# A Case for Avoidance of Secret Farmer Liens: The California Producer's Lien

by

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Originally published in SAN JOAQUIN AGRICULTURAL LAW REVIEW
4 SAN JOAQUIN AGRIC. L. REV. 37 (1994)

# A CASE FOR AVOIDANCE OF SECRET FARMER LIENS: THE CALIFORNIA PRODUCER'S LIEN

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The United States has traditionally been an agrarian society, and farmers have long been the beneficiaries of special legislation protecting them from some of the harshness of the usual rules applicable to commercial transactions. Examples include tax provisions for cancellation of indebtedness which exclude farmers from the group of persons for whom debt cancellation is taxable;[1] preferential treatment under the Uniform Commercial Code which distinguishes "farm products" from other types of goods;[2] and provisions under the Bankruptcy Code which provide that an involuntary case cannot be filed against a farmer, and a farmer who is a debtor in a case under chapters 11, 12 or 13 cannot be involuntarily converted to chapter 7.[3]

Arguably, the same beneficial treatment continues today, though the farm bloc no longer possesses the political influence it once enjoyed now that American society has significantly departed from its agricultural roots as it has become more urbanized. An example of such specialized protection is embodied in California's producer's-lien law,[4] which provides that any producer of farm products that are sold to any food processor shall have an automatic lien on that product for the agreed

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[1] 26 U.S.C.S. § 108(a)(1)(C) (Law. Co-op. 1993).

[2] U.C.C. § 9-109(3), cmt. 4; *see also* U.C.C. § 9-307(1), cmt. 2; CAL. COMM. CODE § 9109(3), cmt. 4 (West 1990 & Supp. 1994); *see also* CAL. COMM. CODE § 9307(1), cmt. 2 (West 1990 & Supp. 1994).

[3] 11 U.S.C.S. § 1112(c) (Law. Co-op. 1987 & Supp. 1993).

[4] CAL. FOOD & AGRIC. CODE §§ 55631-55653 (West 1986 & Supp. 1994).

sale price. No formal perfection requirements exist within this law.

This article focuses on the conflict that exists when a state, such as California, enacts a statute which gives a small class of persons a secret lien right that survives even in bankruptcy. Although the author believes that farmers deserve protection from the failure of food processors, he concludes that secret liens should not serve as the means for achieving this end if the underlying policies of the bankruptcy laws are to be fairly applied to all creditors.

The article begins with an overview of the Bankruptcy Code provisions that allow for the avoidance of statutory liens. Next, the article describes examples of such "secret liens" from several states including California. The author then focuses on California's producer's-lien law as a paradigm of this conflict. The writer then turns to a description of the direct conflict between secret liens and the Bankruptcy Code and the Ninth Circuit's strained attempts to enforce such liens despite this clear conflict.

The Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, provides that certain statutory liens can be avoided by a bankruptcy trustee.[5] For instance, section 545(1) invalidates a lien that first becomes effective when the lienholder files bankruptcy or becomes insolvent. Section 545(2) invalidates state statutory liens which are unenforceable against

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[5] 11 U.S.C. § 545(1) (1982), *as amended by* Bankruptcy Amendments of 1984, Pub. L. No. 98-353, § 460, 98 Stat. 333, 377 (1984), provides:

> The trustee may avoid the fixing of a statutory lien on property of the debtor to the extent that such lien—
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> (1) first becomes effective against the debtor—
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> (A) when a case under this title concerning the debtor is commenced;
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> (B) when an insolvency proceeding other than under this title concerning the debtor is commenced;
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> (C) when a custodian is appointed or authorized to take or takes possession;
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> (D) when the debtor becomes insolvent;
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> (E) when the debtor's financial condition fails to meet a specified standard; or
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> (F) at the time of an execution against property of the debtor levied at the instance of an entity other than the holder of such statutory lien;
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> (2) is not perfected or enforceable at the time of the commencement of the case against a bona fide purchaser that purchases such property at the time of the commencement of the case, whether or not such a purchaser exists;
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> (3) is for rent; or
>
> (4) is a lien of distress for rent.

a bona fide purchaser of the goods to which the lien applies.[6] Statutory liens for rent or for distress of rent are similarly unenforceable.[7]

Although no uniform definition of "lien" exists, a lien generally gives "a person who has provided goods or services on credit an interest in specific property to assure payment for the goods or services."[8] The Bankruptcy Code defines "lien" as a "charge against or interest in property to secure payment of a debt or performance of an obligation."[9] This article focuses on liens against personal property, namely crops and proceeds, although liens may also exist against real property.

