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An Agricultural Law Research Article

**Securing an Interest in Raw Materials  
(Crops, Timber and Minerals)**

by

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## SECURING AN INTEREST IN RAW MATERIALS (CROPS, TIMBER AND MINERALS)

Legal rights in crops, timber and minerals<sup>1</sup> are especially important to the Northwest. Firms producing these raw materials have recently experienced an economic double bind, because their income has decreased, while the costs of production have increased. The unsecured creditor of raw materials firms is in an unenviable position. Article 9 of the Uniform Commercial Code [hereinafter UCC or Code] may afford a creditor some protection against loss. It is significant that the 1972 version of the Code was recently enacted in Washington and became effective on midnight June 30, 1982.<sup>2</sup> Furthermore, raw materials are interesting in an analytical way because their physical condition, use and legal definitions are not static.

This Comment will focus on legal issues related to perfecting a secured interest in raw materials and will note any peculiarities in Washington law. Washington case law follows the majority of other jurisdictions. The Washington legislature adopted a version of the UCC similar to the official text of the Code.<sup>3</sup>

This Comment will be organized into four major areas beginning with a survey of the background of Article 9 and the drafters' objectives. Second, the steps necessary to create a perfected Article 9 security interest in crops, minerals and timber will be addressed. Third, the problem of overlapping and uncertain authority to create an encumbrance between Article 9 and real estate law will be addressed. Finally, the performance of Article 9 in the area of

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1. This Comment will use terms in both their technical and ordinary meanings. Quotes will be put around words to indicate the technical meaning whenever ambiguity is possible.

2. WASH. REV. CODE tit. 62A (1981) (effective midnight June 30, 1982) will be the primary reference for the Uniform Commercial Code in this Comment. The official text of the Code is the most convenient source for the official comments. See UNIFORM COMMERCIAL CODE, 1972 OFFICIAL TEXT (1972). The 1972 official text will be indicated by the use of U.C.C. and section numbers. Any reference to other versions of the Code will be explicit.

3. B. CLARK, THE LAW OF SECURED TRANSACTIONS, app. C (Supp. 1982).

crops, timber and minerals will be examined in light of the Code drafters' objectives.<sup>4</sup>

### I. THE ARTICLE 9 REVOLUTION

Article 9 is the most recent American statutory scheme concerning secured transactions in personal property.<sup>5</sup> When the authors of Article 9 examined the existing structure of security law, they concluded that it functioned poorly.<sup>6</sup> It contained a multiplicity of nineteenth-century security devices. Each device created different rights, formalities and filing procedures.<sup>7</sup> The old system was also thought to be too inflexible to accommodate new forms of property, for example television or motion picture rights.<sup>8</sup> The result was confusion, useless formalities, and gaps in coverage.<sup>9</sup>

The drafters<sup>10</sup> aimed to achieve a unified and simple, yet flexible structure.<sup>11</sup> They did away with distinctions among security devices and used a new and simpler terminology.<sup>12</sup> They chose to make distinctions along functional lines. The authors of Article 9 anticipated that a rational filing system would make information easier to obtain and reduce the cost of credit. They also hoped that a simplified and flexible system would allow the development of secured financing into new areas.<sup>13</sup> In short, the drafters sought to achieve their goals by creating "a comprehensive scheme for the

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4. Article 9 issues of general applicability will not be covered.

5. The creation and reform of security interests has been reported since the earliest legal systems. Herodotus wrote that Egyptians would pawn their ancestors' mummies to secure a loan. Upon default the lender was permitted to enter the family tomb and prevent further burials. HERODOTUS, *THE HISTORIES* 173 (J. Powell trans. 1949). One of the most important features of Solon's reform of Athenian law was a prohibition on securing debt by the borrower's person. W. WOODHOUSE, *SOLON THE LIBERATOR* 70-72 (1965).

6. Gilmore, *The Secured Transactions Article of the Commercial Code*, 16 *LAW & CONTEMP. PROBS.* 27, 29 (1951).

7. U.C.C. § 9-101 official comment.

8. *Id.*

9. *Id.*

10. A large number of individuals assisted in the development of Article 9 from its original draft through subsequent major revisions. See *UNIFORM COMMERCIAL CODE, 1972 OFFICIAL TEXT* General Comment, Reports 1, 2, and 3 of the Permanent Editorial Board, and Foreword (1972).

11. U.C.C. § 9-101 official comment; *WASH. REV. CODE* § 62A.1-102(2)(a), (c) (1981).

12. Coogan, *A Suggested Analytical Approach to Article 9 of the Uniform Commercial Code*, 63 *COLUM. L. REV.* 1 (1963).

13. U.C.C. § 9-101 official comment; *WASH. REV. CODE* § 62A.1-102(2)(b) (1981).

regulation of security interests in personal property and fixtures."<sup>14</sup>

## II. STEPS REQUIRED TO CREATE A PERFECTED SECURITY INTEREST IN CROPS, TIMBER AND MINERALS

It is possible for Article 9 to protect a creditor's interest in personal property from the competing interests of the debtor, other creditors, or a bankruptcy trustee if the requirements of the Code are satisfied. If the transaction is within the scope of Article 9, the creditor's interests receive protection when two steps are taken:

1. Creation of an "attached" security interest enforceable against the debtor;<sup>15</sup> and
2. Creation of a "perfected" security interest enforceable against other parties.<sup>16</sup>

A prudent creditor will satisfy the requirements of the Code and thus attain the "most exalted status . . . that of (a) perfected secured creditor."<sup>17</sup>

### A. *Bring the Transaction Within the Scope of Article 9*

Whether a transaction is subject to Article 9 is determined by a two step test, of inclusion then exclusion. First, RCW 62A.9-102<sup>18</sup> generally includes a transaction within the Code if it results from the mutual consent of the parties to create a security interest and if the collateral involved consists of certain kinds of property. Second, RCW 62A.9-104 excludes a list of transactions. One general theme of these two sections is to include personal property and exclude realty.

Real estate connected collateral is dynamic. The evolution of raw materials frequently gives rise to analytical problems. Real estate connected collateral can move in either direction across the boundary between realty and personal property. When the movement is from personalty to real property status the collateral be-

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14. Gilmore, *supra* note 6, at 27.

15. WASH. REV. CODE § 62A.9-203 (1981) (effective midnight June 30, 1982).

16. U.C.C. § 9-303 official comment.

17. B. CLARK, *THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE* ¶ 1.2(2), at 1-12 (1980).

18. WASH. REV. CODE § 62A.9-102 (1981) (effective midnight June 30, 1982).

comes a fixture.<sup>19</sup> When realty becomes personal property there is no comprehensive treatment of the associated problems by the Code. Rather, raw materials are treated severally as "crops," "timber" and "minerals." See Appendix I for a chart illustrating how Code terminology changes as crops evolve physically. Also, see Appendix II for a chart describing how terminology affects the correct methods for "perfection". The first of the problems associated with the dynamic nature of raw materials is to determine when the evolving property becomes subject to Article 9.

### 1. Crops

Growing crops are defined as "goods" by RCW 62A.9-105(1)(h). "Goods" are a kind of property included within the scope of Article 9 under RCW 62A.9-102. Additionally, in RCW 62A.9-109(3) the drafters specifically included crops or products of crops in their unmanufactured state within the definition of "farm products."<sup>20</sup> Crops as soon as they have begun their physical development have met the inclusionary portion of the test.

Two Code sections give authority for the exclusion of transactions involving crops from the UCC. First, RCW 62A.2-107(2) implicitly excludes crops sold in conjunction with the land from Code coverage. This section of Article 2 was used by the authors of the Code to define "goods" for both Articles 2 and 9.<sup>21</sup> Second, RCW

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19. See WASH. REV. CODE § 62A.9-313(1)(a) (1981) (effective midnight June 30, 1982) for the Code definition of fixtures. A considerable discussion of fixtures is available. Coogan, *Security Interests in Fixtures Under the Uniform Commercial Code*, 75 HARV. L. REV. 1319 (1962); Gilmore, *The Purchase Money Priority*, 76 HARV. L. REV. 1333 (1963); Kripke, *Fixtures Under the Uniform Commercial Code*, 64 COLUM. L. REV. 44 (1964). As a result of criticism, the 1962 Code provisions concerning fixtures were redrafted. See U.C.C. § 9-313 app. Reasons for 1972 Change; Coogan, *The New UCC Article 9*, 86 HARV. L. REV. 477 (1973).

