

FARM COLLATERAL UNDER THE UCC: "THOSE ARE SOME MIGHTY TALL SILOS, AIN'T THEY FELLA?"

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This article examines the Uniform Commercial Code's treatment of farm collateral. It discusses the categorization of this collateral as either farm equipment or farm products and identifies the special problems which are typical to each type of collateral. It also comments on special problems involving purchase money security interests. Finally, the cases in which there have been unauthorized sales of farm products are analyzed. Throughout the article, the author states practical means of avoiding the problems presented by the Code.

INTRODUCTION

The producers of agricultural products in the United States are a diversified group. The orange groves of Florida, the giant feeder cattle operations of Colorado and Texas, the Idaho and Maine potato plantings, the rich grain fields of the Dakotas and the dairy herds of Wisconsin all are part of the farming community. Some producers are giant corporations and some are one-man operations, but they all have the same hallmark: a need for borrowed capital. These credit needs are long, intermediate and short term credit needs. Long term credit is generally used for the purchase and substantial improvement of real estate; intermediate credit, one to seven years, is used to finance equipment, dairy herds and less substantial improvements; short term, one year or less, is used to finance the purchase of feed, feeder livestock, crop plantings and the like.¹

Because short and intermediate term credit often is secured by personal property collateral, Article Nine of the Uniform Commercial Code (hereinafter the Code or UCC) governs these credit transactions in the forty-nine states in which it has been adopted.² To

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1. Clark, *Some Problems in Agricultural Lending Under the UCC*, 39 U. COLO. L. REV. 352 (1967) [hereinafter cited as Clark].

2. J. WHITE & R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* 4 (1972) [hereinafter cited as WHITE & SUMMERS]. Citation shall be to the UNIFORM COMMERCIAL CODE (1962) [hereinafter U.C.C.]. Because the South Dakota Code Commission inexplicably decided to renumber the U.C.C., as enacted in South Dakota, this article provides parallel citation to the relevant South Dakota and U.C.C. sections.

Any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures, including goods, documents, general intangibles, chattel paper, accounts or contract rights is subject to the Code. S.D. COMPILED LAWS ANN. § 57-35-2 (1967); U.C.C. § 9-102. A security interest is defined as an interest in personal property or

facilitate application of the Code, its draftsmen applied uniform solutions to many problems as diverse and varied as the agricultural community itself. Many of these rules do not conform to the reality, needs or practices of modern agriculture.

The draftsmen gave the farmer special and supposedly needed protection against unscrupulous creditors. Not only is the farmer coddled under the Code, but also the farm lender is covered by a unique protective blanket. The Code approaches farming as an occupation peopled by simple, unsophisticated tillers of the soil who need the mantle of protective legislation to survive;³ it evidences a similar attitude toward the sophistication of the farm lender. The companies which market the farmer's products, on the other hand, are presumed not only to be sophisticated, but possessed of a "deep pocket" to bail out unwary lenders.

The reasons for the Code's special treatment of farmers and farm lenders are twofold. First, the original UCC was drafted by commercial financiers without detailed knowledge of farm financing.⁴ Second, the draftsmen of the UCC did not have much to work with because many of the various state laws were illogical and inconsistent.⁵

Today's agriculture is vastly different from that of 1951 when the first UCC official draft appeared. Dean Hawkland has stated it well:

Until well into the 20th century it would have been ludicrous to compare the farmer to a businessman, especially a large businessman. Isolated and alone, the early-day American farmer operated without substantial capital and frequently on a subsistence basis. In this economic context there was little need for financial capital expansion and aggressive agricultural development, but small-town banks were constantly called upon to make loans that would enable the necessitous farmer to survive a hard winter or a dry summer. These loans, often secured, generated a body of agricultural law quite different from its financial counterpart in urban areas. This corpus was modeled to a great extent on the real estate mortgage with all of its rigidities,

fixtures which secures payment or performance of an obligation. S.D. COMPILED LAWS ANN. § 57-1-10 (1967); U.C.C. § 1-201(37).

3. The misunderstanding of the farmer is well exemplified by the attitude of the city-slicker who, upon noticing a man, obviously of rural roots, looking at tall city buildings, states: "Those are some mighty tall silos, ain't they fella?"

