

Indiana Law Review

Volume 24

1991

Number 4

ARTICLES

Should the Unique Treatment of Agricultural Liens Continue?

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INTRODUCTION

Most states have a plethora of agricultural liens which protect unpaid creditors in varying degrees.¹ Typically, state legislatures have created statutory liens to give special protection to certain people and economic groups involved in the production or financing of agricultural products. Most of these statutory liens were created in the 1930s or 1980s, when the agricultural economy was severely depressed. Examples of those receiving special protection include: Those making special contributions to the value of the asset to which the lien attaches; unpaid agricultural product sellers and others who cannot be expected to comply with Article 9 of the Uniform Commercial Code (UCC);² and groups that might be subordinated to prior perfected secured creditors.

There is neither intrastate nor interstate uniformity with regard to statutory agricultural liens. Such liens vary with respect to how the lien

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Professor Meyer wishes to thank the University of Kansas School of Law's Postlethwaite Fund for its support and Derek I. Grimes for his fine research assistance.

1. For example, California has at least 14. *See* CAL. CIV. CODE §§ 3051-52, 3061 (West 1974 & Supp. 1991) (veterinary and thresher); CAL. FOOD & AGRIC. CODE §§ 3062-64 (West 1986 & Supp. 1991). Florida has 14. *See, e.g.*, FLA. STAT. ANN. §§ 83.10-19 (West 1987) (landlord); *id.* § 534.54 (West 1988) (seller of hogs or cattle). Illinois has 11. *See, e.g.*, ILL. ANN. STAT. ch. 26, para. 9-104 (Smith-Hurd 1974 & Supp. 1990) (landlord).

2. *See* U.C.C. §§ 9-203(4), 9-303 (1989). The citations in this Article are to the 1989 version of the Uniform Commercial Code unless otherwise indicated. The source is SELECTED COMMERCIAL STATUTES (West 1990).

is created, perfected, and enforced. Likewise, they vary with respect to the priority of the statutory lienholder vis-a-vis other creditors and purchasers of the good subject to the lien. Moreover, they are not found in one place in the statutes nor are they cross referenced in Article 9. Some agricultural liens are common-law liens. Although liens give the creditor rights in specific property of the debtor that are equivalent to those of a secured party, Article 9 normally is inapplicable.

The economic difficulties of the late 1970s and 1980s produced record numbers of conflicts between creditors and between farmers and creditors.³ During this period, the use of archaic statutory liens increased dramatically, and state legislatures promulgated new ones.⁴ Secured creditors who diligently complied with Article 9 were not as protected as they thought. Many were junior to liens that, in many instances, were not recorded. Often the legal system does not provide any clear, easily discoverable rules governing competing claims to agricultural collateral upon the default of the debtor when one of the claimants has a lien not covered by Article 9. This is true whether questions of priority arise in state court or in a bankruptcy proceeding.

Article 9 provides relatively simple, clear rules for resolving disputes between lien creditors and secured creditors and between two secured creditors. However, with the exception of those limited possessory liens covered by section 9-310, Article 9 does not apply to conflicts involving nonpossessory liens. State law concerning statutory liens is difficult to understand and to ascertain.⁵ The situation regarding bankruptcy is basically the same. Sections 506 and 544 of the Bankruptcy Code make clear that the rules in Article 9 govern priority questions covered by Article 9. On the other hand, statutory liens are treated differently. For

3. Priority issues arose both in and out of bankruptcy. Priority battles in bankruptcy will almost always involve different questions because of the trustee's avoidance powers under sections such as 11 U.S.C. §§ 544, 545, 547, 551 (1989).

4. Many sellers of essential inputs such as fertilizer, seed, and chemicals got into the credit business but did not try to comply with Article 9. Consequently, many relied on statutory liens or wanted the UCC changed to protect them because normally, if they complied with Article 9, they would not have priority due to the first to file rule of § 9-312(5). See *infra* text accompanying note 153.

5. See State Survey and Rapid Finder Chart prepared by the Subcommittee on Agriculture and Agribusiness Financing, Commercial Financial Services Committee, Section of Business Law of the American Bar Association. This report is available through Steven Turner, partner at Baird, Holm, McEachen, Pedersen, Hamann & Strasheim, in Omaha, Nebraska, and will appear in the *Oklahoma Law Review*. See also Dainow, *Vicious Circles in the Louisiana Law of Privileges*, 25 LA. L. REV. 1 (1964); Dieball, *Addressing Priority Disputes Between a Statutory Landlord's Lien and an Article Nine Security Interest in Texas*, 31 S. TEX. L.J. 191 (1990); Saxowsky, Fagerlund & Priebe, *Modernizing Agricultural Statutory Liens After the Federal "Clear Title" Law — the North Dakota Experience*, 11 J. AGRIC. TAX'N & L. 30 (1989).

example, landlord liens are avoidable by a bankruptcy trustee under section 545.⁶ Other statutory liens that are not perfected or enforceable against a bona fide purchaser on the date of bankruptcy can be avoided under section 545(2). However, whether a lien is perfected or whether a bona fide purchaser takes free of the lien is determined by state law. Results are not easily predictable because Article 9 does not apply. No uniform rule exists for perfection or for determining who wins as between a lien holder and other creditors or purchasers of goods subject to statutory liens.

Agricultural credit has other problems. Congress became involved in secured financing by enacting a poorly drafted and unclear federal farm products rule that applies to the sale of farm products subject to an Article 9 security interest but not to statutory liens.⁷ Many producers complain that Article 9's first to file priority rule is unfair. They argue that if a farmer gave a perfected security interest in all then-owned crops and livestock and all after-acquired crops and livestock and then defaulted, the farmer could not obtain financing from anyone else for a new crop because the first lender would not subordinate and would not finance again unless the old debt was retired.⁸

6. 11 U.S.C. § 545 (1988) provides in part: "The trustee may avoid the fixing of a statutory lien on property of the debtor to the extent that such lien . . . (3) is for rent; or (4) is a lien for distress for rent." See, e.g., *In re Waldo*, 70 Bankr. 16 (Bankr. N.D. Iowa 1986).

In many states the landlord lien is considered to have priority over a perfected secured creditor. E.g., *Meyer v. Hawkeye Bank & Trust Co.*, 423 N.W.2d 186 (Iowa 1988); *Perkins v. Farmers Trust & Savings Bank*, 421 N.W.2d 533 (Iowa 1988). The trustee might use § 551 to try to defeat the secured creditor to the extent of the landlord's lien priority over the secured creditor. 11 U.S.C. § 551 (1988) provides: "Any transfer avoided under section . . . 545 . . . is preserved for the benefit of the estate but only with respect to property of the estate." This is also the case in Minnesota. "A perfected landlord lien has priority over all other liens or security interests in crops grown or produced on the property that was leased and the crop products and proceeds." The trustee can probably use § 551 to defeat the secured creditor to the extent of the landlord lien's priority in that state. MINN. STAT. ANN. § 514.960 (West 1990).

7. 7 U.S.C. § 1631 (1989). See *infra* note 64.

8. See U.C.C. §§ 9-203-04, 9-312(5). Section 9-312(2) often did not help because the debt was not in arrears for longer than six months. For cases dealing with § 9-312(2), see, e.g., *In re Cress*, 89 Bankr. 163 (Bankr. D. Kan. 1988), in which the court held that because Farmers Home Administration (hereinafter FmHA) could have declared the whole debt due for failure to pay an installment, the debt was considered overdue when the installment was missed. *But see* *United States v. Minster Farmers Co-operative Exchange, Inc.*, 430 F. Supp. 566 (N.D. Ohio 1977); *In re Smith*, 82 Bankr. 62 (S.D. Ill. 1988). *In re Connor*, 733 F.2d 523 (8th Cir. 1984) (debtor's obligation was less than six months overdue and other installments not due) was distinguished. See also *In re Rogers*, 39 Bankr. 295 (Bankr. W.D. Ky. 1984); *McCoy v. Steffen*, 227 Neb. 27, 416 N.W.2d 16 (1987). Section 9-312(2) is the subject of Nickles, *Setting Farmers Free: Righting the Unintended*

These events, among others, raised many questions about how the legal system was dealing with agricultural liens, whether it was causing the UCC to be a nonuniform code regarding agriculture, and how these events were affecting the availability of credit to agriculture. This Article will examine some of these issues, and concludes with some suggestions on how Article 9 can be changed to better address these problems.

I. BACKGROUND

No uniform definition of "lien" exists. Liens give a person who has provided goods or services on credit an interest in specific property to assure payment for the goods or services. A lien on specific property may be obtained in a variety of ways.

Generally, there are three categories of liens: judicial liens, statutory liens, and consensual liens. Liens can exist in either real estate or personal property. Only personal property liens will be covered in this Article.

Judicial liens normally are created in the litigation process when the creditor seeks a money judgment on an unpaid debt and then enforces the judgment by properly taking control of nonexempt property.⁹

Statutory liens are not consensual and do not depend upon judicial action by the creditor. They are status liens that arise by operation of law because of a particular creditor's status. The statutory lien gives the creditor an interest in specific goods to assure payment for goods, services, land, labor, or whatever was provided by the person entitled to the lien. Statutory lien holders are, in effect, given the rights of a secured creditor even though they did not bargain for security. Finally, these liens normally are given to creditors who sell goods on credit or who perform a service or otherwise give value that preserves or enhances the value of the property subject to the lien.¹⁰

Anomaly of UCC Section 9-312(2), 71 MINN. L. REV. 1135 (1987).

A secured party has no obligation to file a termination statement if there is outstanding debt. U.C.C. § 9-404(1).

9. Each state's enforcement mechanism and exemptions differ. Once the judgment is satisfied by seizure of specific personal property, the creditor is a lien creditor under Article 9. U.C.C. § 9-301(3).

10. Liens given for the sale of goods or the performance of services relating to the good to which the lien attaches are similar to purchase money security interests. Article 9 deals with purchase money security interests in the financing of the purchase of a good. U.C.C. § 9-107 defines purchase money security interests for Article 9:

A security interest is a "purchase money security interest" to the extent that it is (a) taken or retained by the seller of the collateral to secure all or part of its price; or (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

Consensual liens are obtained pursuant to an agreement and are covered by Article 9 of the UCC. It must be noted that under Article 9, the term "lien" is used as a contradiction to a security interest that is considered to be a consensual interest, as opposed to a lien that is not created by contract.¹¹

Although three categories of liens are recognized, lawyers and judges often refer to liens in a generic fashion, rather than making clear what type of lien exists. It is important to note that liens are defined differently in different contexts. For example, under the Bankruptcy Code, a "[l]ien' means charge against or interest in property to secure payment of a debt or performance of an obligation."¹² The Bankruptcy Code defines the three specific types of liens. A judicial lien is a "lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding."¹³ A statutory lien is a

lien arising solely by force of a statute on specified circumstances or conditions, or lien of distress for rent, whether or not statutory, but does not include security interest or judicial lien, whether or not such interest or lien is provided by or is dependent on a statute and whether or not such interest or lien is made fully effective by statute.¹⁴

A "security interest" in the Bankruptcy Code is a "lien created by an agreement."¹⁵

Article 9, adopted in some form in all fifty states, controls consensual liens but it does not use the term "lien." Rather, "security interest" is the key concept. "'Security interest' means an interest in personal property or fixtures which secures payment or performance of an obligation."¹⁶ Security interests are voluntary consensual interests that arise pursuant to an agreement between a creditor and a debtor. These are the only types of interests in personal property that Article 9 authorizes.

Federal and state statutory liens exist with their own unique requirements for creation, perfection, and enforcement. Each state has agricultural liens that tend to reflect that state's struggle with bad economic times in the agricultural community. Agricultural liens normally are not found in just one section of a state statutory system, are not cross referenced in Article 9, and have no uniform requirements regarding

11. 1 GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 307-08 (1965).

12. 11 U.S.C. § 101(33) (1989).

13. *Id.* § 101(32).

14. *Id.* § 101(49).

15. *Id.* § 101(47).

16. U.C.C. § 1-201(37).

creation, perfection, enforcement, or priority. In addition, common law liens create the same detection and priority problems.¹⁷

A. *Conflicting Claims to Personal Property — Article 9 of the UCC*

In general, disputes concerning claims to personal property are governed by Article 9 of the UCC. However, most agricultural liens are not covered by Article 9. Section 9-102¹⁸ declares that Article 9 applies to all *transactions*¹⁹ regardless of form, *intended by the parties* to create a security interest in personal property. In other words, it applies to all contracts or agreements intended to create a security interest, and by negative implication does not apply to nonconsensual interests created in personal property.

Sections 9-102(2) and 9-104 exclude certain types of transactions. The last sentence of section 9-102(2) states: "This Article does not apply to statutory liens except as provided in Section 9-310."²⁰ Apparently, this sentence was added to make clear that security interests could not be considered statutory liens for bankruptcy purposes, and thus not subject to avoidance by the trustee under section 67(c) of the old Bankruptcy Act.²¹ This is no longer a justification for this provision in view of the Bankruptcy Code definitions making clear that statutory liens and security interests are separate and distinct.²² Also, section 9-104(b) excludes landlords' liens from coverage,²³ and section 9-104(c) provides that Article 9

17. Common-law liens exist in many states and sometimes are combined with statutory provisions. *See, e.g., In re Stookey Holsteins, Inc.*, 112 Bankr. 942 (Bankr. N.D. Ind. 1990) (common-law artisan's lien in frozen cattle embryos).