The three generally accepted categories of liens are judicial liens, statutory liens and consensual liens. Judicial liens are "obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding."[10] Consensual liens are obtained by agreement between the lienholder and debtor. Statutory liens arise by operation of law. According to the Bankruptcy Code, a statutory lien arises

> solely by force of a statute on specified circumstances or conditions, or lien of distress for rent, whether or not statutory, but does not include security interest or judicial lien, whether or not such interest or lien is provided by or is dependent on a statute and whether or not such interest or lien is made fully effective by statute.[11]

State agricultural liens are examples of such statutory liens. They afford farmers and ranchers protection from the effects of "bad economic times in the agricultural community."[12] They are generally similar in that each has its own unique requirements for creation, priority and enforcement, and no central reference system exists by which such requirements can be determined. In addition, they become effective upon some act by the lienholder, usually involving the transportation of goods and/or the performance of services. Perfection does not require the giving of notice to the work, i.e., to other lienholders, potential or actual. For this reason, they are called "secret" liens—as *only* the lienholder and debtor may be aware of their existence. Of course, sophisticated creditors are aware that state law provides for the existence of these secret statutory liens, but their very nature prevents the creditor from discovering them in specific day-to-day operations. These liens

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[6] 11 U.S.C.S. § 545(2) (Law. Co-op. 1986 & Supp. 1993).

[7] *Id.* §§ 545(3),(4).

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

[9] 11 U.S.C.S. 101(37) (Law. Co-op. 1985 & Supp. 1993).

[10] *Id.* 101(36).

[11] *Id.* 101(53).

[12] Meyer, *supra* note 8, at 1319 n.9.

are secret until discharged by the creditor who holds the lien.

Because of the size and economic importance of California's agricultural industry, the California legislature has been particularly active in adopting and enacting secret agricultural liens. They include a thresh-ermen's lien,[13] a lien for all expenses of dipping or treating cattle or sheep,[14] a loggers' and lumbermen's lien,[15] and a producer's lien.[16]

Other states have also enacted secret-liens statutes. For example, Ohio has adopted an agricultural product lien law,[17] and Massachusetts has adopted a statute which provides for liens on vessels.[18] Additional examples of state statutory liens include a lien for stud service; a lien for merchant commissions for the sale of farm products; a lien for livestock feeders and stable keepers; a lien for farriers; liens for unpaid pasture and crop rents; a lien for veterinarian services; a lien for harvest labor and machinery; a lien for the processing of farm products; a lien for the production of feed, fertilizer, seed and chemicals; and a lien for bovine brucellosis treatment.[19]

The legislative history of section 545 emphasizes the importance of perfection or the giving of notice to third parties of the lienholder's claim in certain, specified goods:

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[13] CAL. CIV. CODE § 3061 (West 1993).

[14] CAL. FOOD & AGRIC. CODE § 9331 (West 1986).

[15] CAL. CIV. CODE § 3065a (West 1993).

[16] CAL. FOOD & AGRIC. CODE §§ 55631-55653 (West 1986 & Supp. 1994).

[17] OHIO REV. CODE ANN. § 1311.55 (Anderson 1993).

[18] *In re* Bay State Yacht Sales, Inc., 117 B.R. 16, 17-18 (Bankr. D. Mass. 1990) (citing "Massachusetts Liens on Vessels Statute, M.G.L. ch. 255, section 14, *et seq.*, and the Federal Maritime Statute codified in 46 U.S.C. Appx. § 971." [§ 971 (Act of June 5, 1920, ch. 250, sec. 30, subsec. P, 41 Stat. 1005) *repealed by* Act of Nov. 23, 1988, Pub. L. No. 100-710, tit. I, sec. 106(b)(2), 102 Stat. 4752, effective Jan. 1, 1989]).