4. "It so happens that the sponsors of the Code were unsuccessful in enlisting the aid of anyone with a technical knowledge of farm financing comparable to knowledge of other business financing supplied by some of the advisors to the draftsmen." Coogan & Mays, *Crop Financing and Article 9: A Dialogue with Particular Emphasis on the Problems of Florida Citrus Crop Financing*, in 1B P. COOGAN, W. HOGAN & D. VAGTS, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE § 27.08, at 2827 (1968) [hereinafter cited as COOGAN, HOGAN & VAGTS].

5. See COATES, LAW AND PRACTICE IN CHATTEL SECURED FARM CREDIT (1954) [hereinafter cited as COATES].

but it was seasoned by concessions to the favorite of the law, those who till the soil. These rigidities and concessions operated to make up a curious patchwork of law often at cross purposes with itself.

Some of these inconsistencies were resolved by the enactment of the Uniform Commercial Code, but its draftsmen continued to treat the farmer differently from businessmen, overlooking the fact that present-day farming is a business operation that is practically indistinguishable functionally and economically from other forms of industry. The failure to recognize the farmer as a businessman is a serious shortcoming in the present U.C.C. and it has caused difficulties and expense.⁶

As agriculture has evolved, so has the UCC. In 1972 a new official text was promulgated by the American Law Institute and the National Conference of Commissioners on Uniform State Laws which was recommended to the states for adoption. Several states have adopted this revised text;⁷ however, the vast majority of the states still have versions of the 1962 Code in effect. Because the 1962 Code is still the most prevalent version, this article was based primarily on the provisions of the 1962 Official Text of the UCC, although changes made by the 1972 Code to relevant 1962 Code sections will also be discussed. Citations to Code sections will be to the 1962 Code unless specifically identified as 1972 sections.

This article focuses on the various provisions of Article Nine of the UCC which relate directly to farm personal property collateral. UCC financing provisions which only incidentally relate to farm financing are not stressed. Thus the purpose of this article is to serve as a guide to solution of problems which the practitioner might confront in dealing with agricultural collateral and to discuss the unresolved issues in the field.

There are two major types of UCC collateral which are directly related to agriculture: farm equipment and farm products. Each is discussed separately, with farm products being subdivided into several further classifications.

FARM EQUIPMENT

With the average farm becoming larger each year,⁸ and with shortages of nonfamily farm labor developing, the farmer is be-

6. Hawkland, *The Proposed Amendment to Article 9 of the U.C.C.—Part 1: Financing the Farmer*, 76 COMM. L.J. 416-17 (1971) (footnotes omitted) [hereinafter cited as Hawkland].

7. The 1972 amendments have been adopted in Arkansas, Illinois, Nevada, North Dakota, Oregon, Texas, Virginia and Wisconsin.

8. As of March 1, 1973, the total value of farm land and buildings in South Dakota was \$4,439,000,000 and the value per acre was \$97.00; in 1960 the comparable figures were \$2,309,000,000 and \$51.00; in 1950 the comparable figures were \$1,402,000,000 and \$31.00. SOUTH DAKOTA DEP'T OF AGRICULTURE, SOUTH DAKOTA CROP AND LIVESTOCK REPORTING SERVICE, CROP REPORTING SERVICE BULLETIN 63 (1965).

coming even more dependent on sophisticated and expensive machinery. This machinery is categorized generally as "equipment" under the UCC.⁹ However, for some purposes, equipment is more specifically grouped as "farm equipment"¹⁰ and as "equipment used in farming operations."¹¹ These specialized terms are not defined, nor are they differentiated by the provisions of the UCC. For the purpose of this article, they will be considered synonymous and used interchangeably.

Filing

There are two basic ways in which the treatment of farm equipment differs from nonfarm equipment. They both relate to filing: one concerns the *necessity* of filing¹² and the other relates to the *place* of filing.¹³

A. Necessity of Filing

Ordinarily a financing statement must be filed to perfect a security interest in equipment.¹⁴ However, section 9-302(1)(c)¹⁵ provides that a purchase money security interest in farm equipment having a purchase price not in excess of 2,500 dollars (other than fixtures and motor vehicles) may be perfected without filing. The apparent purpose behind adoption of this provision was to reduce the clerical and filing expense of farm implement dealers and thus free farm credit on lower-priced farm equipment. Some agricultural states, such as Missouri and Kentucky, have questioned the wisdom of this reasoning and have reduced the purchase price limitation to 500 dollars.¹⁶ The effectiveness of the automatically perfected purchase money security interest is of limited value to a creditor as section 9-307(2) provides that a buyer of farm equipment, other than fixtures, having an original purchase price not