20. Contracts for the sale of growing crops (apart from land) are goods. WASH. REV. CODE § 62A.2-105(1) (1981); U.C.C. § 2-105 official comment; WASH. REV. CODE § 62A.2-107(2) (1981) (effective midnight June 30, 1982). See generally E. REILEY, *GUIDEBOOK TO SECURITY INTERESTS IN PERSONAL PROPERTY* § 12 (1981). But, real estate law determines rights in growing crops between a landlord and tenant or between a seller and purchaser or when the doctrine of emblements comes into play (crops produced annually by a tenant). *In re Machlied's Estate*, 60 Wn. 2d 354, 374 P.2d 164 (1962) (probate of landlord's estate); *Finley v. McClure*, 222 Kan. 637, 567 P.2d 851 (1977) (probate of life tenant's estate). See 5 R. POWELL & P. ROHAN, *POWELL ON REAL PROPERTY* ¶ 663 (1981).

21. U.C.C. § 9-105 official comment 3 refers to U.C.C. § 2-105 which in turn refers to U.C.C. § 2-107.

62A.9-104(j) excludes interests or liens on real estate. The Code recognizes that a mortgage is an interest in real estate.<sup>22</sup> The Washington Supreme Court, in discussing a contract for the sale of real estate, has characterized "a vendee's interest as real property and a vendor's interest as personal property."<sup>23</sup> No Washington cases discuss deeds of trust or other interests in real estate in the context of secured financing. Lacking guidance from the UCC as to other types of interests, Washington courts should examine whether the interest is more like a mortgagee's or a vendor's interest. Because an Article 9 security interest can burden collateral already covered by a real estate encumbrance, it is always prudent to secure an interest in crops by complying with Article 9.<sup>24</sup> In summary, interests in crops sold in conjunction with the sale of land and interests in crops secured by a mortgage are said to be explicitly exempted from Article 9; otherwise crops are subject to the Code.

## 2. Minerals and Timber

Minerals, including oil and gas, are generally defined as "goods" for purposes of Articles 2 and 9,<sup>25</sup> and therefore are brought within the scope of Article 9 by RCW 62A.9-102. However, minerals before extraction are excluded by RCW 62A.9-105(h). In Washington and the majority of jurisdictions an interest in minerals before extraction is classified as real property,<sup>26</sup> and would also be removed from Code coverage by RCW 62A.9-104(j) which excludes interests or liens on real estate.<sup>27</sup> Beware that an interest in

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22. WASH. REV. CODE § 62A.9-105(1)(j) (1981) (effective midnight June 30, 1982). *But cf.* UNIFORM LAND TRANSACTIONS ACT § 3-210(a), 13 U.L.A. 671 (1980) (unless the parties agree no security interest attaches to crops).

23. *Freeborn v. Seattle Trust & Sav. Bank*, 94 Wn. 2d 336, 340, 617 P.2d 424, 427 (1980).

24. Coogan & Clovis, *The Uniform Commercial Code and Real Estate Law: Problems for Both the Real Estate Lawyer and the Chattel Security Lawyer*, 38 IND. L.J. 533, 551-55 (1963).

25. WASH. REV. CODE §§ 62A.2-107(1), 62A.9-105(h) (1981) (effective midnight June 30, 1982).

26. *McCoy v. Lowrie*, 44 Wn. 2d 483, 268 P.2d 1003 (1954); 1 H. WILLIAMS & C. MEYERS, OIL AND GAS LAW, § 214 (1981). *But see* *Chambers v. Nation*, 178 Colo. 124, 497 P.2d 5 (1972) (oil and gas lease with an option to purchase for little consideration was treated as a chattel mortgage).

27. Other "[i]nterests arising from oil and gas leases, mineral or royalty deeds are interests in land." 1 H. WILLIAMS & C. MEYERS, *supra* note 26, at § 212. The one clear excep-

real estate that is pledged to secure another obligation would be subject to Article 9.<sup>28</sup>

The UCC defines timber under contract to be severed by the buyer or seller as "goods" for purposes of Articles 2 and 9.<sup>29</sup> Prior to being severed, timber, like crops,<sup>30</sup> can be encumbered by both Article 9 and real estate law.

### *B. Create an "Attached" Security Interest Enforceable Against the Debtor*

Article 9 gives a party rights enforceable against a debtor when the security interest "attaches."<sup>31</sup> Under RCW 62A.9-203 a security interest attaches<sup>32</sup> to crops, timber and minerals, unless an explicit agreement postpones the time of attaching after three conditions are met:

1. The collateral is in the possession of the secured party pursuant to an agreement, or the debtor has signed a security

tion to this rule is found in New York, where a statute makes oil and gas leases personal property. N.Y. GEN. CONSTR. LAW § 39 (McKinney 1951). In other states there may be uncertainty about individual types of interests because they have not been considered by courts recently in the context of the Code. Kansas, New York and Ohio are said to define oil and gas interests as personal property, while Indiana and Kentucky are said to be uncertain. E. REILEY, *supra* note 20, at § 12.2(a) n.13. See Vagts, *The Impact of the Uniform Commercial Code on the Oil and Gas Mortgage*, 43 TEX. L. REV. 825, 833-41 (1965). See also H. WILLIAMS & C. MEYERS, *supra* note 26, at § 214; Annot., 90 A.L.R. 770 (1934) (oil and gas royalty as real or personal property); Annot., 101 A.L.R. 884 (1936) (oil and gas royalty as real or personal property); Annot., 131 A.L.R. 1371 (1941) (oil and gas royalty as real or personal property); Annot., 68 A.L.R. 2d 728 (1959) (solid mineral royalty as real or personal property). In states which define an interest in minerals before extraction as personal property, the U.C.C. § 9-105 official comment 3 states that "[t]he resulting problems [are to] be considered locally." These interests are to be excluded from treatment under U.C.C. § 9-103(3), (5), as well as classified as general intangibles under U.C.C. § 9-106.

28. U.C.C. § 9-102 official comment 4. See B. CLARK, *supra* note 17, ¶ 13.2, at 13-5 (assignment of a limited partnership interest subject to Article 9).

29. WASH. REV. CODE §§ 62A.2-107(2), 62A.9-105(h) (1981) (effective midnight June 30, 1982).

30. See *supra* note 24 and accompanying text. The 1962 version of the U.C.C. treated timber and minerals alike. Timber before severance was not within the scope of Article 9. See E. REILEY, *supra* note 20, at § 12.3(c).

31. U.C.C. § 9-203 official comment 1. When dealing with a corporation, WASH. REV. CODE § 23A.24.010 (1981) adds additional requirements to Article 9. *Pierce v. Astoria Fish Factors, Inc.*, 31 Wn. App. 214, 218, 640 P.2d 40, 43 (1982). Attachment is also a requirement for "perfection" of a security interest. WASH. REV. CODE § 62A.9-303(1) (1981).

32. WASH. REV. CODE § 62A.9-203 (1981) (effective midnight June 30, 1982) does not supersede WASH. REV. CODE § 62A.4-208 (1981) (security interest of collecting banks) or WASH. REV. CODE § 62A.9-113 (1981) (security interests arising under Article 2).

agreement which contains a description of the collateral and the land concerned; and<sup>33</sup>

2. Value has been given; and
3. The debtor has rights in the collateral.<sup>34</sup>

Descriptions of collateral and the related real estate are often a problem in the raw materials setting. Because crops, timber and minerals change physically, raw materials frequently evolve through several Code collateral classifications. The definitional pigeon hole in which the collateral is placed is also the key to the next step of "perfecting" the security interest. This means that scrupulous attention to the requirements of every relevant definitional category is important to an effective collateral description.

