The Priority Race: The Winner Takes the Horse

by

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Introduction

Financial problems in recent years within the equine industry have highlighted the inevitable conflict between the numerous participants claiming interests in horses. Secured lenders, buyers, bankruptcy trustees, agisters, owners of stallion breedings, veterinarians, insurers, trucking companies, sales companies, agents, judgment lienholders, and others often must compete with each other to effectively enforce a legitimate debt.

The possible combinations in which these competing claims can and do arise are certainly complex. Moreover, the problem is exacerbated by the incredible paucity of accepted case law relating to (a) many of the claims presented against horses and (b) how their respective priority ranks. Also, Article 9 of the Uniform Commercial Code (U.C.C.),[1] while otherwise an exceptionally well-conceived and drafted legislative scheme, does not effectively account for many subtleties in the horse industry.

Article 9 does not categorically address the problems caused by the common use of certificates regarding horses. Horses cannot be registered without a mating certificate, which must be provided by the owner of the stallion. A horse must be registered to race

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[1] Unless noted otherwise, any reference to the Uniform Commercial Code will be to the 1972 version of the text and its accompanying official commentary. The 1972 version has not been universally adopted and some states still retain the 1962 version. The Kentucky codification generally adopting the 1972 version (effective July 1, 1987) will form a discussion framework at many points in this Article. Irrespective of the particular version adopted by a state, there are myriad local statutory variations that the prudent reader will investigate. As will be discussed more fully, *infra* notes 188-208 and accompanying text, some federal statutes such as the Bankruptcy Code and the Food Security Act of 1985 will have a preemptive effect upon state law.

or for its foals to race. Upon registration, a registration certificate is issued. With many breeds other certificates may also be issued.

Article 9 also does not effectively address the difficulty of characterizing horses as collateral. The characterization problems stem largely from the different uses to which a horse is put during its lifetime, the differing occupations of its owner, and its need to be transported from state to state. A yearling on the farm may be characterized differently from a horse of racing age being shipped from state to state for racing meets. The same stallion may be characterized differently depending upon the occupation of the owner and the nature of the ownership interests, whether individually owned or through shares of a syndication agreement. All too often, nuances of the Bankruptcy Code[2] further complicate the problem.

The Article 9 problems are not unprecedented and to some degree have been addressed by prudent equine lenders and courts in the past, although unanswered questions still abound.[3] What the down cycle of the market has introduced, however, is expanded classes of creditors looking to equine collateral as the sole means to their financial recovery. Their interests may exist under Article 9, be created by other statutes, common law, equitable principles or may be an animal of contract. The focus of this Article is to address both the recent developments in the field of equine liens and to try to reconcile the conflicting priorities raised by the various types of interests. Particularly in a down market, this priority game often goes from being a theoretical discussion to "winner take all."

I. SPECIAL CONCEPTS AFFECTING EQUINE SECURITY INTERESTS

There are certain concepts that must be explored before effectively analyzing the participants in the priority race, the basis of their claims, and the priority scheme. These concepts arise out of special laws of limited applicability or the vagaries of horse industry practice and trade custom. These concepts are in many ways both counter-intuitive and foreign to the normal analysis of competing liens.

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[2] Bankruptcy Reform Act of 1978, 11 U.S.C. §§ 101-1330 (1988).

[3] Many of these problems were addressed in Lester, *Secured Interests in Thoroughbred and Standard Horses: A Transactional Approach*, 70 KY. L.J. 1065 (1981-82). Where the law has not significantly changed, this Article will summarize the previous article rather than restating the law in depth.

A. *The Food Security Act of 1985*

The Food Security Act of 1985 (F.S.A.)[4] enacted a provision protecting the rights of purchasers of farm products subject to security interests and liens. This section ("Farm Products Section") is codified at 7 U.S.C. section 1631 (1988) and became effective on December 23, 1986.[5] To understand the genesis of this provision, one must first understand the inconsistent state codifications of U.C.C. section 9-307 and the varying degrees of protection it afforded the purchasers of farm products.[6]

Under the 1972 Official Draft of U.C.C. section 9-307:

> (1) 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.[7]

Thus purchasers of a horse or other farm product could not avail themselves of the normal protection available to buyers in the ordinary course of business. This version of section 9-307 was originally adopted in forty-nine states.[8] As of the enactment of the F.S.A.,[9] twenty states[10] had opted out of this farm products exception in whole or in part. The Kentucky codification follows this trend.

Kentucky makes exceptions for tobacco sold through a licensed warehouse,[11] livestock sold at public auction through a licensed stockyard,[12] and horses whose racing is regulated by Kentucky Revised Statutes Chapter 230 (K.R.S.).[13] In each instance, the bona fide purchaser for value takes free of any lien.[14]

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[4] 7 U.S.C. § 1631 (1988) [hereinafter F.S.A.].

[5] *Id.* at subsection (j).

[6] For purposes of this discussion it will be assumed that a horse constitutes a farm product. *See* discussion of characterization *infra* notes 87-128 and accompanying text. Horses are expressly within the definition of farm products contained in the F.S.A. 7 U.S.C. § 1631(c)(5).

[7] UNIFORM COMMERCIAL CODE § 9-307(1) (1972) [emphasis added] [hereinafter U.C.C.].

[8] H.R. REP. No. 271, 99th Cong., 1st Sess., pt. 1, at 108, reprinted in 1985 U.S. CODE CONG. & ADMIN. NEWS 1103, 1212.

[9] 7 U.S.C. § 1631.

[10] *See supra* note 8, at 1213.

[11] KY. REV. STAT. ANN. § 355.9-307(2) (Baldwin 1989) [hereinafter K.R.S.].

[12] *Id.* at § 355.9-307(4).

[13] *Id.* at § 355.9-307(6). K.R.S. ch. 230 regulates racing of thoroughbreds, standardbreds, quarter horses, appaloosas, and Arabian horses.

[14] K.R.S. § 355.9-307(1).

Additionally, the warehouse stockyard or auctioneer is also not liable to the holder of a lien unless he or she had been given written notice of the lien by registered mail prior to the sale.[15] Without the protection afforded by statutory variations such as those enacted in Kentucky, the purchaser of a farm product could end up paying for the product twice—once to the seller and once to the creditor or lienholder.

The state responses to a perceived problem caused by U.C.C. section 9-307 in turn caused additional problems. First, the "exceptions to the exception" enacted by states such as Kentucky were not all encompassing. A review of Kentucky's provision reveals no change in the treatment of a purchaser of a farm commodity other than tobacco or the purchaser of livestock from other than a licensed stockyard or the purchaser of a horse not subject to the racing regulations of K.R.S. Chapter 230.[16] Further, the variations of other states follow no set pattern. By way of example, Georgia protects a commission merchant selling agricultural products[17] but not the ultimate purchaser.[18] Utah grants blanket protection to the purchaser of farm products in the ordinary course of business unless the creditor or other lienholder complies with special rules promulgated by the Division of Corporations and Commercial Code.[19]

The purpose behind the original version of U.C.C. section 9-307 was to grant the creditors of farmers greater protection. By 1985, the financial crisis in American farming had resulted in a shift in priorities and a general attitude that the risk of credit supervision should reside with the lenders instead of innocent buyers of farm products.[20] In many instances, these buyers have little or no way to verify the existence of a lien.[21]

The fact that twenty states opted out of this onerous provision merely exacerbated the problem, as the Code was no longer uniform.[22] Congress viewed this in and of itself as a burden on

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[15] *Id.* at (4).

[16] *Id.*

[17] GA. CODE ANN. § 11-9-307(3) (1982).

[18] *Id.* at (1).

[19] UTAH CODE ANN. § 70A.-9-307(4) (Cum. Supp. 1984).

[20] *See supra* note 8.

[21] While this discussion centers on the effects of the statutory provisions on equine liens, farm products include fungible commodities often sold subject to twenty-four hour payment rules. Trade in these goods is not conducive to leisurely searches of various county U.C.C.-1 files.

[22] *See supra* note 8.

interstate commerce.[23] The central provision of the F.S.A. dealing with farm products essentially negates the exception language of U.C.C. section 9-307:

> Except as provided in subsection (e) of this section and notwithstanding any other provision of Federal, State, or local law, a buyer who in the ordinary course of business buys a farm product from a seller engaged in farming operations shall take free of a security interest created by the seller, even though the security interest is perfected; and the buyer knows of the existence of such interest.[24]

The F.S.A. does provide protection to a vigilant creditor under the provisions of subsection (e).[25] Buyers will continue to take farm products subject to existing liens only if creditors provide them with written notice of the security interest and certain other matters and the buyers have failed to perform their payment obligations or if the farm product is sold in a state that has established an approved centralized filing system.[26] Unfortu-

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[23] *Id.*

[24] 7 U.S.C. § 1631(d).

[25] *Id.* at (e).

[26] 7 U.S.C.A. § 1631(e) states:

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

(1)(A) within 1 year before the sale of the farm products, the buyer has received from the secured party or the seller written notice of the security interest organized according to farm products that —

(i) is an original or reproduced copy thereof;

(ii) contains,

(I) the name and address of the secured party;

(II) the name and address of the person indebted to the secured party;

(III) the social security number of the debtor or, in the case of a debtor doing business other than as an individual, the Internal Revenue Service taxpayer identification number of such debtor;

(IV) a description of the farm products subject to the security interest created by the debtor, including the amount of such products where applicable, crop year, county or parish, and a reasonable description of the property; and

(iii) must be amended in writing, within 3 months, similarly signed and transmitted, to reflect material changes;

(iv) will lapse on either the expiration period of the statement or the transmission of a notice signed by the secured party that the statement has lapsed. whichever occurs first; and

(v) any payment obligations imposed on the buyer by the secured party as conditions for waiver or release of the security interest; and

(B) the buyer has failed to perform the payment obligations, or

nately for creditors situated in states, like Kentucky, that do not have centralized filing systems, it is not always possible to discover the identity of the purchaser or even the existence of a sale until it is too late.

The policy and effect of the Farm Products Section of the F.S.A. is illustrated by *United States v. Progressive Farmers Marketing Agency*.[27] In that case, the creditor of several hog farmers brought an action for conversion against a marketing agency that had sold some of the farmer's hogs.[28] The farmers had executed a series of promissory notes with the Farmers Home Administration (F.H.A.) and had granted a security interest in their farm products.[29] The F.H.A. had in turn properly filed financing statements with the Recorder of Deeds in the proper county and with the Iowa secretary of state.[30] The farmers then sold their hogs through the marketing agency, which had no actual notice of the security agreement.[31] The agency remitted the purchase price, minus commission, to the farmers.[32] The F.H.A. then brought suit seeking an accounting of the value of the hogs.[33]

The district court, relying on Iowa's version of U.C.C. section 9-307, held that the sale did not extinguish the F.H.A.'s security interest.[34] The agency had argued that once it gained possession

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

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

(B) the secured party has filed an effective financing statement or notice that covers the farm products being sold; or

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

(A) receives from the Secretary of State of such State written notice as provided in subparagraph (c)(2)(E) or (c)(2)(F) that specifies both the seller and the farm product being sold by such seller as being subject to an effective financing statement or notice; and

(B) does not secure a waiver or release of the security interest specified in such effective financing statement or notice from the secured party by performing any payment obligation or otherwise. . . .

As Kentucky does not have a centralized filing system for farm product liens, 7 U.S.C. § 1631(e)(2) does not apply.

