should be avoided.[35]

In the case of a syndicate share, the collateral should be carefully described to show that the collateral consists of the debtor's undivided interest in the horse as well as all other rights the debtor may have under the syndicate agreement. Exercising such care is important because of the particular difficulty in classifying the collateral and the possibility that there are really two types of collateral involved in such a situation.[36]

C. *Special Documents for Syndicate Shares*

A special security agreement should be used for syndicate shares. The rights of the debtor are particularly difficult to characterize and several unusual problems may surface if there is a need for enforcement.[37]

In addition, substantial consideration must be given to the syndicate agreement, particularly as to any prohibitions against transfer. Almost all syndicate agreements contain some type of express prohibition against assignment. The issue is whether the particular provision will affect the creation of a security interest which is, of course, a type of limited assignment.

Section 9-318(4) of the 1962 version of the Code provides: "A term in any contract between an account debtor and an assignor which prohibits assignment of an account or contract right to which they are parties is ineffective."[38] The 1972 version of the Code expands "account or contract rights" to include "general intangible."[39] In either version, the potential problem relative to the characterization of a syndicate share as collateral[40] is whether

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[35] *See, e.g., In re* Little Brick Shirthouse, Inc., 347 F. Supp. 827 (N.D. Ill. 1972) (argument rejected that collateral subject to security interest should be limited to only the collateral located at the debtor's principal address, stated in the financial statement); First State Bank of Nora Springs v. Waychus, 183 N.W.2d 728 (Iowa 1971) (financing statement's erroneous description of the location of collateral held insufficient to invalidate the financing statement).

[36] For a discussion of the difficulties inherent in dealing with syndicate shares as collateral, see text accompanying notes 62-74 *infra*.

[37] See text accompanying notes 62-74 *infra*.

[38] U.C.C. § 9-318(4).

[39] For a discussion of why these changes were made, see U.C.C. § 9-318 Reasons for 1972 Change (1972).

[40] The problems in characterizing syndicate shares as collateral are more fully handled in the text accompanying notes 62-74 *infra*.

the syndicate share should be characterized as goods or as an account, contract right or other intangible. If the syndicate share is goods, section 9-318(4) will not apply.[41]

If section 9-318(4) of the Code does not apply, we must look to the common law.[42] In the early part of this century, courts were likely to hold an anti-assignment provision effective as to an assignee with knowledge; however, this rule has been substantially undermined.[43] Thus, the *Restatement (Second) of Contracts* provides that, "unless a different intention is manifested," a contract term prohibiting assignment is for the benefit of the obligor and does not "prevent the assignee from acquiring rights against the assignor."[44] In fact, some courts have held assignments effective, simply ignoring anti-assignment provisions.[45] In addition, some courts have held that prohibitions against assignment do not affect assignments for security unless the agreement specifically prohibits assignments for security.[46]

Whatever risk that exists in this regard can be reduced by obtaining an estoppel certificate or similar document from the syndicate manager. That is, a lender may find it advisable to have the syndicate manager provide documentation of the following:

(1) a certified copy of the syndicate agreement;

(2) the identity of the present owner of the share as shown on the syndicate manager's records;

(3) whether the transfer of the share to the debtor and

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[41] The application of U.C.C. § 9-318(4) is limited to terms which prohibit the assignment of an account or the creation of a security interest in a general intangible for money due or to become due, and to terms which require an account debtor's consent to such assignment or security interest. U.C.C. § 9-318(4) (1972).

[42] *See* U.C.C. § 1-103.

[43] *See, e.g.*, Portuguese-American Bank v. Welles, 242 U.S. 7 (1916). *See also* U.C.C. § 9-318 comment 4; 3 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 422 (3d ed. 1960). *But see, e.g.*, Harris v. Clinton, 112 A.2d 885 (Conn. 1955) (demand for specific performance of bilateral contract by assignees denied because contract, involving provisions personal in nature, could only be performed by the assignor); National Lumber Co. v. Goodman, 123 N.W.2d 147 (Mich. 1963) (same).

[44] RESTATEMENT (SECOND) OF CONTRACTS § 322(2) (1981).

[45] *See generally* 4 A. CORBIN, CORBIN ON CONTRACTS § 873 (1951) and cases cited therein. Of course, these cases must be carefully analyzed with consideration given to the subject matter of the applicable contracts and the status of the parties' performance.

[46] *E.g.*, Fox-Greenwald Sheet Metal Co. v. Markowitz Bros., Inc., 452 F.2d 1346 (D.C. Cir. 1971); Inter-Southern Life Ins. Co. v. Humphrey, 84 So. 625 (Miss. 1919); Aetna Ins. Co. v. Smith, 78 So. 289 (Miss. 1918).

all previous transfers complied with the requirements of the syndicate agreement;

(4) whether the syndicate agreement or any other agreement known to the syndicate manager would prohibit the creation of the security interest;

(5) the balance, if any, due with respect to the purchase of the share;

(6) any other liens on the share known by the syndicate manager, and

(7) whether the syndicate manager will note the secured party's lien on its records and notify the secured party of any attempt to transfer the share.

D. *Opinions of Counsel*

A lender may require an opinion of counsel reflecting the examination of records in the appropriate locations. This is complicated by frequent changes in ownership, the difficulty in determining where financing statements should be filed[47] and the possibility that some states may have special legislation in this area of the law.[48] Of course, the value of such an examination is inherently limited because no state requires the registration of title to thoroughbred or standardbred horses.[49]

E. *Insurance Documentation*

Most lenders will want to obtain other normal documentation for a loan with a horse as collateral. This would normally include the assignment of appropriate insurance coverage. Several types of insurance coverage are available with respect to horses. Mortality insurance will probably be required by most secured parties. The lender should exercise caution when dealing with a syndicated horse because in some instances mortality in-

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[47] For a discussion of the determination of where to file a financing statement, see text accompanying notes 94-108 *infra*.

[48] *See, e.g.*, KY. REV. STAT. § 355.9-307(4) (Bobbs-Merrill Supp. 1982) [hereinafter cited as KRS].

[49] The value of states having such a registration requirement can be seen by considering the benefits which the prevalent certificate of title requirements for automobiles provide. *Compare* U.C.C. § 9-103(3) (1962) *with* U.C.C. § 9-103(2) (1972).

surance is purchased by each shareholder and in others by the syndicate manager. Other insurance which may be available includes fertility insurance (which provides protection from a reduction in the value of a stallion if he proves infertile) and in utero insurance (which can protect against the loss of a foal while in the uterus).

II. PERFECTION OF THE SECURITY INTEREST

A. *Filing*

After the necessary documents have been obtained, the creditor must determine how the security interest should be perfected. There are several different methods in which to perfect a security interest, with the appropriate method for a particular transaction depending largely upon how the collateral is characterized. The desires of the parties also may affect the appropriate method of perfection.