### 1. *Policies Behind Description Requirements*

Both the security agreement and the financing statement required for filing must contain a description of the collateral.<sup>35</sup> For crops and timber Washington requires a description of the land concerned on the security agreement.<sup>36</sup> For timber and minerals the financing statement must contain a real estate description, "sufficient if it were contained in a mortgage of the real estate to give constructive notice of the mortgage under the law of this state."<sup>37</sup> Real estate and collateral descriptions have caused considerable trouble for the potential secured party.<sup>38</sup>

These descriptions have two purposes. First, in the financing statement the description puts subsequent searchers of the records on notice that a prior interest may exist. Second, in the security agreement the collateral must be defined with enough certainty to

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33. *But see* Kreiger v. Hartig, 11 Wn. App. 898, 527 P.2d 483 (1974) (application for a truck title certificate is an "agreement").

34. WASH. REV. CODE § 62A.9-203(1) (1981) (effective midnight June 30, 1982). Mere lawful possession is not sufficient to constitute "rights in the collateral." Disch v. Raven Transfer & Storage Co., 17 Wn. App. 73, 76, 561 P.2d 1097, 1099 (1977).

35. WASH. REV. CODE §§ 62A.9-203(1)(a), 62A.9-402(1) (1981) (effective midnight June 30, 1982).

36. WASH. REV. CODE § 62A.9-203(1)(a) (1981) (effective midnight June 30, 1982).

37. WASH. REV. CODE § 62A.9-402(5) (1981) (effective midnight June 30, 1982). Nevertheless, the general rule is that both the security agreement and the financing statement must include a description of the real estate. [1 Uniform Commercial Code Selected Provisions] SECURED TRANSACTIONS GUIDE (CCH) ¶¶ 723, 762, 823, 862 (June 29, 1983).

38. *See* Annot., 67 A.L.R. 3d 308 (1975) (sufficiency of description of crops under U.C.C. §§ 9-203(1)(b) and 9-402(1)).

allow a court faced with a dispute to distinguish the property subject to the secured interest from other goods. The line between a sufficient and an ineffective description of collateral or land cannot be drawn without reference to the circumstances of the transaction.

• **COLLATERAL DESCRIPTIONS.** The use of Code classifications to describe the collateral is acceptable. In *United States v. Riceland Foods, Inc.* the use of the cryptic word "crop" was a sufficient collateral description; although, the court would have preferred the financing statement to give its notice using the phrase "all crops".<sup>39</sup>

A clearly defined collateral description on a security agreement is a prerequisite to sorting out the rights of the parties should a dispute arise. The minimum detail needed is a factual determination unique to every situation, but the courts will demand that the collateral description make possible the identification of the goods described.

• **COMPLETE REAL ESTATE DESCRIPTIONS.** The complete lack of a real estate description is not a minor error.<sup>40</sup> A real estate description for Article 9 "must raise a warning flag, as it were, providing a key to the identity of the property."<sup>41</sup>

A legal description sufficient, "to give constructive notice of

39. *United States v. Riceland Foods, Inc.*, 504 F. Supp. 1258, 1262-63 (E.D. Ark. 1981).

40. A "minor error" is one which is "not seriously misleading" thus an instrument can be "effective even though it contains minor errors." WASH. REV. CODE § 62A.9-402(8) (1981) (effective midnight June 30, 1982). See *infra* notes 79-83 and accompanying text. See also *In re Mount*, 5 U.C.C. REP. SERV. (CALLAGHAN) 653 (Bankr. S.D. Ohio 1968). In *United States v. Big Z Warehouse*, a description of "90 acres . . . 1 mile North of Offerman, Ga" was sufficient to describe land owned by a named farmer. 311 F. Supp. 283, 285-86 (S.D. Ga. 1970).

41. *United States v. Big Z Warehouse*, 311 F. Supp. 283, 286 (S.D. Ga. 1970). A lesser degree of precision was also required to give notice when a party was the vendor of the property in question. *United States v. Newcomb*, 682 F.2d 758, 762 (8th Cir. 1982) ("880 acres . . . located in Jasper County, Missouri, approximately 15 miles northwest of Carthage, Missouri" was sufficient). Also, less precision may be required when a party had previously been a party to a subordination agreement. *First Sec. Bank v. Wright*, 521 P.2d 563 (Utah 1974). Nevertheless, imprecise real estate descriptions are often found to be ineffective. See *Piggot State Bank v. Pollard Gin Co.*, 243 Ark. 159, 419 S.W.2d 120 (1967) (specified acreage of a specified crop to be produced on the land of a named individual was an insufficient description). *Accord Chanute Prod. Credit Ass'n v. Weir Grain Supply, Inc.*, 210 Kan. 181, 499 P.2d 517 (1972) ("land owned or leased by the debtor in Cherokee County, Kansas" was insufficient).

[a] mortgage . . ."<sup>42</sup> is not required for a financing statement covering crops. But, it is prudent to give a redundant legal language land description. When crops on less than the total acreage of the described property are to be covered by a security agreement, a precise land description is required.<sup>43</sup> If timber or minerals are to be a part of the collateral the precise legal language description is also required.<sup>44</sup> A sufficient plain language description of the premises in order to satisfy the purposes which underly the requirements for real estate descriptions should include the total acreage, the owner of the property and references that would allow one to find the property. For example, "[a complete collateral description] on 160 acres owned by \_\_\_\_\_, 10 miles west of George, Washington, southeast of the intersection of Highway 1 and Route 2" would be sufficient.

## 2. Collateral Descriptions for Crops

The fact that real estate connected collateral is not static gives rise to another problem. Raw materials, especially crops, may evolve through several Code collateral definitions. Questions of third party rights, priority, filing and rights after default are affected by the class to which the collateral is assigned.<sup>45</sup> If one fails to identify any substantial interest represented by a classification, an inadequate security interest may result.

Creditors will most often want to retain their secured interest in a crop as it evolves through ensuing collateral classifications. A "broad collateral" description is beneficial to the secured party. Subsequent security agreements can serve under a single broadly worded financing statement.<sup>46</sup> Also, a broadly worded collateral description might forestall the effects of subsequent errors by the creditor.<sup>47</sup> However, the debtor may be precluded from obtaining

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42. WASH. REV. CODE § 62A.9-402(5) (1981) (effective midnight June 30, 1982).

43. *Piggot State Bank v. Pollard Gin Co.*, 243 Ark. 159, 419 S.W.2d 120 (1967). Washington omitted the Code's requirement of a description of the land concerned on security agreements covering crops. WASH. REV. CODE § 62A.9-203(1)(a) (1981) (effective midnight June 30, 1982). Cf. U.C.C. § 9-203(1)(a).

44. WASH. REV. CODE § 62A.9-402(9) (1981).

45. U.C.C. § 9-109 official comment 1. See *infra* notes 73-74 and accompanying text for the effect of definitions on filing. See also *infra* Appendix II.

46. E. REILEY, *supra* note 20, § 3.8(c)(3).

47. See *Ellingsen v. Western Farmers Ass'n*, 12 Wn. App. 423, 529 P.2d 1163 (1974).

other financing because an overly broad collateral description is made.<sup>48</sup>

The Code divides collateral into two general types — tangibles and intangibles.<sup>49</sup> The Code and RCW 62A.9-109 then further subdivides tangible goods into four mutually exclusive categories: consumer goods, equipment, farm products and inventories.<sup>50</sup>

The structure of Code collateral classifications is not a convenient terminology with which to describe the physical evolution of crops and the associated issues of agricultural financing.<sup>51</sup> Nevertheless, it is important to identify the relevant collateral classifications which can affect an Article 9 security interest.