[27] 788 F.2d 1327 (8th Cir. 1986).

[28] *Id.* at 1328.

[29] *Id.*

[30] *Id.*

[31] *Id.*

[32] *Id.*

[33] *Id.*

[34] *Id.* at 1328-29.

of the hogs, they ceased to be farm products and became inventory not subject to the U.C.C. section 9-307 exception.[35] The district court rejected this argument as it would allow farmers to avoid liens merely by using agents to sell their farm products instead of selling directly.[36]

The court of appeals reversed the district court, holding that the lien was indeed extinguished by a sale through a commission merchant.[37] The appellate court relied upon a recent amendment to Iowa's version of U.C.C. section 9-307, conceptually similar to Kentucky's, that excepted out of the farm products exception buyers without actual written notice of the existence of a security interest.[38] Their amendment was not effective at the time of the alleged acts; however, the court used its contemporaneous enactment as evidence of public policy.[39] The court also noted that the enactment of the Food Security Act likewise was evidence of a public policy—contrary to the plain language of the existing statute.[40]

The logic of the court in *Progressive Farmers* does not withstand detailed scrutiny. It ignores both the plain language of U.C.C. section 9-307 and assumes that the Iowa legislature and Congress merely reaffirmed the existing state of the law instead of correcting a perceived problem. The case does highlight the general dissatisfaction with the effect of U.C.C. section 9-307's "farm products" exception and the inequities that it could create. The enactment of the F.S.A. injects a degree of certainty into the

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[35] *See id.* at 1329.

[36] *Id.*

[37] *Id.* at 1331.

[38] *Id.* at 1330. IOWA CODE ANN. § 554.9307(4)(a) (West 1985), in effect at the time the court rendered its decision, read:

> (4)(a) A buyer in the ordinary course of business buying farm products from a person engaged in farming operations takes free of a security interest created by that person's seller even though the security interest is perfected, unless the buyer receives prior written notice of the security interest, or unless the buyer purchases the farm products outside of the seller's trade area, or the buyer's principal place of business is located outside of the seller's trade area. The "seller's trade area" consists of the county in which the seller resides or a county that is contiguous to or corners upon the county where the seller resides.

[39] Progressive Farmers, 788 F.2d at 1330.

[40] *Id.* at 1331. The court noted that the state and federal provisions were both enacted after the sale at issue and neither contained a provision applying it retroactively. *Id.* at 1330-31. The court also noted a statutory presumption in favor of prospective application of statutes. *Id.* at 1330 n.3 (*citing* IOWA CODE ANN. § 4.5 (1985)). However, the court went on to hold that the amendment to U.C.C. § 9-307 was merely related to the procedure by which substantive law is enforced.

field by putting the creditor on notice both of the risks in relying upon farm products as collateral and the necessity to act aggressively to ensure the continued validity of its lien. A creditor so forewarned is in a stronger position than was the F.H.A., which erroneously relied upon the plain language of a statute.

A trap for the unwary arises from the broad nature of the F.S.A.'s provisions. As noted, many states such as Kentucky had provided some relief from the provisions of U.C.C. section 9-307 in the form of statutory revisions. Unlike many of these, the provisions of the F.S.A. are not limited to specific situations such as a licensed stockyard. The Act addresses any situation where the buyer in the ordinary course of business purchases farm products from a seller engaged in farming operations.[41]

B. *U.C.C. Section 9-310*

U.C.C. section 9-310 provides substantial guidance in analyzing the priority between perfected security interests and certain other liens. This provision states:

> 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.[42]

The official commentary to the U.C.C. states that this reflects a policy that liens "arising from work intended to enhance or preserve the value of the collateral take priority over an earlier security interest even though perfected."[43] While this provision may inject a degree of uncertainty as to the future relative priority of a lien, on the whole, it promotes an equitable result.

The entity providing the services has an incentive to either preserve or enhance the collateral, while the prior lienholders generally benefit from having the collateral's value enhanced. Additionally, the priority gained only remains as long as possession is maintained,[44] although possession may not be necessary

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[41] 7 U.S.C. § 1631(d).

[42] U.C.C. § 9-310.

[43] *Id.* at comment 1.

[44] *Id.* at comment 2. That a tradesman-type lien is subordinate to a perfected security interest lien when possession is relinquished is implicit in U.C.C. § 9-310. *See* Blazer Mach. Co. v. Klineline Sand & Gravel Co., 533 P.2d 321, 324 (Or. 1975). *See generally*, A. ANDERSON, UNIFORM COMMERCIAL CODE § 9-310:9 (3d ed. 1985).

for the creation, perfection, or validity (as opposed to priority) of the particular statutory or common law lien. Finally, the provision does not enhance the lien's priority if the statute expressly provides otherwise.[45]

For purposes of this discussion, the types of liens affected by this priority enhancing provision are primarily those created in favor of agisters, veterinarians, trucking companies, and other entities that would take actual possession of a horse. Analysis under both the new and pre-1984 version of K.R.S. section 376.400 shows the application of U.C.C. section 9-310. Under the old version of K.R.S. section 376.400, the statute expressly limited the lien in the manner of a landlord's lien for rent. Under K.R.S. section 383.070, a landlord's lien on property of the tenant on the leased premises is superior to any lien "created while the property is on the leased premises, whether the rent accrued before or after the creation of the other liens" to the extent of four months rent.[46]

Applying this statutory restriction to an old version agister's lien created the following results. A lien perfected before the agister ever came into possession of the horse at issue remained superior to the agister's lien.[47] The priority bump of U.C.C. section 9-310 did not kick in because the statute "expressly provide[d] otherwise."[48] Once the agister gained possession, however, any lien credited for unpaid services was bumped up in priority above liens created after possession was gained even if that lien had been perfected prior to the time that the agister provided the services for which he was not paid.[49] The increased priority was only to the extent of four months services.[50]

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[45] U.C.C. § 9-310.

[46] K.R.S. § 383.070(3).

[47] Lee v. VanMeter, 32 S.W. 137, 138 (Ky. 1895).

[48] U.C.C. § 9-310. The priority of the pre-1984 agister lien was addressed in *Vanmeter*, a pre-U.C.C. case. The court held the lien subordinate to an interest perfected prior to the agister taking possession of the livestock at issue. *Id.* at 138. The same result was reached in Washington County Bank v. Red Socks Stables, Inc., 376 N.W.2d 782 (Neb. 1985), a case applying U.C.C. § 9-310. Under the Nebraska agister statute at the time, agister's liens were superior to prior liens "as long as the holder of any prior liens shall have agreed in writing to the contract for the feed and care of the livestock involved . . ." *Id.* at 784 (*citing* NEB. REV. STAT. § 54-201 (Reissue 1984)). Since the bank had not consented to the contract, the bump up provision of U.C.C. § 9-310 did not apply. *Id.* at 784-85. In both scenarios, under the present version of K.R.S. § 376.400 and U.C.C. § 9-310 taken together, the agister would have prevailed.

[49] K.R.S. § 383.070(3) (1979).

[50] *Id.*

Finally, the agister had to be vigilant with respect to possession. While the old agister lien statute provided a mechanism for enforcement,[51] after the horse had left the premises, the priority bump of U.C.C. section 9-310 was lost as the possession requirement was no longer met. The lien itself continued for ten days.[52]

Under the present version of K.R.S. section 376.400, there is no tie in to landlord liens.[53] Thus, while in possession, an agister has a lien superior to security interest liens perfected before the agister came into possession of the horse. This lien will remain in effect for up to one year after possession is relinquished.[54] Of course, the priority bump of U.C.C. section 9-310 is lost when possession is relinquished.

An interesting theoretical problem arises in this area with respect to common law and equitable liens. In many instances, statutory liens reflect a codification of existing common law concepts. U.C.C. section 9-310 affects the priority of these liens as well. Being non-statutory, the common law liens are therefore not subject to any statutory limitations. Neither is the old version of Kentucky's agister lien statute or Nebraska's present agister lien statute which was discussed earlier.[55] In the event that lienholders wish to avail themselves of the priority enhancing features of U.C.C. section 9-310 but the applicable statutory lien has limiting language, thought should be given to characterizing the lien in terms of its common law or equity origins.[56] While the counter to this characterization is that the applicable statute preempted the field, this would at least arguably keep U.C.C. section 9-310 in play.

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[51] K.R.S. § 376.410 (1981). The agister's lien shall continue and be enforceable for up to ten days after possession is relinquished. The current version of the statute allows enforcement up to one year after removal.

[52] *Id.*

[53] K.R.S. § 376.400.

[54] *Id.*

[55] *See supra* notes 45-54 and accompanying text.

[56] As an example, a lien is expressly created by K.R.S. § 376.420 for the service fee of a stallion. This type of lien was recognized at common law as well. Sawyer v. Gerrish, 70 Me. 254, 255 (1879); Grinnell v. Cook, 3 Hill 485, 492 (N.Y. Sup. Ct. 1842). In the case of this particular statute, there is no express impediment to the application of U.C.C. § 9-310. If the statute did contain express limitations, however, at least arguably the common law lien could be invoked. An equitable lien that is judicially imposed is a limited form of the constructive trust, giving a party a security interest in property to prevent unjust enrichment. *See* D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES 248-250 (1973). As it is a creature of equity, the existence of a statutory remedy militates against its application in the situation described, but its assertion should at a minimum increase the level of discomfort felt by the prior lienholder confronting the harsh realities of U.C.C. § 9-310.

C. *Waiver of Interest*

The practices and customs of the horse industry, coupled with certain provisions of the U.C.C., make waiver of rights a real possibility for unsophisticated or imprudent creditors.[57] One such waiver provision, already discussed, is contained in U.C.C. section 9-307(1) dealing with buyers in the ordinary course of business. Another trap for the unwary is contained in U.C.C. section 9-306(2), which states:

> Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof *unless the disposition was authorized by the secured party in the Security Agreement or otherwise*, and also continues in any identifiable proceeds including collections received by the debtor.[58]

The "or otherwise" language raises the spectre that merely allowing participation in an event such as a claiming race or horse sale constitutes a waiver of the security interest.

In *Cessna Finance Corp. v. Skyways Enterprises, Inc.*,[59] the Kentucky Court of Appeals invoked U.C.C. section 9-306(2) to vitiate a security agreement's requirement of the express consent of the secured party prior to disposition of the collateral—in that case an airplane.[60] The debtor had been permitted to sell aircraft as a dealer and to collect the full purchase price.[61] When the dealer collected the purchase price, he did not in that instance remit to Cessna the amount of the mortgage.[62] Cessna then attempted to assert its lien against the new owner.[63] Using U.C.C. section 9-306(2), the court held that the security interest of Cessna had been extinguished.[64]

In affirming this result,[65] the Kentucky Supreme Court chose to rely upon the buyer in the ordinary course of business provisions of U.C.C. section 9-307(1).[66] While this may be the sounder

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[57] For an in-depth discussion of the waiver issue, see Smith, *Implied and Conditional Consent in the Sale of Horse Shares or Seasons*, 74 KY. L.J. 839 (1985-86).

[58] U.C.C. § 9-306(2) (emphasis added).

[59] 23 U.C.C. Rep. Serv. 1015 (Ky. App. 1978).

[60] *Id.* at 1018-19.

[61] *Id.* at 1018.

[62] *Id.* at 1016.