The general rule under the 1972 version of the Code is that a financing statement must be filed to perfect a security interest; however, section 9-302(1) provides several exceptions to the general filing requirement.[50] The 1962 version of the Code includes a provision, not in the 1972 version, which excludes from the filing

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[50] In part, U.C.C. § 9-302(1) (1972) provides:

A financing statement must be filed to perfect all security interests except the following:

a) a security interest in collateral in possession of the secured party under Section 9-305;

b) a security interest temporarily perfected in instruments or documents without delivery under Section 9-304 or in proceeds for a ten day period under Section 9-306;

c) a security interest created by an assignment of a beneficial interest in a trust or a decedent's estate;

d) a purchase money security interest in consumer goods; but filing is required for a motor vehicle required to be registered; and fixture filing is required for priority over conflicting interests in fixtures to the extent provided in Section 9-313;

e) an assignment of accounts which does not alone or in conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts or contract rights of the assignor;

. . . .

g) an assignment for the benefit of all the creditors of the transferor, and subsequent transfers by the assignee thereunder.

requirement a security interest in farm equipment having a purchase price not in excess of $2,500.[51] Kentucky Revised Statutes (KRS) section 355.9-302(1) adopts the 1962 provision, except it changes the $2,500 limit to $500.[52]

In analyzing whether a financing statement must be filed, it will be assumed that possession of the animal pursuant to section 9-305 is not a practical solution, either because the debtor will normally require possession or because most creditors are not prepared to perfect by possession. Of course, in some instances possession by an agent may be appropriate.[53] It also will be assumed that neither The Jockey Club nor The United States Trotting Association certificates are "instruments" which must be perfected by possession.[54]

A detailed discussion of perfection by possession is not appropriate here because it applies to other types of collateral as well and thus exceeds the scope of this Article. However, one should keep that possibility in mind, particularly with the use of an agent, for an unusual case where there is no suitable alternative. Possession may be particularly useful in the case of a retained security interest in connection with the syndication of a stallion.[55] Moreover, sections 9-302(1)(a) and (b) have importance to a lender beyond providing a method of perfection because of the possibility that the person in possession of the horses may have priority over the lender.[56] Thus, if one other than the debtor is in possession of the horse, the lender should consider demanding a letter from the party in possession disclaiming any security interest in the horse, either on the possessor's behalf or as an agent for another person.

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[51] The 1972 version eliminated the exception for farm equipment to enhance the ability of farmers to use their equipment as collateral. U.C.C. § 9-302 Reason for 1972 Change (1972).

[52] KRS § 355.9-302(1)(c) (1972).

[53] *See* U.C.C. § 9-305 comment 2; WHITE & SUMMERS § 23-10, *supra* note 21. Certainly, though, neither the debtor nor a person the debtor controls can be the secured party's agent for purposes of perfection by possession. U.C.C. § 9-305 comment 2.

[54] *See* U.C.C. § 9-304(1). See text accompanying notes 12-21 *supra* for a discussion of the role of registration certificates in the context of Article 9.

[55] *See* U.C.C. § 9-302(1)(a), which excludes from the filing requirement a security interest in collateral in possession of the secured party under U.C.C. § 9-305.

[56] *See* U.C.C. §§ 9-302, 9-312.

If horses can be treated as "farm equipment," section 9-302(1)(c) of the 1962 version of the Code may be significant; a financing statement need not be filed if the horse's value is less than $2,500.[57] However, the 1972 version deleted the exception for farm equipment.[58] It is this author's belief, however, that it is inappropriate to classify horses as "farm equipment" even though they might be classified as "equipment" in some instances.[59]

While it may be possible for horses to be used as "consumer goods" and therefore not require filing,[60] this Article will not deal with this problem because few loans will be secured by that type of horse. Further, the argument that a horse may fail at stud and be converted to another use is likely to have little consequence, not only because of the amount of money involved but also because section 9-302(1)(d) is limited to purchase money security interests.[61]

A more substantial problem exists with section 9-302(1)(e) because of the possibility that a syndicate share may be characterized, at least in part, as an account or contract right. An unrecorded assignment by the debtor might exist at the time the lender perfects its security interest. If so, and if that together with other assignments to the same transferee does not constitute a significant part of the transferor's accounts or contract rights, the pre-existing assignee could have priority under section 9-312 if the syndicate share is characterized as a contract right or account. Several questions have arisen in interpreting section 9-302(1)(e), such as how much is a "significant part"[62] and whether the Code applies to an unconditional assignment of accounts.[63]

The most difficult issue in this regard, though, is whether the syndicate share is an account, contract right, a good or even

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[57] U.C.C. § 9-302(1)(c). Note, however, under Kentucky's version, filing is required for farm equipment valued above $500.

[58] The reason for this deletion is discussed in note 51 *supra*.

[59] *See, e.g.*, U.C.C. § 9-109(2)-(3). For a further discussion of this point, see text accompanying notes 101-108 *infra*.

[60] *See* U.C.C. § 9-302(1)(d).

[61] *Id.*

[62] *See* WHITE & SUMMERS § 23-8, at 926, *supra* note 21.

[63] *See, e.g.*, Spurlin v. Sloan, 368 S.W.2d 314 (Ky. 1953). *See also* WHITE & SUMMERS § 23-8.

something else. Of course, the importance of this issue goes beyond the question of the necessity to perfect by filing, for it also is relevant in determining which state's laws apply and where to file within a particular state.[64] This analysis cannot be made adequately without first analyzing the terms of the particular syndicate agreement.

Most syndicate agreements purport to convey an undivided interest in the horse to each shareholder and to delineate the shareholder's access and other rights with respect to the horse. Based upon this, it seems that the collateral is an interest in the horse and, thus, goods.[65] However, syndicate agreements often provide for pools, receipts for outside breedings and other matters. Thus, the collateral could be characterized partially as goods and partially as an intangible. It may, of course, be argued that the collateral is purely an intangible since the rights of the shareholder are merely those outlined in the agreement.

Perhaps the most helpful case in dealing with this question is *Harry F. Guggenheim*,[66] a Tax Court case. In 1958, Guggenheim syndicated the thoroughbred stallion, *Turn-To.[67] The stallion was divided into thirty-five shares, fifteen of which were retained by Guggenheim. The syndicate agreement was typical of many syndicate agreements now in use. The Internal Revenue Service argued that the sale of the shares was actually the sale of breeding rights (thus not I.R.C. section 1231 property) and that the gain should be taxed as ordinary income.[68] However, the Tax Court agreed with the taxpayer that the sale was of undivided interests in the horse, a capital asset, and the gain was taxable as a long-term capital gain.[69] While the issue before the Tax Court was not exactly the same as the Article 9 question, the same reasoning applies. The Tax Court noted that the syndicate agreement stated that the rights being conveyed were undivided inter-

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[64] For a discussion of the importance of properly characterizing collateral, see U.C.C. § 9-109 comment 1.

[65] For a discussion of characterizing the horse as goods under U.C.C. § 9-109, see text accompanying notes 101-108 *infra*.

[66] 46 T.C. 559 (1966).

[67] An asterisk appearing in front of a horse's name indicates that the horse was bred outside the United States.

[68] 46 T.C. at 566.

[69] *Id.* at 568.

ests in the horse and explained:

> The parties agree that something was sold by reason of the syndication of *Turn-To but do not agree on what was sold. The syndication agreement purports to pass undivided ownership interests, and while the form and language of the agreement are not conclusive as to the true character of the transaction, they are of some relevance. See *Comtel Corp.*, 45 T.C. 294 (1965). Moreover, the actions of the parties were consistent with the sale of undivided ownership interests. Petitioner, on his records, stopped taking depreciation on the entire horse and began taking depreciation on only a four-sevenths interest. Some of the shareholders, if not all, capitalized their interests in the horse after the purchase of the shares and depreciated those interests. Petitioner, after the syndication, insured only his interest in the horse. Some of the shareholders, if not all, insured their interests in the horse after the purchase of the shares.
>
> . . . .
>
> The differences between ownership of property having a limited life and the right to the full enjoyment and use of that property for its life are not appreciable. It can be argued that there are no significant economic differences.
>
> . . . .
>
> We agree with respondent that, due to the arrangement of the syndicate, the rights and obligations of a shareholder may have no substantial economic value above and beyond the rights and obligations of a lifetime season holder. However, they are substantive indicia of ownership, and, when combined with the form of the transaction, lead us to believe that the property interests transferred by the syndication agreement should be considered undivided ownership interests in *Turn-To.[70]

This writer likewise believes it is appropriate to characterize a typical syndicate share as goods even though there are arguments it should be treated as a contract right, general intangible, instrument or a combination of these. The position of the Securities and Exchange Commission in recent no-action letters that at least certain syndicate shares are not securities also may support this argument.[71]

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[70] *Id.* at 566-68 (footnotes omitted).

