A POTPOURRI OF ARTICLE 9 ISSUES

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The agricultural economy, like the general economy, is facing a number of challenges. Many producers are having credit problems which involve the application of Article 9 of the Uniform Commercial Code. Article 9 was revised in 1999 and is now effective in all fifty states.[1]

Article 9 is basically divided into five parts: scope,[2] attachment,[3] perfection,[4] priorities,[5] and enforcement (default).[6] This article will examine a number

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1. As of July 1, 2001, all fifty states had enacted Revised Article 9. 1 Secured Transactions Guide (CCH) ¶ 4991 (Apr. 9, 2002). In Alabama, Mississippi, and Florida, revised Article 9 became effective after July 1, 2001 and it became effective in Connecticut on October 1, 2001. *Id.*

2. U.C.C. § 9-109 (2000).

3. *Id.* §§ 9-108, 9-203, 9-204, 9-315(a).

4. *Id.* § 9-502 cmt. 2 (stating that perfection is designed to give public notice of a security interest). Revised section 9-308 defines perfection as follows:

of issues and the discussion will be organized around all these parts except enforcement.

I. SCOPE

The scope of Article 9 is defined in section 9-109. Section 9-109(a) states that the rules of Article 9 apply to:

> (1) [Any] transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract;[7]
> (2) an agricultural lien;[8]
> (3) a sale of accounts, chattel paper, payment intangibles, or promissory notes;[9]
> (4) a consignment;[10]
> (5) a security interest arising under [other sections of the U.C.C.][11]

Revised Article 9 also applies to security interests granted by non-consumers in deposit accounts.[12] Sections 9-109(c) and (d) set forth a number of transactions

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> (a) [Perfection of security interest.] Except as otherwise provided in this section and Section 9-309, a security interest is perfected if it has attached [under §§ 9-203-204] and all of the applicable requirements for perfection in Sections 9-310 through 9-316 have been satisfied. A security interest is perfected when it attaches if the applicable requirements are satisfied before the security interest attaches.

In general, depending on the type of collateral, perfection can occur in five different ways: (1) the secured party files a financing statement in a public office; (2) the secured party takes possession of the collateral; (3) the secured party obtains control; (4) the security interest is noted on the certificate of title; or (5) perfection can occur automatically upon attachment of the security interest under revised section 9-203(b). *See id.* §§ 9-308 to 9-316.

5. *Id.* §§ 9-317 to 9-339. *See also id.* § 9-201 (discussing the effectiveness of a security agreement).

6. *Id.* §§ 9-601 to 9-624.

7. *Id.* § 9-109(a)(1) (indicating no change from old Article 9).

8. *Id. §* 9-109(a)(2) cmt. 3 (expressing a major change; it applies to nonpossessory statutory liens in farm products).

9. *Id.* § 9-102(a)(2) (expanding the definition of accounts and including coverage of intangibles and promissory notes); *compare id.* § 9-102(a)(2) *with* former U.C.C. § 9-106 (1994).

10. U.C.C. § 9-109(a)(4) (2000) (treatment is basically the same as former Article 9); *compare id.* §§ 9-102(a)(19) to (21), (28), 9-103(d) *with* former Article 9, U.C.C. § 9-114 (1994) and old U.C.C. § 2-326 (1972).

11. U.C.C. § 9-109(a)(5) (2000). *See also id.* §§ 4-210, 5-118, 9-110 (showing examples of security interests arising under other sections of the U.C.C.).

that are not within the scope of Article 9.[13] Scope issues involving agricultural credit have arisen in a number of areas. Four particularly interesting issues in-

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12. *See id.* § 9-109(d)(13) (providing that revised Article 9 does not apply to an assignment of a deposit account in a consumer transaction, but sections 9-315 and 9-332 apply to consumer transactions with respect to proceeds and priorities in proceeds).

13. *Id.* § 9-109(c)-(d). Section 9-109(c) provides:

> This article does not apply to the extent that:
> (1) a statute, regulation, or treaty of the United States preempts this article;
> (2) another statute of this State expressly governs the creation, perfection, priority, or enforcement of a security interest created by this State or a governmental unit of this State;
> (3) a statute of another State, a foreign country, or a governmental unit of another State or a foreign country, other than a statute generally applicable to security interests, expressly governs creation, perfection, priority, or enforcement of a security interest created by the State, country, or governmental unit; or
> (4) the rights of a transferee beneficiary or nominated person under a letter of credit are independent and superior under Section 5-114.

Section 9-109(d) provides:

> This article does not apply to:
> (1) a landlord's lien, other than an agricultural lien;
> (2) a lien, other than an agricultural lien, given by statute or other rule of law for services or materials, but Section 9-333 applies with respect to priority of the lien;
> (3) an assignment of a claim for wages, salary, or other compensation of an employee;
> (4) a sale of accounts, chattel paper, payment intangibles, or promissory notes as part of a sale of the business out of which they arose;
> (5) an assignment of accounts, chattel paper, payment intangibles, or promissory notes which is for the purpose of collection only;
> (6) an assignment of a right to payment under a contract to an assignee that is also obligated to perform under the contract;
> (7) an assignment of a single account, payment intangible, or promissory note to an assignee in full or partial satisfaction of a preexisting indebtedness;
> (8) a transfer of an interest in or an assignment of a claim under a policy of insurance, other than an assignment by or to a health-care provider of a health-care-insurance receivable and any subsequent assignment of the right to payment, but Sections 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds;
> (9) an assignment of a right represented by a judgment, other than a judgment taken on a right to payment that was collateral;

volve (1) growing crops, (2) the flow of payments from an installment land contract or contract for deed, (3) non-true leases, and (4) statutory liens.

Questions relating to real estate have arisen in several situations: a seller of land, pursuant to an installment contract or contract for deed, repossesses land with growing crops subject to a perfected security interest of another; a mortgagee forecloses a real estate mortgage and claims growing crops that are subject to the perfected security interest of another creditor, and a real estate mortgagee claims an interest in growing crops when the farmer debtor files a bankruptcy petition. Pre-Article 9 cases held that crops unharvested at the time of a real estate foreclosure are part of the real estate and pass with the land at foreclosure. Today, it is clear that a real estate lender who desires an interest in growing crops must comply with Article 9. This is true in all of the situations just set out.[14]

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(10) a right of recoupment or set-off, but:
(A) Section 9-340 applies with respect to the effectiveness of rights of recoupment or set-off against deposit accounts; and
(B) Section 9-404 applies with respect to defenses or claims of an account debtor;
(11) the creation or transfer of an interest in or lien on real property, including a lease or rents thereunder, except to the extent that provision is made for:
(A) liens on real property in Sections 9-203 and 9-308;
(B) fixtures in Section 9-334;
(C) fixture filings in Sections 9-501, 9-502, 9-512, 9-516, and 9-519; and
(D) security agreements covering personal and real property in Section 9- 604;
(12) an assignment of a claim arising in tort, other than a commercial tort claim, but Sections 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds; or
(13) an assignment of a deposit account in a consumer transaction, but Sections 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds.

14. *Id.* § 9-334(i) (stating, "[a] perfected security interest in crops growing on real property has priority over a conflicting interest of an encumbrance or owner of the real property if the debtor has an interest of record in or is in possession of the real property"); *see id.* § 9-102(a)(44)(iv) (stating that "growing crops" are specifically included in the definition of goods).

The Kansas Supreme Court in *Mortiz Implement Co. v. Matthews*, 959 P.2d 886 (Kan. 1998), considered a mortgage foreclosure on land with unsevered crops subjected to a perfected security interest. The court held that Article 9 is the exclusive statutory scheme governing security interests in growing crops. *Id.* at 889. Thus, anyone claiming an interest in the crops to satisfy an unpaid debt is subject to Article 9. Moreover, the court held that a perfected security

Another scope issue concerns the flow of payments under a contract for deed or an installment land contract. This issue frequently arises when an owner of real estate sells the real estate, pursuant to a contract for deed, to a buyer who promises to pay for it in monthly payments. The seller borrows money from a bank and uses the interest in the sold land and interest in the proceeds of the contract for deed. The bank does not file a financing statement. The seller files a bankruptcy petition. Article 9 applies to the flow of payments and the bank does not have a perfected security interest because it did not file a financing statement.

Former Article 9 did not cover pure real estate transactions[15] and neither does revised Article 9. Revised section 9-109(d)(11) provides that Article 9 does not apply to "the creation or transfer of an interest in or lien on real property, including a lease or rents thereunder . . . ."[16] The monthly payments are personal property under either version of Article 9.[17] Under former Article 9, the payments were considered to be general intangibles which had to be perfected by the filing of a financing statement centrally.[18] Since the bank filed no financing statement, it was an unperfected secured creditor.[19] The bank is also unperfected under revised Article 9, but it must be noted that the flow of payments is classified as an account and not as a general intangible. Revised Article 9's definition of "account" is much broader than under former Article 9. Revised Article 9 defines an account to include the right to payment of a monetary obligation for "'property' that has been . . . sold, leased, licensed, assigned or otherwise disposed of . . . ."[20] The term "property" covers both personal as well as real property.[21] Former Article 9's definition of accounts covered only monetary obliga-

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interest in crops remained attached after the redemption period expires in a mortgage foreclosure sale even though the real estate had been transferred as a result of the foreclosure sale. *Id.* at 892.

15. U.C.C. § 9-104(j) (1994).

16. U.C.C § 9-109(d)(11) (2000).

17. *See* U.C.C. § 9-106 (1994) (stating that "'[g]eneral intangibles' means any personal property . . . other than . . . accounts," and "'[a]ccount' means any right to payment…."); *see also* U.C.C. § 9-102(a)(2) (2000) (defining "account" as "a right to payment of a monetary obligation" including an obligation for leased property); BLACK'S LAW DICTIONARY 1217 (6th ed. 1990) (defining "personal property" as "everything subject to ownership, not coming under denomination of real estate" and "[a] right or interest in things personal . . . ").

18. U.C.C. §§ 9-106, 9-401(1) (1994).

19. *See, e.g., In re* Huntzinger, 268 B.R. 263, 267 (Bankr. D. Kan. 2001).

20. U.C.C. § 9-102(a)(2)(i) (2000).

21. *See id.* § 9-102(a)(2) (providing that:

> "Account", except as used in "account for", means a right to payment of a monetary obligation, whether or not earned by performance, (i) for property

tions arising from the sale of goods, and the term "goods" was defined to include only personal property and fixtures.[22] Because revised Article 9's definition of account includes the right to payment for "property" sold, the flow of payments under an installment land contract or contract for deed is now deemed an account instead of a general intangible.[23] A security interest in both accounts and general intangibles is perfected by filing centrally.[24] It is important to note that while both are perfected in the same manner, a fatal error will occur if the payments are improperly described in the security agreement and financing statement.[25] Types of collateral can be used as descriptions under both sections 9-108 and 9-504, but if a drafter today describes the collateral as a payment intangible or general intangible in the security agreement, the creditor will be an unsecured creditor.[26]

> that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of, (ii) for services rendered or to be rendered, (iii) for a policy of insurance issued or to be issued, (iv) for a secondary obligation incurred or to be incurred, (v) for energy provided or to be provided, (vi) for the use or hire of a vessel under a charter or other contract, (vii) arising out of the use of a credit or charge card or information contained on or for use with the card, or (viii) as winnings in a lottery or other game of chance operated or sponsored by a State, governmental unit of a State, or person licensed or authorized to operate the game by a State or governmental unit of a State. The term includes health-care-insurance receivables. The term does not include (i) rights to payment evidenced by chattel paper or an instrument, (ii) commercial tort claims, (iii) deposit accounts, (iv) investment property, (v) letter-of-credit rights or letters of credit, or (vi) rights to payment for money or funds advanced or sold, other than rights arising out of the use of a credit or charge card or information contained on or for use with the card).

22. *See* U.C.C. §§ 9-102(a), 9-105(h) (1994).

23. *Compare* U.C.C. § 9-102(a)(42) (2000) (stating that

> "General intangible" means any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of- credit rights, letters of credit, money, and oil, gas, or other minerals before extraction. The term includes payment intangibles and software);

with id. § 9-102(a)(61) (defining payment intangible as a general intangible under which the account debtor's principal obligation is a monetary obligation).

24. *See id.* §§ 9-310, 9-501.

25. *See id.* § 9-108(a)-(b).

26. *See id.* §§ 9-203, 9-308. Section 9-308(a) reads:

> [Perfection of security interest.] Except as otherwise provided in this section and Section 9-309, a security interest is perfected if it has attached and all of

This problem can be avoided by simply describing the collateral in lay terms, such as "the monthly payments under the contract for deed between buyer and seller dated . . . ."

Under former Article 9, if the owner in the above example were to have sold the right to receive the flow of payments to the bank, the bank did not have to worry about Article 9. Former Article 9 did not apply to the sale of general intangibles, and the flow of payments was considered a general intangible.[27] However, under revised Article 9, the flow of payments is an account, and the sale of accounts is within the scope of Article 9.[28] This means the bank as a buyer of accounts is considered a secured party and has to file a financing statement to be perfected.[29]

Another scope issue dealing with real estate related collateral concerns federal payments for land placed in the Conservation Reserve Program ("CRP"). Courts have struggled with whether these payments are personal property. After thoroughly considering the cases and issues, the Bankruptcy Court in *In re Isenbart*[30] held that CRP payments are personal property rather than rent of real estate.[31] They are in the nature of contract rights, general intangibles, or accounts under former Article 9. This decision was enunciated when former Article 9 was in effect. Clearly, revised Article 9 applies to any transaction creating a security interest in personal property, which includes the CRP payments under the *In re Isenbart* decision. The question becomes how are CRP payments classified under revised Article 9? A comment to revised section 9-102 provides:

> This Article does not contain a defined term that encompasses specifically rights to payment or performance under the many and varied government entitlement programs. Depending on the nature of a right under a program, it could be an account, a

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> the applicable requirements for perfection in Sections 9-310 through 9-316 have been satisfied. A security interest is perfected when it attaches if the applicable requirements are satisfied before the security interest attaches.

Section § 9-203(b)(3) requires an authenticated security agreement to contain a description of the collateral.

27. *See* U.C.C. §§ 9-102, 9-106 (1994).

28. U.C.C. § 9-109(a)(3) (2000); s*ee also id.* §§ 9-109(a)(2), 9-102(a)(72)(D) (noting that a secured party includes the buyer of accounts); *id.* § 9-102(a)(28)(B) (indicating that debtor includes the seller of accounts); *id.* § 1-201(37) (defining a security interest to include the interest of a buyer of accounts).

29. *See id.* §§ 1-201, 9-102, 9-109.

30. 255 B.R. 62, 67 (Bankr. D. Kan. 2000).

31. *Id.* at 67.