9. There are three basic types of U.C.C. collateral: documents, intangibles and goods. Each contains several subtypes: intangibles include accounts and contract rights, S.D. COMPILED LAWS ANN. § 57-35-24 (1967); U.C.C. § 9-106; documents include chattel paper, documents of title and instruments, *id.* § 57-35-20; U.C.C. 9-105; goods include consumer goods, equipment, fixtures, inventory and farm products, *id.* §§ 57-35-27 to -30; U.C.C. § 9-109. All goods are classified by the U.C.C. according to the purpose for which they are held except for farm products, which classification is based on the occupation of the holder of the collateral. If goods are farm products, they are neither equipment nor inventory. *Id.* § 57-35-29; U.C.C. § 9-109(3). If they are inventory, they are not equipment. *Id.* § 57-35-40; U.C.C. § 9-109(4). The classes of goods are mutually exclusive; the same property at the same time and as to the same person can be within but one classification. U.C.C. § 9-109 & Comment 2.

10. S.D. COMPILED LAWS ANN. §§ 57-35-28, 57-37-31 (1967); U.C.C. §§ 9-109, 307(2).

11. *Id.* § 57-38-1; U.C.C. § 9-401(1) (second and third alternatives).

12. *Id.* § 57-37-4(3); U.C.C. § 9-302(1)(c).

13. *Id.* § 57-38-1; U.C.C. § 9-401(1) (second and third alternatives).

14. *Id.* §§ 57-38-1 to -18; U.C.C. § 9-302.

15. S.D. COMPILED LAWS ANN. § 57-37-4(3) (1967).

16. 5C F. HART & W. WILLIER, FORMS AND PROCEDURES UNDER THE UNIFORM COMMERCIAL CODE T 179-80 (1974) [hereinafter cited as HART & WILLIER].

in excess of 2,500 dollars takes free of an unfiled perfected security interest if he buys without knowledge of the security interest, for value, and for his own farming operation.¹⁷

The limit of 2,500 dollars on the automatic perfection provision has engendered considerable litigation. There is, for example, a conflict of opinion whether the purchase price could be the cash sale price of the equipment, or should include not only the cash sale price, but also the interest and carrying charges on a deferred payment sale.¹⁸ If the purchase price, including interest and carrying charges, will exceed 2,500 dollars, the wise purchase money creditor would file to insure that there is no question of his priority.

Furthermore, there has been a question not only as to what is included in the price, but also as to whether the price relates to each item of farm equipment sold or to the total sold in a single transaction. In a recent decision, the Florida Supreme Court has held that the 2,500 dollar exemption relates to each item of farm equipment and not to the total amount purchased. In *International Harvester Credit Corp. v. American National Bank*¹⁹ the court held that the intent of the legislature must be that each item be valued individually, otherwise the exception could be defeated by lumping together many small items. It is this writer's opinion that the decision is erroneous; such an interpretation is an untoward interference with the Code's system of requiring notice to conflicting creditors. The allowance of an exemption from the notice requirements should be construed strictly.

In addition, the courts should recognize that farm implement dealers are sophisticated commercial entities, fully aware of the Code's filing requirements. If such a purchase money seller elects to lump together several small items so that the purchase price exceeds 2,500 dollars, he should be held to have waived the automatic perfection protection.

Fortunately, the exemption from filing for purchase money security interests in farm equipment has been deleted from the 1972 Code as has the companion provision of section 9-307(2).²⁰ Dean Hawkland has referred to section 9-302(1)(c)²¹ of the 1962 Code as a "foolish monument of a foolish privilege and as a trap for the unwary."²² He reasons that the filing exemption was not used by farm implement dealers because the risk of the cutting off of their security interest under section 9-307(2)²³ was greater than the

17. S.D. COMPILED LAWS ANN. § 57-37-31 (1967).

18. *Compare* Mammouth Cave Production Credit Ass'n v. York, 429 S.W.2d 26 (Ky. 1968) (cash price), with *In re La Rose*, 7 UCC REP. SERV. 964 (D. Conn. 1970) (bankruptcy) (deferred payment price).

19. 296 So. 2d 32 (Fla. 1974).