[19] Meyer, *supra* note 8, at 1324; *see generally* MARTHA L. NOBLE, STATUTORY AGRICULTURAL LIENS (1993)(containing the results of a state lien-laws survey performed under the aegis of the National Center for Agricultural Law Research and Information, School of Law, University of Arkansas, Fayetteville); *compare with* Packers and Stockyards Act, 1921, ch. 64, tit. I, sec. 1, 42 Stat. 159 (1921) (codified as amended at 7 U.S.C. §§ 181-229 (1993), and Perishable Agricultural Commodities Act, 1930, ch. 436, sec. 1, 46 Stat. 531 (1930) (codified as amended at 7 U.S.C. §§ 499a-499t (1993) (compared with secret-lien statutes, these laws compose a statutory trust on assets to ensure repayment to farmers and ranchers); *see also In re* Milton Poulos, Inc. 947 F.2d 1351, 1351 (9th Cir. 1991) (holding that "defendant suppliers had properly perfected their PACA trust rights . . . ."), and *In re* San Joaquin Food Service, Inc. 958 F.2d 938, 938 (9th Cir. 1992) (state lien avoidable under § 545(2) but federal lien not avoidable; holding that "supplier's failure to include terms of payment in its invoices to debtor buyer voided its rights in PACA trust . . . .").

> Liens that are not perfected or enforceable on the date of the petition against a bona fide purchaser are voidable. If a transferee is able to perfect under section 546(a) and that perfection relates back to an earlier date, then in spite of the filing of the bankruptcy petition, the trustee would not be able to defeat the lien, because the lien would be perfected and enforceable against a bona fide purchaser that purchased the property on the date of the filing of the petition.[20]

Thus, liens which would not be enforceable against a bona fide purchaser would be invalidated under section 545(2). Federal courts struggling to apply the bona fide purchaser test have, however, developed inconsistent standards,[21] and Congressional intent has been seriously undermined by the continuing proliferation of secret liens created by state legislatures to give special protection to farmers.

Secret liens are generally disfavored by bankruptcy courts "as contrary to the values of openness and equality which characterize and are basic to bankruptcy."[22] At least one court has concluded that "one of the principal purposes of the Bankruptcy Reform Act is to discourage the creation of 'secret liens' by invalidating all transfers occurring within 90 days prior to the filing of the petitions."[23] Nor, as commentators have observed, "is any one factor conclusive standing alone. Each transaction must be viewed on its facts bearing in mind the Code's abhorrence of secret liens."[24]

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[20] H.R. REP. NO. 595, 95th Cong., 2d Sess. 371 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6327.

[21] Dale Bratton, Note, *The California Agricultural Producer's Lien, Processing Company Insolvencies, and Federal Bankruptcy Law: An Evaluation and Alternative Methods of Protecting Farmers*, 36 HASTINGS L.J. 609 (1985). The author describes and discusses the following federal court interpretations of the bona fide purchaser test: (1) the "statutory requirements" approach—lien validated in bankruptcy "if the lienholder has complied with all the requirements of the relevant state statute[,]" *id.* at 618; (2) the "express language" approach—lien validated in bankruptcy if "the statute expressly provides that a perfected lien is enforceable against a bona fide purchaser[,]" *id.* at 619; (3) the "any one type" approach—lien validated in bankruptcy "if under state law the lien could be enforced against any one of several types of bona fide purchasers[,]" (footnote omitted), *id.* at 619; (4) the "factual circumstances" approach—lien validated in bankruptcy "if the lien would be enforceable against a bona fide purchaser in the factual circumstances of the actual bankruptcy case[,]" *id.* at 620; and (5) the "notice" approach—lien validated in bankruptcy "if the state statute requires actual or constructive notice to a bona fide purchaser via recording, seizure of the goods, or equivalent means[,]" *id.* at 621.

[22] *In re* Bay State Yacht Sales, Inc., 117 B.R. at 18.

[23] *Id.* (quoting *In re* Arnett, 731 F.2d 358, 363 (6th Cir. 1984).