18. Section 9-102(1) states: "Except as otherwise provided in Section 9-104 on excluded transactions, this Article applies (a) to any transactions (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper or accounts . . ." U.C.C. § 9-102(1) (1987).

19. These transactions must be consensual in nature, and all contracts and agreements are covered regardless of form. These agreements need not be in writing if the secured party has possession of the property. U.C.C. § 9-203(1)(a) (1987). Section 1-201(3) of the U.C.C. defines "agreement."

Also note that the new version of § 1-201(37) defines in more detail than in the previous uniform version when a document entitled a lease is really a security interest and the transaction is covered by Article 9. Remember that if a transaction is covered by Article 9 all rules (attachment, perfection, priority, and default) apply.

20. U.C.C. § 9-102(2).

21. *See* 1 GILMORE, *supra* note 11, at 306-08.

22. *See supra* text accompanying notes 9-16.

23. Professor Gilmore in this treatise indicated that landlord liens were excluded for two reasons. First, Article 9 is designed to apply only to consensual security interests. 1 GILMORE, *supra* note 11, at 313. Second, the landlord's lien does not create an interest in personal property. *Id.* Yet, it should be noted that in many states a landlord's lien for

does not apply "to a lien given by statute or other rule of law for services or materials except as provided in Section 9-310 on priority of such liens."²⁴ An explanation of this treatment is found in Comment 3 to section 9-104, which provides in part:

In all jurisdictions liens are given suppliers of many types of services and materials either by statute or by common law. It was thought to be both inappropriate and unnecessary for this Article to attempt a general codification of that lien structure which is in considerable part determined by local conditions and which is removed from ordinary commercial financing.²⁵

Even though recognizing that state lien law was not uniform and that there was a need for a uniform law on liens for services and materials, the drafters of the UCC refused to develop a uniform lien scheme or to incorporate one into Article 9's coverage, with the exception of possessory liens covered under section 9-310.²⁶ Currently, nonArticle 9 liens play a significant role in agriculture financing.²⁷ However, section 9-310 is currently the only section that covers liens. Section 9-310 provides:

When a person in the ordinary course of his business furnishes services or materials with respect to goods subject to a security interest, a lien upon goods in the possession of such person given by statute or rule of law for such materials or services takes priority over a perfected security interest unless the lien is statutory and the statute expressly provides otherwise.²⁸

Liens are either possessory or nonpossessory. Section 9-310 only applies to possessory liens. The creditor claiming the protection of section 9-310 must have possession of the good whose value has been enhanced or preserved by services or materials supplied by the creditor, and a statutory or common law lien must exist. In the only situation to which Article 9 applies, a qualified possessory lienholder defeats a prior perfected

unpaid rent of farm land attaches to crops produced on the rented land when rent is not paid. *E.g.*, KAN. STAT. ANN. § 58-2524 (1983). Crops are clearly considered personal property under Article 9. U.C.C. §§ 9-105(1)(h), 9-203, 9-402(1), official comment 1.

24. U.C.C. § 9-104(c).

25. *Id.* § 9-104 official comment 3.

26. 1 GILMORE, *supra* note 11, at 306.

27. Unsecured lending and landlord liens play a significant role in agriculture today. More than 40% of land farmed today is leased; fertilizer, seed, feed, chemical, and petroleum suppliers sell supplies on open account relying on statutory liens if the purchaser does not pay. See Bailey, *Where Farmers Borrow*, 61 BANKING 75 (Mar. 1969).

Some states (for example, Kansas, Iowa, and Minnesota) have created special statutes dealing with suppliers of agricultural inputs.

28. U.C.C. § 9-310.

secured creditor. This priority rule is very similar to the super-priority given to purchase money security interest under section 9-312(4).²⁹

Interestingly, the drafters of the UCC did not define the elusive concept of possession. While some sections indicate that the drafters did not intend to limit possession to physical possession,³⁰ common-law and nonUCC statutes of a particular state law play a large part in defining possession.³¹ Courts recognize and distinguish actual possession, constructive possession, and custody, and thereby indicate that an owner may relinquish physical custody but retain legal possession.³²

Occasionally, possession has not been limited to physical possession under state statutory liens requiring possession. For example, in *Henkel v. Pontiac Farmers Grain Co.*,³³ a thresher's statutory lien continued notwithstanding the thresher-lienor's surrendering physical possession. Other courts have construed the possession requirement narrowly. In *Northeast Kansas Produce Credit Association v. Ferbrache*,³⁴ the court, noting that secret liens are disfavored, held that the statutory veterinarian's lien requiring possession could be enforced only if the veterinarian had

29. U.C.C. § 9-312(4) states:

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

This rule is an exception to the first to file rule, which normally determines priority under Article 9 when there is a conflict between two perfected secured creditors. See U.C.C. § 9-312(5)(a). It must be noted that § 9-310 does not require any public notice. Apparently, the drafters believed that possession was the only public notice that was required. This is consistent with the way Article 9 treats perfection; possession by the creditor of a good can amount to perfection under § 9-305 so long as attachment has occurred under §§ 9-203 and 9-303(1). Remember § 9-203 requires that there be an agreement between creditor and debtor, and it need not be in writing if the creditor has possession. U.C.C. §§ 9-203(1), 1-201(3).

30. See, e.g., U.C.C. § 9-305 official comments.

31. U.C.C. § 1-103 states:

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.

32. E.g., *Jacobson v. Aetna Casualty & Surety Co.*, 233 Minn. 383, 46 N.W.2d 868 (Minn. 1959). See also *In re Klipfer*, 62 Bankr. 290 (Bankr. S.D. Ohio 1986); *In re Roberts*, 37 U.C.C. Rep. Serv. (Callaghan) ¶ 1721 (Bankr. D. Kan. 1984). *Contra In re Walkington*, 62 Bankr. 989 (Bankr. W.D. Mich. 1986) (severed crops are not farm products). See generally Baird & Jackson, *Possession and Ownership: An Examination of the Scope of Article 9*, 35 STAN. L. REV. 175 (1983).

33. 55 Ill. App. 3d 898, 13 Ill. Dec. 635, 371 N.E.2d 352 (1977).

34. 236 Kan. 491, 693 P.2d 1152 (1985).

physical possession of the treated animals.³⁵ An interesting question is whether section 9-310's possession requirement would be controlled by a state court's interpretation of the relevant state lien's possession requirement. Because possession is not defined in the UCC, the state court's interpretation of the relevant law creating the lien arguably should control unless the conclusion is totally inconsistent with the section 9-310 possession requirement.

However, it is not clear why the possession requirement was included, and whether it was designed to provide some kind of public notice. Apparently, the drafters were attempting to preserve the priority that had been given by common law or by state statute to people such as warehousemen, garagemen, and inn keepers who had liens premised upon *physical possession* of the good.³⁶ It is also unclear whether the UCC drafters intended to exclude lien holders who were expressly given statutory liens under state law if they filed public notice of the lien. Moreover, it is not clear whether the priority was to be continued for lien holders who did not have possession, but who were given priority either by statute or court construction under preUCC law.

Section 9-310 does not cover many types of agricultural liens. Those that are covered include garageman,³⁷ warehouseman,³⁸ agister,³⁹ or feeder liens.⁴⁰

B. *Judicial Liens and Article 9*

Lien creditors attempting to enforce a judgment against personal property are covered by Article 9. Section 9-201 provides: "Except as otherwise provided by this Act a security interest is effective according to its terms between the parties, against purchasers of the collateral and against creditors."⁴¹ The definition of creditor includes lien creditors⁴² whose priority is determined by section 9-301. This section provides: "A 'lien creditor' means a creditor who has acquired a lien on the property involved by attachment, levy or the like . . . and a trustee in bankruptcy from the date of the filing of the petition or a receiver in equity from

35. *Id.*

36. 1 GILMORE, *supra* note 11, at 887-89.

37. *E.g.*, COLO. REV. STAT. § 38-20-106 (1990); FLA. STAT. ANN. §§ 713.50, .56, .73, .76 (West 1988 & Supp. 1990); KAN. STAT. ANN. § 58-201 (Supp. 1990).

38. *E.g.*, U.C.C. § 7-209.

39. *E.g.*, COLO. REV. STAT. §§ 38-20-102 to -103; 38-20-107 to -116 (1990); KAN. STAT. ANN. § 58-220 (1983).

40. *E.g.*, IOWA CODE ANN. §§ 579.1 to .3 (West 1950); KAN. STAT. ANN. § 58-220 (1983).

41. U.C.C. § 9-201.

42. U.C.C. § 1-201(12).

the time of appointment."⁴³ Section 9-301 also deals with priority conflicts between unperfected secured creditors, lien creditors, and other third parties. Section 9-301(1)(b) states: "[A]n unperfected security interest is subordinate to the rights of a person who becomes a lien creditor before the security interest is perfected."⁴⁴ Thus, a lien creditor⁴⁵ defeats an unperfected secured creditor. On the other hand, a perfected secured creditor defeats a lien creditor.

*C. Conflicts Between a Perfected Secured Party and Lien Holders
Not Covered by Sections 9-310 or 9-301*

Agricultural liens not covered by the UCC are numerous and not uniform between the states or within one state. Examples include liens for stud service, for a commission merchant selling farm products, for a livestock feeder or stable keeper, for shoeing animals, for unpaid pasture rent, for unpaid rent of crop land (landlord lien), for veterinarian services, for labor and machines used to harvest farm products, for processing farm products, for production of supplies such as feed, fertilizer, seed and chemicals, and for bovine brucellosis treatment. Most of these liens are statutory and differ in substance, creation, perfection, enforcement, and priority relative to other creditors, or purchasers of farm products that might be subject to a statutory lien. No model or uniform lien laws exist, and it is often not clear how the lien is created, enforced, or what priority it is to receive. It is also difficult to determine what liens exist. These uncertainties cause a variety of problems. Creditors, and lawyers advising them, have no firm basis for making decisions. Both state and federal courts, particularly bankruptcy courts, have had difficulties resolving priority disputes involving agricultural liens. Agricultural liens present a number of bankruptcy issues.

II. AGRICULTURAL LIENS AND BANKRUPTCY

Agricultural liens can be attacked by a trustee under at least three sections: 544(a), 545, and 547. Under section 544(a)(1), the trustee becomes a hypothetical lien creditor; the trustee is empowered to avoid any transfer⁴⁶ that, under nonbankruptcy law, is voidable by a creditor who

43. U.C.C. § 9-301(3). A creditor who files a civil action seeking payment of an unpaid debt obtains a judgment and writ of execution, and a public official who seizes specific property becomes a lien creditor. In short, a general creditor does not become a lien creditor until it has control of specific property. *Id.*

44. *Id.* § 9-301(1)(b).

45. Remember that a trustee in bankruptcy is also a lien creditor. U.C.C. § 9-301(3).

46. Obtaining any interest in property of the debtor in any manner whether voluntary or involuntary is a transfer for purposes of the bankruptcy code. 11 U.S.C. § 101(50) (1990).

extended credit and obtained a lien on a debtor's property at the time the bankruptcy petition is filed. In other words, a trustee has the invalidation powers of a creditor who obtained an enforceable judicial lien against all of the debtor's property, irrespective of whether such creditor exists. This is the so-called "strong arm" clause. Conflicts between a trustee and creditors having Article 9 security interests will be determined by Article 9. Unperfected secured creditors will lose to a trustee under sections 9-301(1)(b) and 544(a)(1),⁴⁷ whereas a perfected security interest is not vulnerable under these sections. Section 544(a)(1) also applies to statutory liens and other nonconsensual liens such as judicial liens. This means that an unperfected statutory lien can be avoided.⁴⁸ Whether a statutory lien is perfected is determined by state law.⁴⁹ State law also determines whether the trustee as a hypothetical lien creditor can defeat a perfected statutory lien holder or another lien creditor that existed prior to bankruptcy.⁵⁰ In short, whether the trustee can prevail under section 544(a) is determined by state law.⁵¹ Although it is beyond the scope of this Article, it must be noted that section 544(a)(3) gives a trustee the rights of a hypothetical bona fide purchaser of real estate from the debtor. Specifically, section 544(a)(3) empowers the trustee to invalidate a transfer of real estate which, under nonbankruptcy law, is voidable as to a bona fide purchaser of real estate, whether or not such a creditor actually exists.⁵² This is similar to the bona fide purchaser avoidance power the trustee can use to attack statutory liens under section 545(2).

47. See U.C.C. § 9-301(1)(b) and comment 2. Remember that the trustee is a lien creditor under § 9-301(3). The effect of § 9-301(1)(b) and § 544(a)(1) is to make an unperfected security interest unenforceable in bankruptcy. Perfected secured creditors cannot be affected by § 544(a)(1).

48. E.g., *In re Nicholson*, 57 Bankr. 672 (Bankr. D. Nev. 1986) (unperfected statutory attorney's lien avoidable under § 544(a)(1)).