20. U.C.C. §§ 9-302, 307(2) (1972 version).

21. S.D. COMPILED LAWS ANN. § 57-37-4(c) (1967).

22. Hawkland, *supra* note 6, at 417.

23. S.D. COMPILED LAWS ANN. § 57-37-31 (1967).

savings from not filing; the provision actually had a deleterious effect on the availability of farm credit because secured lenders were wary of advancing credit when unknown and unfiled security interests in items of a farmer's equipment would be prior to the filed interests.²⁴

B. Place of Filing

The correct place for filing a financing statement covering "equipment used in farming operations" is the county of residence of the debtor. In the ordinary transaction involving the individual farmer this is a good rule because the filing will be made in the same office, and presumably on the same financing statement, as a concomitant interest in farm products.²⁵ However, there are at least two problems with this local filing. The first problem shows the small-farmer myopia of the Code draftsmen; the Code language presumes that the farmer has a home for a residence, and it makes no provision for determining the residence of a farm corporation.²⁶ Residence could be in either the county of the principal office of the corporation, or if a foreign corporation, the county in which the registered agent is located. This oversight has been remedied in the 1972 Code which provides that the residence of an organization is its place of business, if it has only one, or its chief executive office, if it has more than one place of business.²⁷

Second, the Code provides for a different filing office for farm equipment than for nonfarm equipment. As noted previously, a farm equipment filing is made in a local office. On the other hand, depending on whether a state selected the second or third alternative to section 9-401(1), the filing for nonfarm equipment is made in the Secretary of State's office and a local office, or in the state office alone.²⁸

The place of filing requirements have aroused controversy over whether the collateral is farm or nonfarm equipment. The cases decided on this point require that the equipment be classified as farm or nonfarm according to the use to which such equipment is put. In *Sequoia Machinery, Inc. v. Jarrett*²⁹ a custom harvester who owned no land was the debtor. The secured party filed his financing statement covering the debtor's combines in the state

24. Hawkland, *supra* note 6, at 417. See also U.C.C. § 9-302, Reasons for 1972 Change (1972 version).

25. S.D. COMPILED LAWS ANN. § 57-38-1 (1967); U.C.C. § 9-401(1) (second and third alternatives). Note that if the other collateral was crops, the interest in crops would be perfected not by filing in the county of the debtor's residence, but the county in which the crops were grown. *Id.*

26. Clark, *supra* note 1, at 359-60.

27. U.C.C. § 9-401(6) (1972 version).

28. South Dakota adopted the second alternative which requires filing in the state office alone for nonfarm equipment. S.D. COMPILED LAWS ANN. § 57-38-1 (1967).

29. 410 F.2d 1116 (9th Cir. 1969).

rather than the local office. The trustee of the bankrupt custom harvester sued to have the security interest declared unperfected on the grounds that the combines were "equipment used in farming operations." The court held for the trustee and ruled that the determinant was the actual use of the equipment, not the occupational status of the debtor. This decision conforms to the Code's method of classifying goods, except farm products, according to the use to which they are put or for which they are bought. A similar result was reached in a case in which an owner of a feed store purchased a haybine to use for commercial hay cutting; the haybine was held to be farm equipment.³⁰ This method of classification was logically extended in *In re Anderson*³¹ in which equipment used in a city egg production factory was held to be "equipment used in farming operations" because the equipment was used to produce eggs: a farm product. Because the secured party had filed in the local office, the farm equipment filing office, his perfected security interest prevailed over the trustee in bankruptcy.

These cases indicate that only the vigilant secured party can be certain of the validity of his interest. Farm equipment, unlike farm products, is defined by its principal use rather than by the status of its owners.³² Furthermore, in many situations, equipment designed for farm use, such as a farm tractor, may actually be used in a nonfarm capacity. For example, a farm tractor might be used to remove snow in a town. If in doubt as to the use of the equipment, the prudent creditor should file both in the local and the state offices.

Sufficiency of Description

The UCC provides that a description of collateral is sufficient if it reasonably identifies what is described.³³ Generally, the sufficiency of the description of farm equipment has not been an issue; however, two Kentucky cases have required a description of substantial specificity. In *Mammouth Cave Production Credit Association v. York*,³⁴ a description covering "all farm equipment" plus "replacements of, and additions to equipment" was held too vague and indefinite. The court reasoned that the description must identify the collateral so that it can be distinguished from property not covered. In *In re Anselm*³⁵ the security agreement purported to cover "all farm machinery and equipment, including but not limited to tractors, tanks, tilling and harvesting tools." The court held

30. *Citizens Nat'l Bank v. Sperry Rand Corp.*, 456 S.W.2d 273 (Tex. Civ. App. 1970).