[24] *In re* Bay State Yacht Sales, Inc., 117 B.R. at 18 (citing *In re* Puckett 60 B.R. 223, 233 n.21 (Bankr. M.D. Tenn. 1986) (citing JAMES J. WHITE & ROBERT S. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE,

Consistent with this policy, the legal effect of section 545 is to make secret liens avoidable under the Bankruptcy Code. Although secret liens may receive deferential treatment by the federal appellate courts, it appears that such liens held by farmers are avoided by bankruptcy courts and most trial courts.

Among California's many secret agricultural liens, the producer's lien may be the most significant.[25] It provides a lien to the farmer who sells farm products to a processing company until such time as the processor fully pays for the goods received. The producer's lien was adopted by the California legislature following processor failures in the 1970's and early 1980's, many of which held goods delivered by farmers for which final payment had not yet been made.[26]

Typical of secret-lien statutes, the producer's lien seeks to improve the legal position of any farmer who has not yet received final payment for his or her products by giving him or her an automatically perfected lien, without notice, in certain of the assets of the processing company which purchases such products.[27] It provides that the farmer who sells farm products "grown by him" to a processing company receives a lien on the products, themselves, "and upon all processed or manufactured forms"[28] of such products which are "in the possession of the processor without segregation of such product."[29] The value of the lien is established as the contract price, or the value of the delivered products if there is no agreed price.[30] The lien attaches to the delivered products from the date of delivery and is perfected from the date of delivery, except where there is a series of deliveries under a given contract, in which case perfection occurs "from the date of the last delivery."[31] The lien is apparently limited to products and their proceeds still in the processor's possession[32] and would not be enforceable against a purchaser or other person who takes possession of the goods for value. Its duration is indefinite,[33] and the statute does not specify whether it extends beyond the delivered product, itself, to proceeds such as cash or

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§ 22-3, at 878 (2d ed. 1980)).

[25] CAL. FOOD & AGRIC. CODE §§ 55631-55653 (West 1986 & Supp. 1994).

[26] Bratton, *supra* note 21, at 609 n.1.

[27] *See, e.g.*, CAL. FOOD & AGRIC. CODE § 55631 (West 1986 & Supp. 1994).

[28] *Id.*

[29] *Id.* § 55634.

[30] *Id.* § 55631.

[31] *Id.* § 55635.

[32] *Id.* § 55634.

[33] *Id.* § 55635.

accounts receivable.[34] In effect, the producer's lien automatically primes consensual security interests against the processed product.

Significantly, California's producer's-lien statute does not require that the farmer file or give any notice in order to perfect the lien. By mere delivery, a producer acquires a lien described as "a preferred lien prior in dignity to all other liens, claims, or encumbrances"[35] except employee wage and salary claims[36] and warehouseman's liens as provided by division 7 of the Uniform Commercial Code.[37] Although the statute was first enacted in 1933, there are no recorded cases which consider validity, extent or priority of the producer's lien outside the bankruptcy context.[38] The reason for this lack of judicial attention is that until January 1, 1980, a lender seeking to finance a processor's inventory could file a statement of intention to finance with the Director of the California Department of Agriculture.[39] This statement served to put farmers on notice of the existence of a lien or liens on the processor's inventory. Ironically, the state statute permitted a bypass of Bankruptcy Code section 545, since most processor loans were personally guaranteed by a principal. In 1979, however, the California legislature eliminated this protection for secured lenders[40] and also eliminated the 60-day limitation on the lien's duration.[41] As a result of the 1979 amendments, lenders who lend money to food processors cannot be certain that their security interest in the borrower's inventory is first in priority or subject to a secret producer's lien of unlimited duration and amount.[42]

The fact that the California legislature received little opposition to the 1979 amendments was apparently because lenders assumed that a farmer could and would waive the producer's lien and, therefore, preserve a lender's first priority security interest in inventory.[43] Yet no such right exists under the statute, and the legislative history is silent

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[34] JOHN D. AYER ET AL., SECURED TRANSACTIONS IN CALIFORNIA COMMERCIAL LAW PRACTICE § 8.68 (Edward D. Giacomini et al. eds., 1986 & Supp. 1993).