49. *Id.*

50. A creditor who has become a lien creditor by obtaining an interest in specific property of the debtor within 90 days of bankruptcy will be subject to attack by the trustee under 11 U.S.C. § 547(b). If the creditor is considered an insider (see 11 U.S.C. § 101(30) (1988)), the trustee could avoid a lien that arose within one year of bankruptcy. 11 U.S.C. § 547(b)(4) (1988).

51. *Nicholson*, 57 Bankr. at 676 (1986).

52. The following hypothetical illustrates the application of § 544(a)(3). On January 1st, X borrows \$20,000 from S & L, and X gives S & L a real estate mortgage covering Greenacre. On March 1st, X files a bankruptcy petition. S & L did not record its mortgage. X's trustee can invalidate S & L's mortgage under § 544(a)(3) because normally, under state law, for a mortgagee to be protected against bona fide purchasers the mortgage must be recorded in the appropriate public office. The trustee is simply given the rights of a bona fide purchaser, and because a bona fide purchaser would prevail against S & L, the trustee will also prevail. See, e.g., *McCannon v. Marston*, 679 F.2d 13 (3d Cir. 1982); *In re Great Plains Western Ranch Co.*, 38 Bankr. 899 (Bankr. C.D. Calif. 1984); *In re Euro-Swiss Intern. Corp.*, 33 Bankr. 872 (Bankr. S.D.N.Y. 1983).

A. Statutory Liens

Section 545 governs avoidance of statutory liens.⁵³ Under this section, a trustee can avoid a statutory lien on property of the debtor in a number of situations. Under section 545(1), a lien that becomes effective upon the filing of a bankruptcy petition or when the debtor becomes insolvent is avoidable. Pursuant to section 545(2), statutory liens that are "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 may be avoided, regardless of whether such a purchaser exists."⁵⁴ Finally, statutory liens for rent or liens for distress are unenforceable.⁵⁵ Accordingly, many agricultural statutory liens are avoidable in bankruptcy.

B. Landlord Liens

Landlord liens for unpaid rent are avoidable in bankruptcy.⁵⁶ Unique questions arise concerning landlord liens. Under a Minnesota statute, a person or entity that leases agricultural land "has a lien for unpaid rent on the crops produced on the property in the crop year and on the crop products and their proceeds."⁵⁷ The lien is perfected by filing a lien statement with the appropriate office under UCC section 9-401 within thirty days after the *crops become growing crops*.⁵⁸ Even if the landlord

53. 11 U.S.C. § 545 (1988) states:

The trustee may avoid the fixing of a statutory lien on property of the debtor to the extent that such lien —

- (1) first becomes effective against the debtor—
 - (A) when a case under this title concerning the debtor is commenced;
 - (B) when an insolvency proceeding other than under this title concerning the debtor is commenced;
 - (C) when a custodian is appointed or authorized to take or takes possession;
 - (D) when the debtor becomes insolvent;
 - (E) when the debtor's financial condition fails to meet a specified standard;
 - or
 - (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;
- (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;
- (4) is a lien of distress for rent.

54. *Id.*

55. 11 U.S.C. § 545(3), (4) (1989).

56. *See, e.g., In re Waldo*, 70 Bankr. 16 (Bankr. N.D. Iowa 1986).

57. MINN. STAT. ANN. § 514.960 (West 1990).

58. *Id.*

lien is perfected, it can be avoided in bankruptcy under section 545(3), which does not make reference to perfection, unlike section 545(2). Thus, perfection under state law is irrelevant. In such cases, it is a statutory involuntary lien and would be covered by section 545(3). Yet, section 546 limits the avoidance powers of the trustee under a number of sections, including section 545. Section 546(b) recognizes any state law grace period for perfection. Thus, if under state law a statutory lien still may be perfected at the time the bankruptcy is filed, and that perfection relates back to a prebankruptcy date, the lien will be considered perfected on the date the petition is filed. For example, in Minnesota if a bankruptcy occurred the day crops were planted, it appears that the landlord has thirty days to perfect. When a landlord perfects, the lien would be considered perfected on the date the bankruptcy petition was filed. However, this should not affect the trustee's ability to avoid landlord liens. Again, section 545(3) makes no reference to perfection, and it appears that section 546(b) was designed to protect creditors when the trustee was utilizing the other avoidance powers such as under sections 544, 547, and 545(2), in which perfection is a key question. This is not the case for landlord liens. Perfected or not, a landlord's lien is avoidable in all cases.⁵⁹

In many states, the landlord lien has priority over a perfected secured creditor.⁶⁰ In these cases, a trustee can use section 551 to defeat the perfected secured creditor to the extent of the landlord's lien priority over the secured creditor. Section 551 provides: "Any transfer avoided under . . . 545 . . . is preserved for the benefit of the estate but only with respect to property of the estate."⁶¹

59. *E.g.*, *In re Coal-X Ltd.*, "76", 103 Bankr. 276 (Bankr. C.D. Utah 1986).

60. Some landlord lien statutes specifically provide that the landlord's lien has priority over a prior perfected security interest. *E.g.*, MINN. STAT. ANN. § 514.960 (West 1990) states: "A perfected landlord lien has priority over all other liens or security interests in crops grown or produced on the property that was leased and the crop products and proceeds." Courts also reach this result. *E.g.*, *Meyer v. Hawkeye Bank & Trust Co.*, 423 N.W.2d 186 (Iowa 1988); *Perkins v. Farmers Trust & Savings Bank*, 421 N.W.2d 533 (Iowa 1988). See also Note, *Priorities Between Article Nine Security Interests and Statutory Liens in Iowa*, 23 DRAKE L. REV. 169 (1973); *Dwyer v. Cooksville*, 117 Ill. App. 3d 1001, 454 N.E.2d 357 (1983). In Nebraska, an unpaid landlord apparently will lose to a prior perfected secured creditor. *McCoy v. Steffen*, 227 Neb. 72, 416 N.W.2d 16 (1987).

If custom farming or what some call "sharecropping" is involved, there can be no landlord lien because the owner of the land owns all of the crop. See *In re Hilligoss*, 849 F.2d 280 (7th Cir. 1988).

Remember that Article 9 does not apply to a landlord's lien because such a lien is not consensual, and § 9-104(b) excludes landlord liens. Thus, priority battles between landlord liens and other interests, such as perfected security interests, are determined by rules not found in Article 9. For a discussion of Illinois law, see Shockey, *Illinois' Farm Landlord's Lien—Is It Time for a Change?*, ILL. B.J. 864 (1989).

61. *E.g.*, *In re Coal-X Ltd.*, "76", 103 Bankr. 276.

Much agricultural land is rented for cash. A variety of cash leases exist, but the most typical is a straight cash lease in which the rent is either a fixed price per acre or a fixed amount for the entire piece of land, payable in installments or in a lump sum.⁶² Many cash leases are oral, and the only possible protection for nonpayment is the landlord lien. From a planning or advising perspective, these landowners with a straight cash lease either must get the money up front *or* obtain a perfected security interest⁶³ to be protected in the event the tenant files bankruptcy. However, even though a perfected security interest in the crops being produced on the rented land will be enforceable in bankruptcy, problems may still exist for the land owner.

For example, the priority rules of Article 9 may cause problems for the unsuspecting. Under section 9-312(5)(a), the first to file will prevail. This can be a problem for a landlord who obtains a security interest for the first time from a tenant who has been farming the ground for some time. If the tenant has signed a security agreement with a crop lender that includes an after-acquired property clause which grants a security interest in future crops to be grown on the land involved, the landlord will lose to the prior *perfected* crop lender. The priority of the first secured party dates from the filing of the financing statement. With a properly drafted security agreement containing a future advances clause and an after-acquired property clause, a secured creditor who files first will have priority if timely continuations of the financing statement are filed. Consequently, unless the landlord-tenant relationship is just beginning or new land is being added that the tenant previously has not farmed, the landlord is given only limited protection by the creation of an Article 9 security interest. Of course, a subordination agreement under section 9-316 may be sought from a prior secured party.

Another potential problem arises when the tenant sells the crop and the landowner is not paid. In order to enforce its security interest against the purchaser of the crop, the land owner *must* establish compliance with

62. Flexible cash leases occur when the amount of cash rent varies according to production conditions and/or crop prices. Hybrid cash leases have some elements similar to those found in crop-share leases. Examples include the cash value of a certain number of bushels, and the tenant or guaranteed bushel leases in which the tenant agrees to deliver a specified amount of a certain type of grain to the landowner by a certain date.

63. The landowner will have to have a tenant sign a properly drafted security agreement. See U.C.C. §§ 9-203(1), 9-204 (1987). While an Article 9 security interest can be created in the lease form, it may be better to have two documents because the inclusion of all necessary Article 9 provisions may cause the lease to be too long. A landowner must also file an appropriate UCC-1 form. Of course, a security interest cannot be created if an oral lease is involved and no written security agreement is signed. See Meyer, *Should a Farm Lease Include an Article 9 Security Interest*, 5 J. TAX'N & LAW 60-69 (1983).

the notice requirements of the federal farm products rule of 7 U.S.C. § 1631.⁶⁴

C. Crop-Share Leases

Typically, landlord liens are not relevant to crop-share leases that usually require the rent be paid in proportion to the crops produced on the land, and the landlord normally pays part of the production expenses such as seed, fertilizer, and other chemicals. The recent bankruptcy case, *In re Norton*,⁶⁵ raises serious questions about how crop-share leases will be treated in bankruptcy. In *Norton*, the court held that the crop-share landlord who had paid half of the seed, lime, fertilizer, and other inputs and was to receive half of the crop produced on the rented land was only entitled to rent for the number of days that a Chapter 7 trustee had possession of the land.⁶⁶ The landowner's half of the bean crop totaled \$2165, but he was allowed only \$462. The court focused on the impact of Bankruptcy Code section 365.⁶⁷ However, the court's decision seems to have been premised on its conclusion that, under Illinois law, growing crops are treated as part of the realty until severed.⁶⁸ Consequently, because the tenant possessed the land until bankruptcy, the landowner had no ownership rights in the growing crops.⁶⁹ The court relied upon a 1962 case that predates the UCC, and concluded that the tenant had title to the whole crop until the lessor's share is severed.⁷⁰ The court did not focus on Article 9 or on the fact that the Illinois legislature enacted statutes in 1988 making clear that a real estate mortgagee and a receiver take subject to a perfected security interest in growing crops.⁷¹

64. 7 U.S.C. § 1631 (1988). See, e.g., Kershen and Hardin, *Congress Takes Exception to the Farm Products Exception of the UCC: Centralized and Presale Notification Systems*, 36 U. KAN. L. REV. 383 (1988); Kershen and Hardin, *Congress Takes Exception to the Farm Products Exception of the UCC: Retroactivity and Preemption*, 36 U. KAN. L. REV. 1 (1987); Meyer, *Congress's Amendment to the U.C.C.: The Farm Products Rule Change*, 55 J. KAN. B. 17 (Sept./Oct. 1986). See also Meyer, *Litigation Under the Federal Farm Products Rule*, 12 J. AGRIC. TAX'N & LAW 373 (Winter 1991).

If no bankruptcy is involved, a statutory lien (landlord lien) prevails against purchasers in some states.

65. 112 Bankr. 932 (Bankr. C.D. Ill. 1990).

66. *Id.* at 936.

67. For a thorough discussion of farm leases and bankruptcy, see Grossman & Fischer, *The Farm Lease in Bankruptcy: A Comprehensive Analysis*, 59 NOTRE DAME L. REV. 598 (1984).

68. *Norton*, 112 Bankr. at 935-36. However, the court stated that the question of whether the crops were personalty or realty was "irrelevant." *Id.* at 935.

69. *Id.*

70. *Id.*

71. ILL. ANN. STAT. ch. 5, ¶ 2501-04 (Smith-Hurd Supp. 1990); *id.* ch. 110, ¶ 15-1702(f). See also *United States v. Newcomb*, 682 F.2d 758 (8th Cir. 1982).

Clearly, Article 9 applies to growing crops because they are considered goods,⁷² and any attempt to obtain a security interest in them must comply with Article 9 attachment and perfection requirements.⁷³ Any real estate creditor who fails to comply will lose to a perfected secured party. The *Norton* court suggested that the only way the crop-share landlord can be protected in bankruptcy is to obtain a perfected security interest.⁷⁴ Thus, the court seemed to recognize that growing crops are personal property, and it must have assumed that the tenant had all of the rights in the crops. This conclusion is erroneous. If the tenant had rights in all crops being produced on the rented land, the tenant could give its lender a security interest in all of the crops. This is incorrect. The tenant only has the rights that he or she is entitled to under the lease, which in *Norton* was fifty percent. To create a security interest, the debtor must have rights in the collateral, and the tenant clearly did not have rights in all of the crops. The concept of rights is not defined in the UCC; thus, common law and other sections of the UCC become relevant.⁷⁵

72. U.C.C. §§ 9-105(1)(h), 9-203(1), 9-402(1) and comment 1 (1987).

73. *Id.* §§ 9-203-04, 9-303, 9-401-02.

74. *Norton*, 112 Bankr. at 936.