• FARM PRODUCTS. The RCW 62A.9-109(3) definition of "farm products" includes crops in two stages of development — growing crops and products of crops. Products of crops are harvested crops "in the possession of a debtor engaged in . . . farming operations."<sup>52</sup>

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48. See *infra* note 70 and accompanying text for the cures to an overly broad collateral description.

49. J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 23-1, at 901 (2nd ed. 1980).

50. U.C.C. § 9-109 official comment 2. The intent of the debtor at the time the security interest attaches controls the characterization of the collateral. *Commercial Credit Equip. Corp. v. Carter*, 83 Wn. 2d 136, 139, 516 P.2d 767, 769 (1973).

51. See *infra* Appendix I for a chart depicting this problem.

52. WASH. REV. CODE § 62A.9-109(3) (1981) (effective midnight June 30, 1982). The status of farm products collateral is most favorable to the farm lender. The original Code drafters viewed the farmer as an "unsophisticated tiller of the soil," and the 1962 version of the U.C.C. treated the farmer more paternalistically than did the 1972 version. Miller, *Farm Collateral Under the U.C.C.: "Those Are Some Mighty Tall Silos, Ain't They Fellas?"*, 1980-81 AGRIC. L.J. 253, 255; Hawkland, *The Proposed Amendment to Article 9 of the UCC-Part 1: Financing the Farmer*, 76 COM. L.J. 416, 416-17 (1971); Clark, *The Agricultural Transaction: Equipment and Crop Financing*, 11 U.C.C. L.J. 15, 18-20 (1978). The drafters were said to be unable to obtain the aid of anyone with a technical knowledge of farm financing. Coogan & Mays, *Crop Financing and Article 9: A Dialogue with Particular Emphasis on the Problems of Florida Citrus Crop Financing*, 22 U. MIAMI L. REV. 13, 17 (1967). A paternalistic view of the farmer was expressed in the 1962 version of the U.C.C. by three exceptions to main themes of the Code. First, WASH. REV. CODE § 62A.9-204(4) and 62A.9-312(2) (1981) (effective until midnight June 30, 1982) attempted to limit the otherwise generous provisions of the U.C.C. with respect to acquiring an automatic interest in after-acquired property. The restrictions contained in the 1962 version of WASH. REV. CODE § 62A.9-204 (1981) (effective until midnight June 30, 1982) could be avoided by obtaining a new security agreement each year signed by the debtor. If the original financing statement covers the new security agreement, the financing statement would retain its priority for five

• **INVENTORY.** In the agricultural setting “inventory” results most often from crops or products of crops losing their “farm products” character. This category should be separately mentioned as an element of collateral. The loss of “farm products” character happens when the goods come into the possession of a person not engaged in farming operations, such as a marketing agent.<sup>53</sup>

What constitutes possession is not settled. An argument by analogy for a broad definition of possession can be drawn from RCW 62A.9-305. This provision covers the situation when possession by the secured party perfects a security interest and allows possession by an agent.<sup>54</sup> Possession in this context is thought to put others on notice and give them grounds for further inquiry. This interpretation promotes the use of a wider variety of field warehousing arrangements.<sup>55</sup>

For purposes of classifying crops as “farm products,” possession should not be extended to forms of constructive possession in others. A more limited definition of possession would increase the likelihood that notice was given and received. A narrow definition would carry out the natural expectations of the parties. A limited definition would also give parties greater certainty and thus promote the secured financing of farm products.

Crops may also lose their farm products status if they are subject to a manufacturing process. But “some processes are so closely connected with farming — such as . . . boiling sap to produce maple syrup or maple sugar — that they would not rank as manufacturing.”<sup>56</sup> An argument can also be made that some manufacturing will result in “supplies used or produced in farming operations,” another aspect of the farm products definition of RCW 62A.9-

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years. *United States v. Gleaners & Farmers Coop. Elevator Co.*, 481 F.2d 104 (7th Cir. 1973); U.C.C. § 9-204 app. Reasons for 1972 Change. Second, WASH. REV. CODE § 62A.9-302(1)(c) (1981) (effective until midnight June 30, 1982) excluded the purchase money security interest in farm equipment having a purchase price not greater than \$2,500 from filing. These first two provisions were eliminated in the 1972 revision of the Code. Third, WASH. REV. CODE § 62A.9-307(1) (1981) (effective until and after midnight June 30, 1982), still retained in the 1972 version of the U.C.C. excepts the purchaser of farm products from the protection ordinarily afforded to a buyer in the ordinary course of business.

53. U.C.C. § 9-109 official comment 4.

54. U.C.C. § 9-305 official comment 2.

55. See J. WHITE & R. SUMMERS, *supra* note 49, § 23-10, at 935-37.

56. U.C.C. § 9-109 official comment 4.

109(3). Grain might be processed into animal feed and either used on the farm or held for sale and still retain its farm products classification.<sup>57</sup>

The phrase "all crops of every kind to be grown or growing and the products of those crops" will describe several important aspects of "farm products" — growing crops, products, some proceeds and future crops.<sup>58</sup> The phrase "products of those crops" should describe the collateral after harvest sufficiently to secure it as long as it remains in an unmanufactured state and in the hands of a debtor engaged in farm operations.<sup>59</sup>

• **PROCEEDS.** The thorny issue of proceeds would seem to have been laid to rest by the 1972 revision of Article 9.<sup>60</sup> Under RCW 62A.9-203(3), "[u]nless otherwise agreed a security agreement gives the secured party the rights to proceeds. . . ."<sup>61</sup> The creative secured party can use this provision to obtain a security interest in other assets of the debtor. For example, federal farm subsidy payments have been held to be proceeds.<sup>62</sup>

57. E. REILEY, *SUPRA* note 20, § 13.5(c).

58. Meyer, *Potential Problems Connected with the use of "Crops" as Collateral for an Article 9 Security Interest*, 1981-1982 AGRIC. L.J. 115, 125. "Crops" as seen in *Riceland Foods* is sufficient to describe currently growing crops. See *supra* note 39 and accompanying text.

59. As new more automated agricultural technology develops, what is a "farm operation" becomes less clear. *In re K. L. Smith*, 28 U.C.C. REP. SERV. (CALLAGHAN) 534, 539 (Bankr. D. Colo. 1980).

60. Under the 1962 version of the Code a "proceeds box" was checked on the financing statement to "perfect" a security interest in proceeds. The routine use of this procedure, "creat[ed] massive priority disputes between inventory financiers, receivable financiers and chattel paper financiers, to name but a few." T. QUINN, UNIFORM COMMERCIAL CODE COMMENTARY AND LAW DIGEST ¶ 9-306[A][3], at 9-169 (1978).

61. "The pre-1972 section 9-306 was not clear as to whether proceeds must be claimed in the security agreement; it was clear that proceeds must be claimed in the financing statement." 1A P. COOGAN, W. HOGAN & D. VAGTS, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE § 7.11A[2][p][iv] (Nov. 12, 1977).