[35] CAL. FOOD & AGRIC. CODE § 55633 (West 1986).

[36] *Id.* § 55633(a).

[37] *Id.* § 55633(b).

[38] AYER ET AL., *supra* note 34.

[39] *Id.; see also id.* § 8.4 (discussing the distinction between farm products and inventory under CAL. COMM. CODE § 9109 (West 1990 & Supp. 1994)).

[40] 1979 Cal. Stat. 969, § 6.

[41] CAL. FOOD & AGRIC. CODE § 55635 (West 1986 & Supp. 1994); *see also* AYER ET AL., *supra* note 34.

[42] AYER ET AL., *supra* note 34.

[43] *Id.*

on this issue. However, the Ninth Circuit has expressly denied the validity of such waivers which, until recently, were contained on preprinted forms prepared by institutional lenders and signed by farmers at the urging of the processor due to the insistence of lenders who would not lend unless assured of having a first priority consensual lien.[44]

Therefore, despite questions concerning its extent and priority, the California producer's lien provides significant protection for producers who deliver products to a processing company, which then fails to make required payments under the delivery contract. As long as the processing company remains solvent with assets to which the lien may attach, the farmer is reasonably protected. When the processor declares bankruptcy, however, section 545 should permit avoidance of any such prefiling secret lien which could not be enforced against a bona fide purchaser of the goods subject to the lien.[45] "The producer's lien therefore could be invalidated in the one situation—bankruptcy—in which farmers most need its protection."[46]

Despite the clear meaning of section 545(2), the Ninth Circuit has favored California farmers with unique treatment following the bankruptcy of processors—it has reversed bankruptcy courts on at least two occasions by upholding the enforcement of producers' liens despite the clear wording of section 545. For instance, in *In re Loretto Winery Ltd.*, the Ninth Circuit overruled decisions by the bankruptcy court and the bankruptcy appellate panel by holding that "[t]he California producer's lien is good against a bona fide purchaser when the processor has sold the product but retains the possession and does not apply the proceeds to satisfy the lien."[47]

The case arose after the farmer-producer-lienholder sold grapes to

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[44] *In re* T. H. Richards Processing Co., 910 F.2d 639 (9th Cir. 1990).

[45] Whether a lien is perfected or enforceable against a bona fide purchaser is decided under principles of state law. *In re* Marino, 813 F.2d 1562, 1565 (9th Cir. 1987) (citing *In re* Morse, 30 B.R. 52, 54 (Bankr. 1st Cir. 1983); *In re* Gurs, 27 B.R. 163, 164 (Bankr. 9th Cir. 1983); *In re* Great Plains W. Ranch Co., 38 B.R. 899, 905 (Bankr. C.D. Cal. 1984)); *see* 4 COLLIER ON BANKRUPTCY ¶ 544.02 (Lawrence P. King ed., 15th ed. 1993). "Courts look to state law to determine the 'underlying property interests and commercial arrangements' at issue in bankruptcy proceedings." *In re* Loretto Winery Ltd., 898 F.2d 715, 718 (9th Cir. 1990) (citing Selby v. Ford Motor Co., 590 F.2d 642, 646 (6th Cir. 1979) (citing Chicago Bd. of Trade v. Johnson, 264 U.S. 1, 10 (1923). *See also In re* Anchorage Int'l Inn, Inc., 718 F.2d 1446, 1451 (9th Cir. 1983) ("applying state law in determining that lien on liquor license survived section 545 avoidance."). *In re* Loretto Winery Ltd., 898 F.2d at 718.

[46] Bratton, *supra* note 21, at 610; *see also* AYER ET AL., *supra* note 34.

[47] *In re* Loretto Winery Ltd., 898 F.2d at 724-25.