31. 6 UCC REP. SERV. 1284 (S.D. Ohio 1969) (bankruptcy).

32. U.C.C. § 9-109, Comment 2; *In re La Rose*, 7 UCC REP. SERV. 964 (D. Conn. 1970) (bankruptcy).

33. S.D. COMPILED LAWS ANN. §§ 57-35-31, 57-36-3 (1967); U.C.C. §§ 9-110, 203.

34. 429 S.W.2d 26 (Ky. 1968).

35. 344 F. Supp. 544 (W.D. Ky. 1972).

that the security interest covered a tractor but not a spraying rig and tillage disc because these items were "machinery" and would not, because of their size and function, be considered "tools." In contrast to the Kentucky cases, the court in *Maryland National Bank v. Porter-Way Harvester Manufacturing Co.*³⁶ adopted an entirely different approach and held that the term "equipment" was adequate to describe "farm equipment" because it put third parties on notice that the secured party held a security interest in the debtor's equipment. Because the debtor was a farmer his equipment would be farm equipment and the notice was adequate. The last cited case is closer to the intent of the notice filing provision of the Code than are the Kentucky cases: "equipment" is a defined term under the UCC and the use of that description would give reasonable notice. However, the secured party should be well warned that lack of specificity invites litigation.

FARM PRODUCTS

Goods are farm products if they are crops or livestock or supplies used or produced in farming operations or if they are products of crops or livestock in their unmanufactured states (such as ginned cotton, wool-clip, maple syrup, milk and eggs), and if they are in the possession of a debtor engaged in raising, fattening, grazing or other farming operations.³⁷

Two categories of farm products are apparent from this definition: 1) crops, livestock or supplies used or produced in farming operations; and 2) products of crops or livestock in their unmanufactured states.

Both of these categories are subject to the additional provision that they be *in the possession* of a debtor engaged in farming operations. As long as they are in the hands of such a debtor acting in a capacity as a farmer, the purpose for which they are used is immaterial. This result is contrary to the basic classification of goods according to their use by the Code. The farmer who grows crops for use in feeding his herd is treated identically under the Code provisions to the cash crop farmer who grows crops for sale. Similarly, the large livestock feeding operations which constantly sell cattle are governed by the same rules as are dairy farmers whose livestock is used primarily for milk production and only incidentally for sale.

For products of crops or livestock to be included in the farm products definition, the Code requires that they be held in an "unmanufactured" state. The Code does not define the term but the Official Comments indicate that major processing of the prod-

36. — Del. —, 300 A.2d 8 (1972).

37. S.D. COMPILED LAWS ANN. § 57-35-29 (1967); U.C.C. § 9-109(3).

ucts must be performed by the farmer before the farm products become inventory.³⁸ There are, however, no recorded cases on the precise issue of what constitutes this major processing.

LIVESTOCK

Livestock as Collateral

The value of livestock as collateral varies depending upon the type of farm. In dairy operations, the dairy herd is very stable security because it depreciates slowly, if at all, and the herd itself produces steady income for the farmer. Because milk, not sale of livestock, is the primary source of income to the dairy farmer, the lender often may take a security interest not only in the livestock, but also in the milk products of the livestock and in the accounts arising from the sale of the milk products. The lender also knows and expects that the dairy farmer will sell the male young of the dairy herd and will cull and replace dairy cows to produce a better quality dairy herd.

In cattle feeding operations, on the other hand, the lender is looking to ultimate sale of the livestock for repayment. The lender's security is not as stable because it depends on lump sum payments, not the constant amortization of the loan from a monthly milk check. In both dairy and feeder operations the lender also must consider taking a security interest in crops, products of crops and purchased feed to insure, as much as possible, that feed would be available for the livestock.