[63] *Id.*

[64] *Id.* at 1018.

[65] Cessna Fin. Corp. v. Skyway Enter., Inc., 580 S.W.2d 491 (Ky. 1979).

[66] *Id.* at 494-95.

basis for the result, *Cessna Finance* and U.C.C. section 9-306(2) nonetheless create serious implications for a secured party by allowing the debtor to conduct sales of horses on a regular basis, particularly where neither section 9-307 nor the Food Security Act can be made to apply.

Indeed, the rationale of the court of appeals in *Cessna Finance* was followed in a case involving equine liens. *Trimble v. North Ridge Farms*[67] dealt with a nomination right in the stallion Affirmed. The debtor had purchased a fractional share in the Affirmed syndication, paying a portion in cash, and executing a promissory note for the balance.[68] The seller took a security interest in the share that was properly perfected.[69] The syndication agreement contained a provision whereby breeding rights could be sold.[70] The debtor sold her 1982 nomination to North Ridge Farms.[71] Subsequently, the debtor defaulted on the promissory note, causing the seller to repossess her share.[72] The share was then resold.[73] Both the new owners of the share and North Ridge Farm claimed the 1982 breeding right.[74]

While the circuit court held for the new share owners, the Kentucky Court of Appeals held for North Ridge, a decision affirmed by the supreme court.[75] The crux of the supreme court decision was that an authorized sale extinguished the security interest under U.C.C. section 9-306(2).[76] The clear impact of both *North Ridge* and *Cessna I* is that a secured creditor must be vigilant in protecting its rights to the extent that its actions do not constitute a waiver.

D. *Claiming Races*

If the horse that is the subject of a security interest is of racing age, the claiming race presents a novel problem not to be overlooked by the lienholder. Essentially, a claiming race is a device to equalize competition and provide opportunities for horses

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[67] 700 S.W.2d 396 (Ky. 1985).
[68] *Id.* at 397.
[69] *Id.*
[70] *Id.*
[71] *Id.*
[72] *Id.*
[73] *Id.*
[74] *Id.*
[75] *Id.* at 397-98.
[76] *Id.* at 397.

of lesser quality. The conditions for a particular claiming race, drawn up by the racing secretary at each track, will specify a particular price or prices for horses in the race.[77] Entering a horse in that race constitutes an irrevocable offer to sell the horse at that price.[78] Normally, this offer can be accepted only by licensed owners in good standing at that race meet or by the holder of a certificate of eligibility to claim.[79] A claim of the horse may be made at any time up to fifteen minutes prior to the post time of the race.[80] If there is more than one claim of the same horse, the stewards determine by lot the new owner of the horse.[81]

The premise behind the claiming race is that it ensures horses of equal value will compete against each other. For example, the owner of a fifty thousand dollar horse would not enter it in a ten thousand dollar claiming race for it would almost certainly be claimed. Even though the purse is distributed to the original owner, this would still be an economically poor decision. Likewise, the owner of a fifteen hundred dollar horse would not enter it in a twenty-five thousand dollar claiming race as there is little likelihood of the horse either being claimed for that price or of winning against better quality horses. The premise has for the most part proved correct, and a substantial number of American thoroughbred and harness races are claiming races.

For the lienholder, allowing the debtor to enter a horse in a claiming race raises the spectre of a waiver of the lienholder's position.[82] As an initial proposition, the owner/debtor must hold either the Jockey Club or the United States Trotting Association eligibility certificate in order to enter the horse in a race.[83] U.C.C.

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[77] *See, e.g.*, Daily Racing Form, July 3, 1989, at 13. The first race at Arlington Park on that date was a $10,000 claiming race; however, for each $500 decrease in claiming price, a horse would be allowed to race at two pounds under the set weight of 122 pounds. If the owner were willing to enter the horse at a $9,000 claiming price, the horse would race at 118 pounds.

[78] 810 Ky. Admin. Regs. 1:015 §§ 1, 11 (1989) [hereinafter K.A.R.]. The regulations in 810 K.A.R. ch. 1 cover thoroughbred racing. Similar regulations for harness racing are contained in 811 K.A.R. Chapter 1; for quarter horse, appaloosa, and Arabian racing, 811 K.A.R. ch. 2. As the provisions are similar, reference will be made to the thoroughbred regulations for simplicity.

[79] 810 K.A.R. 1:015 § 1.

[80] *Id.* at § 8.

[81] *Id.* at § 10.

[82] A more complete discussion on waiver is contained in the text *supra* accompanying notes 57-76.

[83] *See, e.g.*, 810 K.A.R. 1:012 § 1 (requiring horse to be registered with the Jockey Club).

section 9-306(2) allows the sale of collateral free of a security interest if the sale is authorized by the secured party in the security agreement or otherwise.[84] The mere fact that the creditor allowed the debtor to retain the registration certificate and to enter the collateral in a claiming race may constitute authorization to sell the collateral free of the security interest.

In addition, the racing regulations may expressly provide for this situation with respect to liens. The Kentucky thoroughbred racing regulations state:

> Any person holding a lien of any kind against a horse entered in a claiming race must record the same with the racing secretary and/or horseman's bookkeeper at least thirty (30) minutes before post time for that race. If none is so recorded, it shall be assumed that none exists.[85]

At first glance, this regulation may seem draconian from the perspective of the creditor as it effectively creates another filing requirement for an already perfected security interest. The regulation, however, provides a degree of clarity. Also, a lender taking a security interest in a horse of racing age should possess a degree of sophistication with respect to racing practices.

E. *Characterization of Property Interests*

Any analysis of the relative priority of conflicting liens in horses will at some point turn upon the category of collateral to which the horse belongs. This category will determine, among other things, the proper state and office in which financing statements should be filed, the proper method to perfect a security interest, the proper choice of law, and, in extreme instances, whether the U.C.C. is even applicable.

Unfortunately, characterization is a complex issue not capable of easy resolution.[86] The problem is exacerbated by the fact that

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[84] U.C.C. § 9-306(2).

[85] 810 K.A.R. 1:015 § 15.

[86] Currently before the Kentucky legislature during the 1990 session is Senate Bill 300 which would amend certain provisions of the U.C.C. Specifically K.R.S. 355.9-109 would be amended to make it clear that equine interests are farm products irrespective of whether the debtor is engaged in farming. K.R.S. 355.9-401 would likewise be amendment to make it clear that the proper place for the filing of a security interest in equine is the county of the debtor's residence if within Kentucky and in the office of the Secretary of State if the debtor is a nonresident of Kentucky. These amendments, if adopted, will greatly simplify the characterization problem.

the same horse will be characterized differently—depending upon its use and the business or occupation of the owner. Finally, concepts such as stallion syndication shares, registration certificates, mating certificates, and pooling of shares cause further confusion.

The characterization analysis of an equine controversy typically begins with an attempt to divide horses into one of four categories of goods under U.C.C. section 9-109. This is premature because an initial determination needs to be made as to whether the particular property interest constitutes goods at all. If the horse itself is the property interest, the characterization as goods is clearly appropriate.[87] The more difficult question arises when the interest is a breeding season, stallion share, or right to proceeds from a pooling agreement. These conceivably could be characterized as an account[88] or general intangibles.[89] Registration papers may be treated as documents or arguably instruments.[90]

In *Kwik-Lok Corp. v. Pulse,*[91] the court considered whether the sale of breeding rights was the sale of goods governed by Article 2 of the U.C.C.[92] The parties in that action had jointly owned two thoroughbred stallions.[93] In transferring full ownership of the stallions to Kwik-Lok, Pulse was granted two free breedings a year in each stallion.[94] The breeding rights were not retained as part of the bills of sale but were granted contemporaneously by letter.[95] Thereafter, Kwik-Loc sold the stallions and informed Pulse that his breeding rights were terminated.[96] Kwik-Loc then brought an action seeking to determine the enforceability of the letter.[97] The lower court held for Pulse,[98] a decision affirmed in part and reversed in part by the court of appeals.[99] On appeal, Kwik-Loc argued that the sale of breeding rights was a sale of

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[87] *See* Keck v. Wacker, 413 F. Supp. 1377, 1382 (E.D. Ky. 1976) (holding Article 2 of the U.C.C. to apply to the sale of a horse).

[88] *See* U.C.C. § 9-106.

[89] *See id.*

[90] *See id.* at (j).

[91] 702 P.2d 1226 (Wash. App. 1985).

[92] *Id.* at 1228.

[93] *Id.* at 1227.

[94] *Id.*

[95] *Id.*

[96] *Id.* at 1228.

[97] *Id.*

[98] *Id.*

[99] *Id.* at 1231, 1232.

goods subject to Article 2 of the U.C.C.[100] The court held this not to be a sale of goods, and thus not subject to Article 2's gap filling provisions.[101]

Kwik-Loc turned on the fact that sperm inside a stallion was not readily separable, and hence was not movable.[102] The court noted that, had artificial insemination been employed, a different result might have been reached.[103] The case did not consider arguments that the utility of the stallion is completely tied to the value of its breeding rights and that the grant of the breeding rights constituted an interest in the stallion.

Once the determination is made of whether the interest constitutes goods, U.C.C. section 9-109 divides the concept of goods into four subcategories: consumer goods,[104] equipment,[105] farm products,[106] and inventory.[107] The commentary to the U.C.C. views these four subcategories as mutually exclusive with the determination of the proper subcategory hinged primarily upon the use of collateral.[108] The commentary also expressly recognizes that the same goods may be characterized differently in the hands of a different owner.[109]

The definition of farm products[110] sets up a myriad of possible results as the horse progresses from a foal on the farm to a horse of racing age to a mare or stallion back on the farm. The owner may be actively engaged in farming operations, an investor with no other connection to farming, an owner engaged in the business of racing, etc. Racing itself could be construed as an adjunct to farming under some scenarios. The characterization problem may in fact become more a process of elimination and in any event must be acutely attuned to the vagaries of a particular jurisdiction.

The case law is instructive if only in the sense that it highlights the difficulty of the characterization problem. As an initial mat-

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[100] *Id.* at 1228. Kwik-Loc's application of the U.C.C. was intended to shorten the contract length to less than the breeding life of the stallions. How application of the U.C.C. would achieve this is less than clear.

[101] *Id.*

[102] *Id.*

[103] *Id.* at n.1.

[104] U.C.C. § 9-109(1).

[105] *Id.* at (2).

[106] *Id.* at (3).

[107] *Id.* at (4).

[108] *Id.* at comment 2.

[109] *Id.*

[110] *Id.* at (3).

ter, one can probably eliminate the category of consumer goods. The types of horses for which conflicting security interests become a problem are normally not intended "primarily for personal, family or household purposes."[111]

In re Bob Schwermer & Associates, Inc.[112] illustrates the proper approach to characterization. In that case, the debtor had granted a security interest in six thoroughbred horses to a bank in exchange for a commitment to refrain from collecting a pre-existing debt.[113] Critical to whether the bank had properly perfected its interest was a determination of whether the horses were "farm products" or "equipment"—categories subject to different filing requirements.[114] The debtor had purchased the horses for the business of racing and further was not engaged in farming or breeding of horses.[115] The court concluded that the horses constituted equipment and that the bank had properly perfected its interest by filing a financing statement with the Illinois Secretary of State.[116]

The problem presented to the court by *In re Bob Schwermer* is straightforward and the conclusion clearly correct. Yet it takes no great imagination to see that the issue will rarely be so clear-cut. What if the debtor had been engaged in farming and breeding? What if the horses were not yet of racing age and still being kept on the farm? What if the horses had been purchased not for racing but for resale? The court was not required to answer any of these questions, but the prudent lender may well be required to do so.