> payment intangible, a general intangible other than a payment intangible, or another type of collateral. The right also might be proceeds of collateral (e.g. crops).[32]

The classification of a government payment becomes important, because if the payment is classified as a payment intangible, the sale of it, as well as the transaction creating a security interest in it to secure a loan, is covered by revised Article 9.[33]

The drafters of revised Article 9 made nonpossessory statutory liens on farm products subject to the perfection, priority, and enforcement rules of Article 9. How and when a statutory lien attaches to farm products and/or the proceeds of farm products is determined by state law. A statutory lien on farm products is called an agricultural lien. Section 9-102(a)(5) defines an "agricultural lien" as:

> [A]n interest[, other than a security interest,] in farm products:
> (A) which secures payment or performance of an obligation for:
> (i) goods or services furnished in connection with a debtor's farming operation; or
> (ii) rent on real property leased by a debtor in connection with its farming operation;
> (B) which is created by statute in favor of a person that:
> (i) in the ordinary course of its business furnished goods or services to a debtor in connection with a debtor's farming operation; or
> (ii) leased real property to a debtor in connection with the debtor's farming operation; and
> (C) whose effectiveness does not depend on the person's possession of the personal property.[34]

An agricultural lien is perfected when the lien is effective under the statute creating it and a proper financing statement has been filed centrally.[35] If the statute creating the lien has different perfection requirements than found in revised Article 9, presumably revised Article 9 controls.[36] As for priorities, agricultural liens and security interests have priority according to time of filing or perfection, whichever occurs first, unless the statute creating the lien specifically provides otherwise.[37] A perfected agricultural lien has priority over a conflicting

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32. U.C.C. § 9-102 cmt. 5(i) (2000).
33. *Id.* § 9-109(a)(1), (3).
34. *Id* § 9-102(a)(5).
35. *Id.* §§ 9-308(b), 9-310(a).
36. *Id*. §§ 9-109(a)(2), 9-109 cmt. 10.
37. *Id*. § 9-322(a)(1).

unperfected security interest or an unperfected agricultural lien.[38] The first security interest or agricultural lien to attach or become effective has priority if a conflicting security interest or agricultural lien is unperfected.[39] If a statute under which an agricultural lien is created provides that the agricultural lien has priority over a conflicting security interest or agricultural lien in the same collateral, that statute governs priority if the agricultural lien is *perfected*.[40]

As to conflicts between a buyer of a farm product subject to an agricultural lien, the agricultural lien continues in the farm products notwithstanding sale or lease of the collateral "unless the secured party authorized the disposition free of the . . . agricultural lien."[41] The Federal Farm Products rule does not apply to statutory liens.[42] It only applies to security interests created by agreement.[43] What about the proceeds generated from the sale of the farm products?[44] Section 9-315(a)(1) specifically refers to agricultural liens and provides unless the secured party waives its security interest or its agriculture lien they continue in the *collateral* upon sale or disposition, but Section 9-315(a)(2) provides *only* that the security interest attaches to any identifiable proceeds of the collateral. Agricultural liens are not mentioned. The negative inference is that proceeds of collateral subject to an agriculture lien are not covered by Article 9. Also, comment 2 of revised section 9-302 provides in part:

> Inasmuch as no agricultural lien on proceeds arises under this Article, this section does not expressly apply to proceeds of agricultural liens. However, if another statute creates an agricultural lien on proceeds, it may be appropriate for courts to apply the choice-of-law rule in this section to determine priority in the proceeds.

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38. *Id*. § 9-322(a)(2).
39. *Id.* § 9-322(a)(3).
40. *Id*. § 9-322(g).
41. *Id*. § 9-315(a)(1).
42. *See* 7 U.S.C. § 1631 (2000).
43. 7 U.S.C. § 1631(d) (2000) (providing that buyer takes "free of a security interest created by the seller"). An agricultural lien, however, is not created by the seller, it is created by statute. Some states' statutory provisions, such as Minnesota and Illinois, provide that a landlord's lien is effective against a good faith purchaser but only if within six months of the purchase the purchaser has received from the lien holder via registered or certified mail an appropriate written notice of the lien. *See* 735 ILL. COMP. STAT. 5/9-316; Pub. Act 92-0819, 92d Gen. Assem. (Ill. 2002), *available at* http://www.legis.state.il.us.
44. *See* U.C.C. § 9-102(64) (2000) (defining proceeds); s*ee also id.* § 9-102(a)(9) (defining cash proceeds); *id.* § 9-102(a)(58) (defining non-cash proceeds).

Arguably, Article 9's silence is not a basis for preventing an agricultural lien's attachment to proceeds of sold property that was subject to an agricultural lien. Comment 9 to revised section 9-315 is also relevant and states:

> This Article does not determine whether a lien extends to proceeds of farm products encumbered by an agricultural lien. If, however, the proceeds are themselves farm products on which an "agricultural lien" . . . arises under other law, then the agricultural-lien provisions of this Article apply to the agricultural lien on the proceeds in the same way in which they would apply had the farm products not been proceeds.

In summary, a state statute creating the nonpossessory lien must exist and must provide how the lien is created and when it attaches. All statutory liens on farm products must be perfected by filing a proper financing statement centrally. This will be a change for many current statutory liens by eliminating secret liens. Under section 9-322(g), individual states are free to provide for agricultural liens to have priority over prior perfected security interests. However, all such liens will be subject to the *perfection and enforcement rules of Article 9*. If the statute creating the lien does not provide for a super-priority, the normal priority rules of 9-322 will apply.[45]

Perhaps the most significant impact of the coverage of agricultural liens is that landlord's liens are now covered by Article 9.[46] The definition of an agricultural lien includes a statutory non-possessory lien created in farm products to secure the performance of an obligation for rent of real property leased in connection with debtor's farming operation.[47] Thus, a landlord's lien on crops for unpaid rent for land upon which the crops are produced is now subject to the perfection, priority, and enforcement rules of revised Article 9.

Two issues concerning landlord's liens merit discussion. One concerns perfection and the other concerns priority. The landlord who wants to claim a landlord's lien *must* file an appropriate financing statement centrally even though

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45. *See, e.g.,* Donald W. Baker, *Some Thoughts on Agricultural Liens Under the New U.C.C. Article 9*, 51 ALA. L. REV. 1417 (2000); Linda J. Rusch, *Farm Financing Under Revised Article 9*, 73 AM. BANKR. L.J. 211 (1999); Drew L. Kershen & Alvin C. Harrell, *Agricultural Financing: Comparing the Current and Revised Article 9*, 33 UCC L.J. 169 (2000).

46. *See In re* Parks Planting Co., 2002 WL 1397250 (W.D. Tenn. June 5, 2002) (rejecting a claim of a landlord's lien and holding the landlord could only claim an interest in the specific crops if the landlord had a perfected security interest); *see also* Fratesi v. Fogleman, 32 S.W.3d 38 (Ark. Ct. App. 2000) (holding a landlord's lien on crops for unpaid rent is not covered by former Article 9).

47. U.C.C. § 9-102(a)(5) (2000).

the relevant state law provides that the landlord's lien has priority over secured creditors. The uniform version of the section 9-322(g) provides: "A *perfected* agricultural lien on collateral has priority over a conflicting security interest in or agricultural lien on the same collateral if the statute creating the agricultural lien so provides."[48] Clearly, the uniform act contemplates that an agricultural lien must be filed. The reason for including agricultural liens was to eliminate secret liens by requiring a public filing.

Some states have made non-uniform amendments to Article 9's treatment of agricultural liens. An example is Illinois. As of August 21, 2002, Illinois no longer requires landlord's liens to be perfected by the filing of a financing statement, and has provided by statute that the landlord's lien has priority to a prior perfected security interest in the same crops.[49]

The Illinois approach is ineffective in providing the landlord with total priority protection. If the tenant that owes the unpaid rent files a bankruptcy petition, the bankruptcy trustee ("TIB") most assuredly will attack the landlord's lien under 11 U.S.C. § 545 and should trump conflicting state provisions.[50] This section provides in relevant part:

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48. *Id*. § 9-322(g) (emphasis added).

49. *See* 810 ILL. COMP. STAT. 5/9-102(a)(5) (2002); Pub. Act 92-0819, 92d Gen. Assem. (Ill. 2002), *available at* http://www.legis.state.il.us.

50. 11 U.S.C. § 545 (2000). Section 545 provides in its entirety:

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

> The trustee may avoid the fixing of a statutory lien on property of the debtor to the extent that such lien . . .
>
> (2) is not perfected or enforceable at the time of the commencement of the case against a bona fide purchaser that purchases such property at the time of the commencement of the case, whether or not such a purchaser exists;
>
> (3) is for rent; or
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> (4) is a lien of distress for rent.[51]

The TIB should prevail under either subpart three or subpart four of § 545 because the landlord's lien is for rent. Also, under § 545(2) the TIB should be able to avoid the landlord's lien because it is not perfected. Ironically, the TIB may also be able to defeat the landlord who has perfected its agricultural lien by filing a proper financing statement in the proper place. Sections 545(3) and (4), dealing with liens for rent, appear to apply to any type of statutory lien for rent. Thus, unless a landlord wants to litigate this issue, the best way to proceed is to obtain a perfected security interest in the crops to be grown on the rented land. However, if a prior perfected security interest exists, the landlord will be second in line[52] unless the first to file agrees to subordinate.[53] The safest approach for the land owner is to require the cash up front. Presumably, this places the financial risk on lenders who are in a position to evaluate the credit worthiness of the tenant. The lender who has or is contemplating financing the tenant-operator has an incentive to provide the cash for the lease.

In most states, through either the statute creating the landlord's lien or through case law, landlord's liens are granted priority over a prior perfected security interest.[54] As indicated above, landlord's liens are avoidable in bankruptcy.

Two applications of this section are *In re* Wedemeir, 239 B.R. 794 (B.A.P. 8th Cir. 1999), and *In re* Marshall, 239 B.R. 193 (Bankr. S.D. Ill. 1999). In the *Marshall* case the landlords argued that a consensual security interest was created in the lease and therefore § 545 was not germane. While the court recognized that a security interest can be created in a lease, the leases involved did not contain language which could be construed as creating a security interest. Moreover, even if one was created, the landowners were unperfected because no financing statement was filed. In *Wedemeir*, landowners leased land to a farmer who filed a bankruptcy petition. Unpaid landowners claimed a lien on the crops that were produced on their land. The court held that the liens claimed by the landowners could be avoided by the trustee under 11 U.S.C. § 545(3)-(4) if they were statutory landlord's liens or avoided under 11 U.S.C. § 544(a)(1) if they were considered contractual liens because they were not perfected.

51. 11 U.S.C. § 545 (2000).

52. U.C.C. § 9-322(a)(1) (2000).

53. *See id.* § 9-339.

54. *See, e.g., In re* Marshall, 239 B.R. 193, 196 (Bankr. S.D. Ill. 1999); Perkins v. Farm-

This raises an interesting problem in bankruptcy. A section of the Bankruptcy Code provides in relevant part: "Any transfer avoided under . . . [§§] 544, 545, [or] 547 . . . is preserved for the benefit of the estate but only with respect to property of the estate."[55] Utilizing this section, a TIB can avoid the landlord's lien but preserve it for the benefit of the bankruptcy estate and avoid a portion of the secured party's secured claim.[56] The following situation illustrates this result. If a landlord had a lien for unpaid rent of $20,000 on crops and the secured party who was owed $30,000 had a perfected security interest in the same crops, the trustee could avoid $20,000 of secured creditor's $30,000 perfected security interest.

A final scope issue considered here concerns tort claims. Former Article 9 excluded tort claims from coverage. The court in *Corcoran v. Land O'Lakes*[57] considered this issue under former Article 9.[58] In that case, a hog producer granted a perfected security interest in all rights to payments and general intangibles now owned or hereafter acquired to Norwest.[59] The hog producer defaulted and Norwest foreclosed against the hog producer.[60] Apparently before default, the hog producer had sued Land O'Lakes on a number of theories including tortious interference with contract and prospective business relationship between lender and producer.[61] The court rejected Land O'Lakes' argument that the lender's foreclosure of the lender's security interest in general intangibles deprived the producer of its right to prosecute its claim against Land O'Lakes.[62] According to the court, foreclosure gives the lender a first priority lien in any proceeds from any judgment obtained by debtor.[63] Moreover, the lender's security interest in general intangibles did not cover debtor's tort claims and its foreclosure does not affect the debtor's right to prosecute his tort claims.[64]

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ers Trust & Savings Bank, 421 N.W.2d 533, 535 (Iowa 1988); Prior v. Rathjen, 199 N.W.2d 327, 332 (Iowa 1972). *See also* Dwyer v. Cooksville Grain Co., 454 N.E.2d 357, 359 (Ill. App. 1983); Dean Powell, Note, *Priorities Between Article Nine Security Interests & Statutory Liens in Iowa,* 23 DRAKE L. REV. 169 (1973).

55. 11 U.S.C. § 551 (2000).
56. *See, e.g., In re* Coal-X, Ltd., "76", 103 B.R. 276 (Bankr. D. Utah 1986).
57. 39 F. Supp. 2d 1139 (N.D. Iowa 1999).
58. *Id.* at 1147-48.
59. *Id.* at 1143.
60. *Id.* at 1144.
61. *Id.*
62. *Id.* at 1147-48.
63. *Id.* at 1149.
64. *Id.*

Today, revised Article 9 is relevant. A secured party can obtain a security interest in a commercial tort claim because revised Article 9 covers the assignment of a claim arising out of a commercial tort[65] that falls within the definition of section 9-102(a)(13):

> a claim arising in tort with respect to which (A) the claimant is an organization; or (B) the claimant is an individual and the claim (i) arose in the course of the claimant's business or profession; and (ii) does not include damages arising out of personal injury to or the death of an individual.[66]

Comment 15 to section 9-109 provides some interesting commentary. It states in part:

> This Article now applies to assignments of "commercial tort claims" (defined in Section 9-102) as well as to security interests in tort claims that constitute proceeds of other collateral (e.g., a right to payment for negligent destruction of the debtor's inventory). Note that once a claim arising in tort has been settled and reduced to a contractual obligation to pay, the right to payment becomes a payment intangible and ceases to be a claim arising in tort.[67]

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65. U.C.C. § 9-109(d) (2000) provides that "[t]his article does not apply to . . . (12) an assignment of a claim arising in tort, other than a commercial tort claim, but Sections 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds."

66. *Id*. § 9-102 cmt. 5(g) (stating that commercial tort claim is a new term and a tort claim may serve as original collateral under this Article only if it is a commercial tort claim); *see also id*. § 9-109(d).

Although security interests in commercial tort claims are within its scope, this Article does not override other applicable law restricting the assignability of a tort claim. *See id*. § 9-401. A security interest in a tort claim also may exist under this Article if the claim is proceeds of other collateral.

67. *Id*. § 9-109 cmt. 15 continues by stating:

> This Article contains two special rules governing creation of a security interest in tort claims. First, a description of collateral in a security agreement as "all tort claims" is insufficient to meet the requirement for attachment. See Section 9-108(e). Second, no security interest attaches under an after-acquired property clause to a tort claim. See Section 9-204(b). In addition, this Article does not determine whom the tortfeasor must pay to discharge its obligation. Inasmuch as a tortfeasor is not an "account debtor," the rules governing waiver of defenses and discharge of an obligation by an obligor (Sections 9-403, 9-404, 9-405, and 9-406) are inapplicable to tort-claim collateral.

II. ATTACHMENT

If a transaction is covered by Article 9, the key question becomes what is the status of the parties? For a creditor to be a secured party it must have an enforceable security interest. This requires attachment.[68] For attachment to occur, the creditor must give value,[69] the debtor must have rights in the collateral "or the power to transfer rights in the collateral to a secured party,"[70] and an appropriate security agreement must exist.[71] The rights and security agreement requirements merit further comment.

A. *The Rights Requirement*

The term "rights" is not defined under the U.C.C. Rights in the collateral does not necessarily mean "title." Clearly an owner has rights in property and a thief who has mere possession does not. It is also clear that the debtor does not have to be an owner to be able to create an enforceable security interest. However, it is not clear on the continuum between actual ownership and mere possession what relationship with collateral establishes rights sufficient to create a security interest in goods that the debtor does not own. In general, it appears that the debtor must have the "power" to create a security interest. Because the term "rights" is not defined, section 1-103 is relevant. This Section provides that "unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions."[72] Thus, the debtor can obtain the power to create a security inter-

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68. *Id*. § 9-203(a).

69. U.C.C. §§ 9-203(b)(1) (2000); U.C.C. § 1-201(44) (1991). Section 1-201(44) provides in part:

> [A] person gives "value" for rights if he acquires them (a) in return for a binding commitment to extend credit or for extension of immediately available credit . . . or (b) *as security for or in total or partial satisfaction of a pre-existing debt covers* (after-acquired collateral) . . . or (d) generally, in return for any consideration sufficient to support a simple contract (emphasis added).

70. U.C.C. § 9-203(b)(2) (2000).

71. *Id*. § 9-203(b)(3).