[71] *See, e.g.*, John R. Gaines, SEC No-Action Letter (available Aug. 18, 1977). *See*

Of course, any sums due a syndicate member from the syndicate manager can appropriately be characterized as an "account." To the extent a syndicate agreement or other collateral may be characterized as an intangible, we must turn to section 9-106 to determine whether the collateral is an "account," a "contract right" or a "general intangible." Section 9-106 states:

> "Account" means any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper. "Contract right" means any right to payment under a contract not yet earned by performance and not evidenced by an instrument or chattel paper. "General intangibles" means any personal property (including things in action) other than goods, accounts, contract rights, chattel paper, documents and instruments.[72]

The 1972 version of the Code deleted the use of the term "contract rights."[73] Such deletion may aid an argument that the collateral is a "general intangible" rather than a "contract right." However, that change apparently was not intended to make a substantive distinction.[74]

A detailed analysis of these definitions must be made in the context of the particular syndicate agreement. In doing so, it should be kept in mind that while all syndicate agreements differ, thoroughbred syndicate agreements normally differ considerably from standardbred syndicate agreements. Also, a syndicate manager may hold funds for a substantial time before making a distribution to shareholders. Of course, to the extent the syndicate manager actually holds funds already due and pay-

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also Campbell, *Stallion Syndicates as Securities*, 70 KY. L.J. No. 3 (1981-82) (in print) for an extensive discussion of syndication and securities as they relate to stallions.

[72] U.C.C. § 9-106.

[73] U.C.C. § 9-106 (1972).

[74] *See* U.C.C. § 9-106 Reason for 1972 Change (1972) which explains:

> The term "contract right" has been eliminated as unnecessary. As indicated by a sentence now being eliminated from Section 9-306(1), "contract right" was thought of as an "account" before the right to payment became unconditional by performance by the creditor. But the distinction between "account" and "contract right" was not used in the Article except in subsection (2) to Section 9-318 on the right of original parties to modify an assigned contract, and that subsection has been redrafted to preserve the distinction without needing the term "contract right."

Id.

able, it seems the collateral should be treated as an account.

In summary, a secured party will likely determine that a security interest in a horse should be perfected by filing, at least as a precautionary matter. The lender also should take steps to assure that it will not be unexpectedly second in priority to a security interest perfected by possession or one which is automatically perfected.[75]

B. *Choice of Law*

Once a lender determines it should perfect by filing, the next step is to analyze where to file. This analysis also is relevant to the need to file again when the collateral is moved. These considerations are important with respect to horses because of the frequency with which they can be and are moved. The appropriate place to begin this analysis is with sections 9-102[76] and 9-103[77] of

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[75] As to those few instances in which automatic perfection may occur, see U.C.C. § 9-302(1).

[76] U.C.C. § 9-102 provides:

> (1) Except as otherwise provided in Section 9-103 on multiple state transactions and in Section 9-104 on excluded transactions, this Article applies so far as concerns any personal property and fixtures within the jurisdiction of this state
>
> (a) to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper, accounts or contract rights; and also
>
> (b) to any sale of accounts, contract rights or chattel paper.
>
> (2) This Article applies to security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security. This Article does not apply to statutory liens except as provided in Section 9-310.
>
> (3) The application of this Article to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this Article does not apply.

Id.

[77] U.C.C. § 9-103 provides:

> (1) If the office where the assignor of accounts or contract rights keeps his record concerning them is in this state, the validity and perfection of a security interest therein and the possibility and effect of proper filing is governed by this Article; otherwise by the law (including the conflict of laws rule) of the jurisdiction where such office is located.
>
> (2) If the chief place of business of a debtor is in this state, this Article governs the validity and perfection of a security interest and the possibility

the Code which deal with the choice of law issue, including the state in which perfection of the security interest must take place.

The Kentucky versions of these sections follow the 1962 offi-

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and effect of proper filing with regard to general intangibles or with regard to goods of a type which are normally used in more than one jurisdiction (such as automotive equipment, rolling stock, airplanes, road building equipment, commercial harvesting equipment, construction machinery and the like) if such goods are classified as equipment or classified as inventory by reason of their being leased by the debtor to others. Otherwise, the law (including the conflict of laws rules) of the jurisdiction where such chief place of business is located shall govern. If the chief place of business is located in a jurisdiction which does not provide for perfection of the security interest by filing or recording in that jurisdiction, then the security interest may be perfected by filing in this state . . . .

(3) If personal property other than that governed by subsections (1) and (2) is already subject to a security interest when it is brought into this state, the validity of the security interest in this state is to be determined by the law (including the conflict of laws rules) of the jurisdiction where the property was when the security interest attached. However, if the parties to the transaction understood at the time that the security interest attached that the property would be kept in this state and it was brought into this state within 30 days after the security interest attached for purposes other than transportation through this state, then the validity of the security interest in this state is to be determined by the law of this state. If the security interest was already perfected under the law of the jurisdiction where the property was when the security interest attached and before being brought into this state, the security interest continues perfected in this state for four months and also thereafter if within the four month period it is perfected in this state. The security interest may also be perfected in this state after expiration of the four month period; in such case perfection dates from the time of perfection in this state. If the security interest was not perfected under the law of the jurisdiction where the property was when the security interest attached and before being brought into this state, it may be perfected in this state; in such case perfection dates from the time of perfection in this state.

(4) Notwithstanding subsections (2) and (3), if personal property is covered by a certificate of title issued under a statute of this state or any other jurisdiction which requires indication on a certificate of title of any security interest in the property as a condition of perfection, then the perfection is governed by the law of the jurisdiction which issued the certificate.

(5) Notwithstanding subsection (1) and Section 9-302, if the office where the assignor of accounts or contract rights keeps his records concerning them is not located in a jurisdiction which is a part of the United States, its territories or possessions, and the accounts or contract rights are within the jurisdiction of this state or the transaction which creates the security interest otherwise bears an appropriate relation to this state, this Article governs the validity and perfection of the security interest and the security interest may only be perfected by notification to the account debtor.

Id.

cial version with no substantial variations.[78] While the 1972 changes in the Code included a complete rewriting of section 9-103, the focus of those changes was primarily to cause this section to deal solely with perfection and not with the validity of security interests.[79] Other changes were more substantial, including changing the location for filing with respect to intangibles.[80] However, our analysis focuses on classification of collateral and is relative to either version. Of course, if the laws of a state which has adopted the 1972 version of the Code govern the transaction, special attention must be given to the appropriate statute.

The first determination with respect to a horse is whether it is a movable good, that is, whether it is "goods of a type which are normally used in more than one jurisdiction" and is "classified as equipment or classified as inventory by reason of their being leased by the debtor to others."[81] An analysis should start with a determination of whether the horse can be classified as equipment or inventory because of a lease by the debtor. While a horse will most frequently be considered a "farm product" and, thus, not "equipment" or "inventory," it sometimes may be appropriate to classify a horse as "equipment" or "inventory."[82]

Where a horse is classifed as "equipment or "inventory" leased by the debtor, an analysis of section 9-103(2) must continue.[83] If so, the fact that section 9-103 focuses on the "type" of goods involved rather than the characteristics of the particular item creates a problem.[84] For example, a stallion may be a great race horse and travel all over the country or world for a few years and then retire to Kentucky to stud. Or, the horse may be a mare which never leaves Kentucky or one which is moved around the country to be bred to different stallions. The question, then, should be whether the type of collateral is a "thoroughbred or standardbred race horse" (which normally travels), a "thorough-

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[78] *See* KRS § 355.9-102 (1972); KRS § 355.9-103 (1972).