A quarter horse stallion has been held not to be a farm product or equipment used in farming.[117] The debtor in the *In re Butcher* case, a banker and businessman,[118] executed a security agreement granting a purchase money security interest in Sonny Dee Bar, a quarter horse stallion, to Landers, who filed a financing statement with the Texas Secretary of State.[119] The horse was used exclusively for breeding purposes after the sale,[120] al-

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[111] *Id.* at (1).
[112] 27 Bankr. 304 (Bankr. N.D. Ill. 1983).
[113] *Id.* at 306.
[114] *Id.* at 308.
[115] *Id.*
[116] *Id.*
[117] *In re* Butcher, 39 U.C.C. Rep. Serv. 345 (Bankr. E.D. Tenn. 1984).
[118] *Id.* at 349.
[119] *Id.* at 347.
[120] *Id.* at 349.

though the original intent of the seller was to form an investment syndication.[121] The debtor was later the subject of an involuntary bankruptcy petition.[122] The trustee asserted the horse, as a farm product, was subject to local filing and thus the trustee's interest was superior to the unperfected interest of Landers.[123]

In analyzing whether the stallion constituted either a farm product or equipment used in farming, the court used a definition of farming operations somewhat narrower than the common usage of either term.[124] Thus, the mere fact that equipment is useable on a farm, or in fact is actually, physically employed on a farm, was not viewed as being determinative.[125]

With respect to the debtor, according to the court, the mere fact that he undertook an activity ancillary to farming did not make him a person engaged in farming operations.[126] Thus, according to the court, the stallion was neither a farm product nor equipment used in farming operations.[127] Landers' interest was deemed properly perfected.[128]

This is a troublesome case because breeding operations would clearly seem to constitute farming operations. The court seems to have been heavily influenced by the primary occupation of the debtor. Would it not have been better to view the debtor as being employed in more than one occupation? Nothing in the U.C.C. indicates "primary" occupation is dispositive.

F. *Registration Certificates*

Various private associations control the registration of horses in the United States, with each association normally concerned with a specific breed of horse. Particularly germane to this discussion are the Jockey Club, the United States Trotting Association (U.S.T.A.), the American Quarter Horse Association (A.Q.H.A.), and the Arabian Horse Registry of America. These associations regulate the registration of thoroughbreds, standardbreds, quarter horses, and Arabians, respectively.[129] Each

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[121] *Id.* at 347.

[122] *Id.*

[123] *Id.* at 349.

[124] *See id.* at 351-52.

[125] *Id.* at 352.

[126] *Id.*

[127] *Id.* at 354.

[128] *Id.* at 355.

[129] *See, e.g.*, Mattheis v. Jockey Club, 387 F. Supp. 1126 (E.D. Ky. 1975); Adams v. American Quarter Horse Ass'n, 583 S.W.2d 828, 831 (Tex. Civ. App. 1979).

association has its own standards and rules.[130] Courts have routinely recognized the right of these private associations to regulate the industry and their members, subject only to limited judicial review.[131] An analysis of the activities of these associations is beyond the scope of this Article. However, the registration certificate that an association may provide for a particular horse is a critical component in any security interest analysis. For this discussion, the certificates of the Jockey Club and the U.S.T.A. will be examined.

These certificates serve one or more primary purposes. First, they may serve as an indicia of title. Second, the certificate serves as the authenticating document for a horse to race or to be used for breeding purposes. For thoroughbreds in Kentucky, the administrative regulations state that:

> Registration Required. No horse may be entered or raced in this state unless duly registered and named in the registry office of the Jockey Club in New York and unless the registration certificate or racing permit issued by the Jockey Club for such horse is on file with the racing secretary; except, however, the stewards may for good cause, in their discretion, waive this requirement if the horse is otherwise correctly identified to the stewards' satisfactions. Jockey Club registration certificate of each horse must be filed with the horse identifier within forty-eight (48) hours after the horse's arrival on the grounds.[132]

Similar regulations govern standardbred racing.[133]

The importance of the certificate highlights some inherent problems, particularly with respect to a horse of racing age. The most prudent policy for a creditor to follow would be to retain possession of the certificate. However, racing regulations clearly prevent this, with respect to thoroughbred horses engaged in racing,[134] raising the possibility of a waiver by a secured party. As previously discussed, the possession of the certificate may assist the owner in transferring a horse, particularly in the instance of a claiming race, with or without the lienholder's consent.[135]

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[130] *See Mattheis*, 387 F. Supp. at 1126; *Adams*, 583 S.W.2d at 824.

[131] *See Mattheis*, 387 F. Supp. at 1127-28; *Adams*, 583 S.W.2d at 824.

[132] 810 K.A.R. 1:012 § 1.

[133] *See* 811 K.A.R. 1:030(1), (2).

[134] 810 K.A.R. 1:012 § 1. For standardbreds this problem may be alleviated to some degree by the use of an eligibility certificate, a document separate and distinct from the registration certificate. 811 K.A.R. 1:030.

[135] *See supra* note 83 and accompanying text.

One court has even gone so far as to treat the certificate itself as property separate and distinct from the horse. In *Lee v. Cox*,[136] a seller retained the registration certificates to eight Arabian horses as security for the balance of the purchase price.[137] No other action was taken by the seller to perfect his security interest.[138] The bankruptcy court determined that the seller had no security interest in the horses, a conclusion the appellant did not contest.[139] The district court, however, reversed the bankruptcy court's determination that the papers should be turned over to the debtor in possession to facilitate sale of the horses.[140] The court held that either under common law or under U.C.C. precepts the seller had perfected a security interest in the certificates themselves relying primarily upon a contracted right to retain them.[141]

This Solomon-like decision resulted in the seller retaining the certificates, which had no actual value, and the debtor having a right to sell the horses at the best price obtainable without the certificates.[142] While this case may reach an equitable result, it does not either have a meaningful conceptual basis nor does it take into account the real nature of the registration certificates. *Lee* has recently been both rejected[143] and cited favorably;[144] however, it would certainly be at least academically unfortunate if *Lee* were to find its own niche in the law of equine security interests.

The holding of *Lee* was criticized in *In re Blankenship-Cooper, Inc.*,[145] a case that reflects a sound and conceptually proper analysis of the issue. In that case, two separate security agreements with the debtor, both purporting to perfect liens in the American quarter horse stallion Shawnee Bug, had been executed.[146] The first granted a purchase money security interest in the horse to

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[136] 18 U.C.C. Rep. Serv. 807 (M.D. Tenn. 1976).

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

[138] *Id.* at 809.

[139] *Id.* at 808-09.

[140] *Id.* at 811.

[141] *Id.* at 810-11.

[142] *Id.* at 811.

[143] *In re* Blankenship-Cooper, Inc., 39 U.C.C. Rep. Serv. 1008, 1012 (Bankr. N.D. Tex. 1984).

[144] *In re* Wildlife Center, Inc., 102 Bankr. 321, 325-26 (Bankr. E.D. N.Y. 1989) (holding that deletion was not entitled to turnover of horse certificates in which other parties possibly had interest).

[145] 39 U.C.C. Rep. Serv. 1008, 1012 (Bankr. N.D. Tex 1984).

[146] *Id.* at 1010.

A.R. Levis, who had sold the horse to the debtor.[147] Six months later, the debtor executed a second security agreement with InterFirst Bank Dallas granting a security interest in the horse and all general intangibles.[148] Additionally, InterFirst was in possession of the horse's registration papers.[149] InterFirst contended that possession of the certificate and a security interest in general intangibles gave it a superior lien on Shawnee Bug's breeding rights.[150]

With respect to the registration certificate, the court disagreed.[151] The certificate could be replaced by the A.Q.H.A. upon a showing of superior title.[152] With respect to the second argument, that the breeding rights were a general intangible not covered by a security interest in the horse,[153] the court held that the breeding rights were not severed from the horse absent an express agreement, such as a syndication agreement, to do so.[154] Additionally, Levis' "interest 'in and to *all* of the debtor's interest and property rights' in SHAWNEE BUG" was sufficiently broad to include unsevered breeding rights.[155] The interest of Levis was held to be superior.[156]

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[147] *Id.*

[148] *Id.*

[149] *Id.*

[150] *Id.* at 1010-11.

[151] *Id.* at 1012-13. The court stated:

> The holding of the District Court in Lee would appear to give InterFirst a perfected security interest in the A.Q.H.A. certificate in its possession. However, upon closer analysis of the present facts, this conclusion is questionable on several grounds. Like the registration certificates issued in Lee, American Quarter Horse Association registration certificates clearly do not possess the qualities which would allow them to be fitted into one of the categories of § 9.305. . . . To characterize a registration certificate as an instrument would be a conceptual anomaly. See generally R. Lester, Security Interests in Thoroughbred and Standard Bred Horses: A Transaction Approach, 70 Ky. LJ 1065 (1981-82). Under Rule 25 of the Official Handbook of the American Quarter Horse Association (32d ed 1984). "Ownership of an issued registration certificate remains with the Association; . . .". Since the registration certificate does not possess attributes of negotiability (a requirement under the Code definition of instrument, see § 9.105(a)(9)); and can be owned only by the Association, it is not the complete embodiment of the underlying right and therefore not an instrument which can be perfected by possession under § 9.305.

(Footnotes omitted).

[152] *Id.* at 1013. *See, e.g.*, Principal Rules and Requirements of the American Stud Book, Rule 7(c); U.S.T.A. Rule 26 (1987).

[153] *See In re* Blankenship-Cooper, Inc., 39 U.C.C. Rep. Serv. 1008, 1014 (Bankr. N.D. Tex. 1984).

[154] *Id.* at 1016-17.

[155] *Id.* at 1017 (emphasis in original).

[156] *Id.*

In sum, registration certificates present a problem not capable of easy resolution. They are not absolute documents in the sense of a motor vehicle title. Mere possession of the certificate will not perfect a security interest. Further retention of the certificate will not be practical in the case of a horse actively engaged in racing because the certificate may be necessary in order for the horse to compete. Proper use of the certificate by a creditor can enhance its position if for no other reason than the leverage it may afford.

G. *Mating Certificates*

A mating certificate is required in order to register a foal with any of the various registration bodies.[157] It is provided by the stallion owner and constitutes the certificate of authenticity as to the foal's bloodlines. By contract, the stallion owner will often retain the mating certificate pending payment of the stallion fee. This raises the same types of questions with respect to property interests as retention of registration papers.[158] The foal has *de minimis* value without the mating certificate.

A recent bankruptcy court decision addressed the problem of dealing with retention of both mating certificates and registration certificates.[159] In *In re Wildlife Center, Inc.*, the debtor sued to compel other parties to turn over the documents in question.[160] Relying on *Lee*, the court treated both the mating certificate and the registration certificates at issue as property, separate and distinct from the horses to which the documents related.[161] As the documents were not in the possession of the debtor at the time of filing, under 11 U.S.C. section 541 they did not constitute property of the estate. The court refused to issue an order compelling them to be turned over.[162]

Both *Lee v. Cox* and *In re Wildlife Center* reach arguably equitable results, but they do so on analytically shaky grounds. The documents do not conceptually represent property, as they

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[157] *See* Principal Rules and Requirements of the American Stud Book, Rule 2; U.S.T.A. Rule 26.