72. *Id*. § 1-103.

est through any of the bodies of law set out in section 1-103.[73] The debtor may have rights in the collateral even before delivery, if, for example, the supplier of goods has earmarked the goods for him or her.[74]

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73. *Id.* Numerous courts have considered the rights issue. One example is where the debtor is a commercial feedlot operator. It is necessary to determine whether the debtor owns all of the cattle located in the lot. Often some of them will be owned by people who have hired the operator to fatten them. A debtor cannot create a security interest in animals the debtor does not own and holds as bailee for the limited purpose of fattening. *See* Nat'l Livestock Credit Corp. v. First State Bank of Harrah, 503 P.2d 1283 (Okla. Ct. App. 1972); *see also* Kinetics Tech. Int'l Corp. v. Fourth Nat'l Bank, 705 F.2d 396 (1983); Morton Booth Co. v. Tiara Furniture, Inc., 564 P.2d 210, 214 (Okla. 1977) (noting that rights exist "where debtor gains possession of collateral pursuant to agreement endowing him with any interest other than naked possession"); Chrysler Corp. v. Adamatic, Inc., 208 N.W.2d 97, 104 (Wis. 1973) (indicating that bailee's possessory interest for limited purpose of repair was not sufficient "rights in the collateral"); *In re* Cook, 63 B.R. 789 (Bankr. D.N.D. 1986) (stating that fact the non-debtor son held title in cattle claimed by the secured party was not dispositive as to whether his parents (the debtors), who had possession of the cattle, had sufficient rights to grant a security interest in the cattle). The debtor possesses sufficient rights in collateral if the true owner agrees to the debtor's use of the cattle as collateral or if the true owner is estopped to deny creation of the security interest. The intent of the parties is the key and the lender has the burden of proof. *But see* Thorp Credit, Inc. v. Wuchter, 412 N.W.2d 641 (Iowa Ct. App. 1987) (holding that possession of livestock presented only rebuttable presumption of ownership). For another example, see In re *Atchison*, 832 F.2d 1236 (11th Cir. 1987). The owner signed the security agreement on behalf of the corporation and the equipment that he owned was being used by the corporation in operation of the corporation's business. The owner's permission to use his goods as collateral gives the debtor (here the corporation) sufficient rights for attachment purposes. The court noted that tests employed by courts to define rights include: (1) owner's permission to use goods as collateral gives debtor sufficient rights to create a security interest; (2) the debtor's right to use and control the collateral gives the debtor sufficient rights to create a security interest. Also, see *Colorado National Bank-Longmont v. Fegan*, 827 P.2d 796 (Kan. Ct. App. 1992). The bank's perfected security interest in all of landowner Fegan's crops "growing or to be grown" attached to only Fegan's one-third interest in the crops produced under his crop-share lease of the land to Roths. *Continental Grain Co. v. Brandenburg*, 587 N.W.2d 196 (S.D. 1998), considers a unique situation. Continental financed Bud and Margery Brandenburg's cattle purchases and fattening for many years. Originally, the transactions were in Bud's name, but after he had difficulties with the law, the family cattle business was done in Margery's name. In this case, Continental had loaned money to Margery, who had signed a security agreement granting a security interest in the cattle purchased with the loan proceeds and had filed a proper financing statement. Bud was also a cattle order buyer and was authorized by Welte to buy cattle by issuing checks drawn on Welte's bank account at Heritage Bank, sell the cattle to a third party, and use the proceeds to repay Welte. The cattle in question were purchased by Bud from Shasta with a check signed by Margery and a check drawn by Bud on Welte's account. Shasta gave Bud a receipt showing he had bought the cattle and shipped them before checks had cleared, notwithstanding that Shasta knew that Bud's checks had been returned in the past. Bud called Continental and said that the cattle would be placed in its feedlot for Margery. Continental, as it had done many times in the past, mailed

A recent Minnesota Court of Appeals case raises the issue in the context of the purported seller keeping possession of a good purportedly sold. In *American State Bank v. Ladwig*,[75] the Ladwigs, who owned a combine, agreed to sell fifty percent ownership in the combine for roughly $35,000 to the Herickhoffs if the Herickhoffs made five annual payments on the combine.[76] The Ladwigs were to keep possession, provided that the Herickhoffs would be able to use the combine each year to harvest their crops.[77] The Herickhoffs borrowed money from the bank and signed a security agreement granting a security interest in the combine to the bank who filed a proper financing statement.[78] The Herickhoffs used the combine for six harvests but made only two payments to the Ladwigs.[79] The Herickhoffs defaulted on their obligations to the bank and the bank demanded

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Margery a check, the proceeds of which were to be used to pay for the cattle. When Margery's check and the Welte account check were dishonored because of a stop payment order, a controversy arose as to who was entitled to the cattle. One of the issues was whether Margery had sufficient rights for Continental's security interest to attach. The court, however, relied only on common law concepts to find that Margery had sufficient rights for Continental's security interest to attach. It made several observations. Possession alone is not enough to give the debtor the power to create a security interest. However, possession coupled with the appearance of ownership and control sufficient to mislead potential creditors establishes rights for Article 9 purposes. This is the situation here, in that Margery had possession, had a writing showing she had purchased the cattle from Bud, who had a receipt saying he was the owner of the cattle in question. Also, the court concluded that the unpaid sellers—Shasta, Welte, and the bank—were estopped from asserting that Margery did not have rights, given the fact that they were aware of Bud's prior activities and bad checks. While the court fails to mention § 2-403(1)(b), it, too, may be applicable. As indicated, under this section, a purchaser who pays with a check that is subsequently dishonored has voidable title, and this is sufficient to give the purchaser rights for attachment. *See In re* Samuels & Co., 526 F.2d 1238; Swets Motor Sales, Inc. v. Pruisner, 236 N.W.2d 299 (Iowa Dist. Ct. 1975). Finally, consider In re *Haase*, 224 B.R. 673 (Bankr. C.D. Ill. 1998), where the debtor fattened his own cattle and fed cattle that belonged to others. The debtor and Interstate entered into an agreement under which the debtor would feed ninety head of Interstate's cattle, but title to the cattle would remain in Interstate. Interstate would make all marketing decisions as to the cattle and would require the debtor to segregate the cattle. The bank had a security interest in all of the debtor's cattle. When the debtor defaulted, the bank claimed rights in all the cattle in the debtor's possession and proceeds from the sale of them. The court held that the debtor did not have rights in Interstate's ninety head of cattle. The court concluded that the cattle had been entrusted to the debtor under a contract for bailment for the purpose of fattening the animals. Consequently, the debtor obtained no rights in the cattle in which a security interest could attach.

74. U.C.C. §§ 2-401, 2-501 (2000).
75. 646 N.W.2d 241 (Minn. Ct. App. 2002).
76. *Id.* at 242.
77. *Id.* at 243.
78. *Id.* at 242-43.
79. *Id*. at 243.

that the Ladwigs deliver the combine for liquidation.[80] The Ladwigs refused.[81] The issue was whether the bank had a security interest in the combine.[82] This issue turned on whether the Herickhoffs had sufficient rights in the combine to grant a security interest in it.[83]

The court rejected the bank's argument that the Ladwigs' sale of the combine and retention of title until the Herickhoffs paid for it was in fact a sale and retention of a purchase money security interest.[84] The Ladwigs had not filed a financing statement, which meant the Ladwigs would have been unperfected secured creditors.[85] Because the Ladwigs had not perfected their security interest and the bank had a perfected security interest, the bank argued it was entitled to fifty percent of the value of combine.[86] Focusing on the fact the Ladwigs' sale involved only a partial interest in the combine and the seller retained possession, the court concluded that the test for determining whether the buyer of a partial interest in the combine has rights sufficient to grant a security interest is whether "delivery" has occurred under section 2-401.[87] Thus, the issue becomes a question of fact.

It seems the real issue is whether a contract for sale exists. If the question is whether a contract for sale was formed, delivery is not the key concept, and clearly Article 2 de-emphasizes the title concept that means ownership is not the key. Section 2-204(1), dealing with the formation of a contract for sale states that "[a] contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract."[88] Here it appears that the Herickoffs were obligated to pay the Ladwigs a substantial sum for a period of time for the right to use the combine and had in fact made some payments. It is important to note that a security agreement creating a security interest is a contract. No special words are required to create a security interest in the combine. The agreement here provided that the Herickhoffs would have a fifty percent interest in the combine if the required payments were made.[89] This sounds like a credit sale with the reservation

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80. *Id.*
81. *Id.*
82. *Id.*
83. *Id.* at 245.
84. *Id.* at 244-45.
85. *Id.* at 244.
86. *Id*.
87. *Id.* at 246.
88. U.C.C. § 2-204(1) (2000).
89. *Am. State Bank*, 646 N.W.2d at 242.

of a security interest in the combine. The substance of the transaction, not the intent of the parties, should control.[90]

Finally, it seems that the Ladwigs would have been better off to have argued that in fact a credit sale had occurred and that it had a security interest that was perfected[91] before the bank obtained its perfected security interest. The bank did not have a purchase money security interest and therefore was a junior creditor priority wise.[92] Thus, the bank as a junior creditor did not have the right to foreclose on the combine.

The issue of whether the debtor has a sufficient interest in collateral to create a security interest comes up in two other situations that focus on whether the debtor has the power to transfer an interest in the collateral to a secured party. Sometimes the debtor will be able to transfer greater rights than the debtor has. For example, under section 2-403(1) a person who has voidable title has the power to pass good title to a good faith purchaser which includes a secured creditor.[93] An example of voidable title is when a seller sells a computer to a business

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90. *Cf.* U.C.C. § 1-201(37) (2000); s*ee also In re* Homeplace Stores, Inc., 228 B.R. 88, 94 (Bankr. D. Del. 1998) (stating that whether a document called a lease is a true lease or a disguised security agreement is determined by state law and the substance of the transaction, not the intent of the parties).

91. The collateral was deemed goods and deemed to be under U.C.C. § 9-313(a) (2000), which can be perfected by possession.

92. U.C.C. § 9-103 (2000); *see also id*. § 9-322(a)(1) (providing that unless otherwise provided, priority dates from the time of perfection or filing, whichever occurs first); *id*. § 9-324(b) (providing that a purchase money security interest ("PMSI") in equipment has priority over a prior perfected secured creditor if the PMSI is perfected before or within twenty days of the debtor's possession). Here it does not appear that the bank had a PMSI. The debtor already had purchased the interest before the bank became involved.

For a thorough discussion of Revised Article 9's treatment of PMSIs see Keith G. Meyer, *A Primer on Purchase Money Security Interests Under Revised Article 9 of the Uniform Commercial Code*, 50 KAN. L. REV. 143 (2001).

93. U.C.C. § 2-403(1) (2000) states:

> A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good faith purchaser for value. When goods have been delivered under a transaction of purchase the purchaser has such power even though
>
> (a) the transferor was deceived as to the identity of the purchaser, or
>
> (b) the delivery was in exchange for a check which is later dishonored, or
>
> (c) it was agreed that the transaction was to be a "cash sale", or

who pays with a bad check. The business has voidable title[94] and this gives it power to pass good title to a good faith purchaser that includes a secured party who has a security interest in the business' inventory.[95]

A merchant who has had a good entrusted to it does not have the power to transfer an interest in property to a secured party.[96] This is illustrated by the following example. An owner leaves her watch with a jeweler to be repaired. The watch has been entrusted to the jeweler, which gives him the power to transfer all rights of the transferor to a buyer in the ordinary course of business.[97] While a secured party is considered a purchaser, it is not a buyer in the ordinary course of business. To be a buyer in the ordinary course of business under section 1-201(9) a sale must occur, that is there has to be a buyer not a purchaser. The

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

Section 1-201(32)-(33) defines a purchase and purchaser as follows:

> (32) 'Purchase' means taking by sale, lease, discount, negotiation, mortgage, pledge, lien, security interest, issue or reissue, gift, or any other voluntary transaction creating an interest in property.
> (33) 'Purchaser' means a person that takes by purchase.

94. *Id*. § 2-403(1)(b).

95. *See id*. § 2-403; *see also In re* Samuels & Co., 526 F.2d 1238 (5th Cir. 1976); Swets Motor Sales, Inc. v. Pruisner, 236 N.W.2d 299 (Iowa 1975) (holding that person buying goods with a bad check has sufficient power to transfer an interest to a secured party). Another example of the voidable title and a bad check is where a farmer delivers and sells grain to an elevator and receives a bad check, and a lender has a perfected security interest in the inventory of the elevator (company owned grain).

96. U.C.C. § 9-203 cmt. 6 (2000) (stating that sometimes a debtor may only have the power to transfer another's rights to a certain class of transferees that does not include a secured creditor) (citing U.C.C. § 9-403(2) as an example for this proposition).

97. *Id*. § 2-403 provides:

> (2) Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business.
> (3) "Entrusting" includes any delivery and any acquiescence in retention of possession regardless of any condition expressed between the parties to the delivery or acquiescence and regardless of whether the procurement of the entrusting or the possessor's disposition of the goods have been such as to be larcenous under the criminal law.

definition of "purchaser" includes both a buyer and a secured party, but the term "buyer in the ordinary course of business" requires a buyer.[98]

B. *Proper Security Agreement*

The third attachment requirement found in section 9-203(b) is that a proper security agreement creating a security interest must exist. Three points concerning the security agreement need to be addressed.

Revised Article 9, unlike former Article 9, no longer requires a signed written security agreement when the debtor has possession of the collateral.[99] Revised Article 9 provides that the debtor must execute an "authenticated security agreement that provides a description of the collateral and, if the security interest covers timber to be cut, a description of the land concerned . . . ."[100] Authenticate is defined in section 9-102(a)(7) meaning "to sign or to execute or otherwise adopt a symbol, or encrypt or similarly process a record in whole or in

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98. *See* Meyer, *supra* note 92; U.C.C. § 1-201(9) (stating in relevant part:

> "Buyer in ordinary course of business" means a person that buys goods in good faith, without knowledge that the sale violates the rights of another person in the goods, and in the ordinary course from a person, other than a pawnbroker, in the business of selling goods of that kind. A person buys goods in the ordinary course if the sale to the person comports with the usual or customary practices in the kind of business in which the seller is engaged or with the seller's own usual or customary practices. A person that sells oil, gas, or other minerals at the wellhead or minehead is a person in the business of selling goods of that kind. A buyer in ordinary course of business may buy for cash, by exchange of other property, or on secured or unsecured credit, and may acquire goods or documents of title under a preexisting contract for sale. Only a buyer that takes possession of the goods or has a right to recover the goods from the seller under Article 2 may be a buyer in ordinary course of business. "Buyer in ordinary course of business" does not include a person that acquires goods in a transfer in bulk or as security for or in total or partial satisfaction of a money debt.)

99. *Id*. § 9-203(b)(3) (stating that an "authenticated" agreement is required unless (1) the collateral is in the possession of the secured party pursuant to the *debtor's security agreement* and the collateral is not a certificated security; (2) the collateral is a certificated security in registered form delivered to the secured party pursuant to the *debtor's security agreement*; or (3) the collateral is deposit accounts, electronic chattel paper, investment property or letter-of-credit rights, and the secured party has control under 9-104, 9-105, or 9-107 pursuant to the *debtor's security agreement*).

100. *Id*. § 203(b)(3)(A).

part, with the present intent of the authenticating person to identify the person and adopt or accept a record."[101] "Record" means "information that is inscribed on a tangible medium or which is stored in an electronic or other medium and is retrievable in perceivable form."[102] Thus, a debtor who signs a writing containing a security agreement identifying itself as the debtor has authenticated the agreement.[103] This is also the case with a debtor who sends an electronic message containing a security agreement in an encrypted form that identifies the debtor as the sender.[104] The definition of authentication does not in fact require the execution of a separate symbol but only that the record itself be produced or adopted with the present intent to authenticate the record.[105] The presence of a symbol will help show the necessary present intent.

The authenticated agreement must additionally contain an appropriate description of the collateral. Revised Article 9, like former Article 9, provides that the description is sufficient if it reasonably identifies what is described.[106] However, unlike former Article 9, revised Article 9 provides some guidance as to what descriptions satisfy the reasonable identification standard. Section 9-108(b) gives several examples of reasonable identification. Descriptions that are sufficient include a specific listing, by category, or by type of collateral as defined in section 9-108.[107] Section 9-108 also identifies descriptions that are not accept-

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101. *Id*. § 9-102(a)(7).

102. *Id*. § 9-102(a)(69).