[79] *See* U.C.C. § 9-103 Reason for 1972 Change (1972).

[80] *See* U.C.C. § 9-103(3) (1972); U.C.C. § 9-103 Reason for 1972 Change (1972).

[81] U.C.C. § 9-103(2).

[82] *See* U.C.C. § 9-109. For a more in-depth discussion of this point, see text accompanying notes 101-08 *infra*.

[83] U.C.C. § 9-103(2).

[84] *See, e.g., In re* Dennis Mitchell Industries, Inc., 419 F.2d 349, 359 (3d Cir. 1969). *See also* U.C.C. § 9-103 comment 5.

bred or standardbred stallion standing at stud" (which normally does not travel), or a "thoroughbred or standardbred broodmare" (which may or may not travel from state to state). Arguably, this analysis is not broad enough and the "type" of collateral is merely a "thoroughbred or standardbred horse" or even a "horse" (both being types which may or may not normally be used in more than one jurisdiction).

On the other hand, it may be arguable that such an analysis is overly broad; for example, whether the mare is of a type which normally would be bred and boarded in only one state or travel to all states seeking the best stallions should be analyzed. This problem is further complicated because a stallion may travel frequently until it is retired to stud. The issue then is whether the "type" of collateral changes at that point and, if so, whether a new filing must be made. For instance, Comment 2 to section 9-109 of the 1972 Code recognizes goods may fall into different categories in the hands of different owners.[85]

The most troublesome problem in this whole area is classification of the collateral, and no cases appear to provide an answer. Of course, the safest approach would be to properly perfect, first, in the state of the "chief place of business"[86] of the debtor (or the state in which "the debtor is located"[87] where the 1972 version applies) if the collateral could be considered a type normally used in more than one jurisdiction and otherwise subject to section 9-103(3)[88] and, second, in the state where the collateral is kept in accordance with sections 9-102[89] and 9-103(3).[90] If the horse is actually moved, additional filings may be required.

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[85] U.C.C. 9-109 comment 2 (1972) states:

> The classes of goods are mutually exclusive; the same property cannot at the same time and as to the same person be both equipment and inventory, for example. In borderline cases—a physician's car or a farmer's jeep which might be either consumer goods or equipment—the principal use to which the property is put should be considered as determinative. Goods can fall into different classes at different times; a radio is inventory in the hands of a dealer and consumer goods in the hands of a householder.

[86] U.C.C. § 9-103(2).

[87] U.C.C. § 9-103(3)(b) (1972).

[88] U.C.C. § 9-103(3).

[89] *Id.* § 9-102.

[90] *Id.* § 9-103(3).

The analysis of the applicable law is further complicated where the security is a person's interest in a syndicated horse. As discussed above, the interest in the syndicate can conceivably be treated as "contract rights." If so, the law of the state where the assignor keeps records concerning the contract rights governs[91] (or where "the debtor is located"[92] if the state has adopted the 1972 version of the Code). Similarly, if a syndicate share is characterized as a "general intangible," the provisions of section 9-103(2)[93] will govern the choice of law issue.

Because of the inherent difficulty in classifying horses as collateral, several filings may be in order, particularly for a interest in a syndicated horse. Multiple filings in states where an attorney is not familiar with recording requirements may cause further problems. Some states have recordation taxes and unusual versions of section 9-402 regarding the requirements for financing statements, such as technical requirements involving type, margin and paper size.[94] Financing statements may be returned, leading to substantial delay and risk. The expense and burden of multiple filings in other states certainly require the lender's attorney to be aware of the appropriate filing requirements before preparing and executing the documents.

C. *Where to File*

After a creditor decides it should file a financing statement, and a determination has been made as to the applicable state law, it is necessary to look to section 9-401(1) of the Code to determine where to file in the appropriate state or states.[95] There

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[91] *Id.* § 9-103(1).

[92] U.C.C. § 9-103(3)(b) (1972).

[93] U.C.C. § 9-103(2). See note 77 *supra* for the full text of § 9-103.

[94] A good source revealing various state variations in Code sections, especially § 9-401, is UNIFORM COMMERCIAL CODE REPORTING SERVICE, STATE CORRELATION TABLES (1979).

[95] A secured party may wish to file financing statements in more than one state if the collateral and/or the secured party has contacts with multiple states and the answer as to where to file is not clear-cut; it is better to file in too many places than to guess at the proper place to file and later find out that your interpretation of the U.C.C. was incorrect. Further, if the states have different versions of the Code, it may be essential to file in both states in order to be perfected in both states.

are various alternatives of section 9-401(1) and it is important to review the appropriate version of each state carefully.[96] In fact,

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[96] The three alternatives of U.C.C. § 9-401(1) are:

First Alternative Subsection (1)

(1) The proper place to file in order to perfect a security interest is as follows:
(a) when the collateral is goods which at the time the security interest attaches are or are to become fixtures, then in the office where a mortgage on the real estate concerned would be filed or recorded;
(b) in all other cases, in the office of the [Secretary of State].

Second Alternative Subsection (1)

(1) The proper place to file in order to perfect a security interest is as follows:
(a) when the collateral is equipment used in farming operations, or farm products, or accounts, contract rights or general intangibles arising from or relating to the sale of farm products by a farmer, or consumer goods, then in the office of the . . . . . in the county of the debtor's residence or if the debtor is not a resident of this state then in the office of the . . . . . in the county where the goods are kept, and in addition when the collateral is crops in the office of the . . . . . in the county where the land on which the crops are growing or to be grown is located;
(b) when the collateral is goods which at the time the security interest attaches are or are to become fixtures, then in the office where a mortgage on the real estate concerned would be filed or recorded;
(c) in all other cases, in the office of the [Secretary of State].

Third Alternative Subsection (1)

(1) The proper place to file in order to perfect a security interest is as follows:
(a) when the collateral is equipment used in farming operations, or farm products, or accounts, contract rights or general intangibles arising from or relating to the sale of farm products by a farmer, or consumer goods, then in the office of the . . . . . in the county of the debtor's residence or if the debtor is not a resident of this state then in the office of the . . . . . in the county were the goods are kept, and in addition when the collateral is crops in the office of the . . . . . in the county where the land on which the crops are growing or to be grown is located;
(b) when the collateral is goods which at the time the security interest attaches are or are to become fixtures, then in the office where a mortgage on the real estate concerned would be filed or recorded;
(c) in all other cases, in the office of the [Secretary of State] and in addition, if the debtor has a place of business in only one county of this state, also in the office of . . . . . of such county, or, if the debtor has no place of business in this state, but resides in the state, also in the office of . . . . . of the county in which he resides.