[158] *See supra* notes 129-56 and accompanying text.

[159] *In re Wildlife Center*, 102 Bankr. at 322.

[160] *Id.* at 321-22. Surprisingly, the context of the case was a motion for default judgment that the debtor lost despite the fact that neither the stallion owner nor the auction company responded to the motion.

[161] *Id.* at 325.

[162] *Id.* at 327.

are merely indicia of the status of registration with a private association. In fact, the associations themselves may own the certificates.[163] The analysis should be whether this in fact is a transaction "intended to create a security interest . . ." under U.C.C. section 9-102(a) or whether it should be viewed as an executory contract, with a condition precedent to turning over the certificate being receipt of payment. If it is the former, the rules of the U.C.C. in perfecting a security interest in the horse should apply. If it is the latter, those rules are inapplicable.

H. *Stallion Shares*

The property interest that constitutes the collateral may not be the horse itself, but a syndicate share in a stallion. This share is a creature of the syndicate agreement and may not constitute goods as that term is used in U.C.C. section 9-109; instead, it may be an account or some form of general intangible or both.[164] The particular syndicate agreement is the key to this analysis. Most syndicate agreements purport to convey an undivided interest in the horse itself to each syndicate member, thus lending itself to a characterization as goods.[165]

That was the position taken by the tax court in *In re Harry F. Guggenheim*,[166] a 1958 case dealing with the syndicate of the thoroughbred stallion *Turn-To.[167] The position of the Internal Revenue Service was that the sale of the shares was the sale of breeding rights and that the gain constituted ordinary income.[168] The position of the taxpayer, adopted by the tax court, was that this was the sale of a capital asset.[169] While not a U.C.C. Article 9 case, the analysis of the tax court is appropriate here as well.

When the breedings are sold, we must consider whether the breedings are proceeds from the share, goods, or a separate intangible. What if the breedings are sold for several years in the future? In *North Ridge Farms Inc. v. Trimble*,[170] the Kentucky

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[163] *See, e.g.*, Rule 25 of the Official Handbook of the American Quarter Horse Association.

[164] U.C.C. § 9-106.

[165] U.C.C. § 9-109.

[166] 46 T.C. 559 (1966).

[167] An asterisk appearing in front of a horse's name indicates a foreign bred horse.

[168] *In re* Harry F. Guggenheim, 46 T.C. 559, 560.

[169] *Id.* at 568.

[170] 30 KY. L. SUMM. 15 at p. 2 (Ky. Ct. App. 1983), *aff'd on other grounds*, 700 S.W.2d 396 (Ky. 1985).

Court of Appeals held that the sale of one year's breeding rights to a stallion was the sale of a general intangible although acknowledging that the value of a syndicate share lies in its appurtenant breeding rights.[171]

Related to the issue of characterization of stallion shares is the concept of pooling arrangements. The syndication agreement for thoroughbred stallions will normally provide for each shareholder to breed a mare to the stallion each season. With respect to standardbreds and other breeds of horses where artificial insemination is allowed, it is common for multiple breedings to be allocated to shareholders. With respect to all breeds, though, it is not unusual to have some sort of pooling of excess or unused breedings. Under this arrangement, breedings are sold by the syndicate manager and the proceeds distributed in some pro rata fashion as determined by the contract. From a security interest analysis, the pool proceeds may be characterized as proceeds from the sale of goods or as an intangible.

II. THE PARTICIPANTS AND THEIR CLAIMS

As previously stated, the nature of the claims against horses can vary greatly. Claimants may have assumed their positions voluntarily as in the case of a lender or seller financing the purchase of a horse by someone else. Creditors may come into their positions reluctantly such as in the instance of a judgment creditor attempting to execute upon an adversary's equine interest. The debt may have been created by providing goods or services. The various interests will be analyzed *seriatim*.

Because the existence and priority of liens are distinct concepts, a two step analysis is necessary. First, is there a lien? If so, is it prior or subordinate to a competing lien? Liens and claims may come into existence in several different manners, including the following: (1) consensual (i.e., security interests); (2) statutory; (3) common law; (4) equitable; (5) execution; (6) bankruptcy; and (7) purchase. Each of these liens and claims is considered in some detail in the following discussion.

Once a lien comes into existence, the lienholder will have a claim against the property that will have priority over others with debts not secured by the property.[172] The situation becomes more

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[171] *Id.* at 3.

[172] *See* Brunner v. Home for the Aged, 429 S.W.2d 381 (Ky. 1968); 51 AM. JUR. 2D: *Liens* § 1 (1970) (tax lien superior to all future estates, including remainders).

complex, however, when there are several liens against a particular horse. That is, how are the proceeds allocated among the competing lienholders?

When the competing liens are consensual security interests, U.C.C. section 9-312 provides us with a relatively well-defined set of rules.[173] If the competition is between a "lien creditor" and

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[173] U.C.C. § 9-312 states:

(1) The rules of priority stated in other sections of this Part and in the following sections shall govern when applicable: Section 4-208 with respect to the security interests of collecting banks in items being collected, accompanying documents and proceeds; Section 9-103 on security interests related to other jurisdictions; Section 9-114 on consignments.

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

(3) A perfected purchase money security interest in inventory has priority over a conflicting security interest in the same inventory and also has priority in identifiable cash proceeds received on or before the delivery of the inventory to a buyer if

(a) the purchase money security interest is perfected at the time the debtor receives possession of the inventory; and

(b) the purchase money secured party gives notification in writing to the holder of the conflicting security interest if the holder had filed a financing statement covering the same types of inventory (i) before the date of the filing made by the purchase money secured party, or (ii) before the beginning of the 21 day period where the purchase money security interest is temporarily perfected without filing or possession (subsection (5) of Section 9-304); and

(c) the holder of the conflicting security interest receives the notification within five years before the debtor receives possession of the inventory; and

(d) the notification states that the person giving the notice has or expects to acquire a purchase money security interest in inventory of the debtor, describing such inventory by item or type.

(4) A purchase money security interest in collateral other than inventory has priority over a conflicting security interest in the same collateral or its proceeds if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within ten days thereafter.

(5) In all cases not governed by other rules stated in this section (including cases of purchase money security interests which do not qualify for the special priorities set forth in subsections (3) and (4) of this section), priority between conflicting security interests in the same collateral shall be determined according to the following rules:

(a) Conflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is first made covering the collateral or the time the security interest is first perfected, whichever is earlier, provided that there is no period thereafter where there is neither

the holder of an unperfected security interest, U.C.C. section 9-301 governs priority.[174] When one of the liens is a perfected security interest and the other is "given by statute or rule of law," section 9-310 governs priority.[175] When the lien is based on the Bankruptcy Act, statutory guidance is also provided in the statute itself.[176]

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filing nor perfection.

(b) So long as conflicting security interests are unperfected, the first to attach has priority.

(6) For the purposes of subsection (5) a date of filing or perfection as to collateral is also a date of filing or perfection as to proceeds.

(7) If future advances are made while a security interest is perfected by filing, the taking of possession, or under Section 8-321 on securities, the security interest has the same priority for the purposes of subsection (5) with respect to the future advances as it does with respect to the first advance. If a commitment is made before or while the security interest is so perfected, the security interest has the same priority with respect to advances made pursuant thereto. In other cases a perfected security interest has priority from the date the advance is made.

[174] U.C.C. § 9-301 states:

(1) Except as otherwise provided in subsection (2), an unperfected security interest is subordinate to the rights of

(a) persons entitled to priority under Section 9-312;

(b) a person who becomes a lien creditor before the security interest is perfected;

(c) in the case of goods, instruments, documents, and chattel paper, a person who is not a secured party and who is a transferee in bulk or other buyer not in ordinary course of business or is a buyer of farm products in ordinary course of business, to the extent that he gives value and receives delivery of the collateral without knowledge of the security interest and before it is perfected;

(d) in the case of accounts and general intangibles, a person who is not a secured party and who is a transferee to the extent that he gives value without knowledge of the security interest and before it is perfected.

(2) If the secured party files with respect to a purchase money security interest before or within ten days after the debtor receives possession of the collateral, he takes priority over the rights of a transferee in bulk or of a lien creditor which arise between the time the security interest attaches and the time of filing.

(3) A "lien creditor" means a creditor who has acquired a lien on the property involved by attachment, levy or the like and includes an assignee for benefit of creditors from the time of assignment, and a trustee in bankruptcy from the date of the filing of the petition or a receiver in equity from the time of appointment.

(4) A person who becomes a lien creditor while a security interest is perfected takes subject to the security interest only to the extent that it secures advances made before he becomes a lien creditor or within 45 days thereafter or made without knowledge of the lien or pursuant to a commitment entered into without knowledge of the lien.

[175] *See supra* notes 42-56 and accompanying text.

[176] 11 U.S.C. § 544 (1988).

Similarly, many of the statutory liens contain guidelines for priority.[177] In the case of purchases, there are a number of differing sources that provide guidance including sections 9-301(1)(c) and 9-307 of the Uniform Commercial Code,[178] part 4 of Article

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[177] *See, e.g.*, FLA. STAT. ANN. §§ 85.011-85.051 (West 1987) (veterinary lien statute that establishes relative priorities).

[178] K.R.S. § 355.9-307, the Kentucky codification of U.C.C. § 9-307, states:

(1) A buyer in ordinary course of business (subsection (9) of KRS 355.1-201) 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.

(2) If any tobacco crop subject to the lien of a security interest is sold at public auction through a duly licensed tobacco warehouse in the ordinary course of business, a bona fide purchaser for value of such crop shall take title thereto free and clear of any such lien, and the warehouseman selling such tobacco crop shall not be liable to the holder of such lien, unless written notice by certified mail, return receipt requested, of such lien, the name and address of the debtor and proper description of the property subject to lien, are given to the tobacco warehouseman prior to the payment of the proceeds of sale to the owner or producer of such tobacco crop.

(3) If any grain or soybean crop subject to the lien of a security interest is sold to any entity which is a bona fide purchaser for value and which holds a current grain storage license issued by the Commonwealth of Kentucky or a current federal warehouse storage license, in the ordinary course of business, such entity shall take title to such crop free and clear of any such lien, and shall not be liable to the holder of such lien, unless written notice by certified mail, return receipt requested, of such lien, the name and address of the debtor and proper description of the property subject to the lien is given to the entity purchasing said crop prior to the payment of the proceeds of purchase to the owner or producer of such grain or soybean crop.

(4) 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, 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.

(5) In the case of consumer goods, a buyer takes free of a security interest even though perfected if he buys without knowledge of the security interest, for value and for his own personal, family or household purposes unless prior to the purchase the secured party has filed a financing statement covering such goods.

(6) If any registered breed of horse, the racing of which is regulated by KRS Chapter 230, subject to the lien of a security interest is sold at public auction in the ordinary course of business by an organization engaged in the business of selling such horses at public auction, a bona fide purchaser for value of such horse shall take title thereto free and clear of any such lien, and the organization selling such horse shall not be liable to the holder of such lien, unless written notice by certified mail, return receipt requested, of such lien and the amount thereof, the name and address of the debtor and proper identification

2 of the Uniform Commercial Code,[179] and the Food Security Act

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of the horse subject to lien are given to the organization prior to the time of sale.