103. *Id*. § 9-102(a)(7)(A). For an interesting case dealing with who is the debtor, see In re *Kevin W. Emerick Farms, Inc.*, 201 B.R. 790 (Bankr. C.D. Ill. 1996). In that case, the creditor was sloppy as to signatures of the debtor on the security agreement listing the debtor as a corporation, and the corporate debtor security agreement was signed by the *individual* producer without any indication of a representative capacity. The court refused to consider parol evidence showing that the individual was signing on behalf of the corporation. Cases with a different decision are In re *Great Basin Transp., Inc.*, 32 B.R. 365 (Bankr. W.D. Okla. 1983) and In re *Mid-Atlantic Piping Prods. of Charlotte, Inc.*, 24 B.R. 314 (Bankr. W.D.N.C 1982). Interestingly, the *Emerick Farms* decision as to parol evidence runs counter to the rule found in U.C.C. § 3-402, which permits, in certain circumstances, a creditor to use parole evidence to show a negotiable instrument was signed by an individual in her representative capacity. *See also id*. § 9-102(a)(28); *id.* § 9-102 cmt. 2.

104. U.C.C. § 9-102(a)(7)(B) (2000).

105. *Id.*

106. *Id*. § 9-108(a) (providing that except as otherwise provided in subsections (c), (d), and (e), a description of personal or real property is sufficient, whether or not it is specific, if it reasonably identifies what is described).

107. *Id*. § 9-108(b) provides:

able.[108] For example, a description only describing the collateral by type is not acceptable for a commercial tort claim, consumer goods, a security entitlement, a securities account, or a commodity account.[109] Supergeneric descriptions such as "all the debtor's assets" or "all the debtor's personal property" are insufficient for security agreements,[110] but are none-the-less sufficient for financing statements.[111]

Unlike former Article 9, revised Article 9 does not require a security agreement covering crops to be grown or growing crops to contain a real estate description.[112] One might be required to reasonably identify the collateral if

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> [Examples of reasonable identification.] Except as otherwise provided in subsection (d), a description of collateral reasonably identifies the collateral if it identifies the collateral by:
> (1) specific listing;
> (2) category;
> (3) except as otherwise provided in subsection (e), a type of collateral defined in [the Uniform Commercial Code];
> (4) quantity;
> (5) computational or allocational formula or procedure; or
> (6) except as otherwise provided in subsection (c), any other method, if the identity of the collateral is objectively determinable.

Section 9-108(d) provides that "[e]xcept as otherwise provided in subsection (e), a description of a security entitlement, securities account, or commodity account is sufficient if it describes (1) the collateral by those terms or as investment property; or (2) the underlying financial asset or commodity contract".

108. *Id*. § 9-108(e).

109. *Id*. § 9-108(e) states:

> [When description by type insufficient.] A description only by type of collateral defined in [the Uniform Commercial Code] is an insufficient description of: (1) a commercial tort claim; or (2) in a consumer transaction, consumer goods, a security entitlement, a securities account, or a commodity account.

110. *Id*. § 9-108(c) (stating that a description of collateral as "all the debtor's assets" or "all the debtor's personal property" or using words of similar import does not reasonably identify the collateral).

111. *Id*. § 9-504(2).

112. *Id*. §§ 9-108, 9-203. *Cf.* U.C.C. §§ 9-203(1)(a); 9-402(1) (1994).
An interesting case under former Article 9 is again *In re Kevin W. Emerick Farms*, 201 B.R. 790 (Bankr. C.D. Ill. 1996). The lenders made loans to Kevin and Sherry Emerick who farmed land in Illinois as three different entities: as individuals, and as two corporations where Kevin was the sole shareholder for one corporation, and where Sherry was the sole shareholder of the other corporation. A lender obtained a security agreement granting a security interest in a corn crop, livestock, and equipment. The Emericks' businesses failed and they filed a bankruptcy petition which raised

debtor owns multiple pieces of land and only crops growing on one of them are subject to the security interest. If the security interest is in timber to be cut, a land description is needed.[113]

Revised Article 9 does not provide any guidelines as to what descriptions are sufficient if the security agreement contains an after-acquired property clause. Section 9-204(a) continues to broadly authorize these clauses by stating that "[a] security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral."[114] Examples of after-acquired property clauses include "all inventory now owned or hereafter acquired by debtor," "all equipment now owned or hereafter acquired by debtor," or " all accounts now due or to become due to debtor." Specific after-acquired property clauses should be included to make clear that after-acquired property was intended to be used as collateral. Thus, Article 9 authorizes after-acquired property clauses which permit the debtor to encumber all of its present and future

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a number of issues. One concerned the description of the crops in the security agreement which contained no real estate description of the relevant real estate which, is required under § 9-203(1). The lender argued that the security agreement could be salvaged by the so-called "composite document rule" under which a security agreement can be pieced together by combining all of the loan documents including the promissory note, communications between the debtors and the lender, loan agreements, and the financing statement. The financing statement here contained the relevant real estate description. This argument was rejected on the ground that Illinois law prohibits parol evidence when a security agreement already in existence is unambiguous. The court said the security agreement was clear and unambiguous; it omitted the real estate description and the court would not bail the sloppy creditor out of its bad drafting). Under revised Article 9 this security agreement will be proper because no real estate description is required for crops.

113. U.C.C. § 9-203(b)(3)(A) (2000).

114. *Id*. § 9-204(a). Under Article 9, certain types of collateral cannot be covered by after-acquired property clauses. For example, when the collateral is consumer goods, a secured party cannot obtain a security interest in after-acquired consumer goods unless the debtor acquires them within ten days after the secured party gives value. Also, commercial tort claims are not subject to an after-acquired clause. *Id*. § 9-204(b).

Non-Article 9 limitations exist. The Bankruptcy Code has limited the effectiveness of after-acquired clauses. 11 U.S.C. § 547(b), (c)(3), (c)(5) (1994).

Other federal law limitations exist. An unfair act or practice under the Federal Trade Act is committed if a security agreement covering household goods "contains a non-possessory security interest other than a purchase money security interest." 16 C.F.R. § 444.2(a)(4) (2003). Under other regulations, lenders are prohibited under federal law from obtaining a non-possessory non-purchase money security interest in household goods. 12 C.F.R. §§ 227.13(d), 535.2(a)(4) (2002). Thus, after-acquired property clauses covering household goods are invalid.

Finally, some states may have separate consumer credit protection legislation that regulates after-acquired collateral when consumer credit is involved. *See, e.g.,* Kan. Stat. Ann. §§ 16a-3-301 to 303 (2000).

assets.[115] Questions arise concerning whether the debtor intended to grant the creditor a security interest in after-acquired property when the security agreement does not have a specific after-acquired clause but covers for example "all inventory and accounts" or "all equipment." Revised section 9-108 takes no position on the issue. Official comment 3 of section 9-108 provides that,

> Much litigation has arisen over whether a description in a security agreement is sufficient to include after-acquired collateral if the agreement does not explicitly so provide. This question is one of contract interpretation and is not susceptible to a statutory rule (other than a rule to the effect that it is a question of contract interpretation). Accordingly, this section contains no reference to descriptions of after-acquired collateral.[116]

Courts are split. In cases involving inventory and accounts where the trade expects inventory and accounts to be sold and collected and then replaced, courts find a rebuttable presumption, based on the nature of overturning assets, that a security interest in "all inventory and accounts receivables" includes after-acquired inventory and accounts.[117] In cases where the collateral is equipment and the security agreement description was "all equipment" with no specific reference to after-acquired equipment, the presumption that collateral will turnover would not apply. Many courts have held that after-acquired equipment is not covered when a specific after-acquired property clause does not appear in the security agreement.[118] Finally, it must be noted that courts may consider parties' past course of dealing and industry custom when construing security agreements with no after-acquired property clause.[119] It seems clear that the parties could solve the problem of a missing after-acquired property clause by executing a new security agreement granting a security interest in the new collateral when ac-

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115. After-acquired clauses may cover an increase in existing collateral or products of collateral. For example, where a security agreement covers cattle and one of the cattle gives birth to a calf, there is said to be an increase in collateral. A products example is where the security agreement covers raw materials and the materials are converted into a finished product. But note that the definition of goods in U.C.C. § 9-102(44) (2000) provides in part that "'[g]oods' means all things that are movable when a security interest attaches. The term includes . . . (iii) the unborn young of animals. . . ."

116. *Id*. § 9-108 cmt. 3.

117. *See, e.g., In re* Filtercorp, Inc., 163 F.3d 570 (9th Cir. 1998).

118. *See, e.g.,* Graphic Resources, Inc. v. Thiebauth, 447 N.W.2d 28 (Neb. 1989).

119. *See* U.C.C. § 1-303 (2000) (formerly U.C.C. § 1-205 (1994)).

quired. Finally, remember that the financing statement need not refer to after-acquired property.[120]

Can a security agreement containing a defective description be reformed? Yes, says the bankruptcy court in *In re Schutz*.[121] Normally, a security agreement that describes the collateral as one-hundred head of Holstein cows would not cover one-hundred brown Swiss cows the debtor also owned. In *Schutz*, the security agreement described the collateral as a "1996 Titan Home" when the intended collateral was a "Sunshine-382" mobile home, serial number "AL-S-01258."[122] The creditor did get its security interest noted accurately on the mobile home title application and certificate of title.[123] Debtor filed for bankruptcy and the trustee asserted that creditor was an unsecured creditor because the security agreement was defective and no attachment occurred.[124] The court rejected this argument and permitted reformation of the contract (security agreement) because the defective description was the result of a mutual mistake.[125]

The court seemingly concluded that because the security agreement was clear on its face, the parol evidence rule prevented the introduction of extrinsic evidence to alter the result.[126] However, the court went on to conclude that under Missouri law the extrinsic evidence is admissible under the parol evidence rule to correct a mutual mistake.[127] Reformation is in order when three conditions are satisfied:

> (1) a preexisting agreement between the parties affected by the proposed reformation that is consistent with the change sought;
> (2) an assertion that a mistake was made in that the [document] did not reflect what had been agreed upon; and
> (3) an assertion that the mistake was common to both parties.[128]

The facts in *Schutz* showed these conditions were satisfied.[129] Inasmuch as the reformation of the contract simply enforced the parties intent, the court held that the effective date of the reformed contract was the date the original one

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120. *See* U.C.C. § 9-204 cmt. 7 (2000).
121. 241 B.R. 646 (Bankr. W.D. Mo. 1999).
122. *Id.* at 647.
123. *Id.*
124. *Id.* at 646-48.
125. *Id.* at 651.
126. *Id.* at 648-49.
127. *Id.* at 650.
128. *Id.* at 649.
129. *Id.*

was signed.[130] Restatement (Second) of Contracts section 155, discussing mutual mistake and reformation, provides an exception to the parol evidence rule "to the extent that rights of third parties such as good faith purchasers for value will be unfairly affected."[131]

While the trustee is normally not considered a good faith purchaser, it would appear that because the certificate of title contained the correct information about the collateral, the world was on notice of the security interest.[132] Moreover, once attachment was established, the creditor was perfected because of the proper notation on the certificate of title.[133]

Another description case is *Sims v. First State Bank of Plainview*.[134] One of the issues in *Sims* was whether a security agreement describing the collateral as a "JOHN DEERE MODEL 750 BACKHOE SR# CHO750SO28578" along with all accessions and additions, as collateral for a loan covered the front end loader that had been attached to the tractor when the loan was made but apparently removed by the debtor before repossession was attempted.[135] The court did not discuss section 9-203 or what description is adequate under Article 9. Rather, it notes that the trial court heard extensive testimony that indicated that "the front-end loader was in fact attached to, and an integral part of, the tractor.[136] Under revised sections 9-203(b)(3)(A) and 9-108, the question is did the security agreement description reasonably identify the collateral to be a tractor that had both a front-end loader and a backhoe? In effect, the court was saying that a tractor with a backhoe always has a front-end loader.[137] Remember the security interest is a contract and is designed to memorialize the agreement between the parties and make clear if default occurs what the secured party can repossess.

Finally, a troubling description case is *Shelby County State Bank v. Van Diest Supply Co*.[138] The debtor, a business, purchased goods for its inventory on credit from Van Diest. Van Diest drafted both the financing statement and the security agreement.[139] The financing statement described the collateral as "[a]ll inventory, notes and accounts receivable, machinery and equipment now owned

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130. *Id.*
131. RESTATEMENT (SECOND) OF CONTRACTS § 155 (1981).
132. *See generally* Schutz, 241 B.R. at 650.
133. *Id.*
134. 43 S.W.3d 175 (Ark. Ct. App. 2001).
135. *Id.* at 177-78.
136. *Id.* at 180.
137. *See id.* at 180.
138. 303 F.3d 832 (7th Cir. 2002).
139. *Id.* at 834.

or hereafter acquired, including all replacements, substitutions and additions thereto."[140] The security agreement described the collateral as "[a]ll inventory, including but not limited to agricultural chemicals, fertilizers, and fertilizer materials sold to debtor by Van Diest Supply Co. whether now owned or hereafter acquired, including all replacements, substitutions and additions thereto, and the accounts, notes and any other proceeds therefrom."[141] On the basis of this documentation, Van Diest claimed to have a perfected security interest in all of the debtor's inventory irrespective of whether Van Diest had sold it to the debtor or provided any financing for it.[142] The bankruptcy court found Van Diest's security agreement language ambiguous as it could be read to cover either all inventory of the debtor or only inventory sold to the debtor by Van Diest.[143] The district court found that the "bankruptcy court had created an ambiguity out of thin air and that the language of the security agreement supported only the view that the collateral included all inventory."[144] The Court of Appeals for the Seventh Circuit agreed with the bankruptcy court and reversed the district court.[145]

The court of appeals viewed this as a contract interpretation case and applied Iowa law as the security agreement choice of law provision required.[146] The security agreement description was determined to be ambiguous because the term "all inventory" was followed by the qualifier "including but not limited to agricultural chemicals, fertilizers, and fertilizer materials sold to debtor by Van Diest Supply Co. whether now owned or hereafter acquired."[147] In determining if the clause was ambiguous the court stated:

> It is a basic rule of English syntax (of all syntax, in fact) that a modifier should be placed directly next to the element it aims to modify: placing two modifiers in a row leads to the question whether the latter one modifies only the first modifier, or modifies the entire term. In the first edition of his book on statutory interpretation, Sutherland described the "doctrine of the last antecedent" as providing that "[r]elative and qualifying phrases, grammatically and legally, where no contrary intention appears, refer solely to the last antecedent."[148]

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140. *Id.*
141. *Id.* at 834-35.
142. *Id.* at 834-38.
143. *Id.* at 835.
144. *Id.*
145. *Id.* at 840.
146. *Id.* at 835.
147. *Id.* at 834-35.
148. *Id.* at 835-36.

Once the clause was considered subject to two interpretations, the next question was which one was intended. The court utilized a variety of theories. First, it considered the past conduct or dealing of the parties.[149] This was inconclusive because some of the previous security agreements had described the collateral as "all inventory" without any modifier and some had provided "[a]ll inventory, including but not limited to agricultural chemicals, fertilizers, and fertilizer materials sold to debtor by Van Diest Supply Co. whether now owned or hereafter acquired . . . ."[150]

Next, the court focused on Van Diest's actions after the execution of the security agreement. The court pointed to notices that were sent by Van Diest to other creditors. The court argues this showed that Van Diest treated the security agreement as covering only goods it had financed because it sent notices to other secured parties of record indicating it had supplied new inventory to debtor.[151] Then the court applied the age old construction doctrine that ambiguities should be resolved against the drafter.[152] It stressed the compelling reason to construe the document against the drafter was that third parties, who are prospective creditors, are almost always involved in this type of case.[153] These creditors who examine an ambiguous security agreement have no way of determining what really transpired between the debtor and Van Diest and how to resolve the ambiguities.[154] Interestingly enough, there is no indication that the other creditors here were in any way misled by Van Diest's security agreement.