Loretto Winery which processed them into wine and wine products. The producer's deliveries were made under contract and involved a series of deliveries during the course of the 1985 harvest. Eight days after the producer's last delivery, Loretto Winery filed chapter 11. The bankruptcy case was subsequently converted to chapter 7, and the trustee brought an adversary proceeding in the bankruptcy court seeking to avoid the producer's lien under section 545. If avoided, it would mean the inventory sale proceeds would be distributed in accordance with the chapter 7 scheme of distribution and the grape-grower farmers would have been treated as general unsecured creditors. The bankruptcy court granted summary judgment in favor of the trustee ruling that section 545(2) permitted avoidance of the producer's lien. The grape growers appealed and the bankruptcy appellate panel subsequently affirmed the bankruptcy court.[48]

The grape growers appealed to the Ninth Circuit and successfully argued that the producer's lien is not subject to avoidance under section 545 because, under California law, the producer's lien is good against a hypothetical bona fide purchaser who has possession of the product. On the other hand, the chapter 7 trustee argued that a fundamental bankruptcy policy is frustrated if producers are given priority over other creditors by virtue of California's producer's lien law. "A central policy of federal bankruptcy law is distribution of the bankrupt's assets ratably among creditors."[49] The Ninth Circuit reversed the bankruptcy appellate panel's decision and upheld the producer's-lien rights; however, the Ninth Circuit recognized under bankruptcy law "that social, economic, or political policy sometimes justifies deviations from a strict rule of equity."[50] The court noted that

> [t]he producer's lien is central to an extensive California statutory scheme giving farm product producers a lien on all farm products they sell. [Citation omitted.] . . .' [T]he clear legislative intention and purpose behind [the lien statute] is that the producers shall be assured full payment for their farm products . . .' [Citation omitted.] . . . The sense underlying the statutory scheme is that other creditors should not be allowed to benefit from the pockets of laborers and suppliers who have increased the estate's value or, indeed, have created it. [Citations omitted.][51]

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[48] *Id.* at 717.

[49] *Id.* at 718 (citing *In re* Lewis F. Shurtleff, Inc., 778 F.2d 1416, 1420 (9th Cir. 1985).

[50] *In re* Loretto Winery Ltd., 898 F.2d at 718 (citing S. Rep. No. 1159, 89th Cong., 2d Sess. 1 (1966), *reprinted in* 1966 U.S.C.C.A.N. 2442, 2456 (discussing 1966 amendments to Bankruptcy Act predecessor to § 545).

[51] *In re* Loretto Winery Ltd., 898 F.2d at 720-21.

The Ninth Circuit concluded that the mere filing of bankruptcy did not result in a physical transfer of the goods between the debtor and the trustee as hypothetical bona fide purchaser—there was no *change in possession* which would otherwise invalidate the lien. The court observed that such a result would allow the chapter 7 trustee to avoid the lien "while the debtor-in-possession [in a chapter 11 case] would not, even with all other circumstances identical."[52] The court added:

> In this case, the debtor, and therefore the trustee, had possession of the grapes when it filed for bankruptcy. [Footnote omitted.] Under the California statute, the lien remains on the grapes only as long as the processor retains possession. § 55634. Congress has determined that state law should determine the property interests underlying bankruptcy disputes; and under California state law, the lien lives or dies based on possession.[53]

The Ninth Circuit's analysis gave short shrift to the issue of notice and the traditional bankruptcy protection afforded bona fide purchasers against secret liens. It held that the proper inquiry is whether the particular lien is good against the bona fide purchaser under state law:

> Secrecy and general policy toward bona fide purchasers are not strictly the issues under section 545. The appropriate inquiry is whether *this* lien is good against a bona fide purchaser under the California statutory scheme. We conclude that the producer's lien is indeed good against a bona fide purchaser without possession under California law when the proceeds are not used to satisfy the lien.[54]

The dissent argued that Congress gave the trustee certain avoidance powers including those under section 545 and intended that they be pursued vigorously.[55] Moreover, despite California's policy favoring the producer's lien, federal preemption elevates section 545 over any state-created scheme of creditor priorities: " '[I]f all statutory liens, regardless of what they were in substance, were to be treated as liens in bankruptcy, the order of federally created priorities would be completely

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[52] *Id.* at 721 n.9.

[53] *Id.* at 721.