62. *In re Munger*, 495 F.2d 511 (9th Cir 1974). *But cf.* *First Nat'l Bank v. Bostron*, 39 Colo. App. 107, 564 P.2d 964 (1977) (cattle feeding on secured collateral were not proceeds). It is possible to pursue farm products collateral into the hands of third parties under WASH. REV. CODE § 62A.9-307(1) (1981) (effective midnight June 30, 1982). Miller, *supra* note 52, at 280-81. Transfers of the collateral to subsequent purchasers would not be relieved of the security interest by the protection usually afforded to a buyer in the ordinary course of business under WASH. REV. CODE § 62A.9-307 (1981) (effective midnight June 30, 1982). The security interest would not be one created by the seller and therefore does not meet the test of WASH. REV. CODE § 62A.9-307 (1981) (effective midnight June 30, 1982). See Coates, *Farm Secured Transactions Under the UCC*, 23 BUS. LAW. 195, 200-02 (1967). *But cf.*

• **WAREHOUSE RECEIPTS.** Intangible property such as warehouse receipts received for harvested crops is also an important element of farm financing. When warehouse receipts are not exchanged for crops in the sense that the debtor gives up all rights to the collateral, the warehouse receipts are not proceeds rather they would be negotiable instruments or documents of title.<sup>63</sup> This might occur if harvested crops were stored separately from other harvested crops and the debtor retained some right to control disposition of the crops. Because the holder in due course of a negotiable instrument will obtain priority over even a perfected security interest,<sup>64</sup> it is important for the creditor to limit the freedom of the debtor to take a fully negotiable warehouse receipt for the crops. Additionally, it is necessary to include warehouse receipts as a separate element of collateral. Therefore, add to the litany of phrases making a maximum collateral description: "and all documents issued as evidence of the storage of any goods covered by this agreement."<sup>65</sup>

• **ACCOUNTS.** Another intangible which may arise in the course of a farmer's business is "accounts." The Code does not assume that "accounts" are "proceeds" or any other code classification and neither should the drafter of a collateral definition.<sup>66</sup>

• **COMPLETE COLLATERAL DESCRIPTIONS FOR CROPS.** Prudent creditors will take great pains, including some redundancy, to fully describe their interest. Such a description might read "all accounts, all inventory, all supplies and all crops of every kind [to be grown or growing] and the products and proceeds of those crops, and all documents issued as evidence of the storage of any goods covered by this agreement/statement on [completely described real estate]." This description covers crops as collateral in all of its manifestations including growing crops, future crops, inventory, proceeds, products, supplies, accounts and warehouse receipts.

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United States v. Hext, 444 F.2d 804 (5th Cir. 1981) (purchasers took free of a secured interest because the creditor knew of the debtor's ability to process the crop into inventory).

63. Meyer, *supra* note 58, at 125.

64. WASH. REV. CODE § 62A.9-309 (1981).

65. See Meyer, *supra* note 58, at 131-32.

66. For example, in jurisdictions adopting the second or third alternatives to U.C.C. § 9-401(1) an interest in "farm accounts" is treated differently than ordinary accounts. For a discussion of U.C.C. § 9-401 alternatives see *infra* notes 84-85 and accompanying text.

### 3. *Collateral Descriptions for Timber and Minerals*

Timber and minerals are subject to fewer classification problems. Timber is "inventory" as soon as it comes within the scope of Article 9.<sup>67</sup> An interest in minerals prior to extraction is defined as a "general intangible."<sup>68</sup> An interest in minerals created at or after extraction would be "inventory."

As in crops, in order to make a complete collateral description for timber and minerals it is advisable to mention "all accounts, all inventory, all timber/minerals of every kind [to be grown or growing] and the products and proceeds of that timber/those minerals and all documents issued as evidence of storage of any goods covered by this agreement/statement on [legally described land]."<sup>69</sup>

### 4. *Cures for an Overly Broad Collateral Description*

What can a debtor do who wishes to give another party a security interest in collateral covered by an overly broad collateral description in a prior financing statement? RCW 62A.9-316 specifically permits the use of a subordination agreement. Under RCW 62A.9-406, the secured party may file a statement releasing any part of the collateral. Because such a release is not mandatory, the UCC provides another procedure for the debtor. Under RCW 62A.9-208 the debtor may ask the secured party to approve or correct a list of collateral. A failure to reply will result in liability to the secured party for any loss resulting from the failure, and it

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67. The general rule is that "[o]ne can [only] be a farmer of trees if they are grown from seed and cared for in a nursery setting[;] . . . commercial logging . . . is an industrial operation." *Mountain Credit v. Michiana Lumber & Supply, Inc.*, 31 Colo. App. 112, 498 P.2d 967, 969 (1972); *accord*, *Belgrade State Bank v. Elder*, 157 Mont. 1, 482 P.2d 135 (1971). Because Christmas trees may be a crop, they should be treated as both a crop *and* timber. *Cf. Groth v. Stillson*, 20 Mich. App. 704, 174 N.W.2d 596 (1969) (parties treated Christmas trees as a crop).

68. U.C.C. § 9-105 official comment 3. This is not an advantageous classification. WASH. REV. CODE § 62A.9-301(1)(d) (1981) (effective midnight June 30, 1982), "gives priority to any transferee who has given value without knowledge and before perfection of the security interest." U.C.C. § 9-301 official comment 4. Also, the secured party is subject to any defenses available against the debtor. WASH. REV. CODE § 62A.9-318(1) (1981) (effective midnight June 30, 1982).

69. During a logging operation, timber might also become fixtures, namely in the form of bridges, road beds, and skidding devices. *Cf. Courtwright Cattle Co. v. Dolsen Co.*, 94 Wn. 2d 645, 619 P.2d 344 (1980) (steel tank twenty-four feet in diameter embedded in a concrete slab).

may cause the secured party to be limited in future claims to the collateral shown on the list.<sup>70</sup>

When the collateral description is made in the security agreement and the other general requirements for "attachment" are completed, creditors can enforce their security interest against the debtor, even if nothing else is done to "perfect" the interest.<sup>71</sup>

### C. Create a "Perfected" Security Interest Enforceable Against Other Parties

A "perfected" security interest is one that is effective against third parties. This is the final goal of a prudent creditor.<sup>72</sup> A perfected security interest results from "attachment" plus some additional steps; "[i]f such steps are taken before the security interest attaches it is perfected at the time when it attaches."<sup>73</sup>

The key to determining what the applicable steps are for "perfection" is the definitional pigeon hole in which the collateral is placed. Two methods of perfecting a security interest are important to raw materials:<sup>74</sup>

1. Filing a financing statement; and
2. Possession.

Filing a financing statement is the step which the prudent creditor will prefer. It is the only step to be used for accounts and general intangibles. It is an appropriate step for every collateral definition except instruments.<sup>75</sup> Nevertheless, possession of the col-

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70. For a full discussion of priorities in this situation see E. REILEY, *supra* note 20, at § 3.8(c).

71. WASH. REV. CODE § 62A.9-203(2) (1981) (effective midnight June 30, 1982).

72. "[I]n general after perfection the secured party [may be] protected against creditors and transferees of the debtor and . . . any representative of the creditors in insolvency proceedings. . . ." U.C.C. § 9-303 official comment 1.

73. WASH. REV. CODE § 62A.9-303(1) (1981).

74. Other forms of perfection might occasionally be relevant to raw materials. Automatic perfection of proceeds can occur under WASH. REV. CODE § 62A.9-306(3)(b) (1981) (effective midnight June 30, 1982). A temporary perfection for 21 days of negotiable documents is available under WASH. REV. CODE § 62A.9-304(4) (1981) (effective midnight June 30, 1982) when new value is given, or under WASH. REV. CODE § 62A.9-304(5) (1981) (effective midnight June 30, 1982) when a debtor is given a release in order to allow a sale of collateral.

75. U.C.C. § 9-304 official comment 1. "Once a security interest becomes unperfected, it is vulnerable to the federal tax liens which were subordinate during perfection." *General Elec. Credit Corp. v. Isaacs*, 90 Wn. 2d 234, 240, 581 P.2d 1032, 1035 (1978).

lateral is also a step which generally can perfect a security interest. It is possible to overlook possession when evaluating the existence or potential scope of competing security interests. If a creditor's possession of the collateral is interrupted or lost, priority is also lost.<sup>76</sup>

The purpose of filing is to give notice. This "notice itself indicates merely that the secured party who has filed may have a security interest in the collateral described. Further inquiry from the parties concerned will be necessary to disclose the complete state of affairs."<sup>77</sup>

RCW 62A.9-402(1) covers the features of the document to be filed and it requires:

1. The signature, name and mailing address of the debtor; and
2. The name of the secured party and an address from which information may be obtained; and
3. A collateral description; and
4. A description of the land concerned for crops, timber or minerals.