In short, the *Van Diest* court held that Van Diest's security agreement description "[a]ll inventory, including but not limited to agricultural chemicals, fertilizers, and fertilizer materials sold to debtor by Van Diest Supply Co. whether now owned or hereafter acquired, including all replacements, substitutions and additions thereto, and the accounts, notes and any other proceeds therefrom" did not cover all of the debtor's inventory *but* was limited to that portion Van Diest had specifically financed.[155] The clause "included but not limited to" is common to most security agreements. Many, including myself, consider this language to be clarifying in that it shows the parties all inventory including that

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149. *Id.* at 837; *see also* U.C.C. § 1-205 (2000).
150. *Van Diest Supply*, 303 F.3d at 834-35.
151. *Id.* at 837.
152. *Id.* at 836.
153. *Id.* at 839.
154. *Id.*
155. *Id.* at 834-35.

financed by the secured party to be covered. This decision suggests that the inclusion of this language will always be considered limiting or narrowing.

It seems factually significant that *Van Diest* involved inventory financing.[156] Uncertainty existed under former Article 9 whether an inventory financier who had or wanted to obtain a purchase money security interest ("PMSI") would be adversely affected if an after-acquired or cross-collateral clause was included in the security agreement creating a PMSI in inventory. Under revised Article 9, this uncertainty has been resolved and a PMSI financier is not precluded from having both a PMSI and an ordinary security interest in inventory.[157] Thus, irrespective of whether this case represents the general rule, a PMSI financier can obtain a security interest in all of the debtor's inventory and still maintain its priority over the first-to-file by complying with section 9-324(b) requirements.[158]

III. PERFECTION

In general, attachment makes the security interest enforceable against the debtor and it allows the secured party to pursue its remedies on default as articulated in Part Six of Article 9, whether or not the security interest is perfected. A security interest cannot be perfected until it has attached and all steps required for perfection have been taken.[159] Perfection is required to protect the security interest against third parties such as purchasers of collateral subject to a security interest, other creditors and the trustee in bankruptcy. Remember that perfection does not give protection against the whole world. For example, section 9-320(a) allows the buyer in the ordinary course of business to cut off a perfected security interest in inventory. A valid perfected security interest in after-acquired inventory, livestock, and software or equipment or other goods that are not inventory or livestock lose to a later perfected qualifying purchase money security interest in inventory, livestock, software or equipment or other goods that are not inventory or livestock.[160] Perfection which occurs more than ten days after the creation of the security interest and within ninety days of bankruptcy will probably be set

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156. *See generally id.*

157. *See* U.C.C. §§ 9-103(f)(2) & 9-103(b) (2000); *see also* Meyer, *supra* note 92, at 149-77 (discussing this specific issue and the treatment of PMSIs under revised Article 9).

158. *Id*. § 9-324(b) (dealing with inventory); *id.* § 9-324(d) (dealing with livestock that is treated the same way as inventory).

159. *Id*. § 9-308(a).

160. *Id*. § 9-324.

aside as a preferential transfer under § 547(b) of the Bankruptcy Act unless a PMSI is involved.[161]

The key to determining how to perfect is the correct classification of the collateral. In general, five possible ways to perfect exist. The norm is filing a proper financing statement in the proper public office.[162] Possession of the collateral by the secured party is another method.[163] Additionally, there are methods of the so-called automatic perfection where certain types of security interests are perfected upon attachment.[164] Notation on a vehicle's certificate of title is the only way to perfect a security interest in a vehicle subject to a states's certificate of title law unless the vehicle is held as inventory.[165] Control is the only way to perfect when the collateral is deposit accounts, letter of credit rights, electronic chattel paper, and investment property.[166] Two other perfection possibilities are

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161. *See* 11 U.S.C. § 547(b)-(c)(3) (2000); *see also* U.C.C. § 9-103 (2000).

162. *See* U.C.C. § 9-501 (2000) (concerning where to file); *id.* §§ 9-502 to 506 (concerning what to file). Central filing is required, normally the secretary of state's office, for accounts, consumer goods, chattel paper, equipment, inventory, instruments, investment property, farm products, general intangibles, and negotiable documents. Revised Article 9 for the first time permits filling for instruments and promissory notes. The filing is local, normally in the register of deed's office, for as-extracted collateral, fixtures, and timber to be cut.

163. *Id*. § 9-313 (explaining that goods, instruments, money, negotiable documents of title, tangible chattel paper and certificated securities may be perfected by possession); *id*. § 9-312(b)(3) (explaining that possession is the exclusive means for perfecting an interest in money); *id.* §§ 9-313(c) & cmt. 3-4 (showing that perfection rules are changed when a third party has possession of the collateral, and requiring a bailee to receive notice and to acknowledge in an authenticated record that it is holding the collateral for the secured party's benefit).

164. *Id*. § 9-309 (stating that perfection is automatic upon attachment when a PMSI in consumer goods is involved). *See also id.* §§ 9-103, 9-309 (stating that sales of promissory notes or payment intangibles are automatically perfected under §§ 9-309(3)-(4) and that automatic perfection does not apply to security interests in payment intangibles or promissory notes); *id*. § 9-330(d) (showing that with respect to a promissory note that is an instrument, perfection by filing will not protect the buyer or secured party from a later buyer or secured creditor who gives value and takes possession of the instrument in good faith and without knowledge that the purchase or lien violates the rights of the original buyer or secured party); *id.* § 9-203(g) (providing that attachment of the security interest in the promissory note or other payment obligations automatically causes the security interest to attach to the "supporting obligation," i.e., the mortgage). The security interest in the obligation is automatically perfected in the supporting obligation. *Id.* § 9-308(e). This provides protection against a trustee in bankruptcy, a lien creditor, or a subsequent assignee of the real estate mortgage. However, the interest should be recorded in the real estate records as well. *See generally id.* § 9-309 (showing examples of automatic perfection).

165. *Id*. §§ 9-310(b), 9-311.

166. *Id*. §§ 9-104 to 9-107, 9-312(b), 9-314.

the so-called temporary perfection, which applies in limited situations,[167] and an assignment of a perfected security interest.[168] Finally, note that many types of collateral, except, for example, vehicles subject to certificate of title statutes, can be perfected in more than one way.[169]

Because filing is the most common form of perfection, it will be considered in more detail than the other forms of perfection under revised Article 9. The filing system has been modernized. All filings are to be made with the secretary of state except for fixtures, timber to be cut, as-extracted collateral, and transmitting utilities, which are filed locally.[170] Filings can also be made electronically. The name of the debtor for the financing statement has been clarified. Trade names are legally *insufficient*.[171] If the debtor is a registered organization, the name on the financing statement must show the name of the debtor indicated on the public record of the debtor's jurisdiction of organization.[172] A failure to provide the correct name of the debtor is a seriously misleading error unless "a search of the records of the filing office under the debtor's correct name, using the filing office's standard search logic, if any, would disclose a financing statement that fails sufficiently to provide the name of the debtor . . . ."[173] Perfection

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167. *Id*. § 9-312(e)-(f) (discussing 20 days certificated securities, negotiable documents or instruments when new value given, 20 days when bailee makes goods or documents available to debtor).

168. *Compare id*. § 9-310(b) (stating that if a secured party assigns a perfected security interest or agricultural lien, a filing under this article is not required to continue the perfected status of the security interest against creditors of and transferees from the original) *with* U.C.C. § 9-302(2) (1992) (this is essentially the same rule as set forth under former Article 9). In re *Field*, 263 B.R. 323 (D. Idaho 2001), held that under former U.C.C. § 9-302(2) a creditor as assignee of a perfected security interest was not required to file a financing statement to maintain a bank's perfected security interest status as to a debtor's cattle. Revised Article 9, like former Article 9 encourages the public disclosure of the assignment. *See* U.C.C. §§ 9-514, 9-519 (2000).

169. *See, e.g.,* U.C.C. §§ 9-312 to 9-313 (2000).

170. *Id*. § 9-501.

171. *Id*. § 9-503 (c) (providing that a "financing statement that provides only the debtor's trade name does not sufficiently provide the name of the debtor"). However U.C.C. § 9-506 continues the minor error rule. It provides that a financing statement substantially complying with the requirements of sections in Part 5 of Article 9 is effective even if it has minor errors or omissions, unless those errors or omissions make the financing statement seriously misleading. If the debtors name is incorrect, U.C.C. § 9-506(c) provides that if a search of the records of the filing office under the debtor's correct name using the filing office's standard search logic, if any, would disclose a financing statement that fails to sufficiently provide the name of the debtor, then the name provided does not make the financing statements seriously misleading.

172. *Id*. § 9-503(a)(1).

173. *Id*. § 9-506(c).

has been made easier. Instruments can be perfected by filing. The requirement of the debtor's signature has been eliminated so long as the person filing is authorized, which automatically occurs if the description in the financing statement is the same as in an "authenticated" security agreement.[174] Super-generic descriptions such as "all assets of the debtor" are sufficient in the financing statement but not in the security agreement.[175] Like a security agreement, no real estate description is required when growing crops or crops to be grown are involved.

When dealing with filing, two general questions have to be answered: where to file and what to file. As indicated earlier, all filings are made with the secretary of state except for fixtures, timber to be cut, as-extracted collateral, and transmitting utilities, which are filed locally.[176] The what must be filed question is answered by consulting the provisions specifying the contents of a proper financing statement. Section 9-502(a), which deals with non-real estate related filings, provides that a financing statement is sufficient if it contains only the name of the debtor, the name of the secured party or a representative of the secured party, and a description of the collateral.[177] While a financing statement may be sufficient with only these three things, section 9-516(b) contains additional requirements and 9-520 directs the filing officer to refuse to accept a record that does not meet the additional requirements of 9-516(b). A filing does not occur if the filing officer refuses to accept the proffered record because: (1) the record is not communicated in a manner authorized by the filing office; (2) an appropriate fee is not tendered; (3) the file cannot be indexed because the name of the debtor is not provided; (4) if the financing statement contains no name or mailing address of the secured party; (5) if the financing statement contains no mailing address of the debtor; (6) if the financing statement contains no indication that the debtor is an individual or organization; (7) if the debtor is an organization and the financing statement contains no indication of the type of organization; or (8) if a perfected secured party tries to continue an existing financing statement more than six months before the existing one expires.[178]

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174. *Id*. §§ 9-509, 9-510.

175. *Id*. §§ 9-108(c), 9-504.

176. *Id*. § 9-501.

177. *Id.* § 9-502(a)-(b) deals with real estate related statements—goods that are or are to become fixtures, timber to be cut, and as-extracted collateral. The filing must indicate that it is to be filed in the real estate records, provide a description of the real estate sufficient to be indexed in the real estate records, and the name of the record owner if the debtor does not have a recorded interest in the real estate.

178. *Id*. § 9-516(b).

However, if a filing officer accepts a financing statement which meets the requirements of 9-502, but not the additional requirements of 9-516(b), the filing is effective for most purposes.[179] Thus, in effect two types of defective financing statements exist: one partially defective and one totally defective.

Again, section 9-520(a) requires the filing officer to refuse to accept a record only when it does not meet the requirements of section 9-516(b). Suppose that the financing statement has the name of the debtor, the name of the secured party and a description of the collateral but omits the debtor's address. The filing officer is required to reject the record. Is the financing statement effective if the officer makes a mistake, accepts the record and indexes the financing statement? Under section 9-520(c), if the financing statement satisfies section 9-502, the filing is effective except as to subsequent secured parties or purchasers who reasonably rely upon the incorrect information.[180] A TIB is not a secured party or

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179. *Id*. §§ 9-338, 9-520(c). Section 9-338 deals with the priority of security interests or agricultural liens perfected by filed financing statement providing certain incorrect information. Section 9-338 provides:

> If a security interest or agricultural lien is perfected by a filed financing statement providing information described in Section 9-516(b)(5) which is incorrect at the time the financing statement is filed:
> (1) the security interest or agricultural lien is subordinate to a conflicting perfected security interest in the collateral to the extent that the holder of the conflicting security interest gives value in reasonable reliance upon the incorrect information; and a purchaser, other than a secured party, of the collateral takes free of the security interest or agricultural lien to the extent that, in reasonable reliance upon the incorrect information, the purchaser gives value and, in the case of chattel paper, documents, goods, instruments, or a security certificate, receives delivery of the collateral.

U.C.C. § 9-520(c) provides:

> [When filed financing statement effective.] A filed financing statement satisfying Section 9-502(a) and (b) is effective, even if the filing office is required to refuse to accept it for filing under subsection (a). However, Section 9-338 applies to a filed financing statement providing information described in Section 9-516(b)(5) which is incorrect at the time the financing statement is filed.

180. *Id*. § 9-520(c); *see also id*. § 9-516 cmt. 9 (providing:

> Effectiveness of Rejectable But Unrejected Record. Section 9-520(a) requires the filing office to refuse to accept an initial financing statement for a reason set forth in subsection (b). However, if the filing office accepts such a financing

purchaser under sections 1-201(32-33) and 9-102(a)(72). Therefore, the financing statement containing the proper debtor's name, the secured party's name, and a description of collateral is effective against the TIB.

Suppose that the financing statement has the name of the debtor, the name of the secured party and a description of the collateral, but contains an incorrect address and refers to the debtor as an individual when it is really a corporation. The filing officer is not required to reject this and in fact cannot reject this record.[181] Although the financing statement contains an incorrect address or

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statement nevertheless, the financing statement generally is effective if it complies with the requirements of Section 9-502(a) and (b). See Section 9-520(c). Similarly, an otherwise effective financing statement generally remains so even though the information in the financing statement becomes incorrect. See Section 9-507(b). (Note that if the information required by subsection (b)(5) is incorrect when the financing statement is filed, Section 9-338 applies.)

181. *Id*. § 9-516 cmt. 3 (providing:

Subsection (b) provides an exclusive list of grounds upon which the filing office may reject a record. See Section 9- 520(a). Although some of these grounds would also be grounds for rendering a filed record ineffective (e.g., an initial financing statement does not provide a name for the debtor), many others would not be (e.g., an initial financing statement does not provide a mailing address for the debtor or secured party of record). Neither this section nor Section 9-520 requires or authorizes the filing office to determine, or even consider, the accuracy of information provided in a record. For example, the State A filing office may not reject under subsection (b)(5)(C) an initial financing statement indicating that the debtor is a State A corporation and providing a three-digit organizational identification number, even if all State A organizational identification numbers contain at least five digits and two letters . . . .

A financing statement or other record that is communicated to the filing office but which the filing office refuses to accept provides no public notice, regardless of the reason for the rejection. However, this section distinguishes between records that the filing office rightfully rejects and those that it wrongfully rejects. A filer is able to prevent a rightful rejection by complying with the requirements of subsection (b). No purpose is served by giving effect to records that justifiably never find their way into the system, and subsection (b) so provides.

Subsection (d) deals with the filing office's unjustified refusal to accept a record. Here, the filer is in no position to prevent the rejection and as a general matter should not be prejudiced by it. Although wrongfully rejected records generally are effective, subsection (d) contains a special rule to protect a third-party purchaser of the collateral (e.g., a buyer or competing secured party) who gives value in reliance upon the apparent absence of the record from the files.

an incorrect debtor name, a filing officer is not authorized to challenge the accuracy of information in the record, and can only reject under section 9-516(b)(5) if no debtor name or address is included.[182] Here there was an address and a name. Thus, section 9-520 is not relevant. The last sentence of comment 9 in section 9-516 refers to section 9-516(b)(5) and says that section 9-338 applies to a financing statement containing incorrect information.[183] Section 9-338 is again of no help to the TIB because section 9-338 only applies to secured parties and purchasers, which the TIB is not.[184] The TIB cannot be considered a secured party or purchaser because it did not obtain an interest voluntarily.[185] Remember for a record to be effective under 9-502(a) it must satisfy the core content requirements which are the debtor's name, the name of the secured party, and a description of the collateral.

A recent bankruptcy case considered some of these issues. *In re Grabowski*[186] involved the application of revised Article 9 to a priority battle between two allegedly perfected secured creditors.[187] The conflict concerned the adequacy of the collateral description and an alleged incorrect debtor's address in a filed financing statement.[188] The named debtors, Ronald and Trenna Grabowski, operated a significant farming operation as well as owned and operated a John Deere farm equipment business.[189] Bank of America ("Bank"), the first to file, described the collateral in both its security agreement and financing statement as "[a]ll inventory, chattel paper, accounts, equipment and general intangibles" and listed the debtors' address as 12047 Highway 37, Benton, Ill.,

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> As against a person who searches the public record and reasonably relies on what the public record shows, subsection (d) imposes upon the filer the risk that a record failed to make its way into the filing system because of the filing office's wrongful rejection of it. (Compare Section 9-517, under which a misindexed financing statement is fully effective.) This risk is likely to be small, particularly when a record is presented electronically, and the filer can guard against this risk by conducting a post-filing search of the records. Moreover, Section 9-520(b) requires the filing office to give prompt notice of its refusal to accept a record for filing.