75. The third and final requirement for attachment is that the debtor must have rights in the collateral. U.C.C. § 9-203(1)(c) (1987). This requirement may only be stating the obvious, but the phrase "rights in the collateral" is not defined in the Code. 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 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 "rights" is not defined, other Code sections are relevant. For example, § 1-103 provides: "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." U.C.C. § 1-103 (1987). Thus, the debtor can obtain the power to create a security interest through any of the bodies of law set out in § 1-103. Also, under § 2-403(1)(b), purchasers are granted greater rights than their transferor had. Further, because secured parties are treated as purchasers under § 1-201(32) and (33), a secured party has the status of a purchaser under § 2-403.

This "rights" issue is a potential problem in several agricultural lending situations. One such situation involves a farmer who leases some or all of the land he farms, and who pledges the crops produced on this leased land as collateral. The farmer's rights in the growing crops on this leased land will be determined by the type of lease involved. If a cash lease is involved, the debtor farmer has an interest in all of the crops grown on the leased land. *Finley v. McClure*, 22 Kan. 637, 567 P.2d 851 (1977). However, the farmer with a crop-share lease has the power to create a security interest only in that portion of the crops that the farmer is entitled to under the crop-share lease. *See, e.g.,*

The value of the crops comes with maturity. Even under most *pre-UCC law*, severed crops became personal property upon severance, and

KAN. STAT. ANN. §§ 58-2525, 59-1206 (1986). *But see* Metropolitan Life Ins. Co. v. Reeves-Gustafson, 228 Neb. 233, 422 N.W.2d 72 (1988). Crops should be treated as personal property rather than part of the real estate. The lease should not affect the landowner's interest in growing crops for which the landowner is paying all of the input costs.

The question of ownership arises when the farmer rents his or her land to a chicken breeder or seed company and then uses the chickens or eggs or grain as collateral. Germany v. Farmers Home Admin., 73 Bankr. 19 (Bankr. S.D. Miss. 1986). Debtor, a farmer, and a chicken breeder entered into an egg production agreement which provided that: 1) the farmer would keep the breeder's chickens and collect the eggs; 2) title to the chickens would remain in the breeder who could remove them if the farmer failed to perform his duties; and 3) the farmer would be paid an amount for each chicken he maintained and another amount for each egg that the breeder picked up. Before going bankrupt, the farmer assigned one-half of his income from this contract to the Farmers Home Administration (FmHA). FmHA claimed the assignment was protected from the trustee in bankruptcy because the FmHA had a security interest in "farm products." The court concluded that ownership never vested with the debtor farmer because he had no rights in the collateral; all the debtor had was a services contract terminable at the will of the breeder. *Id.* at 22. At best, FmHA merely had an interest in the farmer's contract for services. FmHA did not assert that it relied upon the farmer's apparent ownership or lacked notice of the breeder's arrangement with the farmer. Moreover, nothing in the case indicated that FmHA checked the public records to determine if the breeder had filed a financing statement. Arguably, the farmer and the breeder had a bailment relationship. Some courts have held against the bailor (breeder) "where the debtor gains possession of collateral pursuant to an agreement endowing him with any interest other than naked possession." Morton Booth Co. v. Tiara Furniture, Inc., 564 P.2d 210, 214 (Okla. 1977). *See also* Kinetics Technology Int'l Corp. v. Fourth Nat'l Bank, 705 F.2d 396 (10th Cir. 1983). Apparently, FmHA had no way to determine from public records who owned the birds and the eggs. This same problem may arise when a seed company contracts with a farmer to raise, on farmer's land, seed grain. These contracts may also be referred to as bailments because they provide that the seed will be furnished by the company and the seed crop produced will at all times be the property of the seed company.

The rights issue may also arise when the debtor is a commercial feedlot operator, because animals in the facility often will be owned by people who have hired the operator to fatten them. The Oklahoma Court of Appeals considered this issue in National Livestock Credit Corp. v. First State Bank of Harrah, 503 P.2d 1283 (Okla. Ct. App. 1972), and concluded that the feedlot-debtor cannot create a security interest in animals that they do not own but hold as a bailee for the limited purpose of fattening. Thus, owners of cattle being fattened should make sure their animals are clearly identifiable by utilizing, for example, particular ear tags or brands.

The often difficult distinction between ownership and mere possession may potentially mislead the bailee's creditors, as discussed in the above cases involving farmers who produce eggs and seed grain. Thus, it is important to examine how much control the feedlot operator has. For example, if the operator is authorized to sell the animals without consulting the owner and there is no specific identification of the animals, the debtor may have the power to create a security interest in animals that do not belong to him.

In re Cook, 63 Bankr. 789 (Bankr. D.N.D. 1986), is another case in which the debtor did not own the collateral. Even though the nondebtor son in *Cook* held title in

the tenant would only have an interest in the tenant's proportionate share.⁷⁶ Thus, it makes no sense to say a tenant can create a security interest in the crops only while they are growing. This is of no value to the lender if it must foreclose. Moreover, as indicated earlier, the Illinois legislature made clear that growing crops are personal property and real estate interests cannot claim growing crops as realty.⁷⁷

A landlord should have rights in the crops the moment they are planted. Crops are personal property, not real estate, and personal property law should govern. To be sure, a lessee has exclusive possessory rights to the land during the term, and traditionally a share of the crop is also considered to be rent. However, this does not mean a landlord has no rights in growing crops. If the landlord pays a percentage of the cost of seed, fertilizer, and chemicals, it is difficult to conclude that the landlord has no rights in the crops growing on the land prior to severance. Further, a crop-share lease is similar to a partnership with each partner

cattle claimed by the secured party, this fact was not dispositive as to whether his debtor parents, who had possession of the cattle, had rights sufficient to grant a security interest in the cattle. The debtor may possess 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 parties' intent is a key factor in determining whether sufficient rights exist and the lender has the burden of proving this element. *See also In re Atchison*, 832 F.2d 1236 (11th Cir. 1987). In *Atchison*, the owner personally signed the security agreement on behalf of the corporation and the equipment that he owned was being used by the corporation in the operation of the corporation business. The owner's permission to use his goods as collateral gives the debtor (corporation) sufficient rights for attachment purposes. *Id.* at 1239. The court noted that tests employed by courts to define rights include: 1) the owner's permission to use goods as collateral gives the debtor sufficient rights to create a security interest; and 2) the debtor's right to use and control the collateral gives the debtor sufficient rights to create a security interest. *Id.* *But see* *Thorp Credit, Inc. v. Wuchter*, 412 N.W.2d 641 (Iowa Ct. App. 1987).

A final example involves an interest gained by virtue of § 2-403(1)(b). In this situation a farmer delivers and sells grain to an elevator and receives a bad check from the elevator. The lender has a perfected security interest in the inventory of the elevator, which consists of company-owned grain. Does the elevator have sufficient rights in the collateral so that the lender's security interest will attach to the grain purchased with a bad check? A number of cases relying on § 2-403(1)(b), which gives the elevator voidable title and the power to transfer a good title to a good faith purchaser for value, have held that it does. Because the definition of "purchaser" in § 1-201(32) and (33) includes a secured party, generally the only question is whether the secured party acted in good faith. *See Samuels & Co. v. Mahon*, 526 F.2d 1238 (5th Cir. 1976), *cert. denied*, 429 U.S. 834 (1976); *In re McLouth Steel Corp.*, 22 Bankr. 722 (Bankr. E.D. Mich. 1982); *In re Western Farmers Ass'n*, 6 Bankr. 432 (Bankr. W.D. Wash. 1980); *Swets Motor Sales, Inc. v. Pruisner*, 236 N.W.2d 299 (Iowa 1975). When poultry, livestock, or perishable commodities are involved, the unpaid producer is given priority over the perfected secured creditor of the buyer. *See generally* 7 U.S.C. §§ 196(b), 197(e) (1989).

76. *See Babcock v. Mississippi River Power Co.*, 113 F.2d 398 (7th Cir. 1940).

77. *See supra* note 68 and accompanying text.

making a contribution and each having an undivided interest in the output of the arrangement. If a crop failure occurs, the landowner and the tenant each get nothing. The landlord's share of the crops comes *only* from the crops produced on the rented land.

Some state statutes provide that landowners with crop-share leases have rights in the crops as soon as the crops are planted.⁷⁸ In other states applying the common law, the landowner is considered the owner of a proportion of the crops being produced on the leased land. For example, in *In re Sumner*,⁷⁹ the bankruptcy court held that under Oregon law the lessor and lessee in a crop-share lease both have an undivided interest in the crops.⁸⁰ One must note that under federal farm programs, both landlord and tenant must sign up to participate. The government benefits allocated to the land will be paid to the tenant and landowner in the same proportion as the crops are shared. Some states treat growing crops as personal property in other contexts, such as under the doctrine of emblements, decedent estates, and landlord liens.⁸¹ The upshot is that the landlord's share of the crops should not be considered an asset of the tenant's bankruptcy estate.⁸²

D. *Unperfected Liens and the BFP Test*

The bankruptcy trustee, under section 545(2), may avoid statutory liens that are either unperfected or not enforceable against a bona fide purchaser (BFP).⁸³ This section does not define perfection or when a lien is not enforceable against a BFP.⁸⁴ Congress apparently intended for these questions to be decided under state law,⁸⁵ and courts have struggled

78. See, e.g., KAN. STAT. ANN. § 58-2525 (1983). See also *Wiehl v. Winslow*, 118 Kan. 147, 149, 233 P. 802 (1925) (landlord has distinct interest in crops from the time of sowing).

79. 69 Bankr. 758 (Bankr. D. Or. 1986).

80. See *DeWolfe v. Kupers*, 106 Or. 176, 211 P. 297 (1923); *Halsey v. Simmons*, 85 Or. 324, 166 P. 944 (1917).

81. E.g., *Finley v. McClure*, 222 Kan. 637, 567 P.2d 851 (1977), KAN. STAT. ANN. §§ 58-2525, 59-1206 (1983). *But see* MINN. STAT. ANN. § 557.10-.12 (West 1988).

82. 11 U.S.C. § 541 (1988).

83. *Id.* § 545(2).

84. See *infra* note 96.

85. See *In re Marino*, 813 F.2d 1562, 1565 (9th Cir. 1987) (powers of the Bankruptcy Code § 544(a) bona fide purchaser of real property are defined by state law); *In re Phillips Constr. Co.*, 579 F.2d 431, 432 (7th Cir. 1978) (upholding the validity of a mechanic's lien).

Courts also use state law to "determine the 'underlying property interests and commercial arrangements' at issue in bankruptcy proceedings." *Selby v. Ford Motor Co.*, 590 F.2d 642, 646 (6th Cir. 1979) (citing *Chicago Bd. of Trade v. Johnson*, 264 U.S. 1, 10 (1924)). See also *In re Anchorage Int'l Inn, Inc.*, 718 F.2d 1446, 1451 (9th Cir. 1983) (applying state law in determining that a lien on a liquor license was not avoidable under Bankruptcy Code § 545). However, states cannot impose their own priorities in a bankruptcy proceeding. E.g., *In re Loretto*, 898 F.2d 715, 718 (9th Cir. 1990).

with this section. Thus, all statutory liens that are not recorded or perfected by a lien holder's possession and all statutory liens that do not specifically provide for priority over purchasers are vulnerable.

Generally, the date the bankruptcy petition is filed determines whether the lien is perfected. However, section 546(b) provides an exception, and permits postbankruptcy perfection. As indicated earlier,⁸⁶ this section recognizes any state law "grace period" for perfection. Therefore, if under state law a statutory lien still may be perfected when bankruptcy occurs and that perfection can relate back to a prebankruptcy date, the lien will be perfected on the date the petition is filed.⁸⁷

Section 545(2) invalidates a lien that "is not . . . enforceable against a bona fide purchaser that purchases such property at the time the commencement of the case, whether or not such a purchaser exists."⁸⁸ Under this section, a lien that is not enforceable against a real or *hypothetical* bona fide purchaser of the liened goods can be avoided by the trustee. The legislative history concerning the BFP avoidance power under the predecessor section to 545(2) stated that "[t]he holders of such liens [statutory] have reason to know that their security is extremely vulnerable."⁸⁹

Federal courts have struggled with the BFP test. Although state law determines property rights, many states have no clear rules for determining whether a particular lien is enforceable against a BFP. Congress did not define BFP, and neither section 545 nor the legislative history indicates that the rights of a BFP can vary depending upon the circumstances. Consequently, federal courts have developed their own standards for determining whether statutory liens are avoidable.

Unfortunately, the federal courts' standards are not always consistent or clear.⁹⁰ Secret liens, liens that the holder is not required to perfect either by filing or possession, present the most difficulties.

86. See *supra* notes 58-59 and accompanying text.

87. E.g., *In re Butler Construction Co.*, 110 Bankr. 281 (Bankr. W.D. Ky. 1989).

88. 11 U.S.C. § 545(2) (1988).

89. S. REP. NO. 1159, 89th Cong., 2d Sess. 7 (1966).

90. E.g., *In re Cummings*, 656 F.2d 1262, 1265 (9th Cir. 1981) (lien on personal property created by statute is ineffective against a BFP and, therefore, ineffective against a trustee in bankruptcy); *In re Mission Marine Assoc.*, 633 F.2d 678, 681 (3d Cir. 1980) (lien avoidable unless state statute requires actual or constructive notice); *In re Trahan*, 283 F. Supp. 620 (W.D. La.), *aff'd per curiam*, 402 F.2d 796 (5th Cir. 1968), *cert denied sub. nom.* *Bernard v. Beneficial Fin. Co.*, 394 U.S. 930 (1969) (lien only avoidable if lien is enforceable against BFP in factual circumstances of case); *In re Allgeier & Dyer, Inc.*, 18 Bankr. 82, 88 (Bankr. W.D. Ky. 1982) (not avoidable if meets all statutory lien requirements); *In re Chesterfield Developers, Inc.*, 285 F. Supp. 689, 691 (S.D.N.Y. 1968) (if more than one type of BFP under state law, the lien must be enforceable against all for the trustee to be able to avoid the lien).