(7) A buyer other than a buyer in ordinary course of business (subsection (1) of this section) takes free of a security interest to the extent that it secures future advances made after the secured party acquires knowledge of the purchase, or more than forty-five (45) days after the purchase, whichever first occurs, unless made pursuant to a commitment entered into without knowledge of the purchase and before the expiration of the forty-five (45) day period.

[179] U.C.C. § 2-401 states:

Each provision of this Article with regard to the rights, obligations and remedies of the seller, the buyer, purchasers or other third parties applies irrespective of title to the goods except where the provision refers to such title. Insofar as situations are not covered by the other provisions of this Article and matters concerning title become material the following rules apply:

(1) Title to goods cannot pass under a contract for sale prior to their identification to the contract (Section 2-501), and unless otherwise explicitly agreed the buyer acquires by their identification a special property as limited by this Act. Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest. Subject to these provisions and to the provision of the Article on Secured Transactions (Article 9), title to goods passes from the seller to the buyer in any manner and on any conditions explicitly agreed on by the parties.

(2) Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods, despite any reservation of a security interest and even though a document of title is to be delivered at a different time or place; and in particular and despite any reservation of security interest by the bill of lading

(a) if the contract requires or authorized the seller to send the goods to the buyer but does not require him to deliver them at destination, title passes to the buyer at the time and place of shipment; but

(b) if the contract requires delivery at destination, title passes on tender there.

(3) Unless otherwise explicitly agreed where delivery is to be made without moving the goods,

(a) if the seller is to deliver a document of title, title passes at the time when and the place where he delivers such documents; or

(b) if the goods are at the time of contracting already identified and no documents are to be delivered, title passes at the time and place of contracting.

(4) A rejection or other refusal by the buyer to receive or retain the goods, whether or not justified, or a justified revocation of acceptance revests title to the goods in the seller. Such revesting occurs by operation of law and is not a "sale".

U.C.C. § 2-402 states:

(1) Except as provided in subsections (2) and (3), rights of unsecured creditors of the seller with respect to goods which have been identified to a contract for sale are subject to the buyer's rights to recover the goods under this Article (Sections 2-502 and 2-716).

(2) A creditor of the seller may treat a sale or an identification of goods

of 1985.[180]

As with many aspects of the horse industry, the priority analysis often is made outside of recognized rules. For example, if a stallion owner refuses to provide a mating certificate needed for a sale the following week, the issue may be determined more by the importance of entering the horse in the sale than whether the other lienholder is entitled to priority.[181]

With respect to non-Article 9 liens, the one rule of priority appears to be that a prior lien will be superior to a subsequent

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to a contract for sale as void if as against him a retention of possession by the seller is fraudulent under any rule of law of the state where the goods are situated, except that retention of possession in good faith and current course of trade by a merchant-seller for a commercially reasonable time after a sale or identification is not fraudulent.

(3) Nothing in this Article shall be deemed to impair the rights of creditors of the seller

(a) under the provisions of the Article on Secured Transactions (Article 9); or

(b) where identification to the contract or delivery is made not in current course of trade but in satisfaction of or as security for a pre-existing claim for money, security or the like and is made under circumstances which under any rule of law of the state where the goods are situated would apart from this Article constitute the transaction a fraudulent transfer or voidable preference.

U.C.C. § 2-403 states:

(1) A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good faith purchaser for value. When goods have been delivered under a transaction of purchase the purchaser has such power even though

(a) the transferor was deceived as to the identity of the purchaser, or

(b) the delivery was in exchange for a check which is later dishonored, or

(c) it was agreed that the transaction was to be a "cash sale", or

(d) the delivery was procured through fraud punishable as larcenous under the criminal law.

(2) Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business.

(3) "Entrusting" includes any delivery and any acquiescence in retention of possession regardless of any condition expressed between the parties to the delivery or acquiescence and regardless of whether the procurement of the entrusting or the possessor's disposition of the goods have been such as to be larcenous under the criminal law.

(4) The right of other purchasers of goods and of lien creditors are governed by the Articles on Secured Transactions (Article 9), Bulk Transfers (Article 6) and Documents of Title (Article 7).

[180] 7 U.S.C. § 1631. *See supra* notes 4-40 and accompanying text.

[181] *See supra* notes 157-63 and accompanying text.

lien.[182] Two caveats must be noted, however. First, notice of a prior lien will be necessary in order to render it superior to another lien.[183] Further, a court of equity has the authority to reprioritize conflicting liens.[184] Thus a lien that has had the effect of preserving or enhancing the value of the common collateral is normally entitled to first priority.[185]

Of course, one way to establish priority is by agreement. U.C.C. section 9-316 provides a key provision which states that "[n]othing in this Article prevents subordination by agreement by any person entitled to priority." Thus, when an impasse is reached, U.C.C. section 9-316 provides one means for resolution. An example would be a lien, such as an agister's lien, that is possession dependent.[186] The owner may request that the agister turn the horse over to a consignor for sale, but this would negate the priority bump of U.C.C. section 9-310. Compliance with the provisions of K.R.S. section 376.410 in having a warrant issued would arguably enhance the agister's position, although it is not clear that this would act as a constructive possession and thus retain the priority bump. Obtaining a subordination agreement may work to preserve the agister's position.

A. *Buyers*

By the contract for sale, a buyer at a minimum acquires all title in the horse that his seller had the power to transfer.[187] If the horse is free and clear of any other lien, claim, or security interest, that title is absolute. Normally this title passes with delivery of the

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[182] 51 AM. JUR. 2D: *Liens* § 51 (1970).

[183] *Id.*

[184] *Id.* One unreported circuit court opinion has addressed the relative priorities of conflicting liens. Buster v. Hale, No. 88-CI-067, slip op. (Scott Circuit Court, May 20, 1988). In that case an agister sought to enforce his lien upon certain horses which were also subject to perfected security interests and stallion keepers' liens. The court first held that the agister's lien was superior to the perfected security interest by operation of K.R.S. 355.9-310 for those horses remaining in the agister's possession. Further the court held that the retention of the mating certificate was "possession" of goods sufficient to give the stallion keeper priority over the perfected security interest. The court then applied the equitable doctrine of marshalling assets, that is that each of the horses must be sold to satisfy the agister's lien upon that horse. The stallion keeper's lien should be next satisfied as the perfected security interest. This case seems to buttress itself more in the court's equitable powers than in the U.C.C. and in that sense may be the correct approach.

[185] *Id.* This is the underlying rationale of U.C.C. § 9-310.

[186] *See infra* notes 209-25 and accompanying text.

[187] U.C.C. § 2-403.

goods.[188] The interest of the buyer is conceptually different because it is an ownership interest and not a lien. Thus, if the buyer's interest is adjudged to have priority, the buyer gets the horse free and clear.

A lien interest with priority on the other hand gets priority only to the extent of the lien. As an example, purchaser A buys a horse for ten thousand dollars. The horse is subject to B's ten thousand dollar lien. By the time the priority question is resolved, the horse has increased in value to twenty thousand dollars. If B's lien interest is found to have priority, he is entitled only to his ten thousand dollars. If A's interest is found to have priority, however, he is entitled to the entire twenty thousand dollars and not just his purchase interest. His interest is title to the property, not a lien upon it.

The rights of the buyer of a horse with respect to other security interests and claims against that horse are dependent on the status of both the buyer and the seller. The first line of protection to a buyer is the F.S.A.[189]

If that act is not applicable, the buyer will next examine the provision of U.C.C. section 9-307(1) that gives protection to a buyer in the ordinary course of business.[190] This provision contains language making it inapplicable to purchasers of farm products from a person engaged in the business of farming; however, if that exception applies, the buyer will likely have been able to rely upon the F.S.A.

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 the ordinary course from a person in the business of selling goods of that kind. . . ."[191] If these requirements are met, the buyer will take free of any security interest even those of which he has actual or constructive notice.

The key question as to the applicability of this exception will be whether the seller is "a person in the business of selling goods

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[188] U.C.C. § 2-401(2).

[189] 7 U.S.C. § 1631.

[190] U.C.C. § 9-307 is discussed more fully at *supra* notes 4-40 and accompanying text in the context of the farm products exception contained in U.C.C. § 9-307(1) and the F.S.A. Whether a horse constitutes farm products and whether the seller is a person engaged in farming operations are two of the central problems in characterization of an equine asset.

[191] U.C.C. § 1-201(9).

of that kind. . . ."[192] The drafters of the U.C.C. did not intend that this provision only apply to merchant sellers although it is clear that it does not apply to a one-time or casual seller.[193] A sale that is merely incidental to the seller's primary business will not qualify.[194] Applying these basic precepts to the horse industry results in a continuum with a large gray area. A major consignor in the business of selling yearlings would clearly qualify.[195] One-time owners selling their stock may not qualify.

In addition to the Food Security Act, state statutory variations may make this more of a theoretical problem. Under K.R.S. section 355.9-307(4), any bona fide purchaser of a race horse sold at public auction takes free and clear of any prior liens. The organization conducting the sale also avoids any liability. This variation is not uniform with other states and any reliance upon it is dependent upon a high degree of comfort that Kentucky law will apply. Also the exception requires that the buyer qualify as a bona fide purchaser, i.e., one who takes in good faith, for value, and without knowledge of the other parties' rights.[196] Thus, in some respects this provision is narrower than U.C.C. section 9-307(1), which applies irrespective of the buyer's knowledge that the property is encumbered. Prior to the F.S.A. of 1985, the large number of important public auctions conducted in Kentucky made this an important provision.

Possession is important to buyers as their title interest normally arises at the time they come into possession unless the contract for sale states otherwise.[197] Furthermore, some types of liens are enforceable only if the lienholder is in possession.

B. *Secured Parties*

The rights of a secured party are governed by Article 9 of the U.C.C. The security interest will attach when the collateral is (a)

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[192] *Id.*

[193] *See* Al Maroone Ford, Inc. v. Manheim Auto Auction, Inc. 208 A.2d 290 (Pa. Super. Ct. 1965) (Seller of automobile was not "in business of selling goods of that kind" when he purchased the auto from a new car dealer and sold it to an auto auctioneer.).

[194] *See, e.g.*, O'Neill v. Barnett Bank, 360 So. 2d 150 (Fla. App. 1978) (purchaser of airplane was aware that seller's primary business was renting aircraft, not selling aircraft); John Deere v. Jeff De Witt Auction Co., 690 S.W.2d 511 (Mo. App. 1985) (farmer who sold tractors occasionally was not a tractor dealer).

[195] Again, this assumes neither the farm products exception nor the F.S.A. is applicable.

[196] K.R.S. § 355.9-307(4).

[197] As an example of title passing without possession, title passes at the fall of the hammer at a public auction. *See, e.g.*, Chernick v. Fasig-Tipton, 703 S.W.2d 885, 887-88 (Ky. App. 1986).

either in the possession of the secured party or the debtor has signed a security agreement; (b) value has been given; and (c) the debtor has rights in the collateral.[198] This is the type of transaction that is the primary focus of Article 9.[199]

The problems facing secured parties with an interest in equine collateral are the proper method to perfect their interest (by filing a financing statement, possession, or otherwise), maintaining protection of their interest in an inherently mobile good, and achieving a priority over the interests of other participants in the priority race. The interest of the perfected secured party will prevail against other liens that do not qualify for priority under U.C.C. section 9-310 or that had not attached prior to perfection of the security interest. The secured party will prevail against a subsequent purchaser unless U.C.C. sections 9-307, 9-306(2) or the Food Security Act applies.