182. *Id*. § 9-516 (b)-(c).
183. U.C.C. § 9-516 cmt. 9 (2000).
184. *See id*. §§ 9-102(a)(52), 9-338, 9-520(c).
185. *Id*. §§ 1-201(32)-(33), 2-403(1).
186. 277 B.R. 388 (Bankr. S.D. Ill. 2002).
187. *Id.* at 390.
188. *Id.*
189. *Id.* at 389.

which was the address of the John Deere dealership.[190] South Pointe Bank ("South Pointe") obtained a security interest in the debtors' equipment including all equipment and farm machinery.[191] South Pointe's financing statement described the collateral as certain specific farm equipment and listed the debtors' address to be P.O. Box 38, Dubois, Ill. Both creditors claimed perfected security interests in equipment used in the debtors' farming operations.[192] South Pointe argued that Bank did not have a perfected security interest in the farm equipment because Bank's financing statement was defective on two counts.[193] First, the description was inadequate because it did not mention farm equipment or farm machinery. [194] South Pointe's second argument was that the debtors' address was incorrect because the debtors' farm equipment business address rather than the address of their farming operation was used.[195] The court rejected both assertions.[196]

As to the description, the court noted that revised section 9-504(2) provides that a description such as all assets or all personal property is sufficient to put a searching creditor on notice of a possible security interest.[197] Thus, Bank's description of "all inventory, chattel paper, accounts, equipment and general intangibles" was not too general and provided "inquiry notice."[198] Apparently, South Pointe also argued that because Bank's financing statement contained the address of the debtors' farm equipment business it was misled and "reasonably concluded" that the only equipment subject to Bank's security interest was the equipment located at the debtors' farm equipment business.[199] The court rejected this argument stating that it was not reasonable for South Pointe to have been misled, pointing out that Bank's collateral description did not contain the business address or restrict the collateral to a particular location.[200]

Interestingly, the court does not mention or discuss the second sentence of 9-520(c) which states, "section 9-338 applies to a filed financing statement providing information which is incorrect at the time the financing statement is

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190. *Id.*
191. *Id.* at 389-90.
192. *Id.* at 390.
193. *Id.*
194. *Id.*
195. *Id.*
196. *Id.* at 392.
197. *Id.* at 391.
198. *Id.* at 391-92.
199. *Id.* at 392.
200. *Id.*

filed."[201] Under section 9-338(1), a secured party perfected by filing a financing statement, which contains incorrect information concerning the mailing address of the debtor, is "subordinate to a conflicting perfected security interest to the extent that the holder of the conflicting security interest gives value in reasonable reliance upon the incorrect information . . . ."[202] Neither the statute nor the comments provide any guidance as to what reasonable reliance is. Instead, it is a factual question to be determined by the trier of fact.

Concerning the *Grabowski* case, assuming the address is treated as an incorrect address, it seems South Pointe would have to show it searched the records and found the financing statement. It then would have to further demonstrate that it gave value relying on the fact that the financing statement did not list the debtors' farming operation address and it reasonably believed that the financing statement covered only equipment located at the John Deere dealership location. It is very important to recognize that, assuming the financing statement was indexed under the debtors' correct name, a search under the legal name would have produced the financing statement.

Finally, it must be noted that Bank would have clearly won if the financing statement contained an incorrect address and it was attacked as ineffective by a TIB. Again, section 9-338(2) protects a purchaser, other than a secured party, who gives value and reasonably relies on incorrect information.[203] A TIB cannot take advantage of this protection because it does not give value, is not a reliance creditor, and is not a purchaser under the U.C.C.[204] The TIB obtains an interest in a debtor's property via an involuntarily lien on all of debtor's property, obtained at the filing of the bankruptcy petition.[205]

A. *Name of the Debtor — Section 9-503*

As indicated one of the core requirements of the financing statement is the name of the debtor.[206] The name of the debtor is the key to the notice system and priority. The financing statement is indexed under the name of the debtor. Section 9-503 articulates the rules for determining when the debtor's name is sufficient. If the debtor is a registered organization, only the name indicated on

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201. U.C.C. § 9-520(c) (2000).
202. *Id*. § 9-338(1).
203. *Id*. § 9-338(2).
204. *See id*. § 1-201(29)-(30) (defining purchase and purchaser).
205. 11 U.S.C. § 544(a)(1) (2000).
206. U.C.C. § 9-502(a)(1) (2000).

the public record of the debtor's jurisdiction of organization is sufficient. A registered organization means "[a]n organization organized solely under the law of a single state or the United States and as to which the state or the United States must maintain a public record showing the organization to have been organized."[207] Typically this includes a corporation, limited liability company, limited partnership, and a limited liability partnership.

When the debtor is a non-registered organization,[208] the name of the organization must be used.[209] If it has no name, the names of the partners, associates or others making up the debtor must be used.[210]

When the debtor is an individual such as a sole proprietor, the name to be used is the legal name of the individual.[211] What is the legal name of an individual? Section 9-503(c) provides only legal names are sufficient, so that a financing statement that provides only the debtor's trade name does not sufficiently provide the name of the debtor.[212] How does one determine the legal name of the individual? Look at a birth certificate or social security card or passport? Every effort *must* be used to obtain the *exact legal name*.

As indicated earlier, section 9-506 purports to continue the minor error rule.[213] It provides that a financing statement substantially complying with the requirements of Part 5 of Article 9 is effective even if it has minor errors or omissions unless those errors or omissions make the financing statement seriously misleading.[214] This section becomes relevant when the debtor's name is incorrect.[215] Section 9-506(c) functions in the following manner. First, the name of the debtor on the filed financing statement must be incorrect.[216] This can be a minor error "[i]f a search of the records of the filing office under the debtors' correct name, using the filing offices standard search logic, if any, would dis-

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207. *Id*. § 9-102(70).

208. *Id*. § 1-201(28) (stating that an organization "means a person other than an individual").

209. *Id*. § 9-503(a)(1).

210. *Id*. § 9-503(a)(4)(B).

211. *Id.*

212. *Id*. § 9-503(c).

213. *See id*. § 9-506(a) (stating that "a financing statement substantially satisfying the requirements of this part is effective if it has minor errors or omissions, unless the errors or omissions make the financing statement seriously misleading"). *See also id.* § 9-506(c) and accompanying text.

214. *Id.*

215. *Id.*

216. *See id*. § 9-506.

close" the filed financing statement containing the incorrect name using the standard search logic.[217] Many states use an exact match search logic. This means that the only filed financing statements that will be found are those indexed under the exact legal name of the debtor. In effect there is no minor error rule for debtor's names.[218]

Consider the following example. Suppose that the debtor is a sole proprietor operating under the name of Mountain Sports. The name of the owner is Timothy F. Meyer. The bank loans money to Mountain Sports, obtains a proper security interest in all of Mountain Sports' inventory, and files a financing statement showing the debtor's name to be Tim Meyer. Mountain Sports defaults on its loan and files a bankruptcy petition. The bank submits a secured claim with the appropriate documentation. Assume that the official search logic used by the secretary of state is the exact legal match, but an unofficial search which individuals can conduct via the internet would produce both Tim Meyer and Timothy F. Meyer.

The TIB has an official search done under Timothy F. Meyer and finds no financing statements. She then asserts that the bank is an unperfected secured creditor as to the inventory. She wins because the legal name of the debtor is Timothy F. Meyer and the use of the name Tim F. Meyer is not a minor error because under section 9-506(c), a search under the legal name using the standard search logic of the filing office did not find the bank's financing statement.

It is interesting to compare the demise of the minor error rule under the exact match search logic test with revised Article 9's treatment of errors connected with financing statements under sections 9-516(d) and 9-520(c). Under section 9-516(d), when a financing statement containing all of the appropriate information is rejected by the filing officer for an inappropriate reason, the unfiled financing statement is treated as valid against the TIB. Also, under section 9-520(c), when a financing statement complies with section 9-502(a) (containing the debtor's name, secured party's name, and description of the collateral) but contains certain errors, for example, an incorrect debtor's address, the financing statement is again effective against the TIB. Sections 9-516(d) and 9-506(c) pro-

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217. *Id*. § 9-506(c).

218. Numerous states have promulgated rules pertaining to search logic. *See generally* KAN. ADMIN. REGS. 7-17-22(a) (2003), *available at* http://www.kssos.org/other/ucc_regs.html (stating that punctuation, accents, and suffixes are disregarded, and further that organizations that contain a designation of what the entity is, such as association, corporation, or college are disregarded).

tect a purchaser who has given value in reasonable reliance upon the absence of a financing statement or in reasonable reliance upon the incorrect information.

Did the drafters contemplate a different standard for a TIB when the filing office, by promulgating an exact match search logic, has eliminated the minor error rule? Arguably, the major difference between 9-516(d) and 9-520 and the minor error rule is that the debtor's name has to be correct.[219]

B. *When Is a Filing Effective?*

This issue can arise when a secured creditor submits a properly completed financing statement with the appropriate fee to the appropriate filing office but the financing statement is not filed at all or it is terminated without authority and without notification to the secured party.

This issue was considered in the case of *In re Masters*.[220] Here a properly filed financing statement was improperly terminated without authorization or notification to the secured creditor.[221] The debtor filed a bankruptcy petition and the TIB asserted that the secured creditor was unperfected because its financing statement had been terminated and could not be found.[222] The court rejected the TIB's argument under former section 9-403(1). The *Masters* court concluded that clerical mistakes do not destroy perfected status.[223] It appears that the same result would be obtained under revised Article 9 as well. Revised section 9-517

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219. Bills have been introduced in Congress that would appear to greatly expand the power of the TIB. One is the Durbin-Delahunt bill entitled Employee Abuse Prevention Act of 2002, S. 2798, 107th Cong. (2002); H.R. 5221, 107th Cong. (2002). While the goal of this bill is to assist employees devastated by recent failures of major corporations, the bill gives the TIB significant broader powers to deal with the corporate fiasco, but it also enables the TIB to attach security interests in a much broader way. For example, the TIB, immediately upon commencement of a case, has the rights and powers of a good faith purchaser who gave value in reliance on incorrect information. These rights belong to the TIB even if no financing statement containing incorrect information exists. The bill's current language gives the TIB the rights of a hypothetical good faith purchaser relying on hypothetical incorrect information. Thus, if this bill is enacted, the TIB will have the rights of a reliance creditor whether there was any mistake in the financing statement or not and the elimination of the minor error rule when the search logic requires an exact match will be rendered meaningless. Many believe that this bill gives the TIB the power to avoid security interests on a wide variety of collateral, including inventory, equipment, and intangible assets like accounts. These bills seem to be dead in the water at the present time.

220. 273 B.R. 773 (Bankr. E.D. Ark. 2002).

221. *Id.* at 777.

222. *Id.* at 774.

223. *See* U.C.C. § 9-407 cmt. 1 (1994).

deals with indexing errors and states that "[t]he failure of the filing officer to index a record correctly does not affect the effectiveness of the filed record."[224] Official comment 2 states that "[section 9-517] provides that the filing office's error in mis-indexing a record does not render ineffective an otherwise effective record. As did former Section 9-403(1), this section imposes the risk of filing-office error on those that search the files rather than on those who file."[225] It appears that it makes no difference if there is a reliance creditor or a lien creditor such as the TIB. Also, 9-516(a) defines filing as a "communication of a record to a filing office and tender of the filing fee or acceptance of the record by the filing office constitutes filing."[226]

Is the filing office liable for mistakes? Under former Article 9 many states enacted nonuniform provisions to insulate filing officers from liability except for willful conduct. At least one state, Kansas, has carried this forward in revised Article 9.[227]

It seems appropriate to summarize the rules dealing with financing statements before going on to priority rules.

1. A financing statement that fails to comply with the requirements of 9-502 is not an effective filing even if it is accepted by the filing officer and properly indexed.
2. If a financing statement complies with 9-502 but not 9-516(b), and the filing officer rejects it for this failure, the filing is not effective.
3. If a filing officer refuses to accept a financing statement for reasons other than set forth in 9-516(b), the financing statement will be considered effective except against purchasers who have extended value in reasonable reliance of the absence of a financing statement.[228]
4. If a filing officer accepts a financing statement that complies with 9-502 but not 9-516(b)(5) (fails to give mailing address of the debtor, fails to disclose whether the debtor is an individual or organization or does not give required information about an organization), the filing is effective against a secured party or purchaser other than a se-

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224. U.C.C. § 9-517 (2000).
225. *Id*. § 9-517 cmt. 2.
226. *Id*. § 9-516(a).
227. *See* Kan. Stat. Ann. § 84-9-523(f) (Supp. 2002); *see also* 5 U.C.C. Rep. Serv. 2d 1211 (1988) (citing Editor's Note stating that other states that had similar protections under former Article 9 including Iowa, Kentucky, Minnesota, Missouri, Nebraska, North Dakota, Oklahoma, and Wisconsin.)
228. U.C.C. § 9-516(d) (2000).

cured party who gave value in reasonable reliance upon the incorrect information. (This rule appears to apply when the required information is omitted as well as if the information provided was inaccurate.)[229]

5. A proper financing statement which is communicated to the filing officer with the appropriate fees and is accepted is effective even if it is mis-indexed or is improperly terminated by the filing officer and cannot be discovered with a proper search under the debtor's legal name

IV. PRIORITY ISSUES

Priority issues can arise when more than one person claims to have priority as to a debtor's property. Normally, at least one of the parties will be claiming a perfected security interest in either the property or its proceeds. Article 9 provides a road map for determining who wins. For purposes of this piece, only a few priority issues will be considered. First, conflicts between two secured creditors will be considered

When two perfected secured creditors are involved, the first-to-file or perfect, whichever is earlier, wins.[230] If one is perfected and the other not, the perfected wins.[231] If both are unperfected, the first to attach wins.[232] Section 9-322(f) recognizes that exceptions to these rules exist. Examples include PMSIs,[233] deposit accounts,[234] transferees of funds or money subject to a perfected security interest,[235] and set offs.[236]

A. *Purchase Money Security Interest*

A number of special priority rules apply to conflicts between a holder of a PMSI and other creditors.[237] The rules dealing with PMSI's in equipment and

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229. *See id.* §§ 9-338, 9-520.
230. *Id.* § 9-322(a)(1).
231. *Id.* § 9-322(a)(2).
232. *Id.* § 9-322(a)(3).
233. *Id.* § 9-324.
234. *Id.* § 9-327.
235. *Id.* § 9-332.
236. *Id.* § 9-340.
237. *Id.* § 9-317(e) (stating that a PMSI perfected by filing "before or within 20 days after

livestock merit some attention. A recent case provides a basis for examining revised section 9-324(a), which deals with a PMSI in goods other than inventory and livestock. *In re K & P Logging*[238] involved a dispute between a lender ("ORIX") with a PMSI in equipment and a prior perfected secured creditor ("BOA") claiming the equipment under an after-acquired property clause. Although former Article 9 was applied, the PMSI rule is basically the same under revised section 9-324(a), which provides:

> (a) [General rule: purchase-money priority.] Except as otherwise provided in subsection (g), a perfected purchase-money security interest in goods other than inventory or livestock has priority over a conflicting security interest in the same goods, and, except as otherwise provided in Section 9-327, a perfected security interest in its identifiable proceeds also has priority, if the purchase-money security interest is perfected when the debtor receives possession of the collateral or within 20 days thereafter.

Prior to ORIX's PMSI loan[239] in 1998, ORIX had loaned the debtor money in 1997 and had filed in 1997 three financing statements describing the collateral as all present and after-acquired equipment.[240] When ORIX made the

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the debtor receives delivery of the collateral" has priority over certain buyers such as a buyer not in the ordinary course, lessees and lien creditors interests "which arise between the time the security interest attaches and the time of filing").