In addition to the general requirements of RCW 62A.9-402(1) a financing statement for timber and minerals must meet the requirements of RCW 62A.9-402(5) by:

1. Showing that it covers this type of collateral (timber to be cut or minerals); and
2. Stating that it is to be filed in the real estate records; and
3. Including a description of the real estate that would be sufficient to give constructive notice of a mortgage; and
4. Showing the name of a record owner.

Collateral and land description issues have already been dealt with in the context of the security agreement.<sup>78</sup> The remaining requirements of a financing statement are simple. The important

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76. WASH. REV. CODE §§ 62A.9-302(1)(a), 62A.9-305, 62A.9-312(5)(a) (1981) (effective midnight June 30, 1982). Statutory liens should also be considered. See WASH. REV. CODE tit. 60 (1981); J.R. Simplot Co. v. Vogt, 93 Wn. 2d 122, 605 P.2d 1267 (1980).

77. U.C.C. § 9-402 official comment 2.

78. See *supra* note 37 and accompanying text.

question is what to do about deviations from the formal requisites of a financing statement. RCW 62A.9-402(8) provides the test that courts will apply: a filing, "substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading." Courts will try to avoid a "fanatical and impossibly refined reading of . . . statutory requirements. . . ." <sup>79</sup>

White and Summers note that "[t]he policies which support the various requisites of a financing statement are not identical, the courts should properly permit more deviations from some than from others."<sup>80</sup> This is the best view in light of the drafters' suggestion that the Code's "language should be construed narrowly or broadly, as may be, in conformity with the purposes and policies involved."<sup>81</sup> White and Summers emphasize that UCC § 9-402(8) involves a two-pronged test.<sup>82</sup> First, the filing must not be seriously misleading. Second, it must not involve a "major error" such as the complete omission of a required entry.<sup>83</sup>

Another crucial issue is often the correct place to file the financing statement. RCW 62A.9-401(1) deals with the place of filing to perfect a variety of types of collateral. Three alternatives to this section were offered and numerous local variations have been adopted.<sup>84</sup> Central filing is mandated in Washington for farm

79. U.C.C. § 9-402 official comment 9; *In re Mistura, Inc.*, 13 Bankr. 483 (Bankr. D. Ariz. 1981) (omission of a real estate description was not fatal when an accurate street address was provided for fixtures); *See Siljeg v. National Bank of Commerce of Seattle*, 509 F.2d 1009, 1012 (9th Cir. 1975) (name of debtor changed by merger); *But cf. In re Thrift Shoe Co., Inc.*, 502 F.2d 1211 (9th Cir. 1974) (financing statement omitting a trade name contrary to a California variation to the Code was not acceptable).

80. J. WHITE & R. SUMMERS, *supra* note 49, § 23-16, at 953.

81. U.C.C. § 1-102 official comment 1.

82. J. WHITE & R. SUMMERS, *supra* note 49, § 23-16, at 954.

83. Washington has emphasized the importance of affording the debtor the protection of the Code and encouraging uniformity. *Hobart Corp. v. North Central Credit Services, Inc.*, 29 Wn. App. 302, 305, 628 P.2d 842, 844-45 (1981).

84. Washington adopted the first alternative which emphasized central filing:

(1) The proper place to file in order to perfect a security interest is as follows:

(a) when the collateral is timber to be cut or is minerals or the like (including oil and gas) or accounts subject to subsection (5) of RCW 62A.9-103, or when the financing statement is filed as a fixture filing (RCW 62A.9-313) and the collateral is goods which are or are to become fixtures, then in the office where a mortgage on the real estate would be filed or recorded;

(b) in all other cases, in the office of the department of licensing.

(2) A filing which is made in good faith in an improper place or not in all of

products, as well as proceeds, warehouse receipts and inventory.

the places required by this section is nevertheless effective with regard to any collateral as to which the filing complied with the requirements of this Article and is also effective with regard to collateral covered by the financing statement against any person who has knowledge of the contents of such financing statement.

(3) A filing which is made in the proper place in this state continues effective even though the debtor's residence or place of business or the location of the collateral or its use, whichever controlled the original filing, is thereafter changed.

(4) The rules stated in RCW 62A.9-103 determine whether filing is necessary in this state.

(5) Notwithstanding the preceding subsections, and subject to subsection (3) of RCW 62A.9-302, the proper place to file in order to perfect a security interest in collateral, including fixtures, of a transmitting utility is with the department of licensing. This filing constitutes a fixture filing (RCW 62A.9-313) as to the collateral described therein which is or is to become fixtures.

(6) For the purposes of this section, the residence of an organization is its place of business if it has one or its chief executive office if it has more than one place of business.

WASH. REV. CODE § 62A.9-401 (1981) (effective midnight June 30, 1982).

Oregon has adopted the first alternative with minor local variations, but did not adopt U.C.C. § 9-401(6):

(1) The proper place to file in order to perfect a security interest is as follows:

(a) When the collateral is timber to be cut or is minerals or the like (including oil and gas) or accounts subject to ORS 79.1030(5) on minerals, or when the financing statement is filed as a fixture filing under ORS 79.3130 and the collateral is goods which are or are to become fixtures, then in the office where a mortgage on the real estate would be filed or recorded.

(b) In all other cases, in the office of the Secretary of State.

(2) A filing which is made in good faith in an improper place or not in all of the places required by this section is nevertheless effective with regard to any collateral as to which the filing complied with the requirements of ORS 79.1010 to 79.5070 and is also effective with regard to collateral covered by the financing statement against any person who has knowledge of the contents of such financing statement.

(3) A filing which is made in the proper place in this state continues effective even though the debtor's residence or place of business or the location of the collateral or its use, whichever controlled the original filing, is thereafter changed.

(4) The rules states in ORS 79.1030 on perfection in multiple state transactions determine whether filing is necessary in this state.

(5) Notwithstanding the preceding subsections of this section, and subject to ORS 79.3020 (3) on required filings, the proper place to file in order to perfect a security interest in collateral, including fixtures, of a transmitting utility is the office of the Secretary of State. This filing constitutes a fixture filing under ORS 79.3130 as to the collateral described therein which is or is to become fixtures.

OR. REV. STAT. § 79.4010 (1981).

Idaho adopted the second alternative to U.C.C. § 9-401(1) which uses both central and local filing:

(1) The proper place to file in order to perfect a security interest is as follows:

(a) When the collateral is *equipment used in farming operations, or farm*

Filing for timber to be cut or minerals is proper, "in the office

*products, or accounts or general intangibles arising from or relating to the sale of farm products by a farmer, or consumer goods, then in the office of the county recorder in the county of the debtor's residence or if the debtor is not a resident of this state then in the office of the county recorder in the county where the goods are kept, and in addition when the collateral is crops growing or to be grown, in the office of the county recorder in the county where the land is located;*

(b) When the collateral is timber to be cut or is minerals or the like (including oil and gas) or accounts subject to subsection (5) of section 28-9-103, or when the financing statement is filed as a fixture filing (section 28-9-313) and the collateral is goods which are or are to become fixtures, then in the office where a mortgage on the real estate would be filed or recorded;

(c) In all other cases, in the office of the secretary of state.

IDAHO CODE § 28-9-401(1) (1980) (emphasis added to show additional local filing).

Montana has retained the second alternative of the 1962 version of § 9-401(1) calling for local filing for farm products:

(1) Except for financing statements filed pursuant to 30-9-409, the proper place to file in order to perfect a security interest is a follows:

(a) when the collateral is equipment used in farming operations, or farm products, or accounts, contract rights, or general intangibles arising from or relating to the sale of farm products, or accounts, contract rights, or general intangibles arising from or relating to the sale of farm products by a farmer, or consumer goods, then in the office of the county clerk and recorder in the county of the debtor's residence or if the debtor is not a resident of this state then in the office of the county clerk and recorder in the county where the goods are kept, and in addition when the collateral is crops in the office of the county clerk and recorder in the county where the land on which the crops are growing or to be grown is located;

(b) when the collateral is goods which at the time the security interest attaches are or are to become fixtures, then in the office where a mortgage on the real estate concerned would be filed or recorded;

(c) in all other cases, in the office of the secretary of state.