[54] *Id.* at 724. The court cited with favor four opinions from the Fifth Circuit as "the only other circuit to examine whether section 545(2) allows a trustee to avoid a statutory lien when the statute has no formal perfection requirements." . . . *In re* Martin Exploration Co., 731 F.2d 1210 (5th Cir. 1984); *In re* Tape City U.S.A., Inc., 677 F.2d 401 (5th Cir. 1982) (per curiam); *In re* Lowery Brothers, Inc., 589 F.2d 851 (5th Cir. 1979); *In re* Trahan, 283 F.Supp. 620 (W.D. La.), *aff'd*, 402 F.2d 796 (5th Cir. 1968) (per curiam) (" 'The district court wrote a well-reasoned and exhaustive opinion which fully sets forth the factual and legal issues involved.'"), *cert. denied sub nom.*, Bernard v. Beneficial Fin. Co., 394 U.S. 930 (1969). *Id.* at 719.

[55] *In re* Loretto Winery Ltd., 898 F.2d at 725.

disrupted.'"[56]

The dissent distinguished the majority's reliance on the Fifth Circuit's opinions,[57] by observing that the Fifth Circuit "simply noted that the statutes did not require filing. It has yet to acknowledge the impact of a policy against secret liens."[58] The dissent cited with favor the Third Circuit case *In re Mission Marine Associates, Inc.*[59] which involved a New Jersey statute providing a non-possessory materialman's lien for work completed on marine vessels prior to launching and which did not require recording. "[D]iscerning a state 'policy concerning the protection of bona fide purchasers against secret non-possessory liens . . . [,]'" the Third Circuit concluded that the state supreme court " 'would apply [this] policy to protect a [buyer] who purchased from Mission Marine without notice of [the creditor's] claim.'"[60] Accordingly, the dissent urged that the "notice" approach requiring actual or constructive notice of a lien[61] be adopted by federal courts of the Ninth Circuit:

> The "notice" approach best enforces the congressional intent underlying the bona fide purchaser test. Under this approach, the states are properly limited in their use of statutory liens. If the states want to give certain groups of creditors secured status, then they may give these creditors lien rights that are evidenced in general commerce by a notice filing. Furthermore, bankruptcy courts can readily administer the "notice" approach. This approach reduces the ambiguity created by the hypothetical bona fide purchaser status of the trustee in bankruptcy. The courts more easily can determine if this hypothetical entity could have had notice of a particular lien than they can determine what type of purchaser he is or what actions beyond purchase he may or may not be supposed to have taken.[62]

According to the dissent, the few California decisions which address the issue uniformly protect the rights of bona fide purchasers against statutory liens which may be perfected without filing or recordation.[63]

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[56] *Id.* (citing S. Rep. No. 1159, 89th Cong., 2d Sess. 2-3 (1966), *reprinted in* 1966 U.S.C.C.A.N. 2442, 2456, 2457).

[57] *See supra* note 54.

[58] *In re* Loretto Winery Ltd., 898 F.2d at 725.

[59] *In re* Mission Marine Assoc., Inc., 633 F.2d 678 (3d Cir. 1980).

[60] *In re* Loretto Winery Ltd., 898 F.2d at 725 (citing *In re* Mission Marine Assoc., Inc., 633 F.2d at 861).

[61] *See* Bratton, *supra* note 21, at 621-23.

[62] *In re* Loretto Winery Ltd., 898 F.2d at 725-26 (citing Bratton, *supra* note 21, at 621-23, 628).

[63] *In re* Loretto Winery Ltd., 898 F.2d at 726 (citing Schut v. Doyle, 336 P.2d 567, 569 (1959); *cf.* 1 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 14.1, at 439 (1965)(" 'The antagonism to the 'secret lien' runs through [California's] law of sales and secured [sic] transactions alike.'") (alteration in original) (footnote

The dissent emphatically concludes: "The California producer's lien gives no actual or constructive notice to subsequent purchasers. It could not be enforced against a bona fide purchaser."[64]

*In re Loretto Winery Ltd.* supports the proposition that statutory liens containing explicit perfection provisions are good against bona fide purchasers only when those provisions have been followed. It extends this reasoning, however, by the implicit holding that statutory liens *without* explicit perfection provisions are enforceable against bona fide purchasers (i.e., automatically perfected) where the state policies behind the lien are of greater importance than the countervailing policies protecting innocent purchasers.