C. *Bankruptcy Trustees*

Bankruptcy trustees (or debtor in possession in a Chapter 11 or 12 reorganization) are in charge of the administration of the bankruptcy estate and as such are empowered to avoid certain preferential transactions. They also have the status of a judicial lien creditor at the time of bankruptcy filing[200] with respect to the bankruptcy estate. Thus the interest of the trustee will prevail against unperfected security interest liens.[201]

Obviously, a complete discussion of the bankruptcy code and the powers of the trustee are beyond the scope of this Article. A case example will suffice to demonstrate that the trustee potentially has the power to upset the ordered priority of interests and liens attaching to equine collateral.

In re Bob Schwermer & Associates[202] dealt with the situation where a bank had taken a security interest in six race horses as collateral for a preexisting debt. The value given by the bank was a commitment to forbear collection of the preexisting debt.[203] The

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[198] U.C.C. § 9-203.

[199] This type of lien is discussed in depth in Lester, *supra* note 3.

[200] 11 U.S.C. § 544(a) (1988).

[201] U.C.C. § 9-301(b).

[202] 36 U.C.C. Rep. Serv. 1400 (N.D. 111. 1983). This case is dealt with in greater detail *supra* in the text accompanying notes 112-16, in the context of the problem of characterizing equine collateral under U.C.C. § 9-109.

[203] *Id.* at 1407.

court found that the bank had a valid and perfected security interest in the horses.[204] The analysis did not conclude there, as it might in the non-bankruptcy context. The court then had to determine whether the transaction occurred in the ninety day voidable preference period prior to the filing of the bankruptcy petition[205] or whether the transaction met one of the fraudulent transfer provisions for transactions occurring in the year before the filing date.[206]

The court ultimately held that the transfer took place outside the ninety day period but within one year preceding filing. A full hearing had to be held[207] to determine whether the transaction met the requirements as a voidable preference. If that could have been proved, the bank's otherwise prior and perfected security interest would have been subject to the trustee's avoiding powers.[208] Thus, whether the interest of the trustee will prevail is dependent upon both the timing of the conflicting interest and whether the transaction upon which it is based is subject to avoidance.

D. *Agister*

An agister is a "person engaged in the business of pasturing of cattle as a bailee in consideration of an agreed price to be paid by owner of cattle."[209] Thus, an agistment is a specialized form of bailment relating to the care of cattle and horses.[210] The rights of an agister are inherently contractual and there was no common law lien arising from the nonpayment of the contractual fee.[211] This group of potential creditors includes stableman and liverymen, operators of boarding farms and, to a limited extent, racetracks, sales companies, and veterinarians.

Agisters are the subject of statutory liens in many jurisdictions, including Kentucky. The Kentucky statute shows the evolving na-

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[204] *Id.*

[205] 11 U.S.C. § 547(b) (1988).

[206] 11 U.S.C. § 548.

[207] *In re* Bob Schwermer & Assoc., 36 U.C.C. Rep. Serv. 1400, 1408 (N.D. Ill. 1983).

[208] 11 U.S.C. § 548(a)(2)(A)-(B) would have allowed the transaction to be avoided if the debtor had been insolvent at the time or there had not been equivalent value in the exchange.

[209] BLACKS LAW DICTIONARY 61 (5th ed. 1979).

[210] The plain meaning of cattle would seem to be limited to bovine livestock. However, it is not uncommon for the statutory definition to include equine animals as well. *See, e.g.*, K.R.S. § 446.010(6).

[211] *See, e.g.*, Hanch v. Ripley, 26 N.E. 70 (Ind. 1890). *See generally* 4 AM. JUR. 2D: *Animals* § 74 (1962).

ture of this type of lien as its amendment in 1984 transformed it, in some respects, from a possessory to nonpossessory lien. Currently, the Kentucky statute states:

> Any owner or keeper of a livery stable, and a person feeding or grazing cattle for compensation, shall have a lien for one (1) year 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.[212]

Coinciding with the amendment to the lien statute itself is a corresponding new enforcement mechanism:

> Any person in whose favor a lien provided for in KRS 376.400 exists may, before the district court of the county where the cattle were fed or grazed, by himself or agent, make affidavit of the amount due him and in arrears for keeping and caring for the cattle, and describing as nearly as possible the cattle kept by him. The court shall then issue a warrant, directed to the sheriff or any constable or town marshall of the county, authorizing him to levy upon and seize the cattle for the amount due with interest and costs. If the cattle are removed with the consent and from the custody of the livery stable keeper or the person feeding or grazing them, the lien shall not continue longer than one (1) year from and after the removal, nor shall the lien in case of such removal be valid against a bona fide purchaser without notice at any time after the removal. The warrant may be issued to a county other than that in which the cattle were fed or grazed, and the lien may also be enforced by action as in the case of other liens.[213]

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[212] K.R.S. § 376.400 (effective July 13, 1984). Compare to the previous enactment, which read:

> 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 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 same limitations and restrictions placed upon a landlord's lien for rent.

The limitations referred to were contained in K.R.S. § 383.070 dealing with landlords liens. Among these restrictions and agister's line was limited to the amount due for the previous four months and was expressly subject to any liens arising after the horse came onto the premises but before the agister's lien actually attached. K.R.S. § 383.070(3).

[213] K.R.S. § 376.410. Significantly, the lien continues for a period of one year after possession is lost instead of ten days.

These amended sections greatly enhance the protection afforded an agister. Heretofore, the lien had been completely dependent upon possession of the animal at issue and would expire ten days after possession was relinquished. Even more important, however, is the fact that the statute is no longer tied to the limitations and restrictions contained in the Landlord Rent Lien statute.[214] Prior to this amendment, there had been an expressed limitation upon both the priority and extent of the lien that to some extent modified the effect of U.C.C. section 9-310.[215] The old agister's lien would only encompass four months boarding fee and would not be superior to a lien perfected prior to the time the agister took possession.

While the district court proceeding authorized by K.R.S. section 376.410 may be helpful where the agister is not in possession, the district court proceeding apparently is not a necessary requisite to the lien itself. Thus, the lien afforded by K.R.S. section 376.400 should be enforceable by judicial foreclosure without a district court proceeding under K.R.S. section 376.410.[216]

An agister in possession of the horse would have priority over all Article 9 liens by operation of U.C.C. section 9-310.[217] The agister in possession may prevail against the interest of a buyer as his or her possession should act as constructive notice of the lien, thus defeating bona fide purchaser status.[218] Absent some priority enhancing statute, even an agister in possession will be subordinate to a valid common law or statutory lien that attached prior to the time the agister's lien attached and to which the agister had notice, subject to the court's inherent equitable power.[219]

An old Kentucky case, *Griffith v. Speaks*[220] gave a stableman some leverage with respect to enforcing charges due from an owner for the boarding of more than one horse. In that case, the owner had brought ten horses to the stable at the same time. Five of the horses were removed prior to the stableman seeking to enforce his lien. The court noted that the stableman had no lien on the horses

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[214] K.R.S. § 383.070.

[215] This statute is discussed more fully, *supra* notes 42-56 and accompanying text.

[216] "The lien may be enforced by distress warrant or by action as in cases of other liens." Speth v. Brangman, 84 S.W. 1149 (Ky. 1905).

[217] *See supra* notes 42-56 and accompanying text.

[218] The interest of the agister will be subject to the operation of the F.S.A. in the proper circumstances.

[219] *See supra* notes 48-51 and accompanying text.

[220] 63 S.W. 465 (Ky. 1901).

that had been removed, but went on to hold that the entire board bill could constitute a lien on the remaining horses.[221] The court held that

> if several head of horses were placed in the stable of appellees by appellants at the same time under a contract to pay for their keep, a lien could be asserted against a part of the horses which still remain in their possession for the keep of others which may have been removed more than 10 days before sending out the warrant.[222]

There are three plausible interpretations of the holding of this case. First, it may be viewed as a pre-U.C.C. case with no continuing validity. Second, it may be narrowly construed as applying to the situation where an owner contracts with an agister to care for a unit of more than one horse. This could be likened to a mechanic's lien that attaches to the entire automobile, not just the part on which work is performed. Finally, a broad construction could be given so that the agister's lien is continuous in nature and attaches to any property of the debtor in the agister's possession.

Of the three, the first would seem the most reasonable. The premise of section 9-310 in giving priority to a statutory lienholder in possession is that value has been added to the collateral.[223] The secured party generally should not be placed at an unfair disadvantage. A secured party might only have a lien upon one horse and it would be unfair to charge board on numerous horses sold separately. Repairing the part to a car adds value to the whole car, but caring for one horse adds no value to other horses.

The broad reading of *Griffith* is, of course, the least fair since it would subordinate a secured party's interest to debts in no meaningful way related to his or her specific collateral. In fact, the holding of *Griffith* does not purport to speak to this situation.

A final note on the subject of agister's liens is provided by the old case of *Black v. Brennan*.[224] In that case an innkeeper was held to have a lien upon a stolen horse brought to the inn by the thief. At first glance this case seems to run directly contrary to the hornbook maxim that a thief can convey no title.[225] Further, since

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[221] *Id.* at 467.

[222] *Id.*

[223] Purpose 1 in the official commentary to U.C.C. § 9-310.

[224] 35 Ky. 310 (1837).

[225] Blue Grass Taxi Garage Co. v. Shepherd, 200 S.W.2d 936 (Ky. 1947) (automobile theif could not convey title).

an agistment is a form of bailment and is contractual in nature, it takes some leap of faith to imply a contract between the true owner and the innkeeper. Irrespective of whether the holding would be followed today, a strong policy argument can be made that the decision was correct. The actions of an agister in general have the effect of preserving the value of the collateral. Any resulting loss in priority or equity on the part of other creditors of the owner arguably would have been lost had the actions not been taken.

E. *Stallion Owners*

In contrast to an agister or stablekeeper, the owner of a stallion had a common law lien for the service fee as long as the stallion owner retained possession of the mare.[226] This common law lien has in many jurisdictions been replaced by a statutory codification. In Kentucky the codification states:

> (1) 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 year after the birth of the progeny.
> (2) This lien may be enforced by action as in cases of other liens, or by warrant as permitted in the case of enforcement of the lien of the keeper of a livery stable or an agister.[227]

The object of the lien is different from its common law antecedent as the "get" referred to is the progeny and not the mare.[228] This is important because it implies into the statute the guarantee of a live foal. Without that, there is nothing to which the lien can attach. The stallion service contract will control this from a contractual standpoint. Some contracts will provide a guarantee of a live foal or allow for the return of the mare in the event of no offspring. This is not universal and some particularly successful stallions whose services are in high demand will stand with no

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

[227] K.R.S. § 376.420. The fact that the statute refers to a "licensed keeper" reflects the fact that contemporaneous with this statute was a requirement that stallion owners maintain a license. This requirement has since been repealed although it could be the subject of a muncipal or county ordinance. One Kentucky case, Smith v. Robertson, 50 S.W. 852 (Ky. 1899), held that there was no lien absent a license. As the law disfavors implicit repeal of a statute, Fiscal Court v. City of Anchorage, 393 S.W.2d 608 (Ky. 1965), it is likely that a court today would ignore the "licensed keeper" language in an action involving this statute.