MONT. CODE ANN. § 30-9-401(1) (1981).

The third alternative to U.C.C. § 9-401(1) uses both central and local filing and adopts a requirement for dual filing in some cases:

(1) The proper place to file in order to perfect a security interest is as follows:

(a) when the collateral is equipment used in farming operations, or farm products, or accounts or general intangibles arising from or relating to the sale of farm products by a farmer, or consumer goods, then in the office of the . . . . . in the county of the debtor's residence or if the debtor is not a resident of this state then in the office of the . . . . . in the county where the goods are kept, and in addition when the collateral is crops growing or to be grown in the office of the . . . . . in the county where the land is located;

(b) when the collateral is timber to be cut or is minerals or the like (including oil and gas) or accounts subject to subsection (5) of Section 9-103, or when the financing statement is filed as a fixture filing (Section 9-313) and the collateral is goods which are or are to become fixtures, then in the office where a mortgage on the real estate would be filed or recorded;

(c) in all other cases, in the office of the [Secretary of the State] and in addi-

where a mortgage on the real estate would be filed or recorded.”<sup>85</sup>

For filing and conflict of laws questions a special rule is set out for interests in minerals which attach upon extraction. Under the 1962 version of the Code, filings of interests in mineral production were to be made at the individual residences of each debtor. Because ventures in oil and gas production are speculative, investors often prefer to share the risk of any given well among a number of principals. Thus, there were any number of offices in which a filing might appropriately occur.<sup>86</sup> The Review Committee for Article 9 sought to define a single location for searches concerning production interests from a particular well.<sup>87</sup> “[T]his special rule is applicable only to security interests created by persons who have interests in the production from the well. . . .”<sup>88</sup> The result is that local filing and local law, including conflict of laws rules, control security interests in mineral production which attach upon extraction.<sup>89</sup>

Because a proper filing preserves the secured party’s original priority and covers every collateral definition relevant to raw materials, a prudent creditor will not rely completely on possession or other provisions of the code to achieve “perfection.” The secured party should make a central filing, and a local filing in appropriate situations, using a complete and broad description of the collateral. The land description should be in a precise legal format and in a plain language format.<sup>90</sup>

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*tion, if the debtor has a place of business in only one county of this state, also in the office of . . . . . of such county, if the debtor has no place of business in this state, but resides in the state, also in the office of . . . . . of the county in which he resides.*

U.C.C. § 9-401(1) Third Alternative Subsection (1) (emphasis added to show local filing requirement).

The alternative selected by a jurisdiction and local variations must be consulted before making any decision about filing. See [1 Uniform Commercial Code Selected Provisions] SECURED TRANSACTIONS GUIDE (CCH) ¶¶ 761, 861 (1982).

85. WASH. REV. CODE § 62A.9-401(1)(a) (1981) (effective midnight June 30, 1982).

86. General Comment on the Approach of the Review Committee for Article 9, § D-3, 3 U.L.A. 16, 21 (1970) (not a part of the U.C.C. official text).

87. *Id.*

88. *Id.*

89. *Id.*

90. For a discussion of land description, see *supra* notes 40-41 and accompanying text.

### III. RIGHTS UNDER ARTICLE 9 VERSUS RIGHTS UNDER REAL ESTATE LAW

The priority problem on which this Comment will now focus arises from the overlapping authority of Article 9 and real estate law to create an encumbrance.<sup>91</sup> The original common law distinction between personal and real property was a jurisdictional one. Royal courts handled the realty portion of an estate, while ecclesiastical courts managed the personal property.<sup>92</sup>

Pre-UCC cases indicated an overlapping of jurisdiction for real and personal property encumbrances before crops were severed.<sup>93</sup> Professor Gilmore, after examining those precedents suggested that pre-Code law would have given priority to a real estate mortgage over a personal property encumbrance only after the mortgagee had taken possession, instituted foreclosure proceedings, or had a receiver appointed.<sup>94</sup> This view was thought to be a "majority position" (using the term very lightly)<sup>95</sup> arising out of confusing and conflicting precedents.<sup>96</sup> One of the Article 2 provisions used to explain the Article 9 definition of goods<sup>97</sup> also indicates that a bona fide purchaser of collateral subject to the overlapping jurisdiction of real and personal property law could not defeat an interest previously recorded in real estate records.<sup>98</sup> RCW 62A.2-107 also implies that the proper way to gain priority for a contract for

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91. Those interested in agricultural collateral should be alerted to the problem of preference analysis which arises under the 1978 Bankruptcy Act. Because farm products including crops are defined as inventory, an increase in value (for example by harvesting) during the preference period may be subject to attack. Bankruptcy Act 11 U.S.C. § 547(a)(1) (1982); See E. REILEY, *supra* note 20, at § 13.4(f); But see Looney, *The Bankruptcy Reform Act of 1978 and the Farmer: A Survey of Applicable Provisions*, 25 S.D.L. Rev. 509, 522-23 (1980).

92. 1 R. POWELL & P. ROHAN, *supra* note 20, at 98.

93. G. GILMORE, *SECURITY INTERESTS IN PERSONAL PROPERTY* 858-63 (1965).

94. *Id.* at 858. *Accord* Exchange Nat'l Bank v. Alturas Packing Co., 269 So. 2d 733 (Fla. Dist. Ct. App. 1972) (sale was a constructive severance prior to foreclosure); Coogan & Mays, *supra* note 52, at 29-37.

95. G. GILMORE, *supra* note 93, at 862.

96. *Id.* at 858-63.

97. "The provisions of this section are subject to any third party rights provided by the law relating to realty records, and the contract for sale may be executed and recorded as a document transferring an interest in land and shall then constitute notice to third parties of the buyer's rights under the contract for sale." WASH. REV. CODE § 62A.2-107(3) (1981) (effective midnight June 30, 1982).

98. R. BROWN, *THE LAW OF PERSONAL PROPERTY* § 17.7 (W. Raushenbush 3rd ed. 1975).

the sale of real estate connected goods is to record the sales contract in the real estate records.

Fixtures are the only real estate connected collateral for which Article 9 elaborates an answer to the problem of a conflict between real and personal property law. RCW 62A.9-313(1) states that nothing prevents the encumbering of fixtures under real estate law. But, no provision is made for real estate connected collateral which is to be severed from the land. One commentator has concluded that the omission is significant and not an oversight.<sup>99</sup> It means that crops are personal property. Hence, a secured interest created under Article 9 always has priority over rights derived from real estate law. It would follow similarly that when timber or minerals become personal property, Article 9 is the exclusive method of securing an interest in them.

Post-UCC cases show that the courts are reluctant to give effect to the implications of § 2-107(3) and to give full support to the policy behind the real estate recording laws. In *Exchange National Bank v. Alturas Packing Co.*, the sale of a growing citrus crop was held to constitute a constructive severance which defeated a real estate mortgage.<sup>100</sup> The Florida court said that the mortgagee must show actual reliance on the real estate records to defeat a non-filing purchaser in the ordinary course of business.<sup>101</sup>

A recent opinion from the United States Court of Appeals, for the Eighth Circuit interpreting Missouri law, is the first modern case to confront the conflict between real property law and Article 9. In *United States v. Newcomb*,<sup>102</sup> the government was the plaintiff in a conversion action. The defendant was the seller of real estate by a contract for deed which was never recorded. During the course of its dealings the government obtained actual notice of Newcomb's interest. The government later obtained a "perfected" interest in the soybean crop which the buyers had planted. Eventually, the buyers were ejected from the property by Newcomb and forfeited their rights under a Missouri court order. Finally, New-

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99. Coogan & Mays, *supra* note 52, at 37.

100. 269 So. 2d 733. (Fla. Dist. Ct. App. 1972). Cf. *Rudy-Patrick Co. v. Dela Costa Farming Co.*, 16 Wn. App. 911, 557 P.2d 869 (1977) (ownership of plants under a seed production agreement is a constructive severance defeating a real estate interest).