Classification of Livestock as "Farm Products"

The term "livestock," although it is not defined in the UCC, has not been the subject of any reported controversy over its meaning. An Official Comment to the Code states that the term includes any useful farm animal such as poultry, sheep, hogs and cattle.³⁹ Further, consistent with the statutory definition of farm products, a court has held that after-acquired livestock covers after-acquired poultry.⁴⁰

There have been some cases, however, in which the issue was whether certain "livestock" were "farm products" as defined in the Code.⁴¹ Livestock are farm products if they are in the possession of a debtor engaged in fattening, raising, grazing or other farming operations. Simply put, livestock are farm products only if they are in the possession of a farmer, whether that farmer be an individ-

38. U.C.C. § 9-109, Comment 4.

39. The term clearly includes poultry. *Id.* But see INT. REV. CODE OF 1954, § 1231 (poultry specifically excluded).

40. *United States v. Pete Brown Enterprises, Inc.*, 328 F. Supp. 600 (N.D. Miss. 1971).

41. *E.g., Clovis Nat'l Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726 (1967).

ual or a large corporation. If they are in the possession of a stockyard and are held for resale, they are inventory, not farm products.⁴² However, the mere fact that an individual or entity is a farmer does not automatically assure the classification of livestock as a farm product. Additionally, the farmer must hold the livestock in his capacity as a farmer.

In *United States v. Mid-States Sales Co.*⁴³ for example, cattle in the possession of a farmer were held to be farm products, not inventory. However, in a case in which an individual was not only a farmer but also a cattle buyer and trader, the cattle which were purchased for resale were classified as inventory rather than farm products.⁴⁴

The classification of livestock as farm products has a fundamental effect on the buyer in the ordinary course of business. As explained in the section on the unauthorized sale of farm products,⁴⁵ such a buyer of inventory will take free of a security interest created by the seller but such a buyer of farm products will not.⁴⁶

Sufficiency of Description

As with farm equipment, description of livestock collateral is sufficient if it reasonably identifies what is described.⁴⁷ The problem of sufficient description of livestock as collateral has been the subject of litigation, but the courts have been lenient toward secured creditors and have found sufficient descriptions such as "all livestock" reasoning that creditors have been put on notice of a security interest.⁴⁸

Another description issue arises in connection with the young of livestock. Under the 1962 Code, a security interest can attach to the unborn young of livestock only after they are conceived.⁴⁹ It is arguable that if a secured party takes a security interest only in livestock and after-acquired livestock, the conceived but unborn are not includable in the collateral because they are not yet livestock. However, because the debtor has a present interest in them, they also are not after-acquired property. A lender should be certain to include not only after-acquired livestock but also increase in his description of collateral.⁵⁰ The 1972 Code obviates this prob-

42. S.D. COMPILED LAWS ANN. § 57-35-30 (1967); U.C.C. § 9-109(4).

43. 336 F. Supp. 1099 (D. Neb. 1971).

44. *First State Bank v. Maxfield*, 485 F.2d 71 (10th Cir. 1973).

45. See notes 119-166 *infra* and accompanying text.

46. S.D. COMPILED LAWS ANN. § 57-37-30 (1967); U.C.C. § 9-307(1).

47. *Id.* §§ 57-35-31, 57-36-3; U.C.C. §§ 9-110, 203.

48. *United States v. Pirnie*, 339 F. Supp. 702 (D. Neb. 1972), *aff'd*, 472 F.2d 712 (8th Cir. 1973); *In re Malzac*, 14 UCC REP. SERV. 1223 (D. Vt. 1974) (bankruptcy).

49. S.D. COMPILED LAWS ANN. § 57-36-6(1) (1967); U.C.C. § 9-204 (2) (a).

50. Coates, *Financing the Farmer*, 20 THE PRAC. LAW. 45, 50 (Nov. 1974) [hereinafter cited as Coates].

lem, because it no longer defines when a security interest attaches to livestock. The 1972 Code Official Comments indicate that the 1962 rules were arbitrary and that the determination of when the debtor acquired rights in the collateral should be left to the courts in individual cases.⁵¹

Another and more serious problem can arise in a dispute between lenders whose descriptions do not adequately identify their respective collateral. For example, a description of collateral as "51 head of Holstein heifers with increase" was found not to fail for insufficiency, but the court held that the description was uncertain enough to impose a substantial burden to identify the collateral securing his interest on a purchase money secured party claiming priority.⁵² This case points out the wisdom of the old saw that it is foolish to have more than one lender in "the same barn." Unless livestock can be physically segregated or permanently marked, a purchase money lender attempting to obtain priority over a previously filed interest in after-acquired property faces a substantial proof burden. If the purchase money lender desires to make a loan secured by unsegregated livestock, it should obtain a subordination agreement from the previously filed lender and should not depend on its purchase money priority.⁵³ Subordination is especially important because of the inherent priority limitations on purchase money interests as they relate to herd increase.⁵⁴