Id.

this is the section of the Code which probably has the greatest variance among states.[97]

Before determining where to file, it again is necessary to characterize the collateral. Depending on the version of the Code and the applicable alternative, a determination must be made as to whether the collateral is: (1) "equipment used in farming operations, or farm products, or accounts, contract rights or general intangibles arising from or relating to the sale of farm products by a farmer, or consumer goods (1962 version);"[98] (2) "equipment used in farming operations, or farm products, or accounts or general intangibles arising from or relating to the sale of farm products by a farmer, or consumer goods (1972 version),"[99] or (3) anything else. There is no difference between the first two categories described above in that property considered a "contract right" in the 1962 version of the Code was included in the definition of "account" in the 1972 version.[100]

The beginning point in characterizing horses as collateral is U.C.C. section 9-109, which divides "goods" into four subcategories: "consumer goods," "equipment," "farm products" and "inventory."[101] These categories are intended to be mutually ex-

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[97] Of the 49 states which have adopted the U.C.C., five (Kentucky, Maryland, Nebraska, Oregon and Wyoming) have their own version of U.C.C. § 9-401(1). Of the remaining 44 states, seven have adopted alternative (1); 24 have adopted alternative (2), and 13 have adopted alternative (3). *See* UNIFORM COMMERCIAL CODE REPORTING SERVICE, STATE CORRELATION TABLES (1979).

[98] U.C.C. § 9-401(1)(a) (Alternatives 2 and 3).

[99] U.C.C. § 9-401(1)(a) (1972) (Alternatives 2 and 3).

[100] This view is explicitly set forth in U.C.C. § 9-106 (1972) Reasons for 1972 Change.

[101] U.C.C. § 9-109 provides:

> Goods are
>
> (1) "consumer goods" if they are used or bought for use primarily for personal, family or household purposes;
>
> (2) "equipment" if they are used or bought for use primarily in business (including farming or a profession) or by a debtor who is a non-profit organization or a governmental subdivision or agency or if the goods are not included in the definitions of inventory, farm products or consumer goods;
>
> (3) "farm products" if they are crops or livestock or supplies used or produced in farming operations or if they are products of crops or livestock in their unmanufactured states (such as ginned cotton, wool-clip, maple syrup, milk or eggs), and if they are in the possession of a debtor engaged in raising, fattening, grazing or other farming operations. If goods are farm products they are neither equipment nor inventory;

clusive.[102] The principal test is the use of the collateral, and where there is more than one use the principal use should be determinative.[103] Further, the same goods may fall into a different category when they are in the hands of a different owner.[104]

While horses offered as security will frequently be considered livestock and thus "farm products" (and therefore not equipment or inventory), a problem occurs if the debtor is not engaged in farming operations. The intent of the drafters of the Code was to have livestock lose its status as "farm products" when no longer used in connection with a farming operation (e.g., racing—unless one could adequately connect the racing to farming), even though the person who is racing the horse may be engaged in farming operations.[105] Also, a horse would apparently lose its status as a "farm product" if it came into the possession of one not engaged in farming operations (e.g., a person who would race it).[106] Another problem may exist where the debtor leases a horse. Can it be said the horse is not a "farm product" because the debtor is no longer engaged in a farming operation? However, if the horse is not classified as a "farm product" because it is not in the possession of a debtor engaged in farming, it would seem that it should not be classified as "farm equipment" for the same reason. If the horse cannot be classified as "farm equipment" for this reason, it must be classified as either "equipment" (other than "farm equipment"), "consumer goods" or "inventory."

Once the appropriate categorizations have been made, it is a relatively simple matter to look to section 9-401 and see where to file. However, it is often difficult to categorize horses, particularly syndicate interests, in the required manner. Depending upon

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(4) "inventory" if they are held by a person who holds them for sale or lease or to be furnished under contracts of service or if he has so furnished them, or if they are raw materials, work in process or materials used or consumed in a business. Inventory of a person is not to be classified as his equipment.

Id. The 1972 version is identical. *See* U.C.C. § 9-109 (1972). The Kentucky version differs only in subsection (3), in which the category labeled "farm products" does not include "supplies." *See* KRS § 355.9-109(3) (1972). However, this variation is of no consequence for purposes of this Article.

[102] U.C.C. § 9-109 comment 2, set out in note 85 *supra*.

[103] *Id.*

[104] *Id.*

[105] *See id.* at comment 4.

[106] *See id.*

the circumstances, horses may be characterized in various ways. Section 9-109 indicates that a horse may be "inventory," "equipment" or even "consumer goods" if it is not a "farm product." Thus, the appropriate analysis is to first determine if the horse is a "farm product," "inventory" or "equipment."

This analysis must be made on a case by case basis and some of the considerations have been discussed above. Where there is an issue as to whether the horse is "used or produced in farming operations," as that phrase is used in section 9-109(3), it may be difficult to be certain of the place to file. After making this analysis, a lender's attorney may often find that precautionary filings are in order.[107] Such categorization is especially difficult where the collateral is a syndicate share.[108]

III. PRIORITY

A. *General*

The foregoing consideration of when and where to file also indicates the location and manner by which pre-existing security interests in the collateral may be perfected. In some circumstances it is possible that perfection by possession and automatic perfection may occur.[109] Because of the ambiguity resulting from the difficulty in characterizing the collateral and the possibility there may have been several previous owners, it is often difficult or impractical to examine all records which could conceivably evidence a pre-existing lien on the collateral. An exception to the problem *may* exist, though, where the horse was purchased by the debtor at certain public auctions in Kentucky. This possibility is provided for in KRS section 355.9-307(4), a section added by the Kentucky legislature.[110] Absent protection being provided

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[107] The desirability of such precautionary filings is the same as discussed for multi-state filings discussed in note 95 *supra;* it is better to file in too many places than to guess at which is the proper place to file and later find out that an interpretation of the requirements of Article 9 was incorrect, leaving a lender's security interest unperfected.

[108] For a discussion of the difficulties in categorizing syndicate shares as collateral, see text accompanying notes 62-74 *supra.*

[109] For a discussion of perfection by possession and automatic perfection as they relate to security interests in horses, see text accompanying notes 53-56 *supra.*

[110] For a discussion of KRS § 355.9-307(4) (Supp. 1982), see text accompanying notes 116-26 *infra.*

by KRS section 355.9-304(4), a business decision will frequently need to be made as to the time and number of owners which the examination should span.

In analyzing the priority issue with respect to progeny, it also is necessary to consider whether the owner of the mare or the stallion has a right to the offspring of the animals. The general rule for most animals is that the offspring of animals belongs to the owner of the dam or mother and is based upon the fact that the male is frequently unknown and the fact that the female is less useful during pregnancy.[111] These factors may, however, have little significance in the case of valuable horses involved in breeding. Of course, the ownership of issue may be contracted away.[112]

An interesting problem is presented when the owner of a mare enters into a lease or similar agreement prior to the creation of a security interest. The Kentucky Court of Appeals in *Maize v. Bowman*,[113] faced a similar situation when the owner of a mare entered into an agreement to allow Bowman to breed the mare and retain the foal. The mare was purchased while in foal at a court sale pursuant to a lien acquired after the date of the agreement. The court held Bowman (rather than the subsequent purchaser) to be entitled to the colt.[114] Similarly, the general rule is that when a mare is hired or leased, other than gratuitously, the bailee or lessee rather than the owner of the mare is the owner of increase during the term of the bailment or lease.[115]

B. *Special Treatment for Horses Sold at Auctions in Kentucky*

After the security interest is perfected, a lender should take all possible steps to make sure its priority is not inadvertently lost or subordinated. This is done in the same manner as with any other collateral, with some significant exceptions. The most significant exception in Kentucky is provided by KRS section 355.9-

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[111] *See, e.g.*, Farris & Co. v. Collier, 136 So. 510 (Fla. 1931).

[112] Maize v. Bowman, 19 S.W. 589 (Ky. 1892).

[113] *Id.*

[114] *Id.* at 589.

[115] *See, e.g.*, Connolley v. Power, 232 P. 744 (Cal. Dist. Ct. App. 1924); Kellogg v. Lovely, 8 N.W. 699 (Mich. 1881).