E. Producer Liens

Secret liens and section 545(2) were recently considered by the Ninth Circuit Court of Appeals in *In re Loretto Winery Ltd.*⁹¹ In *Loretto Winery*, the court was confronted with an unrecorded and nonpossessory producer's lien. Producers sold grapes to Loretto Winery (debtor) to be made into wine and wine products. Shortly after receiving the grapes, the debtor filed a bankruptcy petition. Under a California statute,⁹² a producer automatically receives a lien on any farm product delivered and sold to a processor.⁹³ The lien is complete upon the date of the last delivery by the producer, has no formal perfection requirements, and attaches to the product sold in unprocessed or processed form so long as it remains in the possession or control of the processor. The trustee sought to avoid this lien under section 545(2), arguing that it was a secret lien and unenforceable against a BFP when the petition was filed. The court, with one judge dissenting, held that the trustee could not avoid the state statutory lien because the lien would be enforceable against a BFP under California law.⁹⁴

Noting that a statutory lien can be avoided if it is not perfected or not enforceable against a BFP when the petition is filed, the court's analysis focused on the purchaser requirement, inasmuch as no perfection requirements existed.⁹⁵ Regarding section 545(2)'s hypothetical BFP, the

91. 898 F.2d 715 (9th Cir. 1990). Other courts have considered this issue. See, e.g., *In re Martin Exploration Co.*, 731 F.2d 1210 (5th Cir. 1984); *In re Tape City, U.S.A., Inc.*, 677 F.2d 401 (5th Cir. 1982); *In re Lowery Bros., Inc.*, 589 F.2d 851 (5th Cir. 1979); *Trahan*, 283 F. Supp. 620. *Martin* and *Tape City* involved § 545(2) whereas the other two cases involved § 545's predecessor § 67(c)(1)(B), codified at 11 U.S.C. § 107(c)(1)(B), which is substantively similar. Two other cases considering the old provision are *In re Mission Marine Assocs., Inc.*, 633 F.2d 678 and *In re J.R. Nieves & Co.*, 446 F.2d 188 (1st Cir. 1971). For a case dealing with state and federal maritime liens, see *In re Bay State Yacht Sales, Inc.*, 117 Bankr. 16 (Bankr. D. Mass. 1990) (state lien avoidable under § 545(2) but the federal lien was not).

92. CAL. FOOD & AGRIC. CODE §§ 55632-53 (West 1986 & Supp. 1990). For an interesting discussion of the California producer's lien that appeared before *In re Loretto Winery Ltd.*, 898 F.2d 715 (9th Cir. 1990) was decided, see Note, *The California Agricultural Producer's Lien, Processing Company Insolvencies, and Federal Bankruptcy Law: An Evaluation and Alternative Methods of Protecting Farmers*, 36 HASTINGS L.J. 609 (1985).

93. Producer liens are not uncommon. Ohio recently enacted an agricultural producer's lien that, once perfected, purports to protect the producer in the event of the processor's insolvency. The statute provides that the producer who records its lien within 60 days of delivery apparently has priority over all secured creditors of the processor and all warehouseman's liens. Nothing is said about bona fide purchasers. See OHIO REV. CODE ANN. § 1311.55 (Anderson Supp. 1990).

94. *Loretto Winery*, 898 F.2d at 724. Whether state statutory liens are enforceable against bona fide purchasers is determined by state law. *In re Tropicana*, 24 Bankr. 381, 382-83 (Bankr. C.D. Cal. 1982).

95. *Loretto Winery*, 898 F.2d at 718-19.

court concluded that Congress intended state law to be used to determine bankruptcy property disputes, and specifically, to determine whether a state statutory lien is good against a BFP.⁹⁶ Because the lien statute did not specially provide that the lien would be enforceable against a BFP, and no state precedent law existed, the court applied its own analysis. Initially, the majority stressed that the producer's lien is not only the key to California's extensive statutory scheme designed to protect unpaid producers; there is clear evidence that the California legislature also intended to guarantee farmers full payment for their farm products.⁹⁷

California imposes harsh penalties for impeding the producer's lien. For example, if a processor removes the product to which the lien attaches to another state, removes it from the processor's ownership or control, or does not pay off the lien with proceeds from the sale of the product, the processor's license can be suspended or revoked, and the processor is subject to civil penalties of \$500 per violation.⁹⁸ The processor's sale of farm products or processed products without using the proceeds to pay the producer is a misdemeanor subjecting the processor to a fine ranging from \$500 to \$2000 or up to one year in jail or both.⁹⁹ This treatment persuaded the majority that the California legislature intended to make the lien unavoidable.¹⁰⁰ Interestingly, the statute is silent on whether the producer may enforce the lien against a purchaser, but it is valid only if the farm products remain in the processor's possession.¹⁰¹

96. "Bona fide purchaser" (BFP) is defined in many different ways. The following are examples of how different states have defined a bona fide purchaser.

A BFP is one who purchased property for value without notice of any defects in the seller's title. *Walters v. Calderon*, 25 Cal. App. 3d 863, 102 Cal. Rptr. 89, 97 (1972).

A BFP is one who pays valuable consideration and acts in good faith without notice of any third party's rights with respect to the property sold. *J.C. Equipment, Inc. v. Sky Aviation, Inc.*, 498 S.W.2d 73, 75 (Mo. Ct. App. 1973).

A BFP for value is one who pays the seller valuable consideration and does not have notice of another's claim of right to, or equity in, the property prior to the buyer acquiring title. *Snuffin v. Mayo*, 6 Wash. App. 525, 494 P.2d 497 (1972).

A BFP is one who buys property or to whom a negotiable document of title is transferred in good faith and without notice of any defense or claim against the property or document. The UCC does not use the bona fide purchaser, but instead uses good faith purchaser and buyer in the ordinary course, and taking by due negotiation. *See* U.C.C. §§ 1-201(9), 2-403(1), 1-201(19), 7-501(4), 1-201(25). *See also id.* §§ 9-307(1), 3-302, 3-305.

97. *See* Note, *supra* note 92, at 613-15, in which the author summarizes the changes made in the producer's lien statute to assure producers would be paid.

98. CAL. FOOD & AGRIC. CODE §§ 55872, 55922 (West 1986).

99. *Id.* §§ 55901, 55905.

100. *Loretto Winery*, 898 F.2d at 722.

101. Some states do make specific reference to purchasers of products subject to liens. Others state that the lien will not be good against innocent purchasers. *E.g.*, MICH. COMP. LAWS ANN. § 570.331 (West 1967). Others provide that it will only be good against purchasers with notice. *E.g.*, KAN. STAT. ANN. § 58-2526 (1983) (lien against crops for unpaid rent).

Arguably, the possession requirement and the failure to make the lien enforceable against a BFP permit the negative inference that a lien is not to be enforceable against a BFP. The harsh penalties also might have been considered a substitute for making the lien unenforceable against a purchaser of the lien goods.

Addressing hypothetical BFP avoidance power, the court concluded that the test is whether the lien would be enforceable against a BFP in the factual circumstances of the actual bankruptcy.¹⁰² The court focused on two factual circumstances. First, because the processor possessed the grapes when the bankruptcy petition was filed, the trustee must be considered to have possession at the filing.¹⁰³ Second, the producer's lien is only effective so long as the processor has possession.¹⁰⁴ The court would not classify the trustee as a hypothetical BFP because, in its words, "we will not violate Congress' intent and ignore state law by assuming that the hypothetical bona fide purchaser has possession when the debtor actually had possession at the moment of bankruptcy."¹⁰⁵ The majority ignored the fact that section 545 mandates that the statutory lien must be enforceable against a purchaser who, at the date of the petition, would buy the grapes. In other words, the test is whether the secret lien is enforceable if someone had purchased the grapes from the processor. There is nothing to indicate Congress intended that possession by the debtor (bankrupt) could prevent the trustee from avoiding a lien.¹⁰⁶ Moreover, in most cases, statutory liens will be effective if the person against whom the lien is directed has possession. Accordingly, the BFP avoidance power is neutralized whenever the debtor has possession of the goods.

The dissent noted that Congress intended the avoidance powers to be pursued vigorously.¹⁰⁷ Congress's priority rules for creditors in bankruptcy would be substantially disrupted if all of the numerous statutory liens, regardless of substance, were to be considered enforceable liens in bankruptcy. Under the Bankruptcy Code, lien creditors and perfected

102. *Loretto Winery*, 898 F.2d at 721. This is essentially the test applied in *In re Trahan*, 283 F. Supp. 620 (W.D. La.), *aff'd*, 402 F.2d 796 (5th Cir. 1968), *cert denied sub. nom.* *Bernard v. Beneficial Fin. Co.*, 394 U.S. 930 (1969) (lien only avoidable if lien is enforceable against BFP in factual circumstances of case).

103. *Loretto Winery*, 898 F.2d at 721.

104. *Id.*

105. *Id.*

106. The BFP test of § 544(a)(3) is similar, and the legislative history and cases construing this section are relevant to § 545(2). *See, e.g.*, *McCannon v. Marston*, 679 F.2d 13 (3d Cir. 1982); *In re Great Plains Western Ranch Co.*, 38 Bankr. 899 (Bankr. C.D. Cal. 1984); *In re Euro-Swiss Int'l Corp.*, 33 Bankr. 872 (Bankr. S.D.N.Y. 1983).

107. *Loretto Winery*, 898 F.2d at 725 (Breezer, J., dissenting).

secured creditors generally are considered to have secured claims.¹⁰⁸ In bankruptcy, the creditor having a secured claim has a valid property interest in specific property of the debtor, and this claim must be satisfied before the property can be made available to unsecured creditors. However, Congress placed limits on lien creditors and certain perfected secured creditors via the avoidance powers given to the trustee in sections 544, 545, 547, 548, and 551. Section 545 was designed in part to place restrictions on a state's ability to disrupt Congress's distribution of assets scheme by enacting statutory liens.¹⁰⁹

The dissent advocated that a statutory lien should be enforceable in bankruptcy only if the statute creating it requires actual or constructive notice to a BFP.¹¹⁰ The dissent also argued that notice requirements must be uniformly applied, and if states want to give certain creditors secured status, those liens must have formal notice requirements.¹¹¹ Secret liens should not be countenanced. The producer's lien statute was a secret lien because it had no perfection requirements. The dissent concluded that while the California courts had not determined whether the producer's lien would be good against a purchaser, California courts had a clear policy against upholding secret liens.¹¹² Accordingly, the courts would follow the long-established California policy against enforcement of secret liens against a purchaser. The majority recognized that California law generally protected a BFP against secret liens, but concluded that the only test is whether the lien in question is good against a BFP under the California statutory scheme.¹¹³

Apparently, the trustee in *Loretto* did not try to avoid the producer's lien under section 544(a)(1), because it was not discussed. The trustee may have determined that the lien creditor could not have priority over the secret statutory producer's lien under California law, or the trustee may have just overlooked it.

The farm products sale in *Loretto* occurred in 1985 when the federal farm products rule was not in effect. Had the sale occurred after December 23, 1986, the BFP question would have been even more complicated. Concerning the sale of farm products, the United States Code provides:

108. 11 U.S.C. § 506(a) (1988).

109. See S. REP. No. 1159, 89th Cong., 2d Sess 2-3 (1966); S. REP. No. 989, 95th Cong., 2d Sess. 86 (1978). See also Schneyer, *Statutory Liens Under the New Bankruptcy Code—Some Problems Remain*, 55 AM. BANKR. L.J. 1-7 (1981).

110. *Loretto Winery*, 898 F.2d at 725 (Breezer, J., dissenting).

111. *Id.* In *re* Martin Exploration Co., 731 F.2d 1210 (5th Cir. 1984) and other Fifth Circuit decisions appear to support the majority. In *re* Mission Marine Assoc., 633 F.2d 678 (3d Cir. 1980) supports the dissent.

112. *Loretto Winery*, 898 F.2d at 725 (Breezer, J., dissenting).

113. *Id.* at 720.

Except as provided in subsection (e) [when buyer has notice] of this section and notwithstanding any other provisions of Federal, State or local law, a buyer who in the ordinary course of business buys a farm product from a seller engaged in farming operations shall take free of a *security interest created by the seller*, even though the security interest is perfected; and the buyer knows of the existence of such interest.¹¹⁴

Arguably, section 1631 is a comprehensive scheme and preempts all state law concerning the sale of farm products. However, the language of section 1631 indicates that it does not cover involuntarily created interests in farm products; section 1631(d) applies to *security interests created by the seller*. Security interest is defined for purposes of section 1631 as “an interest in farm products that secures payment or performance of an obligation.”¹¹⁵ This definition is conceivably broad enough to cover involuntarily created interests in farm products like statutory liens or judicial liens. Yet, “security interest” is a term of art in the UCC, and it includes only consensual interests created in property to secure obligations and payments. Moreover, the focus of section 1631 and of the legislative history is on consensual security interests. Finally, even assuming that the definition of “security interest” is broad enough to cover statutory and common law liens, the question remains whether a statutory or common law lien is a security interest “created” by the seller.¹¹⁶ I think not.