A PMSI can trump the first-to-file rule of section 9-322 in certain situations:

- Section 9-324(a) gives a qualifying holder of a PMSI in equipment priority over the first-to-file.
- Section 9-324(b) gives a qualifying holder of a PMSI in inventory priority over the first-to-file.
- Section 9-324(d) gives a qualifying holder of a PMSI in livestock that are farm products priority over the first-to-file.
- Section 9-324(f) gives a qualifying holder of a PMSI in software priority over the first-to-file.
- Section 9-324(g) deals with a conflict between two PMSIs and gives a seller who has a PMSI priority over a lender who has a PMSI in the same collateral; if the conflict is between two lenders each having a PMSI, the first-to-file wins.
- Section 9-334(d) gives a qualifying holder of a PMSI in fixtures priority over a prior recorded real estate mortgagee if a fixture filing was made before or within 20 days of a good becoming a fixture. Also see § 9-334(e).

Revised Article 9 has no special PMSI for production money used to produce crops. Former § 9-312(2) is repealed but not replaced.

238. 272 B.R. 867 (Bankr. D.S.C. 2001).

239. *See* U.C.C. § 9-103 (2000).

240. *K & P Logging*, 272 B.R. at 869-871.

PMSI loan in 1998, ORIX obtained a security interest in specific logging equipment and any other logging equipment presently owned or hereafter acquired.[241] The 1998 financing statement covered the logging equipment but was apparently not filed within twenty days of the debtor's taking possession.[242] BOA, who also had a perfected security interest in the debtor's equipment, attacked ORIX's claim it had a super-priority as a PMSI holder in logging equipment on two grounds.[243] First, the 1998 financing statement had not been filed in a timely fashion and the 1997 financing statements covering all equipment could not be used to establish PMSI priority.[244] Second, ORIX's PMSI had been transformed into a non-PMSI with the inclusion of a cross-collateralization provision in its security agreement.[245] The court rejected both of these arguments.[246]

The court concluded that the prior filed 1997 financing statements, which covered after-acquired equipment, were effective to perfect the PMSI in the logging equipment.[247] The prior financing statement description of equipment covered the specific logging machine and consequently satisfied the general notice requirement.[248] Also, this is no different than if ORIX had filed the 1998 financing statement covering the specific logging equipment before the debtor took possession of the machine.[249] The court stressed that the filing of the 1998 statements does not alter the effect of the first.[250] ORIX was simply following a "belt and suspenders" approach.[251] Finally it is important to note that neither former section 9-312 nor revised section 9-324(a) requires that a holder of a PMSI in equipment notify existing filed secured creditors of a PMSI in noninventory.[252] This is not the case for inventory or for livestock.[253]

The transformation argument was also rejected. While the court applied law other than revised Article 9, the court noted that revised Article 9-103 rejects the transformation rule in non-consumer cases. First, the basic definition of a

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241. *Id.*
242. *Id.*
243. *Id.*
244. *Id.* at 872.
245. *Id.* at 877.
246. *Id.* at 872, 877.
247. *Id.* at 874.
248. *Id.*
249. *Id.* at 875.
250. *Id.*
251. *Id.*
252. U.C.C. § 9-324(a) (2000).
253. *Id*. § 9-324(a)-(b), (d).

PMSI in revised section 9-103(b)(1) recognizes the "dual status" rule by providing that a security interest in goods is a PMSI to the extent that the goods are purchase-money collateral; that is, to the extent that the goods secure a purchase-money obligation incurred with respect to the goods. Next, revised section 9-103(f) specifically rejects the transformation rule in non-consumer transactions.[254] It provides that a properly created PMSI is not destroyed when the purchase-money collateral also secures an obligation that is not a purchase-money obligation, when collateral that is non-purchase-money collateral also secures an obligation that is a purchase-money obligation, or when a purchase money obligation has been renewed, refinanced, or consolidated. Thus, a security interest in collateral may be both a PMSI and a non-PMSI.

One major change in the treatment of PMSIs under revised Article 9 relates to livestock. Former Article 9 treated livestock as non-inventory when a PMSI was involved.[255] This meant that the PMSI financier did not have to file a proper financing statement before debtor obtained possession of the livestock and did not also have to give appropriate written notice to other secured creditors.[256]

Revised Article 9 changes the priority rule governing conflicts between a PMSI in livestock that are farm products[257] and prior perfected security interests in the same livestock. Former Article 9 treated livestock that were farm products as non-inventory.[258] Under revised section 9-324(d) livestock are generally treated as inventory. Section 9-324(d) provides that a purchase money security interest in livestock that are farm products has priority over a conflicting security interest in the same livestock and in their identifiable proceeds (subject to the

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254. *See id.* § 9-103(f) (stating:

> [No loss of status of purchase-money security interest in non-consumer-goods transaction.] In a transaction other than a consumer goods transaction, a purchase-money security interest does not lose its status as such, even if:
> (1) the purchase-money collateral also secures an obligation that is not a purchase-money obligation;
> (2) collateral that is not purchase-money collateral also secures the purchase money obligation; or
> (3) the purchase-money obligation has been renewed, refinanced, consolidated, or restructured.)

255. U.C.C. § 9-109(3) (1994) (stating that if goods are farm products they are not inventory); *see also* U.C.C. § 9-103(f) (2000).

256. *See* U.C.C. § 9-109(3) (1994).

257. *See* U.C.C. § 9-324(d) (2000).

258. U.C.C. § 9-109(3) (1994).

rights of a lender with a security interest in deposit accounts) and "identifiable products in their unmanufactured states."[259] In order to qualify for the purchase money priority, there are several requirements which the secured party must meet: (1) the purchase money security interest must be perfected when the debtor receives possession of the livestock; (2) the purchase money secured party must send an authenticated notification to the holder of the conflicting security interest; (3) the holder of the conflicting security interest must receive the notification within six months before the debtor receives possession of the livestock; and (4) the notification must state that the purchase money secured party has or expects to acquire a purchase money security interest in the described livestock of the debtor.[260]

A couple of potential issues with section 9-324(d) merit mention. The first area concerns the compliance with notice requirements. Questions may arise as to the adequacy of the description of the livestock in the notice required to be sent to the earlier filed secured creditors. Section 9-324(d)(4), and section 9-324(b) covering inventory, provide in part that the notice must "describe the livestock [inventory]." It is not clear how specific the description must be. Arguably, the "reasonably identifies" standard for security agreement descriptions of revised section 9-108(a) should be the benchmark. But note that revised section 9-108(b) gives examples of reasonable identification that include identification by type of collateral or by category. If the new inventory is not unique or easily identified, these two kinds of descriptions arguably do not help the existing inventory financier identify the goods subject to the PMSI. Given the very general description requirement under revised section 9-504 for financing statements, perhaps the drafters expected a general description to be sufficient because it would put the existing creditor on notice that another creditor might have a claim to some of debtor's inventory. Any reasonable creditor could investigate and could obtain the security agreement creating the PMSI. On the other hand, it is not unreasonable to require the PMSI holder to provide a specific description of the inventory in order to get a super-priority. In any event, an adequate written notice must be received by the prior perfected creditor within **six months *before*** the debtor receives possession of the livestock.

The comments raise another issue as to where the notice must be sent. Comment 6 to section 9-324 specifically provides that the PMSI holder complies

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259. U.C.C. § 9-324(d) (2000).
260. *Id*. § 9-324(d).

with the notice requirements if the notice is sent to an address found on the earlier secured creditor's filed financing statement even if that the address is now an inaccurate address.[261]

The scope of this section is not absolutely clear. The collateral must be livestock that are farm products. For a good to be a farm product, the debtor must be engaged in a farming operation and the good must be a crop, aquatic good produced in an aquacultural operation, livestock including aquacultural operations, supplies used in a farming operation or products of crops or livestock.[262] A farming operation is defined as "raising cultivating, propagating, fattening, grazing, or any other farming, livestock, or aquacultural operation."[263] Courts have struggled with determining what is a farming operation under former Article 9 which defined farm products in the same way as revised Article 9 except that the debtor had to have possession and there was no reference to aquaculture or crops produced on vines or trees.[264] Some courts narrowly construed farm products as requiring a traditional farming operation while others have broadly defined it.[265]

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261. *Id*. § 9-324 cmt. 6.

262. *Id*. § 9-102 cmt. 4(a) (stating that the terms crops and livestock are not defined). Revised § 9-102(34) defines farm products as:

> [G]oods, other than standing timber, with respect to which the debtor is engaged in a farming operation and which are:
> (A) crops grown, growing, or to be grown, including:
> (i) crops produced on trees, vines, and bushes; and
> (ii) aquatic goods produced in aquacultural operations;
> (B) livestock, born or unborn, including aquatic goods produced in aquacultural operations;
> (C) supplies used or produced in a farming operation; or
> (D) products of crops or livestock in their unmanufactured states.)

263. *Id*. § 9-102(a)(35).

264. U.C.C. § 9-109(3) (1994).

265. *See, e.g*., *In re* K.L. Smith Enterprises, 2 B.R. 280 (Bankr. D. Colo. 1980) (construing a broad definition of farm products). It has also been suggested that the *Smith* Court improperly construed the meaning of farming operation. *See In re* Blease, 24 U.C.C. Rep. 450 (Bankr. D.N.J. 1978) (suggesting that the "farming operations" should be narrowly construed so as not to include farm related, farm support, or farm like activities); s*ee also In re* Collins, 3 B.R. 144 (Bankr. D. S.C. 1980). *But see In re* Charolais Breeding Ranch, Ltd., 20 U.C.C. Rep. 193 (Bankr. W.D. Wis. 1976). Other courts, when determining the meaning of "farming operations", have stated that part-time farmers can operate farming operations within the meaning of the U.C.C. *In re* Blease, 24 U.C.C. Rep. 450 (Bankr. D.N.J. 1978); *Cf.* Armstrong v. Cornbelt Bank, 55 B.R. 755 (Bankr. D. Ill. 1975) (stating that cash rent does not make lessor a farmer within the definition of "farming opera-

The term livestock is not defined. It clearly includes all types of cattle, such as bulls, steers, heifers, cows, and dairy cows, as well as pigs and sheep. But what about poultry, ostriches, domestic deer, or exotic animals such as llamas?[266] The definition of farm products which refers to livestock including aquatic goods produced in aquacultural operations suggests a broad definition of livestock was contemplated. The comments to former Article 9 indicated that livestock included fowl.[267] Interestingly, most farmers would not use the term livestock to cover poultry. Comment 11 to revised section 9-324 discusses aquatic goods such as catfish raised on a catfish farm and includes some interesting language.[268] Comment eleven notes that, while catfish are farm products within the definition of farm products, the farm products definition does not indicate whether they are crops or livestock. This question is to be resolved by the courts on a case-by-case basis. The negative inference is that courts will determine in all cases whether a farm product is a crop or livestock. In addition, comment 4, subpart (a), to revised section 9-102 specifically states that the terms "livestock" and "crops" are not defined.[269]

The priority rule of revised section 9-324(d) expressly states that it applies only to livestock which are farm products.[270] Accordingly, it is implicit that livestock may yet be "inventory" under revised Article 9. This is the case if such livestock are held by a debtor other than a debtor engaged in farming operations.[271] While this is not as significant as it was under former Article 9 in that

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tions"). Additionally, a number of courts have considered non-traditional businesses to fall within the definition of farming operations, such as a tree and landscaping nursery. *In re* Houts, 31 U.C.C. Rep. 338 (N.D.N.Y. 1981); *Cf. In re* Frazier, 16 B.R. 674 (Bankr. N.D. Tenn. 1981) (holding that plants and shrubs in cultivation were farm products, but mature and ready for sale plants are inventory). It seems clear that there is no clear-cut answer as to what constitutes a "farm product." *See* Keith G. Meyer, *The 9-307(1) Farm Products Puzzle: Its Parts and Its Future*, 60 N.D. L. REV. 401, 412-15 (1984).

266. Dictionary definitions of the term "livestock" vary. For example, MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY (10th ed. 1999), defines livestock as "animals kept or raised for use or pleasure; *esp*: farm animals kept for use and profit." WEBSTER'S NEW WORLD DICTIONARY (1984), defines livestock as "domestic animals" and the number one definition of animals being "any living organism except a plant or bacterium" and with the second definition stating "any such organism other than a human being, esp. a mammal or, sometimes any four-footed creature."

267. U.C.C. § 9-109 cmt. 4 (1994).

268. U.C.C. § 9-324 cmt. 11 (2000).

269. *Id*. § 9-102 cmt. 4(a).

270. *Id*. § 9-324(d).

271. Although running a feedlot is a farming operation, cattle trading is not. *See* Sec.

inventory and livestock are treated generally the same, the devil is in the details. Revised sections 9-324(b) and (d) differ as to length of the effectiveness of the notice—five years for inventory and six months for livestock. Proceeds are also treated differently. The super-priority rule governing livestock extends to all "identifiable proceeds" which presumably would include amounts owed by a livestock processor to a debtor who has sold livestock but is paid after delivery of the livestock to the processor.[272] The priority also extends to all identifiable products in their unmanufactured states.[273] Conversely, the purchase money priority rule for inventory extends only to "identifiable cash proceeds . . . to the extent . . . received on or before the delivery of the inventory to a buyer."[274] Finally, a security agreement description or a financing statement description which described the collateral as all farm products would be fatally defective if the collateral is determined to be inventory.[275]

B. *Purchase Money Security Interest in Crops*

All types of crops such as crops already grown, crops now growing, or crops to be grown are treated as personal property under the U.C.C.[276] Under former section 9-312(2), it was possible for a creditor supplying the credit for the purchase of inputs including seed, fertilizer, and chemicals to obtain a PMSI and a super-priority over a prior perfected secured creditor in limited circumstances. The crop production financier was required to: (1) have a perfected PMSI in the crops; (2) give new value in the form of a loan or credit sale to enable the debtor

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Nat'l Bank v. Bellville Livestock Comm'n Co., 619 F.2d 840 (10th Cir. 1979); Swift & Co. v. Jamestown Nat'l Bank, 426 F.2d 1099 (8th Cir. 1970); Farmers State Bank v. Webel, 446 N.E.2d 525 (Ill. Ct. App. 1983); Burlington Nat'l. Bank v. Strauss, 184 N.W.2d 122 (Wis. Ct. App. 1971). *Cf*. *In re* Maike, 77 B.R. 832 (Bankr. D. Kan. 1987) (holding that puppy kennel was a farming operation); Mountain Credit v. Michiana Lumber & Supply Inc., 498 P.2d 967 (Colo. Ct. App. 1972) (holding that logging operation is not a farming operation). It should also be noted that once cattle cease to be classified as farm products and become part of the packer's inventory, notwithstanding the fact that there was an oral agreement between the seller and the packer, the title would not pass and price would not be determined until carcass grade was determined. *See In re* Samuels & Co., 510 F.2d 139, 148 (5th Cir. 1975), *rev'd*, 526 F.2d 1238 (5th Cir. 1976); First Nat'l Bank of Elkhart County v. Smoker, 286 N.E.2d 203, 209 (Ind. Ct. App. 1972).

272. U.C.C. § 9-324(d) (2000).

273. *Id.*

274. *Id.*

275. *See id*. § 9-108; *see also id.* § 9-504.

276. *See id*. § 9-102(a)(44); *see also* Moritz Implement Co. v. Matthews, 959 P.2d 886, 889-90 (Kan. 1998).

to produce the crops during the current production season; (3) the value must be given not more than three months before the crops become growing crops; and (4) the obligation owing to the prior perfected secured party must be overdue more than six months before the crops become growing crops.[277] This rule made it possible, in limited circumstances, for a farmer who is in default on a loan where lender has a perfected security interest in present and after-acquired crops, to obtain production financing for a new crop.

Revised Article 9 removes former section 9-312(2) without replacing it. However, a so-called model provision for production-money priority is found in appendix II to revised Article 9.[278] This scheme is attached to revised Article 9 as

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277. *See In re* Cress, 89 B.R. 163, 166 (Bankr. D. Kan. 1988); *see also* Salem Nat'l Bank v. Smith, 890 F.2d 22, 22 (7th Cir. 1989) (Kansas Bankruptcy court holding that a production lender had priority over a prior perfected secured party to the extent of new value given to debtors for production costs and the six month requirement was satisfied because one of debtor's installment payments to the prior creditor was more than 6 months past due.)