307(4), under which the bona fide purchaser of a racing horse at certain public auctions takes free and clear of any lien.[116] The organization holding the auction also is not subject to any liability to the lienholder unless it has received written notification of the lien prior to the auction.[117]

This statute may have broad impact because of the number of important horse sales held in Kentucky. As a matter of protecting its liens, a lender may be compelled to check the catalogs from these sales. At the least, the creditor would want to provide the required notice if such a sale were held. As stated above, this statute also may benefit the creditor by eliminating prior liens or limiting the period for which records need to be checked. However, there are problems with respect to the applicability and validity of this statute.

Perhaps the most difficult problem in dealing with KRS section 355.9-307(4) is the choice of law provisions of U.C.C. section 9-103. That is, if the law of another state is to be applied to the continuity of perfection of the prior security interest, the Kentucky statute may not be given effect to nullify the lien as to a bona fide purchaser. Thus, a new security interest perfected after such an auction might not have senior priority. In such a situation, the party obtaining a security interest following an appropriate auction within Kentucky may argue that section 9-103 was not intended to control the choice of law with respect to a statute which discharges a security interest. Such an argument stands a better chance of prevailing if the state whose law is being applied has the 1972 version of the Code, because the 1962 version of section 9-103 specifically refers to the "validity and perfection" of a security interest while the 1972 version refers

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[116] KRS § 355.9-307(4) (Supp. 1982) provides in full:

> If any livestock subject to the lien of a security interest is sold at public auction through a stockyard licensed by the Commonwealth of Kentucky in the ordinary course of business, a bona fide purchaser for value of such livestock shall take title thereto free and clear of any such lien, and the stockyard and selling agents selling such livestock shall not be liable to the holder of such lien, unless written notice by certified mail, return receipt requested or by registered mail, of such lien, the name and address of the debtor and proper description of the livestock subject to lien is given to the stockyard prior to the time of sale.

Id.

[117] *Id.*

solely to "perfection."[118] In any event, a lender faced with such a situation will have to analyze the matter carefully, giving consideration to the location of the parties involved, as well as the applicable version of the Code, before relying upon KRS section 355.9-307(4).

Other questions are unanswered. For example, it might be argued that the statute takes property without due process or that it violates the equal protection clause of the United States Constitution. Few cases address this specific issue, but the North Carolina Supreme Court has held that the state legislature had the power to effect registration requirements without violating due process.[119] In *W.H. Applewhite Co. v. Etheridge*,[120] food subject to a chattel mortgage in North Carolina was moved to Virginia and sold. The secured party sued for the proceeds of the sale. Besides requiring the registration of in-state security interests, Virginia law required the registration of security interests perfected in other states on goods located in Virginia. The trial court held for the defendant because the plaintiff failed to also register in Virginia.[121] On appeal, the plaintiff argued that such a registration requirement violated due process as an unlawful taking. The North Carolina Supreme Court held that the legislature could effect registration of security interest requirements without violating due process.[122]

The Kentucky statute has important limitations on its operation. One such limitation is that the statute only purports to convey the horse free from "the lien of a security interest"; such a lien apparently would not include tax liens, agister's liens, judgment liens and other similar liens.[123] Another noteworthy limitation contained in KRS section 355.9-307(4) is that it only aids "a bona fide purchaser for value of such horse."[124] Frequently, the

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[118] *See* U.C.C. § 9-103. The 1972 version is intended to deal with the perfection of a security interest but not the validity of such a security interest. U.C.C. § 9-103 Reasons for 1972 Change (1972).

[119] W.H. Applewhite Co. v. Etheridge, 187 S.E. 588 (N.C. 1936).

[120] *Id.*

[121] *Id.* at 589.

[122] *Id.*

[123] Such a conclusion may be reached by reading U.C.C. §§ 9-104, 9-102(2) and 1-201(37), which set forth the limited applicability of Article 9 to statutory liens. *See also* WHITE & SUMMERS § 22-2, *supra* note 21.

[124] *See* KRS § 355.9-307(4) (Cum. Supp. 1982).

purchaser of the animal may either be the seller buying back horses or someone else with knowledge of a lender's existing lien. In such cases the purchaser should not be a "bona fide purchaser"—one who takes in good faith, for value[125] and without knowledge of the rights of other parties.[126]

C. *Condition Precedent to Action Against Purchaser or Selling Agent*

Another Kentucky statute not found in the official versions of the Code also may require special consideration. The statute applies when a secured party has a lien in livestock, and the livestock is sold without discharging the debt to the secured party.[127] Under KRS section 355.9-319, the secured party is precluded from bringing an action against the purchaser or selling agent until he or she has fully pursued remedies against the debtor.[128] While this statute is clear and self-explanatory, a creditor should recognize that some delay can be caused in collection.

D. *Agister's Lien and Lien for Service Fees*

In determining whether a creditor with a security interest in a horse has priority among claims to the horse,[129] liens which may be created in the horse by statute must be considered. In Kentucky, the most relevant liens are those which arise in favor of one who keeps a livery stable or who feeds or grazes cattle for compensation, known as an agister's lien, and in favor of a licensed keeper of a stallion for service fees.

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[125] For a bona fide purchaser to "take for value" it is not required that the full fair market value be paid; however, the price paid must be adequate.

[126] *See, e.g.*, Turner v. Risner, 134 S.W.2d 951, 952 (Ky. 1939); Blodgett v. Martsch, 590 P.2d 298, 303 (Utah 1978).

[127] *See* KRS 355.9-319 (Supp. 1982). In full, the statute provides:

> Before a secured party possessing a lien against livestock or grain that has been sold without the debt to the secured party being discharged may bring an action against the purchaser or selling agent of the livestock or grain, he shall pursue his remedy against his debtor to the point where a judgment is rendered on the merits or the suit is dismissed with prejudice.

Id.

[128] *Id.*

[129] U.C.C. §§ 9-301, 9-310 and 9-312 govern priority disputes.

KRS section 376.400 provides for a lien on horses kept in a livery stable, or which are fed or grazed by another for compensation, in favor of the party caring for the horses.[130] The lien is in the amount of the party's reasonable charges for keeping, caring for, feeding and grazing the horses.[131] A lien under KRS section 376.400 is subject to the same limitations as a landlord's lien.[132] The thrust of these limitations is to limit what is covered by the lien to four months rent.[133] A lien created by KRS section 376.400 can be enforced by the lienholder presenting to the proper district court an affidavit setting forth the amount due and the horses so kept.[134] The court issues a warrant and the sheriff levies upon and seizes the horses.[135]

A lien for service fees in favor of a "licensed keeper" of a stallion is created by KRS section 376.420(1).[136] The lien covers the offspring of the stallion kept and exists for one year after the birth of the progeny.[137] This lien for service fees may be enforced by court action or by the method described for an agister's lien.[138]

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[130] In full, KRS § 376.400 (1972) provides:

> Any owner or keeper of a livery stable, and a person feeding or grazing cattle for compensation, shall have a lien upon the cattle placed in the stable or put out to be fed or grazed by the owner, for his reasonable charges for keeping, caring for, feeding and grazing the cattle. The lien shall attach whether the cattle are merely temporarily lodged, fed, grazed and cared for, or are placed at the stable or other place or pasture for regular board. The lien shall be subject to the limitations and restrictions placed upon a landlord's lien for rent.

Id. The term "cattle" as used in the statute is defined as including horses. KRS § 446.010(6) (Supp. 1982).

[131] KRS § 376.400 (1972).