If this statute were to apply, the trustee could always win in a state having a presale notification system requiring a secured party to give appropriate written notice to buyers before the sale in order to preserve the lien. The trustee was an unknown purchaser.¹¹⁷ On the other hand, if a state has opted for what section 1631 deems a “central filing system”¹¹⁸ and the secured party had filed, it would be protected. But if the secured party had not filed, it would seem that the trustee should win because a BFP would have no notice. Congress probably did not intend to make statutory liens subject to section 1631.

Currently, some states require statutory liens to be filed. At least one state has a rule specifically dealing with the enforceability of filed statutory liens against a purchaser. Since June 30, 1988, Minnesota has

114. 7 U.S.C. § 1631(d) (1990) (emphasis added).

115. *Id.* § 1631(c)(7).

116. U.C.C. §§ 9-307(1), 9-306(2) (1987). Section 1631 was promulgated in direct response to criticism of Article 9's farm product rule, which provided that the sale of farm products did not cut off a perfected security interest if the secured party had not consented to the sale.

117. 7 U.S.C. § 1631(e)(1) (1990).

118. *Id.* § 1631(e)(2).

had a priority rule dealing with the sale of farm products subject to a statutory lien.¹¹⁹ A statutory lien is defined as a consensual or nonconsensual lien on farm products, but *does not* include a landlord's lien or security interest under the UCC.¹²⁰ The priority rule¹²¹ is almost identical to the federal farm products rule in 7 U.S.C. § 1631. A buyer who buys farm products from a seller engaged in farming buys free of a statutory lien even though it is perfected and the buyer knows of its existence *unless* the lienholder has perfected its lien and the buyer has received within one year before the sale of the farm products an appropriate written notice of the lien and fails to pay in the manner specified in the notice. A lien notice is effective for five years after the date the lien notice is received by the buyer, commission merchant, or seller. Commission merchants and sellers are given the same protection as buyers. The proceeds received by the seller are subject to the statutory lien.

It seems that in Minnesota a statutory lien would prevail in bankruptcy under section 545(2) if the holder had filed in the appropriate place and attempted to give correct notice to all known buyers. It is unclear how a lien holder determines who the buyers are.¹²² It is also not clear how courts will deal with the BFP concept of section 545 when a lien was perfected but no attempt was made by the holder to give written notice to any buyers. Arguably, it should make no difference. Section 545 provides that the statutory lien can be avoided when the lien "is not perfected *or* enforceable . . . against a bona fide purchaser."¹²³ If the BFP test is applied, it is of course impossible for a hypothetical BFP such as the trustee to have received written notice. Literal application of the Minnesota rule would make it impossible for a statutory lien to survive an attack via section 545(2). The lien would not be valid against a purchaser under state law because no notice was received.

The *Loretto* majority's concern about the producer being protected is justifiable. Without a statutory lien, the unpaid producer is an unsecured creditor if he or she has sold products on credit,¹²⁴ or for a bad check from an insolvent buyer without a demand in writing to return the farm products within ten days after the processor (buyer) received the prod-

119. MINN. STAT. ANN. § 223A.02 (West Supp. 1990).

120. *Id.* § 223A.02(4).

121. *Id.* § 223A.03.

122. *Cf.* 7 U.S.C. § 1631(h) (1990).

123. 11 U.S.C. § 545 (1988).

124. Sometimes producers have no choice but to sell products on credit. This is particularly true in California. Obviously, producers can avoid any problems with the creditworthiness of buyers by being paid in cash or a certified or cashier's check or obtaining a letter of credit. As a practical matter these options are not available to producers.

ucts.¹²⁵ Such a producer will lose in bankruptcy and has no practical way to protect itself. Normally the processor will be financed by a creditor who has perfected a security interest in all of the processor's inventory (present and future). Technically, the producer-sellers could have protected themselves under Article 9,¹²⁶ but this protection is unavailable as a practical matter. The requirements of section 9-312(3), which gives to a holder of a purchase money security interest in inventory a super-priority, must be satisfied. Assuming that a producer's interest is a purchase money interest,¹²⁷ a producer must satisfy the attachment and perfection requirements.

To have attachment, the secured party (producer-seller) would have to obtain a signed security agreement from the processor-buyer granting it a security interest in inventory.¹²⁸ It is difficult to imagine a processor signing a security agreement each time it buys from a producer. Moreover, to defeat the processor's financier, the producer would have to file a financing statement signed by the debtor (processor). In addition, because inventory is involved, the financing statement would have to be filed

125. See 11 U.S.C. § 546(c). Among other things, this section provides that a seller "may not reclaim any such goods unless such seller demands in writing reclamation of such goods before ten days after receipt of such goods by the debtor . . ." 11 U.S.C. § 546(c)(1). Section 546(d) provides that the same 10-day rule applies to farmers or fishermen who sold their respective products to a grain storage facility or fish processing facility. For a general discussion of § 546, see Wallach, *The Unpaid Seller's Right to Reclaim Goods: The Impact of the Uniform Commercial Code and the Bankruptcy Acts of 1898 and 1978*, 34 ARK. L. REV. 252 (1980).

126. See, e.g., *In re Samuels*, 526 F.2d 1238 (5th Cir. 1976), cert. denied, 429 U.S. 834 (1976) (rancher who sold cattle and received a bad check lost in bankruptcy because he was an unsecured creditor and had no remedy against the financier of the packer that had purchased the cattle with the bad check). For other cases following the *Samuels* approach, see *Action Indus., Inc. v. Dixie Enters., Inc.*, 22 Bankr. 855 (Bankr. S.D. Ohio 1982); *In re McLouth Steel Corp.*, 22 Bankr. 722 (Bankr. E.D. Mich. 1982); *In re Western Farmers Ass'n*, 6 Bankr. 432 (Bankr. W.D. Wash. 1980).

The problems raised by *Samuels* and by the bankruptcy of American Beef Packers prompted Congress, in 1976, to amend the Packers and Stockyards Act by adding 7 U.S.C. § 196(b), which requires packers to hold in trust all proceeds from the sale of livestock. From the perspective of the livestock industry, *Samuels* no longer controls in most cases. However, note that § 196(b) only applies to packers buying more than \$500,000 worth of livestock. It does not apply to grain, dairy products, and poultry. In 1987, Congress amended the Packers and Stockyard Act to cover poultry. 7 U.S.C.A. § 197 (West Supp. 1990). Recently, dairy farmers sought federal legislation to set up a prompt payment system and a trust fund to protect them against future bankruptcies of milk processors. Congress recently amended the Perishable Agricultural Commodities Act, 7 U.S.C.A. § 499e (1984), by adding a trust fund. 7 U.S.C.A. § 499e(c) (West Supp. 1984). Compare it with § 196(b) of the Packers and Stockyards Act. One difference is that the perishable commodities trust fund has a 30-day rather than a 15-day notice requirement.

127. See *supra* note 126 and accompanying text.

128. See U.C.C. §§ 9-203, 9-303.

before the farm products were delivered to the processor, and the producer must give written notice to perfected secured parties who filed financing statements covering the processor's inventory.¹²⁹ In short, the suggestion that the producer can protect itself under Article 9 is meaningless.

III. THE FUTURE

A. *The ABA Lien Committee: Proposed Changes*

The severe economic problems experienced by the agricultural sector in the 1970s and 1980s raised many questions about agricultural credit. Some questions involved which rules govern agricultural credit transactions. The numerous state agricultural liens not subject to Article 9 were difficult to deal with in state conflicts as well as in bankruptcy. It also became apparent that the UCC's uniformity concept was being eroded. These questions prompted the ABA to form a subcommittee of the Agricultural and Agribusiness Finance, Commercial Financial Services Committee, Section of Business Law, American Bar Association ("Lien Committee"), to study agricultural liens. The Lien Committee was to survey the lien laws of all fifty states and consider whether agricultural liens could be coordinated with Article 9, and if so, how.

The Committee surveyed state lien laws to determine: 1) the type of lien, 2) the source of the lien, 3) the party protected, 4) the property to which the lien attaches, 5) whether the lien is possessory, 6) whether it must be filed, 7) when and how it attached, and 8) whether any priority provision exists. The project is completed¹³⁰ and the number of liens is overwhelming. Information about these liens has been condensed into Rapid Finder Charts containing the answers to the above-listed questions. A treatise-style analysis of each state's agricultural liens also exists.¹³¹ The Lien Committee also developed a number of ways that the legal system should deal with agricultural liens and conflicting security interests:

1. No change;
2. Nonpossessory liens must be filed in the UCC records in the same manner as a security interest in the good would be, but no priority rule established;¹³²

129. *Id.* § 9-312(3)(a), (b).

130. The lien survey portion of the project was completed in large part because of the work of Martha Noble, Staff Attorney and Assistant Research Professor, National Center for Agriculture Law Research & Information, School of Law, University of Arkansas, Fayetteville.

131. The Committee manuscript, containing both the Rapid Finder Charts and the textual discussion, is about 800 pages.

132. This Committee option is called the minimalist option. It would amend § 9-

3. Nonpossessory liens must be filed in the UCC records in the same manner as a security interest in the good and if filed first will have priority over a subsequently perfected security interest in the *good*;¹³³
4. A super-priority is given in *crops* to a secured creditor who supplies within one year of when crops become growing crops new value for goods or services used in the production of the crop;¹³⁴

310 by making its present language subsection (1) and adding a subsection (2), which reads as follows:

(2) When a person in the ordinary course of business furnishes services, labor, land or materials to a person engaged in farming operations with respect to goods subject to a security interest, a lien upon goods not in the possession of such person given by statute or rule of law for such services, labor, land, or materials may gain priority over a perfected security interest or protection against buyers of the goods only if:

- (a) the lien is enforceable against the debtor: and,
- (b) such person files a notice of the lien identifying such person as a lien claimant in the same place and the same manner, except only the lien claimant need sign the notice, as such person would file in order to perfect a security interest in such goods.

133. This Committee option is referred to as the maximalist option. It provides:

(2) When a person in the ordinary course of business furnishes service, labor, land, or materials to a person engaged in farming operations, a lien upon goods not in the possession of such person given by statute or rule of law for such services, labor, land, or materials takes priority over a conflicting security interest or other liens if, before the security interest is perfected:

- (a) the lien becomes enforceable against the debtor; and,
- (b) such person files a financing statement identifying such person as a secured party in the same place and manner as such person would file in order to perfect a security interest in such goods.

Changes would have to be made in § 9-402 as well as in § 9-104 to clarify that landlord liens would now be covered by Article 9.

Subsection 9-310(2) addresses nonpossessory agricultural judicial or statutory liens for services, labor, land, or materials that subsection 9-310(1) does not. Subsection 1 addresses only possessory liens.

134. Under this Committee option, § 9-312(2) would be amended by substituting the following:

(2)(a) A crop production security interest is a security interest in crops for a new value given while the crops are being produced, or not more than one year before the crops become growing crops by planting or otherwise, to enable the debtor to produce the collateral by acquiring goods or services to be used in producing the crop. Producing crops includes any activity that causally relates to the growing of crops or marketing of crops.

(b) Except as provided in subsection (c), a crop production security interest takes priority over an earlier perfected security interest, and also in the proceeds of the collateral, even though the person giving new value had knowledge of the

5. All creditors supplying production money would share pro-rata in the *farm products*,¹³⁵
-

earlier security interest.

(c) The priority provided for in subsection (b) is subject to these limitations:

(i) The crop production security interest has priority only to the extent that before the debtor receives value, or within ten days thereafter, a financing statement covering the collateral is filed.

(ii) An earlier perfected security interest that secures a purchase money obligation, or rent, for the land on which the crops were grown has priority to the extent of an amount of the obligation or rent that is determined by law to be proportionately and fairly attributable to the six-month period before the crops became growing crops by planting or otherwise.

(iii) Subsection (5) governs priority between conflicting crop production security interests.

(d) Creating or perfecting a crop production security interest shall not operate under any circumstances as a default on, an accelerating event under, or otherwise as a breach of, any note or other instrument or agreement of any kind or nature to pay debt; any loan or credit agreement; or any security arrangement of any kind or nature whether the collateral is real or personal property.

135. Under this Committee option, § 9-312(2) would be changed to read:

(2)(a) A perfected security interest in farm products and proceeds thereof for new value given to enable the debtor for the current production season to produce or to market the farm products by acquiring goods, services, or labor or by acquiring an operating loan for maintenance, insurance, general farm expenses, or reasonable household expenses, and given not more than six months before the farm products become growing farm products by planting or otherwise, takes priority over an earlier perfected security interest in the farm products, and also in the proceeds of the farm products, even though the person giving new value had knowledge of the earlier security interest in farm products. For the purpose of a debtor growing farm products with different production seasons, an indeterminate production season, or a continuous production season, all of the farm products subject to a farm products production security interest shall be deemed to become growing farm products on April 1.