*In re Loretto Winery Ltd.* establishes a rule which seems hopelessly nebulous and difficult to apply and which turns bankruptcy policy on its head. Furthermore, common law principles of statutory interpretation suggest the opposite rule: legislatures are presumed to know the common law when they enact statutes.[65] The long-standing common law policy *against* secret liens holds that bona fide purchasers ordinarily take free and clear of all secret interests unless they are somehow put on notice of a lienor's interest in the security. If the legislature had intended to protect lienors to the detriment of innocent purchasers in violation of established common law policy, it should have done so through artful drafting. Protection of lienors was not accomplished, however, with California's producer's lien statute.

A second Ninth Circuit case that dealt with the California producer's lien is *In re T.H. Richards Processing Co.*[66] In this case, several tomato, peach and pear growers asserted producers' liens against the inventory of T.H. Richards Processing Co., a debtor in bankruptcy. The *In re T.H. Richards Processing Co.* decision did not specifically discuss the avoidance power of section 545 as it pertains to secret liens. Instead, the issue in *In re T.H. Richards Processing Co.* involved whether producers waived their statutory lien rights when agreeing to one-year deferred payment plans. The bankruptcy court held, in a prior order not accompanied by an opinion, that producers' liens were *not* avoidable

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omitted); Finnell v. Finnell, 105 P. 740, 742 (1909)("When the legislature enacts a lien without provisions requiring filing or recordation, the lien will be enforced 'so far as it can . . . without injury to the rights of bona fide purchasers.'") (footnote omitted); *In re* Badger Mountain Irrigation Dist., 885 F.2d 606 (9th Cir. 1989)(where lienholder is not required to file notice of a lien, a "hypothetical bona fide purchaser cannot be held to have had constructive notice of the lien.").

[64] *In re* Loretto Winery Ltd., 898 F.2d at 727.

[65] Viking Pools, Inc. v. Maloney, 770 P.2d 732 (1989).

[66] *In re* T. H. Richards Processing Co., 910 F.2d 639 (9th Cir. 1990).

under section 545(2).[67] One can only conclude that the court was relying on *In re Loretto Winery Ltd.* as authority for upholding the producer's lien.

In various forms, the producers' contracts with T.H. Richards provided for a payment schedule to be concluded one year after delivery, without interest, and contained a section entitled " 'Release of Producer's Lien,' which purported to effect a release of the growers' statutory liens which arise under California law."[68] The bankruptcy court, affirmed by the district court, determined that the growers had released their producer's liens pursuant to California Food and Agriculture Code section 55637 upon agreeing to the deferred payment schedule.[69] The Ninth Circuit reversed decisions by the bankruptcy court and district court holding that a liberal interpretation of California's agricultural producer's-lien statute was necessary to accomplish its statutory purposes and that such a deferred payment plan did not as a matter of law, release a producer's lien.[70]

*In re T.H. Richards Processing Co.* demonstrates the Ninth Circuit's willingness to continue its protectionism of farmers and their secret liens that the court revealed in *In re Loretto Winery Ltd.*

## Conclusion

The author is sympathetic to the financial plight of farmers. It is disheartening when farmers toil for an entire year, finance the production of their crops, and pay labor costs only to sell their products to a processor that goes broke. However, a farmer is no different from a manufacturer or a wholesaler. The latter sellers do not receive special lien protections and neither should farmers.

The Bankruptcy Code embodies the principle that secret liens are avoidable. If secret liens are not avoided, then the several states will quickly enact special secret lien laws for favored groups or industries, and soon thereafter the uniform nature of bankruptcy will be undone. While farmers deserve to be protected, they deserve no more or different protections than other creditors.

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[67] Bratton, *supra* note 21, at 623.
[68] *In re* T. H. Richards Processing Co. 910 F.2d at 641.
[69] *Id.* at 644.
[70] *Id.* at 643 n.3.