Purchase Money Security Interest in Livestock

A purchase money security interest in livestock, if it is a farm product, is generally given priority over conflicting security interests in the same collateral if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within ten days thereafter.⁵⁵ Furthermore, a purchase money secured party is protected against certain lien creditors who acquire a lien within the ten day period if the secured party perfects its interest within that time.⁵⁶ Because priority is dependent upon

51. S.D. COMPILED LAWS ANN. §§ 57-36-3, to -10 (1967); U.C.C. §§ 9-203, 204; U.C.C. § 9-204, Reasons for 1972 Change (1972 version).

52. *United States v. Mid-States Sales Co.*, 336 F. Supp. 1099, 1102 (D. Neb. 1971); see S.D. COMPILED LAWS ANN. § 57-37-39 (1967); U.C.C. § 9-312(4).

53. S.D. COMPILED LAWS ANN. § 57-37-53 (1967); U.C.C. § 9-316.

54. The lender also should recognize an obvious but sometimes misunderstood fact: the financing statement itself does not give an interest in the collateral. This is done by the security agreement. The financing statement only gives notice. In *Tri-County Livestock Auction Co. v. Bank of Madison*, 228 Ga. 325, 185 S.E.2d 393 (1971), the security agreement granted an interest in 800 cattle, and the financing statement covered not only the 800 cattle but also the increase. The court held that the security interest was limited to the 800 cattle described on the security agreement and did not flow to the increase. See also *Barth Bros. v. Billings*, — Wis. —, 227 N.W.2d 673 (1975).

55. S.D. COMPILED LAWS ANN. §§ 57-35-25, 57-37-39 (1967); U.C.C. §§ 9-107, 312(4).

56. *Id.* § 57-37-2; U.C.C. § 9-301(2); see *id.* § 57-37-1(3); U.C.C. § 9-

filing within the ten day period after the debtor acquires possession, courts have struggled with cases in which filing was not made within the ten day period after obtaining possession, but was made within ten days of the person becoming a debtor. In *North Platte State Bank v. Production Credit Association*⁵⁷ a farmer, in November of 1968, purchased cattle from a seller, taking actual possession of them. The Production Credit Association had at that time two filed perfected security interests which included after-acquired property clauses. On January 30, 1969, the bank executed a loan which enabled the farmer to pay for the cattle. The bank filed a financing statement on February 5, 1969, within ten days after the loan was made, thus acquiring a perfected security interest in the cattle. The farmer debtor subsequently defaulted and a priority battle ensued.

The bank argued that the livestock was not "collateral" until the farmer became a "debtor" to the bank through receipt of a loan from the bank. Under its reasoning, the farmer could only be considered to have received the collateral at the time he became a debtor to the bank. The court rejected this argument, finding that the farmer had become a "debtor" when he received, without payment, the possession of the cattle: the debtor status was not withheld until the bank made a loan. Therefore, the court held that the ten day period of the purchase money security interest section had begun to run at the time the farmer received possession of the cattle in November of 1968 and that the bank had failed to file to perfect its interest within the requisite ten days.⁵⁸ It therefore lost to the PCA in the priority battle.

Any lender who relies on a purchase money security interest must recognize its inherent limitations when conflicting with a prior perfected security interest in after-acquired property. Often a lender will advance funds to a farmer for the purchase of cattle based on the purchase money priority rules, only to find later that the cattle have been sold, traded or have otherwise disappeared. The 1962 Code is unclear regarding the relative priority rights in proceeds, be they cash or replacements, between a purchase money interest and a previously filed interest in after-acquired property.⁵⁹ This problem is eliminated by the 1972 Code which specifically states that a properly filed purchase money interest in collateral other than inventory also has a prior interest in the proceeds.⁶⁰

The purchase money priority relates only to the livestock in existence and to increase already conceived at the time the security interest attaches; the purchase money priority rules will not apply

301(1)(c) (certain good faith transfers). *But see id.* § 57-37-30; U.C.C. § 9-307(1).

57. 189 Neb. 44, 200 N.W.2d 1 (1972).