(b) The priority provided for in subsection (a) is subject to these limitations:

(i) The farm products production security interest in farm products has priority only to the extent that before the debtor receives value, or within ten days thereafter, a financing statement covering the collateral is filed.

(ii) An earlier perfected security interest that secures a purchase money obligation, or rent, for the land on which the farm products were grown, a purchase money obligation on livestock, or an obligation for an operating loan for maintenance, insurance, general farm expenses, and for reasonable household expenses has priority over a farm products production security interest to the extent of an amount of the obligation or rent that is determined by law to be proportionately and fairly attributable to a one-year period beginning six months before the farm products became growing farm products by planting or otherwise.

(iii) Purchase money security interests in other goods not used to produce farm products, in equipment (whether or not used to produce the farm products), and inventory cannot be farm products production security in-

6. All perfected secured creditors who have contributed to production even if it is not directly linked to the current year product shall share pro rata in *farm products*,¹³⁶

terests.

(iv) When more than one farm products production security interest attaches to a farm product, they rank equally according to the ratio that the new value incurred with respect to each farm products production security interest bears to the total new value attributable to all of the farm products production security interests.

(v) A purchase money security interest in unused goods that are farm products, but are not crops or livestock or products of crops or livestock in their unmanufactured state, has priority over a conflicting security interest in the same collateral, but not its proceeds or products, if before the debtor receives value, or within ten days thereafter, a financing statement covering the collateral is filed. Upon consumption, a purchase money security interest in such farm products shall be a farm products production security interest if the security agreement and financing statement so provide.

(c) Creating or perfecting a farm products production security interest or security interest under subsection (2)(b)(iv) of this section shall not operate under any circumstances as a default on, an accelerating event under, or otherwise as a breach of, any note or other instrument or agreement of any kind or nature to pay debt; any loan or credit agreement; or any security arrangement of any kind or nature whether the collateral is real or personal property.

Section 9-310 is amended by making its present language subsection (1) and adding a subsection (2), which reads as follows:

(2) If the goods subject to such a lien are farm products, such lien takes priority over a perfected security interest in farm products only if it is a farm products production security interest in accordance with § 9-312(2) and only if the secured party complies with the requirements of § 9-312(2).

136. This Committee option would make agricultural liens subject to Article 9, but would develop a new relationship. This is called the attribution option. Section 9-312(2) would be changed to read:

(2)(a) A perfected security interest in farm products or their proceeds which represents new value given to enable the debtor for the current production season to produce or to market the farm products by acquiring goods, services, or labor or by acquiring an operating loan for maintenance, insurance, general farm expenses, or reasonable household expenses, and given not more than six months before the farm products become growing farm products by planting or otherwise, takes priority over an earlier perfected security interest in the farm products, and also in the proceeds of the farm products, even though the person giving new value had knowledge of the earlier security interest in farm products. For the purpose of this subsection, where a debtor has farm products with different production seasons, an indeterminate production season, or a continuous production season, all of the farm products subject to a farm products production security interest shall be deemed to become growing farm products on April 1.

(b) The priority provided for in subsection (a) is subject to these limitations:

(i) The farm products production security interest in farm products has priority only to the extent that before the debtor receives value, or within

7. *Priority* as to conflicts between security interests in crops and/or conflicts between statutory liens determined by nonUCC rules;¹³⁷ and

ten days thereafter, a financing statement covering the collateral is filed.

(ii) An earlier perfected security interest that secures a purchase money obligation, or rent, for the land on which the farm products were grown, a purchase money obligation on livestock, or an obligation for an operating loan for maintenance, insurance, general farm expenses, and for the reasonable household expenses is a farm products production security interest to the extent of an amount of the obligation or rent that is determined by law to be proportionately and fairly attributable to a one-year period beginning six months before the farm products became growing farm products by planting or otherwise.

(iii) Purchase money security interests in other goods not used to produce farm products, in equipment (whether or not used to produce the farm products), and inventory cannot be farm products production security interests.

(iv) When more than one farm products production security interest attaches to a farm product, they rank equally according to the ratio that the new value incurred with respect to each farm products production security interest bears to the total new value attributable to all of the farm products production security interests.

(v) A purchase money security interest in unused goods that are farm products, but are not crops or livestock or products of crops or livestock in their unmanufactured state, has priority over a conflicting security interest in the same collateral, but not its proceeds or products, if before the debtor receives value, or within ten days thereafter, a financing statement covering the collateral is filed. Upon consumption, a purchase money security interest in such farm products shall be a farm products production security interest if the security agreement and financing statement so provide.

(c) Unless otherwise agreed, a security interest in farm products continues in products of the collateral and the security interest in products is a continuously perfected security interest if the interest in the original collateral was perfected.

(d) Creating or perfecting a farm products production security interest or security interest under subsection (2)(b)(iv) of this section shall not operate under any circumstances as a default on, an accelerating event under, or otherwise as a breach of, any note or other instrument or agreement of any kind or nature to pay debt; any loan or credit agreement; or any security arrangement of any kind or nature whether the collateral is real or personal property.

Section 9-310 is amended by making its present language subsection (1) and adding a subsection (2) which reads as follows:

(2) If the goods subject to such a lien are farm products, such lien takes priority over a perfected security interest in farm products only if it is a farm products production security interest in accordance with § 9-312(2) and only if the secured party complies with the requirements of § 9-312(2).

137. The state of Washington eliminated § 9-312(2) and provided instead that priority conflicts between security interests in crops are governed by WASH. REV. CODE §§ 60.11.010 to .140 (1990). This chapter has 14 sections relating to crop liens. Section 60.11.050 deals

8. Priority as to conflicts in farm products between agricultural lien holders and secured creditors is determined under section 9-312(5), except lien holders providing goods and supplies that are consumed during production will be given a super-priority if they give appropriate written notice to prior filed secured creditors prior to providing the goods or supplies.¹³⁸

with priorities of liens and security interests in crops. With certain exceptions, priority is based on when a lien or security interest is filed. Exceptions are made for landlord liens and service liens, and a security interest in crops is subordinate to a later-filed purchase money security interest in growing crops.

138. This proposal is contained in a June 5, 1991, memorandum from the Lien Committee to the ALI Study Committee. The substance of the proposal is set out below.

Under this proposal, agricultural liens (ag liens) would be covered by Article 9 but not required to satisfy the attachment requirements. Even though ag liens would be defined in Article 9, laws other than Article 9 would control when and how an ag lien is created. An ag lien would be defined in § 9-105 as:

A nonpossessory charge or interest in farm products to secure payment of a debt or performance of an obligation given by statute or rule of law to a person which in the ordinary course of business furnishes supplies or goods to a person engaged in a farming operation, but the term does not include a security interest. All ag liens would be required to be perfected by filing to have priority.

Section 9-310 would be amended by adding subsection (2), which would provide: An ag lien as defined in 9-105 is perfected and may take priority as provided for in 9-312 over a conflicting security interest, other ag liens or other liens if:

- (a) The ag lien becomes enforceable against the debtor; and
- (b) The holder of the ag lien files a financing statement identifying such holder as a secured party in the same place and manner as such holder would file in order to perfect a security interest in such goods.

Section 9-312(5)(a) & (b) would be amended to make them applicable to ag liens.

Section 9-312 would also be amended by the addition of subsection (8) which would provide:

(8) A perfected ag lien in farm products has priority over a conflicting security interest and other ag liens in the same collateral if:

- (a) the agricultural lienholder notifies in writing the holder of any conflicting security interest if the holder of a conflicting security interest had filed a financing statement covering the same types of collateral before the date of the filing made by the agricultural lienholder, and
- (b) the notification states that the agricultural lienholder giving the notice has or expects to provide goods or supplies describing such goods or supplies by item or type and the monetary amount and the notice is sent at least ten days prior to the providing of such goods or supplies, and
- (c) the holder of the conflicting security interest receives the notification within six months before the debtor receives possession of the goods and supplies, and
- (d) when more than one agricultural lienholder complies with this subsection (8), the ag liens share priority according to the ratio of the amount owed by the debtor to each of the agricultural lienholders for the ag lien.

The Lien Committee divided statutory agricultural liens into two categories. One involves sellers who sell goods on unsecured credit; examples include suppliers of seed, fertilizer, chemicals, and feed. If the buyer does not pay, these liens give the seller, as a matter of law, an interest in the products produced from the supplied goods. The Committee characterized these essentially as purchase money liens for the production of specific goods.¹³⁹ The other category includes liens for persons providing land where crops or animals are produced, or for persons providing labor or services that preserve or enhance the value of crops or animals. Liens in this group include landlord, harvester, veterinary, and feeder liens. It must be noted that the Lien Committee did not attempt to address producer's liens, and some of the proposals address all farm products and some deal with only crops. A complete discussion of these proposals will appear in an upcoming issue of the *Oklahoma Law Review*.¹⁴⁰ Some of the proposals will be briefly covered here.

B. Article 9 Should Cover All Financing Liens

Currently, an American Law Institute committee, at the urging of the Permanent Editorial Board of the UCC, is studying whether Article 9 should be revised. One question this committee must confront is how to deal with agricultural credit questions that in many ways present unique issues. For example, Congress changed the farm products rule of section 9-307(1),¹⁴¹ and enacted a special bankruptcy chapter¹⁴² to deal exclusively with farmers. Congress also established trust funds to give unpaid sellers of livestock, poultry, and perishable commodities priority over perfected

139. The purchase money concept is derived from U.C.C. §§ 9-107 and 9-312(2). The property to which the lien attaches is not the product supplied by the seller. Rather, the input supplies facilitate the production of the good to which the lien attaches. Thus, the interest is not a pure purchase money interest. Section 9-312(2) uses the concept of "new value given to enable the debtor to produce crops . . ." Note that § 9-312(2) only applies to crops. It does not apply to livestock, poultry, or other animals. Section 9-107 gives a security interest to the seller when the security interest "is (a) taken or retained by the seller of the collateral to secure all or part of its price; or (b) taken by a person who making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used." U.C.C. § 9-107.

It must be noted that producers who sell goods on credit are, in effect, financing the processor and could have been included but were not, apparently because the focus is on financing producers, not how processors and buyers are financed.

140. Turner, Barnes, Kershen, Noble & Schumm, *Agricultural Liens and the UCC: A Report of Present Status and Proposals for Change*, forthcoming in *OKLA. L. REV.* (1991).

141. 7 U.S.C. § 1631 (1988).

142. 11 U.S.C.A. §§ 1201-08, 1221-31 (West Supp. 1990).

secured parties of the buyers.¹⁴³ The United States Department of Agriculture, maintaining that Congress had given it the power to preempt state laws affecting government farm program payments, promulgated regulations providing that government payments made in the form of commodity certificates were not subject to state Article 9 rules, as well as Article 3 of the UCC.¹⁴⁴ State lien laws that are not covered by Article 9 but which grant lienholders specific rights in personal property normally covered by Article 9 have caused the law resolving priority battles concerning agricultural credit to be less than uniform.

When considering whether the basic premises of Article 9 should be changed, the genius of the drafters must be remembered. This genius is demonstrated by the fact that they condensed a series of complex, difficult to understand rules into fifty-five succinct sections containing relatively simple, understandable rules providing a clear and predictable framework for resolving conflicts.

Although it is beyond the scope of this Article to deal with all agricultural credit issues presenting problems for Article 9 application, it is appropriate to consider agricultural liens. As discussed earlier,¹⁴⁵ Article 9 applies to a limited number of nonconsensual possessory liens, but only as to priority. The statute or the common law creating the lien controls creation, perfection, and enforcement. Article 9 does not apply to the large number of nonpossessory liens, including landlord liens, that give an unpaid creditor a specific interest in personal property.

There is a need to have uniform, simple, and understandable rules dealing with all liens (consensual and nonconsensual) affecting farm products that are codified in one statutory scheme rather than being spread throughout a state code system or developed on a case-by-case basis. One approach is to make all liens subject to Article 9. This would make attachment, perfection, priority, and default rules applicable. Another possibility is to allow an interest in personal property to be created by operation of law but require perfection and make the priority and enforcement rules applicable. Article 9 could be changed to make only the perfection rules and priority rules applicable, or to make only the perfection rules applicable but modify them so that only the lienholder would be required to sign the financing statement.

143. 7 U.S.C. § 196 (1988) (livestock). See generally *In re Gotham Provision Co.*, 669 F.2d 1000 (5th Cir. 1982); 7 U.S.C. § 197 (poultry); *id.* § 449(c) (perishable commodities).

144. 7 C.F.R. pt. 1470.4(b)(2) (1990). Courts are split on the validity of the regulations. See *In re George*, 119 Bankr. 800 (Bankr. D. Kan. 1990); *In re Rutz*, 104 Bankr. 128 (Bankr. S.D. Iowa 1989).

145. See *supra* text accompanying notes 18-40.

I prefer to make all creditors who want to be able to claim an interest in specific farm products subject to Article 9. Article 9 provides a complete set of understandable rules. All creditors can determine what their status would be relative to other creditors and to the trustee in bankruptcy if the debtor were to default. The default rules also are relatively straight-forward, and courts and attorneys are far more familiar with them than with the enforcement procedure of lien laws. There would be no need to develop a new set of terms and rules, which is not the case if a uniform agricultural lien law were created. Any creditor who supplies goods, labor, land, or services to a person engaged in a farming operation and who obtains an interest in farm products would be subject to Article 9. Conflicts concerning a security interest in farm products¹⁴⁶ or goods¹⁴⁷ would be determined under Article 9.