[228] It is not clear whether the statute preempts the common law lien.

guarantee. In the event of no live foal, the stallion owner is left only with a contractual claim.[229]

The other alternative available to the stallion owner is retention of the mating certificate as security for the unpaid stallion service fee.[230] Normally, the breeding contract will provide for this type of leverage on the part of the stallion owner. The document itself is of no value, but without it the foal may not be registered. Additionally, the agister statute may be available with respect to the charges for boarding the mare, although this expense may be *de minimis* in comparison to the stallion fee.

F. *Veterinarians*

A significant expense in the care and upkeep of a horse is veterinary fees and services. Advances in equine medicine have increased both the quality and expense of such services. Horses that in the recent past would have been humanely destroyed as a result of debilitating racetrack injuries can now be restored to productivity. The nature of the veterinarian's financial interest is contractual. If the veterinary fees are not paid, the veterinarian has as an option of bringing a civil action for breach of contract. The viability of this option depends on the availability of a solvent defendant at the end of an increasingly long path of litigation. The nonpayment of the fees would at a minimum make that availability somewhat suspect. The other alternative is to look to the horse itself, particularly if the veterinarian has taken and retained possession of the horse.

As in the case of agisters, veterinary services are generally not the subject of a common law lien.[231] Unfortunately, Kentucky does not provide a statutory lien for veterinarians. It may be possible to argue the existence of a security interest perfected by possession or an equitable lien, or that veterinary services are part of an agister's lien. There are, however, several states with statutory liens

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[229] In the unlikely situation where the stallion owner has retained possession of the mare, arguably, the common law lien could still by asserted in the non-live foal situation.

[230] The mating certificate is an authenticity document required by the various private associations such as the Jockey Club and the United States Trotting Association in order to register the progeny. The various registration documents involved in the horse industry are discussed more fully *supra* notes 129-63 and accompanying text.

[231] There is some authority for extending the common law farrier lien to veterinarians. *See* Lord v. Jones, 24 Me. 439 (1844).

providing for a lien for veterinary services.[232] These state liens can be characterized as either possessory or nonpossessory, although possession may be a key component in either.

An enlightened approach for dealing with veterinarian's liens is typified by lien statutes such as that enacted in Florida:

> LIENS FOR PROFESSIONAL SERVICES OF VETERINARIANS. In favor of any veterinarian who renders professional services to an animal at the request of the owner of the animal, the owner's agent, or a bailee, lessee, or custodian of the animal, for the unpaid portion of the fees for such professional services, upon the animal to which such services were rendered. Such lien shall remain valid and enforceable for a period of 1 year from the date the professional services were rendered, and such lien is to be enforced in the manner provided for the enforcement of other liens on personal property in this state.[233]

The enforcement provisions of the Florida personal property lien provide for self help in the form of retention of possession for up to three months and an action at law or in chancery. The statute also provides for the payment of attorney's fees and costs in an amount up to fifteen percent of the judgment.[234] Certainly this is a more favorable statute to veterinarians, recognizing both the practicalities of the service provided and the strong policy argument that preserving the equine collateral is in everyone's interest.

As previously mentioned, possession is still a factor to be considered even in states providing for nonpossessory liens, such as in Florida. U.C.C. section 9-310 provides that statutory liens such as those provided by the Florida statute shall take priority over an otherwise prior and perfected security interest if possession is retained.[235] Two major problems are inherent in possessory liens

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[232] The following states have enacted specific veterinary lien statutes: Alabama, ALA. CODE § 35-11-390; California, CAL. CIV. CODE § 3051; Florida, FLA. STAT. § 713.655; Georgia, GA. CODE ANN. § 44-14-490; Iowa, IOWA CODE § 581.1; Kansas, KAN. STAT. ANN. § 47-836; Louisiana, LA. REV. STAT. ANN. § 9:4661 (applies only to racehorses); Maryland, MD. COM. LAW CODE ANN. § 16-401; Minnesota, MINN. STAT. ANN. § 514.92; Nebraska, NEB. REV. STAT. § 52-701; New York, N.Y. LIEN LAW § 183; South Dakota, S.D. COMP. LAWS ANN. § 40-27-12 (applicable only for providing vaccinations); Tennessee, TENN. CODE ANN. § 63-12-134; Virginia, VA. CODE § 3.1-796; Washington, WASH. REV. CODE ANN. § 60.56.010. Other states arguably provide lesser degrees of protection by the application of agister or mechanic lien statutes.

[233] 1988 Fla. Laws 713.655.

[234] FLA. STAT. ANN. §§ 85.011-85.051 (West 1987).

[235] See complete discussion of U.C.C. § 9-310 at *supra* notes 42-56 and accompanying text.

from the perspective of the veterinarian. First, it assumes that the veterinarian will come into possession of the animal, which with an animal as large as a horse will not always be the norm. Second, in order for the lien to have continuing validity, possession often must be retained.

G. *Insurers*

Equine mortality or fertility insurance is a common tool employed in the industry and is often made an express requirement in a security agreement with a horse serving as collateral. A question arises as to whether the insurer acquires an interest in any insurance proceeds. This could arise in the situation where there has been a default in the payment of the insurance premium. The insurance contract may or may not provide for a right of setoff for unpaid premium in the event of a loss under the policy.

In Kentucky there is a well-established principle that an insurer has a duty to apply funds due the insured to the payment of premium in order to avoid a forfeiture of the policy.[236] While this is more than just a right of setoff, it is not clear whether this duty can be characterized as a lien. This line of cases typically involves a dividend upon the policy that the insurer is required to apply to an unpaid premium.[237] The only requirement is that the funds be under the control or in the possession of the insurer.[238] Where the same policy ensures more than one horse, this principle may have some applicability. Also, there is the common law right of set off.[239]

H. *Trucking Companies*

Trucking companies may have a lien upon the horse for the cost of transportation services depending upon whether the trucking company can be characterized as a common carrier or a private carrier. The general rule is that a common carrier has a lien upon

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[236] *See, e.g.*, Cheek v. Commonwealth Life Ins., 126 S.W.2d 1084 (Ky. 1939) (law does not favor forfeitures and where insurance company was indebted to insured it should have applied those funds to pay the premium).

[237] *Id.* at 1090.

[238] Metropolitan Life Ins. v. Tye, 157 S.W.2d 274 (Ky. 1941) (cash surrender value was not under insurer's control, therefore insurer had no duty to apply its insured premium payment).

[239] See 20 AM. JUR. 2D: *Counterclaim, Recoupment and Setoff* § 2 (1965 and Supp. 1989).

goods in its possession for unpaid freight charges,[240] while a private carrier does not have the protection of a lien unless it has been granted by special contractual provision.[241] The distinction between the two types of carriers is determined by whether the carrier holds itself out as a common carrier, accepting goods from all persons indifferently subject to a tariff schedule that is federally regulated.[242]

As with other types of bailment related liens, the priority status of this particular lien is possession dependent. It is subject to the priority enhancement features of U.C.C. section 9-310, but in many respects ignores the practicalities and trade practice of the shipping industry with respect to horses. If a company bills the owner after delivery, the priority is lost.

I. *Sales Companies*

As heretofore noted, a sales company has a special status under the Kentucky codification of the U.C.C. If the horse is a race horse sold at public auction, the organization conducting such sale will not be liable to the holder of a lien of a security interest unless the holder of the lien has given notice directly to the sales company by certified mail.[243] Further, the sales company in Kentucky has the additional protection of K.R.S. section 355.9-319, which requires the secured party to first reduce his or her claim against the debtor to a judgment before proceeding against either a purchaser or a selling agent.

The sales company will normally charge a commission on the sales price of the horse that may rise to a security interest on its part chargeable against the horse or the proceeds from the disposition of the horse. There are two possible scenarios in which the interest of the sales company could arise. First, the buyer may default upon payment for the horse after taking possession. Second, the proceeds from the sale may be subject to prior security

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[240] *See, e.g.*, Luther Moving & Storage, Inc. v. Roberts, 526 S.W.2d 557 (Tex. Civ. App. 1975) (moving company was entitled to possessory lien on goods for payment of moving charges).

[241] *See* Campbell v. A.B.C. Storage, 174 S.W. 140 (Mo. Ct. App. 1915) (when goods were moved by a private carrier and there was no special contract to prove a lien, a lien was not present).

[242] *See* United States v. Contract Steel Carriers, Inc., 350 U.S. 409 (1956) (even though contract carrier actively solicited business, it was not representing itself to the public as a common carrier).

[243] K.R.S. § 355.9-307(6).

interests that total more than the sale price. The sales company will normally set out its right to payment from the proceeds in the contract with the consignor. Its priority to these funds as against prior perfected interests can be reached through a waiver theory. The fact that the prior creditor has allowed the sale is a consent to the payment of the commission. Arguably, the sales company would have an equitable lien or a right of set off upon the funds in its possession subject to the application of U.C.C. section 9-310.

The second scenario is more difficult from the sales company's perspective. Once it relinquishes possession, any security interest it has in the horse will be subject to the same requisites as the typical secured creditor, i.e., the sales company must have a security agreement that has been properly perfected. A prudent sales company may arguably enhance its position by the retention of the registration certificate pending payment in the same manner a stallion owner retains a mating certificate.

J. *Agents*

An agent of either the buyer or the seller will be in the same position as the sales company although the statutory protections contained in U.C.C. section 9-307 may not apply where the agent has acted in a private sale. The contract between agent and principal will delineate the rights of the parties. Any interest that the agent claims in the horse will be subject to the normal Article 9 requirements as there is no statutory or common law lien for agents.

K. *Judgment Lienholders*

Article 9 of the U.C.C. is made expressly inapplicable to a lien that arises as a result of a judgment unless that judgment was a result of a right to payment that was collateral in nature.[244] Thus, a general creditor can secure a judgment against a debtor and, in the normal process of levying upon that judgment, obtain a lien upon the debtor's property, which may include equine assets.[245] The problem is defining the relative rights of the judgment creditor

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[244] U.C.C. § 9-104(8).

[245] *See, e.g.*, K.R.S. § 426.10 provides for the execution against property upon the rendering of a final judgment. The execution may not be rendered until ten days from the rendition thereof without special order of the court. *Id.* at § 426.030.

as against other lienholders or secured parties with specific rights in the property against which the judgment creditor is seeking to levy. For purposes of priority, a judgment lienholder will prevail over an unperfected security interest,[246] although his or her interest will be subordinate to any security interest that was perfected prior to the attachment of the judicial lien.[247] In effect, judgment creditors have their liens perfected by the issuance of an execution.

CONCLUSION

In a decision key to the racing industry in Kentucky,[248] the court of appeals held that wagering on horses was a game of both skill and chance, thus keeping it outside constitutional prohibitions against games of pure chance. In many ways that analysis seems appropriate here, as the myriad pattern of conflicting lien interests makes the priority race somewhat a mixed game of skill and chance. There is not always a ready answer or a clear-cut solution. Certain key concepts seem to play an integral role in each analysis. An understanding of these concepts, prior planning, and continued vigilance are the keys to winning the priority race.

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[246] U.C.C. § 9-301(1)(b).

[247] *E.g.*, William Isolin & Co., Inc. v. Burgess & Leigh, Ltd., 276 N.Y.S.2d 659 (1967) (factor's lien took priority over judgment creditors).

[248] Commonwealth v. Kentucky Jockey Club, 38 S.W.2d 987 (Ky. 1931).