278. U.C.C. Article 9 app. II (2000). The following is a summary of the Production-Money priority provisions in Appendix II Model provisions for the production money priority. A Production-Money is defined as follows. A purchase money obligation is an obligation incurred for new value given to enable the debtor to produce crops and the value is in fact used to produce the crops. Model Section 9-103a(c) provides that the production money security interest definition encompasses the normal loan or credit sale concepts and does not lose its purchase money status even though: 1) Purchase money crops "secure an obligation that is not a production money obligation" (living expenses?); 2) collateral other than crops secure the obligation; or 3) "the production-money obligation has been renewed, refinanced or restructured." While the security interest does not lose its status because of one of the possibilities listed above, the production- money status is limited to the extent that it secured value that actually can be traced to direct production. Model Section 9-103a(d) places the burden of proof on the party claiming a production-money security interest. As to priorities, when a conflict between a prior perfected secured party that does not have a production-money security interest and a production-money security interest arises, the production-money security interest has priority in the production-money crops and in their identifiable proceeds if: 1) "the production money security interest is perfected by filing when production-money secured party first gives new value to enable the debtor to produce the crops;" 2) the production-money secured party gives appropriate notice to all security interest holders who have filed a financing statement "not less than 10 or more than 30 days before the production-money secured party first gives new value"; and 3) the notice "states that the production money secured party has or expects to obtain a production-money security interest . . . ." The key is that notification gives the earlier party the opportunity to prevent subordination by extending credit. If two or more production money secured parties exist, priority ranks according to time of filing, not the time of advance. If a prior perfected party supplies purchase money after the production money secured party gives value, the prior secured party wins. If a person holds both an agricultural lien and a production money security interest in the same collateral, the agricultural lien priority rules apply. Thus, unless the statute creating the agricultural lien gives the lien holder priority over a perfected secured party, the lien holder loses to the first to file. However, the comments to Model § 9-324a

model provisions as opposed to being included in the uniform act because no consensus was reached regarding the appropriateness of them. Most states did not adopt appendix II.[279]

While it is beyond the scope of this article and this issue has been discussed thoroughly elsewhere,[280] my preference is to re-instate former section 9-312(2). Appendix II is too complex and there is not sufficient data to establish that the present system is fatally flawed. The current rules are understandable, certain, and workable.

C. *Deposit Accounts*

The last priority conflicts that must be discussed focus on the conflicts concerning bank accounts that contain proceeds that are subject to a perfected security interest. The conflicts can arise in a variety of ways. For example, a farmer grants PCA a perfected security interest in all of his growing crops. The farmer sells the crops and deposits the proceeds from the sale in his checking account with First Bank. One possibility is that the farmer borrows money from First Bank either on an unsecured loan or a loan secured by the farmer's bank account. The farmer defaults on the PCA loan and the bank loan. Both claim priority to the bank account. Another possibility is that farmer uses the proceeds from the bank account to pay an unsecured creditor. Revised Article 9 has rules dealing with these conflicts.

To demonstrate the situation of a perfected secured creditor versus a bank's right of setoff, consider this hypothetical situation:

Jan. 1: PCA loans Farmer money, obtains a perfected security interest in his crops.
Oct. 1: Farmer harvests his crops, sells them and deposits the check in his farm checking account in First Bank.

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state that the holder of a production money security interest can waive its agricultural lien. *See* U.C.C. Article 9 app. II (2000).

279. *See e.g.*, Jason Finch, *The Making of Article 9 Section 9-312(2) into Model Provision Section 9-324A: The Production Money Security Interest*: *Finally a Sensible "Superpriority" for Crop Finance*, 5 DRAKE J. AGRIC. L. 381 (2000) (stating that Maine, North Carolina, and Wyoming have adopted Appendix II); *see also* Meyer *supra* note 92, at 181-86.

280. E-mail from John M. McCabe, NCCUSL Legislative (on file with author) (stating that at least Idaho, Maine, Mississippi, North Carolina, Vermont, Wisconsin, and Wyoming have adopted some form of Appendix II).

Oct. 2: Farmer obtains an unsecured loan from First Bank.
Oct. 5: Farmer defaults on his obligations to PCA and to First Bank. First Bank has a common law right of set off under state law.

Under section 9-340, First Bank will have priority over PCA even though PCA has a perfected security interest in the deposit account. PCA has a perfected security interest in the deposit account if the proceeds are considered identifiable cash proceeds.[281] Assuming that the proceeds from the sale of the crops are not commingled, the deposit will be considered an identifiable cash proceed.

Section 9-340 provides:

> (a) [Exercise of recoupment or set-off.] Except as otherwise provided in subsection (c), a bank with which a deposit account is maintained may exercise any right of recoupment or set-off against a secured party that holds a security interest in the deposit account.
>
> (b) [Recoupment or set-off not affected by security interest.] Except as otherwise provided in subsection (c), the application of this article to a security interest in a deposit account does not affect a right of recoupment or set-off of the secured party as to a deposit account maintained with the secured party.
>
> (c) [When set-off ineffective.] The exercise by a bank of a set-off against a deposit account is ineffective against a secured party that holds a security interest in the deposit account which is perfected by control under Section 9-104(a)(3), if the set-off is based on a claim against the debtor.

In short, a bank in which a deposit account is maintained may exercise any right of set-off against a secured party that has a security interest in the deposit account. The bank must have the right of set-off or recoupment under law other than the U.C.C. However, if the secured party obtains control by becoming the bank's customer, the exercise of a set-off against a deposit account is ineffective against such a secured party.[282]

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281. *See* U.C.C. §§ 9-203(f), 9-315(a)(2), 9-315(b)-(d), 9-310(b)(9) (2000); s*ee also id.* § 9-102(a)(29) (defining deposit account); *id*. § 9-102(a)(64) (defining proceeds); *id*. § 9-102(a)(9) (defining cash proceeds); *id*. § 9-109(d)(13).

282. *Id*. § 9-340(c).

D. *Perfected Secured Creditor Versus Bank with Security Interest in Deposit Accounts*

A deposit account is defined in section 9-102(a)(29) and it includes checking accounts and savings accounts.[283] When a person has a positive balance in a deposit account, the bank is considered the debtor and the person who owns the deposit account is considered a creditor. Thus, the bank owes the person and the deposit holder's right to payment is considered personal property. Revised Article 9 expands the scope of Article 9 to cover nonconsumer deposit accounts as original collateral that is not proceeds. Former Article 9 covered deposit accounts containing proceeds from the sale or disposition of the original collateral but not deposits as original collateral.[284] Under revised Article 9 a creditor can obtain a security interest in a business's deposit account by complying with the attachment rules and can obtain a perfected security interest if it has control.[285] Control is analogous to possession used for collateral that cannot be physically possessed by the secured party. Collateral that may be perfected by control includes deposit accounts[286] and investment property.[287] A secured party has control of a deposit account if:

> (1) the secured party is the bank with which the deposit account is maintained;
> (2) the debtor, secured party and bank have agreed that the bank will comply with the secured party's directions regarding disposition of the funds in the account; or
> (3) the secured party becomes the bank's customer with respect to the deposit account.[288]

Once the secured party obtains control of the deposit account, its security interest is perfected. The security interest remains perfected so long as the secured party retains control.[289]

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283. *Id*. § 9-102(a)(29) (providing that deposit account "means a demand, time, savings, passbook, or similar account maintained with a bank . . . [but excludes] investment property or accounts evidenced by an instrument").

284. *See id*. §§ 9-109(a)(1), 9-109(c)(13), 9-109 cmt. 16.

285. *See id*. §§ 9-104(a), 9-312(b), 9-314.

286. *See id*. §§ 9-102(a)(29), 9-104(a), 9-109(a)(1), 9-109(c)(13), 9-109 cmt. 16, 9-312(b), 9-314.

287. *Id*. § 9-102(a)(49).

288. *Id*. § 9-104(a).

289. *Id*. § 9-314(b).

A classic conflict arises when a debtor has granted a bank in which the deposit account is maintained a security interest in the checking account as original collateral and a secured creditor has a perfected security interest in cash proceeds deposited in the deposit account. Article 9 now has a specific section, 9-327, which governs this priority conflict.[290] Section 9-327(3) provides that "(3) [e]xcept as otherwise provided in paragraph (4), a security interest held by the bank with which the deposit account is maintained has priority over a conflicting security interest held by another secured party."[291]

The following hypothetical illustrates how revised Article 9 resolves this conflict to a deposit account containing identifiable proceeds subject to a perfected security:

Jan. 1: PCA loans Farmer money, obtains a perfected security interest in his crops.
Oct. 1: Farmer harvests his crops, sells them and deposits the check in his farm checking account in First Bank.
Oct. 2: Farmer obtains a secured loan from First Bank with the checking account being collateral for the loan.
Oct. 5: Farmer defaults on his obligations to PCA and to Bank.

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290. *Id*. § 9-327 (stating:

> The following rules govern priority among conflicting security interests in the same deposit account:
> (1) A security interest held by a secured party having control of the deposit account under Section 9-104 has priority over a conflicting security interest held by a secured party that does not have control.
> (2) Except as otherwise provided in paragraphs (3) and (4), security interests perfected by control under Section 9-314 rank according to priority in time of obtaining control.
> (3) Except as otherwise provided in paragraph (4), a security interest held by the bank with which the deposit account is maintained has priority over a conflicting security interest held by another secured party.
> (4) A security interest perfected by control under Section 9-104(a)(3) has priority over a security interest held by the bank with which the deposit account is maintained.)

291. *Id*. § 9-327(3).

Unless a control agreement is executed between Farmer, First Bank, and PCA, or PCA becomes the customer of the bank for purposes of the checking account, the bank wins under section 9-327(3) because it has control.[292]

E. *Transfers From a Deposit Account Subject to a Perfected Security Interest as Proceeds*

Revised Article 9 makes a major change in the rule governing payments from a checking account containing proceeds. Section 9-332 provides:

> (a) A transferee of money takes the money free of a security interest unless the transferee acts in collusion with the debtor in violating the rights of the secured party.
>
> (b) A transferee of funds from a deposit account takes the funds free of a security interest in the deposit account unless the transferee acts in collusion with the debtor in violating the rights of the secured party.[293]

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292. *See id.* §§ 9-102(a)(29), 9-104(a), 9-109(a)(1), 9-109(c)(13), 9-109 cmt. 16, 9-312(b), 9-314. *See also id.* § 9-327 cmt. 4 (stating:

> Under paragraph (3), the security interest of the bank with which the deposit account is maintained normally takes priority over all other conflicting security interests in the deposit account, regardless of whether the deposit account constitutes the competing secured party's original collateral or its proceeds. A rule of this kind enables banks to extend credit to their depositors without the need to examine either the public record or their own records to determine whether another party might have a security interest in the deposit account.
> A secured party who takes a security interest in the deposit account as original collateral can protect itself against the results of this rule in one of two ways. It can take control of the deposit account by becoming the bank's customer. Under paragraph (4), this arrangement operates to subordinate the bank's security interest. Alternatively, the secured party can obtain a subordination agreement from the bank. See Section 9-339.
> A secured party who claims the deposit account as proceeds of other collateral can reduce the risk of becoming junior by obtaining the debtor's agreement to deposit proceeds into a specific cash-collateral account and obtaining the agreement of that bank to subordinate all its claims to those of the secured party. But if the debtor violates its agreement and deposits funds into a deposit account other than the cash-collateral account, the secured party risks being subordinated.)

Consider this hypothetical situation:

Jan. 1: PCA loans Farmer money, obtains a perfected security interest in his crops.
Oct. 1: Farmer harvests his crops, sells them and deposits the check in his farm checking account in First Bank.
Oct. 2: Farmer draws on his farm bank account in First Bank a check payable to a local elevator. The elevator deposits the check and First Bank pays the check. Farmer had an unsecured debt with the elevator for fertilizer expenses used to produce the crop which PCA financed.
Oct. 5: Farmer defaults on his obligations to PCA .
Assume PCA has a perfected security interest in the deposit account as proceeds.[294]

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293. *Id*. § 9-332 cmt. 3 states the policy behind the rule protecting the transferee as follows:

> Broad protection for transferees helps to ensure that security interests in deposit accounts do not impair the free flow of funds. It also minimizes the likelihood that a secured party will enjoy a claim to whatever the transferee purchases with the funds. Rules concerning recovery of payments traditionally have placed a high value on finality. The opportunity to upset a completed transaction, or even to place a completed transaction in jeopardy by bringing suit against the transferee of funds, should be severely limited. Although the giving of value usually is a prerequisite for receiving the ability to take free from third-party claims, where payments are concerned the law is even more protective. Thus, Section 3-418(c) provides that, even where the law of restitution otherwise would permit recovery of funds paid by mistake, no recovery may be had from a person "who in good faith changed position in reliance on the payment." Rather than adopt this standard, this section eliminates all reliance requirements whatsoever. Payments made by mistake are relatively rare, but payments of funds from encumbered deposit accounts (e.g., deposit accounts containing collections from accounts receivable) occur with great regularity. In most cases, unlike payment by mistake, no one would object to these payments. In the vast proportion of cases, the transferee probably would be able to show a change of position in reliance on the payment. This section does not put the transferee to the burden of having to make this proof.

294. *See id.* §§ 9-203(f), 9-315(a)(2), 9-315(b)-(d), 9-310(b)(9); *see also id.* § 9-102(a)(29) (defining deposit account); *id.* § 9-102(a)(64) (defining proceeds); *id.* § 9-102(a)(9) (defining cash proceeds); *id*. § 9-109(d)(13).

Under section 9-332(b), payee, the local elevator, takes free of PCA's security interest unless the elevator acted in collusion with the debtor, Farmer, in violating the rights of PCA. While the term "transferee" is not defined, it is clear the elevator is a transferee for purposes of section 9-332. Collusion is also not defined in Article 9.[295] Elevator does not have to prove a change of position in reliance of the payment. Finally, note that section 9-332 only applies to transfers made from a deposit account.[296]

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295. *Id*. § 9-332 cmt. 4 (discussing collusion and stating:

> To deal with the question of the "bad actor," this section borrows "collusion" language from Article 8. See, e.g., Sections 8-115, 8- 503(e). This is the most protective (i.e., least stringent) of the various standards now found in the UCC. Compare, e.g., Section 1-201(9) ("without knowledge that the sale . . . is in violation of the . . . security interest"); Section 1-201(19) ("honesty in fact in the conduct or transaction concerned"); Section 3-302(a)(2)(v) ("without notice of any claim")).

296. For a case making this point under former Article 9 see *J.R. Simplot Co. v. Sales King International, Inc*., 17 P.3d 1100 (Utah 2000). Bountiful Valley Produce ("BVP"), who produced onions and squash granted Simplot a perfected security interest in its onions. BVP had a marketing contract with Sales King in which Sales King agreed to sell BVP's crops, to collect proceeds from the crop sales, and to retain monies to cover its expenses. BVP also granted Sales King a security interest in the onions and squash but it was unperfected. BVP defaulted on its obligations to Simplot and owed Sales King for expenses. Sales King clearly was subordinate to Simplot's rights to the crops. However, Sales King made an unique argument as to crop proceeds that were retained by Sales King. Sales King argued that it had a superior claim to the proceeds that were paid to cover the expenses connected with selling BVP's crops. Sales King relied upon former Article 9 § 9-306 comment 2(c) which provides in relevant part that "[w]here cash proceeds are deposited into the debtor's checking account and paid out in the operation of the debtor's business, recipients of the funds of course take free of any claim which the secured party may have in them. What has been said relates to payments and transfers in ordinary course." Sales King argued this comment covered the selling expenses because these payments were made in the ordinary course of business and it had priority over Simplot's perfected security interest. The court rejected this argument in part because the payments were not made from debtor's checking account. Thus, if the *Simplot* facts were to arise under U.C.C. § 9-332, the market agent could never have made the argument about a transferee because the funds did not come from a deposit account.