[132] *Id.*

[133] The limitations are found in KRS § 383.070(2), (3) and (4) (1972). A landlord's lien for up to four months rent is *not* limited by these sections to periods prior to a security interest in the delinquent rentor's personal property being created. *See* KRS § 383.070(3) (1972).

[134] KRS § 376.410 (Supp. 1980).

[135] *Id.*

[136] "Any licensed keeper of a stallion, jack or bull shall have a lien for the payment of the service fee upon the get of the stallion, jack or bull, for one (1) year after the birth of the progeny." KRS § 376.420(1) (1972). The "get" in which the lien is created refers to the offspring of the stallion, not the mare being served. 68 Ky. Op. Att'y Gen. 112 (1968) (unpublished).

[137] KRS § 376.420(1) (1972).

[138] KRS § 376.420(2) (1972).

The fact that the lien under KRS section 376.420(1) is in favor of a "licensed keeper" poses an interesting question. At one time Kentucky required a keeper of stallions to maintain a license.[139] In fact, the Kentucky Court of Appeals in *Smith v. Robertson*[140] held there was no lien under this section where the plaintiff did not have the license required to stand stallions for hire.[141] While that requirement no longer appears to be mandated by statute, there could be a local ordinance to this effect.[142] Unfortunately, no Kentucky cases have considered this troublesome language since the repeal of the special licensing requirements. The reasoning of *Smith v. Robertson* would not apply when there is no such requirement, and it would seem likely that a court would ignore the "license" language when applying the statute.

The Code deals with the priority of perfected security interests vis-a-vis statutory liens in section 9-310.[143] Under section 9-310, a party having a statutory lien in a horse for furnishing services or materials in the ordinary course of business, if in possession of the horse, will prevail against a party holding a perfected security interest unless the statute creating the lien provides otherwise.[144] Thus, one with an agister's lien under KRS section 376.400, who in all likelihood will be in possession of the horse, will prevail against a perfected secured party. Likewise, as to liens created under KRS section 376.420(1), if either the offspring or the mare in foal is in the possession of the keeper of the stallion which provided the services when the suit is filed, it seems that the requirements of section 9-310 are met and the lien

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[139] In Smith v. Robertson, 50 S.W. 852 (Ky. 1899), it was stated: "It is not disputed but what the Kentucky Statutes require license to be paid by all persons who stand stallions for hire . . . ." *Id.* at 853.

[140] *Id.* at 852.

[141] *Id.* at 855.

[142] *See* KY. CONST. § 181; KRS § 92.280 (1982).

[143] In full, U.C.C. § 9-310 provides:

> When a person in the ordinary course of his business furnishes services or materials with respect to goods subject to a security interest, a lien upon goods in the possession of such person given by statute or rule of law for such materials or services takes priority over a perfected security interest unless the lien is statutory and the statute expressly provides otherwise.

Id.

[144] *Id.*

of the licensed keeper will take priority over a previously perfected security interest.[145] This analysis, of course, assumes that the security interest of the lender has been properly perfected. A lender must remember that an analysis of liens of this type must be made on a state by state basis and our analysis is limited to Kentucky. Other jurisdictions may provide for similar liens by statute.

In additon to the statutory lien, it may be possible to assert a common law lien where the provider of services retains possession of the animals. At common law, a lien for a service fee was created in favor of a stallion owner who received a mare to be served by the stallion, and the lien existed for as long as the stallion owner retained possession of the mare.[146] However, courts have generally held there is no common law lien for board.[147] It also is possible to argue the existence of an equitable lien[148] or for recovery in equity[149] from a person who benefits from the services or board to the extent the services and care enhance the value of the animal.

Another practical consideration related to bills for service fees and board is that the owner of a stallion may refuse to provide the necessary papers for registration of foals unless the bills are paid.[150] While it may be possible to deal with this problem by litigation, the expense in time and money can be prohibitive. A lender's attorney should, therefore, consider obtaining waivers of such claims or checking for unpaid bills prior to closing the loan. Finally, the significance of the liens created by KRS sections 376.400 and 376.420(1) (or similar statutes in other jurisdictions)

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[145] *Cf.* Corbin Deposit Bank v. King, 384 S.W.2d 302 (Ky. 1964) (holding a similar statutory lien prevails even though KRS § 376.450 provides for precedence of a "mortgage" and "bona fide sale" in certain instances). *See generally* Forrest Cate Ford, Inc. v. Fryar, 465 S.W.2d 882 (Tenn. App. 1970); Annot., 69 A.L.R.3d 1162 (1976).

[146] *See* Sawyer v. Gerrish, 70 Me. 259 (1879); Grinnell v. Cook, 3 Hill 485 (N.Y. 1842).

[147] *See, e.g.*, Shartzer v. Ulmer, 333 P.2d 1084, 1087 (Ariz. 1959); Hanch v. Ripley, 26 N.E. 70, 71 (Ind. 1890); Loader v. Bank of Idana, 216 P. 264, 265 (Kan. 1923).

[148] For a thorough discussion of the creation and enforcement of equitable liens, see L. JONES, A TREATISE ON THE LAW OF LIENS 23-92 (3d ed. 1914).

[149] *See generally* D. DOBBS, HANDBOOK OF THE LAW OF REMEDIES 237-38 (1973).

[150] The papers necessary for registering the foal with either The Jockey Club or The United States Trotting Association, are discussed in the text accompanying notes 3-4 *supra*.

and the possibility that there will be hurdles to the sale or registration unless these bills are paid should not be dismissed because both the board bill and service fee for registered horses are often very high compared with other animals.

E. *Buyers in the Ordinary Course and Authorized Dispositions*

Section 9-307(1) of the Code affords special protection to buyers "in the ordinary course of business," but excludes from that section persons "buying farm products from a person engaged in farming operations."[151] A buyer in the ordinary course of business is defined as "a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind."[152] Buyers within section 9-307(1) take free of any security interest created by the seller even though the security interest may be perfected and even if the buyer knows of the security interest's existence.[153]

In determining whether the private sale of horses will fall within the purview of section 9-307(1), the focus is on whether the seller is "a person in the business of selling goods of that kind." It can be argued that a breeder who periodically upgrades broodmare stock by a private sale of broodmares is not in the business of selling goods of that kind (broodmares). It is generally held that a sale incidental to the seller's principal business does not make the seller a person in the business of selling goods of that kind.[154] Thus, under section 9-307(1), the security interest would arguably be preserved in the broodmares upon the disposi-

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[151] U.C.C. § 9-307(1) provides:

> A buyer in ordinary course of business (subsection (9) of Section 1-201) other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence.

Id.

[152] U.C.C. § 1-201(9).

[153] U.C.C. § 9-307(1).

[154] *See, e.g.*, O-Neill v. Barnett Bank, 360 So. 2d 150 (Fla. Dist. Ct. App. 1978). *But see* American Nat'l Bank and Trust Co. v. Mar-K-Z Motors and Leasing Co., 298 N.E.2d 209 (Ill. App. Ct. 1973) (lessor of cars held to be in business of selling cars when evidence showed it was customary to sell the automobiles after they had been leased).

tion by private sale. On the other hand, there is a good argument that the breeder should be treated as being in the business of selling young horses. In any event, the characterization of the seller's business is important.