58. *Id.* at —, 200 N.W.2d at 6. *See also* James Talcott, Inc. v. Associates Capital Co., 491 F.2d 879 (6th Cir. 1974).

59. S.D. COMPILED LAWS ANN. § 57-37-39 (1967); U.C.C. § 9-312(4).

60. U.C.C. § 9-312(4) (1972 version).

able and the farmer is insolvent, the lender seeks another avenue of redress. Usually participation by the marketing company is the easiest to trace. Even though the marketing company has paid the farmer, it still may be liable to the lender for conversion of the farm product.¹²⁸ The rule in most states appears to be quite clear: An agent is guilty of conversion when he sells farm products for his principal even though he acts in good faith and without knowledge that another creditor holds a security interest in them.¹²⁹

Presumably, Section 9-315 could be applied, if only by analogy, to determine priorities among secured parties. That section provides that a perfected security interest in goods continues "in the . . . mass if the goods are so . . . commingled that their identity is lost in the . . . mass." Priorities are determined "according to the ratio that the cost of the goods to which each interest originally attached bears to the cost of the total . . . mass." In the case of crops which have been grown, "cost" is an unreal measurement; if "cost" means "price," it would be equally unreal. Further, any such test presents evidentiary difficulties. Of course, if the yield of each crop is provable, such a ratio based upon yield or the value of yield could be worked out, but the statute does not provide for this. In fact, the Official Comment does not discuss farm products as examples except insofar as they become lost in a product—milk and eggs which become part of cake mixes. In that example, they would be the manufacturer's inventory and not farm products. 5A HART & WILLER, *supra* note 16, ¶ 93.19 (1968).

For a discussion of the relative priorities when one secured party has a security interest in crops and another has an interest in livestock and the livestock eats the crops, see Clark, *supra* note 1, at 362-63.

128. One of the secured party's fundamental rights on default by the debtor is to take possession of the collateral, unless the debtor has sold the property free of the security interest. See S.D. COMPILED LAWS ANN. 57-39-8 (1967); U.C.C. § 9-503. See S.D. COMPILED LAWS ANN. §§ 57-37-1(3), 19, 30 (1967); U.C.C. §§ 9-301, 306(2), 307. The creditor may follow it into the hands of the purchaser or, in an appropriate case, maintain an action for conversion. U.C.C. § 9-306, Comment 3. Professor Gilmore has stated: "[T]he secured party . . . [has] the right to follow collateral into the hands of good faith purchasers for value and to have whatever recovery, by an action in replevin or conversion, the law of the relevant state may allow." 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 714-15 (1965). "Conversion" is defined in AM. JUR.2d as: "A conversion is a distinct act of dominion wrongfully exerted over another's personal property in denial of or inconsistent with his title or rights therein, or in derogation, exclusion, or defiance of such title or rights." 18 AM. JUR. 2d Conversion, §1 at 158. For further explanation, see *id.* § 30 at 174:

A person who purchases personal property from one not authorized to sell the same may be held liable for conversion thereof, regardless of the fact that the purchaser was honestly mistaken, or acted innocently, in good faith, and without knowledge of the seller's lack of right to make the sale.

See also RESTATEMENT (SECOND) OF TORTS § 229 (1965). In *United States v. Pete Brown Enterprises, Inc.*, 328 F. Supp. 600 (N.D. Miss. 1971), the court held that a secured party could proceed against the purchaser in conversion without exhausting his remedies against the debtor.

129. *E.g.*, *United States v. Big Z Warehouse*, 311 F. Supp. 283, 286 (S.D. Ga. 1970). The Georgia legislature reacted to this type of result by amending section 9-307 of the Georgia U.C.C. by adding a new subsection (3) relieving livestock commission merchants from liability in certain circumstances. See also *United States v. E. W. Savage & Son, Inc.*, 343 F. Supp. 123 (D.S.D. 1972), *aff'd*, 475 F.2d 305 (8th Cir. 1973); *Clovis Nat'l Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726 (1967); Annot., 96 A.L.R.2d 208, 212 (1964). Some conflict has arisen over the effect of the Packers and Stockyards Act, 7 U.S.C. § 181-229 (1970), on the ability of a secured party to recover in conversion from an entity covered by the Act. However, the United States Supreme Court recently decided that the Act was not intended to determine security rights between a seller and third parties. *Mahon v. Sowers*, 94 S. Ct. 1626 (1974).