101. Compare Coogan & Mays, *supra* note 52, at 24-27.

102. 682 F.2d 758 (8th Cir. 1982).

comb harvested the crop refusing to turn over the "proceeds" to the government.

The *Newcomb* Court relied on the Missouri Court of Appeals holding in *Holdsworth v. Key*:<sup>103</sup>

In Missouri it is a settled legal principle of long standing that unless otherwise provided in the deed of trust, unsevered crops standing on mortgaged land at the time of a foreclosure are subject to the lien of the deed of trust and pass to the purchaser of the land at the foreclosure sale. . . . The only way a growing crop can be relieved of the lien of a deed of trust is by an actual severance of the crop from the ground prior to the foreclosure sale. If it is so relieved of the lien of a deed of trust it does not pass to the purchaser at the foreclosure sale.<sup>104</sup>

The *Holdsworth* court had relied on the Missouri Supreme Court's language in the analogous cases of *Farmer's Bank of Hickory v. Bradley*<sup>105</sup> and *Starkey v. Powell*.<sup>106</sup>

The owner of the land could mortgage or sell the unsevered growing crops separate from the land, thereby effecting a severance of ownership, or "constructive severance," which would be good as between him and his grantee, but subject to the prior lien of the deed of trust and the usual incidents consequent upon its foreclosure.<sup>107</sup>

The Court of Appeals for the Eighth Circuit did not follow the above line of decisions. Instead, it approved of the analysis by Chief Judge Clark of the Western District of Missouri "reject[ing] this argument and apply[ing] the UCC as adopted in Missouri."<sup>108</sup> Then, the court noted correctly that the commentators generally support the preference for applying an Article 9 analysis over the use of real estate law.<sup>109</sup> Next, they made two succinct points: "[G]rowing crops are by definition personal property. . . . [I]n order to create a security interest in the soybean crop, *Newcomb* had to comply with the requirements of Article 9. . . ."<sup>110</sup> This view was buttressed by quoting the district court to the effect

103. 520 S.W.2d 637 (Mo. Ct. App. 1975).

104. *Id.* at 639 (citations omitted). The language beginning with "unless" was quoted in the *Newcomb* opinion. 682 F.2d at 760.

105. 315 Mo. 811, 288 S.W. 774 (1926).

106. 315 Mo. 846, 288 S.W. 776 (1926).

107. *See supra* note 105, at 775.

108. *See supra* note 102, at 761.

109. *Id.* *See also* R. BROWN, *supra* note 98, at § 17.7; Coates, *supra* note 62, at 199.

110. *Supra* note 102, at 761.

that the Code "specifically permits the acquisition of a separate security interest over [future] crops in connection with land purchase transactions. Such a provision would be unnecessary if a mortgagee or seller of real estate automatically held a lien over unsevered crops growing on the land."<sup>111</sup> The federal courts were unwilling to grant rights created under real estate law any priority over rights derived from the UCC.

The result of the *Newcomb* case is that the policies of the Code are carried out, secured financing is promoted and there is ease of application. Nevertheless, a general rule of *absolute* priority to Article 9 secured interests presents some difficulties.

The problem of perennial crops and crops with a long period of growth prior to harvest illustrates the troubling implications of the *Newcomb* decision. Alfalfa, fruit and Christmas trees are examples of such crops grown in the Northwest. If secured parties are entitled to realize "proceeds" after foreclosure, they will also be able to tend the "crop" and harvest it themselves. This means that a secured party can continue to fertilize and till the soil, spray for weeds and parasites, and then harvest the crop until the obligation is extinguished. The *Newcomb* decision stands for the proposition that all real estate interests not protected by Article 9 can be subject to a very extensive burden under Article 9 even after a foreclosure sale.

Such a burden could result in interference with the financing of real estate acquisition, because it would seriously diminish the value of the real estate interest after a foreclosure. Vendors and lenders will naturally try to circumvent this burden by taking a complete security interest in all raw materials. Negotiations concerning subordination agreements and the correction of collateral lists will then be required prior to the financing of raw materials production.<sup>112</sup> This process would result in the obstruction of secured financing of raw materials.

The holding of the court in *Exchange National Bank* provides the necessary antidote to the worrisome implications of the *Newcomb* decision. When holders of a prior real estate interest show

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111. *Id.* at 762 (parentheses in original).

112. *See supra* note 70 and accompanying text.

actual reliance on real estate records, their interest should have priority over a subsequent Article 9 secured party. Realty interests would have no additional incentive to perfect a maximum Article 9 secured interest in all the raw materials on the property.

The combination of the *Newcomb* and the *Exchange National Bank* rules will best carry out the policies of the Code. The *Newcomb* holding subjects real estate interest to the very substantial burden of Article 9 even after a foreclosure sale. The *Exchange National Bank* court would protect holders of prior real estate interests who show actual reliance on the real estate records. Both rules are easy to apply and thus provide certainty. Real estate vendors will not need to obstruct the financing of raw materials production. Because all notices are on the record, the natural expectations of the parties will be realized.

#### IV. CONCLUSION

The drafters of Article 9 sought to replace a multiplicity of nineteenth-century security devices with a new structure. Their creation was designed to be unified, simple and flexible. Because of these attributes, it was hoped that information would be easier to obtain and secured financing would develop into new areas.

A unified system has been achieved. The UCC dominates over real estate law when a conflict in jurisdiction to create an encumbrance is encountered. The Code has found favor with the courts to the extent that prudent creditors should secure interests in raw materials collateral by complying with the requirements of Article 9.

As to simplicity, the Code's design is not free of complexity for the would be secured party. Raw materials collateral normally evolves from real property to personal property status. As raw materials change they are subject to a variety of different Code collateral definitions. These definitions are important because they can affect third party rights, priority, filing, and rights after default. Because of the numerous and changing collateral definitions related to raw materials, Article 9 has not achieved the simplicity found in other areas of secured financing.

Flexibility for raw materials is abundant in the code. Local options are provided. And special problems, for example creating a

single place to file secured interests in minerals which attach at extraction, are deftly resolved. The lack of simplicity noted in connection with collateral definitions also contributes to flexibility by allowing the parties to tailor their own agreement.

The goals of the drafters have been achieved in the raw materials area. Washington's adoption of the 1972 revision of the UCC has contributed to further progress. The Code abandoned some provisions favoring farmers which were contrary to main themes in the Code.<sup>113</sup> Additionally, problems which have been exposed in the light of commercial experience have been solved. Article 9 of the UCC has found favor with legislators, courts and commentators. It is the most effective and dominant method to secure an interest in the production of crops, timber and minerals. An understanding of the operation of the code is essential to the successful production of raw materials.

*Francis A. Malone*

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113. See *supra* note 52.

APPENDIX I

CROPS PHYSICAL EVOLUTION	PLANTING	HARVESTING
JURISDICTION TO CREATE AN ENCUMBRANCE	Real Estate Law	
"TANGIBLE" CODE COLLATERAL CLASSIFICATIONS	Article 9	
"INTANGIBLE" CODE COLLATERAL CLASSIFICATIONS	<b>Farm Products</b> —growing crops (exist at time of agreement) —future crops (not yet in existence)	—products of crops  Inventory
		Warehouse receipts Accounts Proceeds

## APPENDIX II

## RELEVANT "PERFECTION" METHODS AND CODE CLASSIFICATIONS

METHODS	CLASSIFICATIONS
1. Automatic "Perfection"	— Isolated Assignments of Accounts — RCW 62A.9-302(1)(e)
2. Temporary "Perfection"	— Instruments or Documents for 21 days and Proceeds for 10 days — RCW 62A.9-302(1)(b) — Goods in Possession of a Bailee — RCW 62A.9-304(5)(b)
3. Possession	— All Categories except Accounts and General Intangibles — RCW 62A.9-305
4. Filing	— All Categories except Money and Instruments — RCW 62A.9-302(1) and 62A.9-304(1)