If the seller is characterized as being "in the business of selling goods of that kind," we must next consider whether the exception applies. That is, section 9-307 of the Code does not affect a prior security interest if the goods sold are "farm products" and the seller is engaged in "farming operations." As previously discussed, goods are characterized according to the definitions contained in section 9-109 of the Code.[155] Goods are farm products if they are "livestock . . . and if they are in the possession of a debtor engaged in raising, fattening, grazing or other farming operations."[156] The Code describes inventory as goods "held by a person who holds them for sale or lease."[157] Classes of goods are mutually exclusive,[158] and the Code explicitly states that goods characterized as farm products are not inventory.[159] Thus, horses held in breeding operations will frequently be farm products, and section 9-307 will not protect buyers of those horses.

A related section is KRS section 35.9-306(2), which terminates a security interest upon the sale, exchange or other disposition of collateral by the debtor if the debtor's action "was authorized by the secured party in the security agreement or otherwise."[160] Of course, most loan agreements will by their terms explicitly allow certain dispositions. However, the real problems are caused by the dispositions which are "otherwise" authorized. For example, there is a sound argument that allowing one to race in a claiming race is authority to sell free of the security interest.[161] Unfortunately, the limitations on the "otherwise" authorization are unclear.

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[155] For a discussion of the characterization of goods, see text accompanying notes 101-08 *supra*.

[156] U.C.C. § 9-109(3).

[157] U.C.C. § 9-109(4).

[158] *See* U.C.C. § 9-109 comment 2.

[159] *See* U.C.C. § 9-109(3).

[160] KRS § 355.9-306(2). The Kentucky provision is identical to the 1962 version of the Code. *See* U.C.C. § 9-306(2). The 1972 version of the Code made minor changes to clarify the provision. *See* U.C.C. § 9-306(2) (1972).

[161] The peculiar nature of a claiming race is discussed in note 1 *supra*. Allowing a

Another substantial risk to a secured party may exist when there has been a practice or custom of allowing a particular debtor to sell a certain type of collateral. In *Cessna Finance Corp. v. Skyways Enter.*,[162] the Kentucky Court of Appeals held that a restriction in a mortgage on an airplane, providing that the debtor (a dealer in airplanes) could not sell the airplane without the prior consent of the mortgagee, was waived by the conduct of the secured party. The secured party had acquiesced in the debtor's sale of other airplanes subject to similar restrictions without its prior consent.[163] *Cessna* may have serious implications where a secured party has allowed sales on a regular basis. Several jurisdictions do not follow the *Cessna* rationale and have held that there is no implied waiver by course of conduct.[164] These decisions are based on section 1-205(4) which states that "[t]he express terms of an agreement and an applicable course of dealing . . . shall be construed wherever reasonable as consistent with each other; but when such construction is unreasonable express terms control . . . course of dealing . . . ."[165] These decisions are supported by U.C.C. section 9-105(4) which provides that Article 1 contains "principles of construction and interpretation applicable throughout this Article."[166] However, some courts obviously are not persuaded by this reasoning.[167]

In reviewing the provisions of sections 9-307(1) and 9-306(2), a lender must be aware of the "two-pronged" nature of each. For example, section 9-306 may make a secured party's lien superior to the lien of an earlier lender but inferior to a subsequent lender.

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horse in which there is an existing security interest to be entered in a claiming race, it can be argued, is authorizing the transfer of the horse's title.

[162] 23 U.C.C. REP. SERV. 1015, 1018-19 (Ky. Ct. App. 1978), *aff'd on other grounds*, 580 S.W.2d 491 (Ky. 1979).

[163] *See also* Clovis Nat'l Bank v. Thomas, 425 P.2d 726 (N.M. 1967). *Cf.* Central Washington Prod. Credit Ass'n v. Baker, 521 P.2d 226 (Wash. Ct. App. 1974) (finding a material issue of fact as to whether plaintiff had directly or impliedly waived the consent requirement).

[164] *See, e.g.*, Environmental Electronic Systems, Inc. v. Nikko Audio, 2 Bankr. 583 (Bankr. N.D. Ga. 1980); Wabasco State Bank v. Caldwell Packing Co., 251 N.W.2d 321 (Minn. 1976); Farmers State Bank v. Edison Non-Stock Coop. Ass'n, 212 N.W.2d 625 (Neb. 1973); Garden City Prod. Credit Ass'n v. Lannan, 186 N.W.2d 99 (Neb. 1971).

[165] U.C.C. § 1-205(4).

[166] U.C.C. § 9-105(5).

[167] For a discussion of these cases, see notes 163-64 *supra* and accompanying text.

In reviewing these provisions, it is helpful to note that the underlying purpose of Article 9 of the Code is "to protect a security interest so long as it does not interfere with the normal flow of commerce."[168] For this reason, secured parties can lose their security interests by authorizing the disposition of the collateral under section 9-306(2) or if the collateral is sold to a buyer in ordinary course of business (except farm products sold by one engaged in farming operations).

IV. DISPOSITION OF COLLATERAL

A lender should give some special considerations to the enforcement of a lien. These issues primarily involve the disposition of the collateral. First, if the collateral is an unregistered security, a secured party will have all of the usual problems in disposing of collateral in such a situation.[169]

Another problem is that a purchaser is unlikely to make any substantial payment for a thoroughbred or standardbred horse unless The Jockey Club or The United States Trotting Association certificates are properly endorsed over or a new certificate is obtained.[170] One possible way of dealing with this problem may be by obtaining a power of attorney in the security agreement. Another may be to have a new certificate issued. The appropriate association may be willing to do so if an attorney provides it with an opinion regarding the effectiveness of the transfer of ownership and if other documents which the association may request are provided. In any case, though, it is important to have the cooperation of The Jockey Club and The United States Trotting Association. In fact, it is certainly arguable that a sale is not commercially reasonable as required by section 9-504(3) of the Code unless accomplished in a manner that contemplates the purchaser obtaining the appropriate certificate.[171]

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[168] McFadden v. Mercantile-Safe Deposit and Trust Co., 273 A.2d 198,209 (Md. 1971).

[169] *See* Comment, *The* Guild Films *Case: The Effect of "Good Faith" in Foreclosure Sales of Unregistered Securities Pledged as Collateral*, 46 VA. L. REV. 1573 (1960).

[170] These organizations are discussed in notes 3 and 4 *supra*.

[171] Few specific requirements govern the conduct of a sale of collateral by a secured party after default, but "every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable." U.C.C. § 9-504(3).

V. SYNDICATE SHARES AS SECURITIES

The securities laws unexpectedly apply to loans to purchase syndicate shares. While the simple sale and delivery of animals does not constitute the sale of a security, the courts will consider substance over form and the sale of a horse could be structured in such a way as to constitute a security.[172] However, the Securities and Exchange Commission in recent No-Action Letters has determined that at least certain syndicate shares will not be treated as securities.[173]

Once a determination is made that a syndicate share is a security, a number of potential problems arise such as a lender being an aider and abettor of the perpetuation of fraud in connection with the sale or purchase of a security or the improper sale or purchase of an unregistered security.[174] Further, if the syndicate share is a security, there may be problems with the disposition of the collateral.

CONCLUSION

The foregoing discussion is intended to present some of the unusual analyses the attorney for a lender should undertake in connection with the creation of a security interest in thoroughbred and standardbred horses. Perhaps the most significant challenge is the difficulty in characterizing interests in horses as collateral. As discussed, these characterization problems arise in nearly every significant part of the analysis.

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[172] *Cf.* Continental Marketing Corp. v. SEC, 387 F.2d 466 (10th Cir. 1967), *cert. denied*, 391 U.S. 905 (1968) (sale of investment contracts for sale and care of bearers was held to be a sale of securities).

[173] *See, e.g.*, John R. Gaines, SEC No-Action Letter (available Aug. 18, 1977).

[174] *See, e.g.*, Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976); Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification and Contribution*, 120 U. PA. L. REV. 597 (1972).