This is a significant departure from the current version of Article 9 in a variety of ways. First, all state liens, possessory and nonpossessory, must be repealed. Anyone wanting to obtain an enforceable security interest under Article 9 to secure a promise to pay or perform would have to comply with the attachment requirements.¹⁴⁸ Permitting a landowner to obtain a security interest in growing crops is not a departure from the current UCC,¹⁴⁹ but requiring it is new. It makes sense to require this because the collateral is personal property, and the landlord liens are avoidable in bankruptcy.¹⁵⁰ Presently, the *priority rule* of section 9-310, giving certain possessory liens priority over prior perfected security interests, would not have to be changed. For example, a section could be drafted to provide that the *secured* creditor, who in the ordinary

146. U.C.C. § 9-109(3) provides:

“[F]arm products” if they are crops or livestock or supplies used or produced in farming operations or if they are products of crops or livestock in their unmanufactured states (such as ginned cotton, wool-clip, maple syrup, milk and eggs), and if they are in the possession of a debtor engaged in raising, fattening, grazing or other farming operations. If goods are farm products they are neither equipment nor inventory.

This clearly includes such things as growing crops, harvested crops, animals, or milk.

147. See U.C.C. §§ 9-105(h), 9-109, 9-203(1), 9-402(1).

148. U.C.C. § 9-203. Of course, the creditor could file a civil action based on an unpaid debt. If a judgment is obtained, then a writ of execution could be obtained and executed, providing nonexempt property can be found. This is typically a more costly and time consuming process. It is also difficult to find unencumbered, nonexempt property. Also, if a lien is obtained within 90 days of filing bankruptcy, it can probably be avoided under 11 U.S.C. § 547(b) (1988).

149. Landlord liens are not covered because they are nonconsensual; however, nothing prevents the landlord from obtaining a perfected security interest. In fact, the landlord should obtain a perfected security interest because landlord liens are not enforceable in bankruptcy. 11 U.S.C. § 545(3). See also *supra* note 63 and accompanying text.

150. 11 U.S.C. § 545(3).

course of business furnishes labor, services, or materials that enhance or preserve the value of goods subject to a prior perfected security interest, will have priority over a prior perfected secured creditor. The creditor supplying the services would have to show that its security interest attached. This means, among other things, that there must be an agreement creating a security interest.¹⁵¹ If the creditor has possession of the goods, the agreement need not be in writing.¹⁵² Perfection can be established by possession.¹⁵³ If the creditor supplying the services does not have possession, it would have to obtain a written security agreement and file a financing statement in the appropriate place.

A provision would also have to be created for a landowner who must obtain a security interest in crops produced on his or her land to secure the promise to pay. This new section should make clear that a landowner who obtains a perfected security interest will have priority over a prior perfected security interest in the crops produced on the rented land. It seems appropriate to require the creditor who is being given a super-priority to file a financing statement within ten days before the service is supplied. Thus, a landlord would have to file within ten days of the debtor obtaining possession of the land.

This super-priority is consistent with the current treatment of purchase money security interests under sections 9-312(4)¹⁵⁴ and 9-312(3). New value is being added. The impact of these rules is illustrated by the following example. Assume a creditor had a perfected security interest in growing crops and the debtor hired a thresher to harvest the crops and then did not pay either. Under the proposed rules, if the thresher obtained a security interest and filed in a timely fashion, it would be prior to the creditor who perfected first. This seems equitable because the crops have more value harvested than in the field, and if the prior creditor had foreclosed while the crops were still in the ground it would have had to hire a thresher.

No doubt this proposed approach changes the rules for a thresher because many states have statutory thresher liens that give the thresher an enforceable lien by operation of law. Under the new rules, a thresher would have to obtain a written security agreement. Most creditors who are given liens by operation of law will object to obtaining an agreement creating a security interest. But why should these creditors be treated differently? Farming is a business, and those dealing with farmers should

151. U.C.C. §§ 9-203(1)(a), 1-201(3).

152. *Id.* §§ 9-203(1), 1-201(3), 1-201(37). Clearly, it would be better practice to require a written security agreement.

153. *Id.* §§ 9-302(1)(a), 9-305.

154. *See supra* note 29.

be held to the same standards as other creditors. The handshake and notes on napkins are, or should be, things of the past.

Moreover, an agreement would make it clear what goods and what amount of money are involved. A thresher also would have to file a financing statement, which is presently required in many states. The thresher must file, unless he or she takes possession of the harvested crop, if he or she wants to be protected in bankruptcy.¹⁵⁵ Once a security interest is created, 7 U.S.C. § 1631 applies, but normally this will not be relevant. If it is, a thresher will probably be more protected than under current law. Many argue that it would place an expensive burden on these types of creditors. However, it seems that the cost would not be that great. The benefits to be gained are many. All creditors are subject to the same rules; everyone knows who has higher priority; a single scheme covers all creditors; public notice is given; and perfected secured creditors' interests cannot be avoided in bankruptcy. Of course, the thresher does not have to become a secured creditor. But the thresher should not complain when the farmer does not pay and files a bankruptcy petition.

This approach does not give a super-priority to suppliers of input needs such as feed, seed, fertilizer, chemicals, and fuel. These creditors are not enhancing or preserving the value of an *existing* good, but rather are financing the farmer's operation. They are selling, on credit, goods that help produce a product but are consumed, and do not remain a distinct, identifiable unit as is the case for creditors given special priorities under section 9-312(4). These inputs are not analogous to those considered inventory and, thus, subject to the super-priority rule of 9-312(3).¹⁵⁶

Moreover, there is no justifiable reason to treat these types of financiers any differently than traditional banks or farm credit banks. Both are supplying credit for the same purpose. If the law were changed to give priority to input suppliers who perfect a security interest, it would seem that farmers would be able to get less credit. The traditional financier, such as a bank who loans a certain amount for input needs, would eliminate that portion of its funding. Otherwise, banks would be

155. See 11 U.S.C. § 545(2) (1988).

156. See U.C.C. §§ 9-109(4), 9-312(3), 9-315. Cf. *First Nat'l Bank of Brush v. Bostron*, 39 Colo. App. 107, 564 P.2d 964, 966 (1977). The court was confronted with a perfected secured party's claim that its security interest in grain survived the grain being consumed by cattle in which the secured party had no interest. The secured party lost. The court, dealing with § 9-315, stated, "Cattle consume food as motor vehicles do gasoline. Once eaten the feed not only loses its identity, but in essence it ceases to exist and thus does not become part of the mass in the sense that the code uses the phrase." *Id.* See also *Farmers Cooperative Elevator Co. v. Union State Bank*, 409 N.W.2d 178 (Iowa 1987). *But see* *Mid-States Sales Co. v. Mountain Empire Dairymen's Ass'n, Inc.*, 741 P.2d 342 (Colo. App. 1987).

loaning money knowing that their farm product collateral may be shared with unknown other creditors having unknown amounts of credit that will have priority over the bank. The key here is that there is no way to know who might loan what amount after the general financier has made its evaluation and loan decisions. Moreover, input suppliers relying on state liens are apparently subject to a different rule if the farmer sells the crops to a purchaser and does not pay a supplier. The federal farm products rule does not apply to statutory liens, but does clearly apply to perfected security interests in crops.¹⁵⁷

Currently, section 9-312(2) provides a very limited window of opportunity to second-in-line creditors. A perfected security interest in crops for new value is given a super-priority if 1) the purpose of the value is to enable the debtor to produce the crops during the current production season, 2) the value is given no more than three months before the crops become the growing crops, *and* 3) the obligation owing to the earlier secured party must have been *due* more than six months before the crops were planted. The principal issue concerns the meaning of the requirement that the previous obligation be "due more than six months." This requirement generally makes this section of limited value.¹⁵⁸ Some states have enacted statutory supplier's liens in an attempt to give the so-called input suppliers a super-priority. However, most of these statutes really do not change the law and only present a trap for the unwary.¹⁵⁹ Some farmers have complained bitterly that section 9-312(2) and broad after-acquired property clauses, coupled with the first to file rule, prevented them from receiving new financing. Unless a subordination is obtained or section 9-312(2) is applicable,¹⁶⁰ a perfected secured creditor having a proper security agreement covering after-acquired property will have a prior claim to any new crops produced, even if the creditor does not provide any new financing.

Interestingly, the prior secured creditor's after-acquired property clause is ineffective in bankruptcy if a debtor plants the crops within ninety days of bankruptcy.¹⁶¹ However, it should be noted that a secured party's interest stems from the fact that a debtor still owed money. It is also interesting that farmers cannot be forced into bankruptcy involuntarily.¹⁶²

157. See *supra* text accompanying note 114.

158. See *supra* note 128.

159. See, e.g., IOWA CODE ANN. § 570A (West Supp. 1990); MINN. STAT. ANN. § 514.950 to .959 (West 1990), and § 514.945 (West Supp. 1991) (Agricultural Producer's Lien).

160. See *supra* text accompanying note 8.

161. 11 U.S.C. §§ 547(b)(4)(A), (e)(3)(f) (1988). See also § 552, which provides that an after-acquired property clause is ineffective relative to property obtained after the bankruptcy petition is filed. Proceeds are treated differently under § 552.

162. 11 U.S.C. § 303(a) (1988).

Unfortunately, not all farmers can or should be saved. Moreover, a complicated scheme should not be created just to save marginal farmers who have no realistic chance of saving their operation. However, one way to deal with these allegations that after-acquired clauses are too sinister is to go back to the approach of the 1962 Code, which provided that attachment could not occur unless the crops became growing crops within *one* year of execution of the security agreement.¹⁶³ This would be far superior to developing a complex statute to deal with the problem¹⁶⁴ or retaining the hodge podge of lien laws that exist today, or both. In any event, these input suppliers should be subject to the first to file rule.¹⁶⁵

It appears inappropriate to try to protect unpaid producers under Article 9. As discussed earlier, unpaid producers currently are unable to protect themselves under Article 9.¹⁶⁶ The problem cannot be solved just by changing a priority rule. The only way to solve it under Article 9 would be to develop a rule similar to section 9-310, giving priority to any producer that had an enforceable lien under state or federal law. It is not appropriate to create a statutory lien in Article 9 just for producers. However, they need protecting because individually they have no way to protect themselves when the purchasers of goods will buy only on credit or with an ordinary check.¹⁶⁷ Although inconsistent with the general purpose of Article 9,¹⁶⁸ a priority lien could be given to the producers in Article 9. This lien would need to be perfected to be valid in bankruptcy.¹⁶⁹

Producers clearly need some way to protect themselves. A number of possibilities exist. At the federal level, Congress already has provided protection for the unpaid sellers of livestock,¹⁷⁰ poultry,¹⁷¹ and perishable commodities¹⁷² by establishing a trust fund. Interestingly, grain and dairy product sellers are not covered. Congress could decide to mandate the same type of protection for grain and dairy sellers. Congress also could

163. See U.C.C. § 9-204(4) (1962).

164. See Nickles, *Setting Farmers Free: Righting the Unintended Anomaly of UCC Section 9-312(2)*, 71 MINN. L. REV. 1135 (1987).

165. U.C.C. § 9-312(5)(a).

166. See *supra* text accompanying notes 124-28.

167. Most purchasers of farm products will not issue a cashiers check or certified check. Some states do require buyers, who buy on a delayed payment or delayed pricing contracts, upon the demand of the seller, to obtain an irrevocable standby letter of credit. KAN. STAT. ANN. § 34-2111 (1986).

168. See *supra* text accompanying notes 18-40.

169. See 11 U.S.C. § 545(2) (1988).

170. 7 U.S.C. § 196 (1988).

171. *Id.* § 197.

172. *Id.* § 499(c).

amend the Bankruptcy Code to provide *real* protections for unpaid sellers, unlike what it did for unpaid grain sellers in the 1984 amendments to the Bankruptcy Code.¹⁷³

State protection is another option. One possible prototype is the California producer's lien which automatically arises upon delivery of the farm products. If the analysis of *Lorreto Winery*¹⁷⁴ is accepted by other courts, these secret liens will not be avoidable in bankruptcy. Clearly, it would be better to require producers to perfect their interest in some manner. This would provide notice, and perfected statutory liens are not subject to avoidance under section 545(2).¹⁷⁵ Some states have created so-called indemnity funds designed to reimburse producers of grain for losses sustained by buyer failure.¹⁷⁶ Private insurance was tried in Iowa and Minnesota but was dropped because of lack of interest, even though it was quite reasonable with a high deductible. Arguably, if farmers are not willing to purchase insurance, legislation should not be created to protect them. However, the stakes are high and it does not seem that producers should have to bear all of the risks or the costs connected with the risk of buyers and processors from failing.

CONCLUSION: A FEDERAL ARTICLE 9

Any serious evaluation of whether and how Article 9 should be changed should include consideration of whether Article 9 should be federalized. Certainly, a federal Article 9 would produce uniformity. A number of factors support a federal scheme. Today, many credit transactions involve multiple states and Article 9 is not uniformly followed. With the Bush administration currently pushing interstate banking, a federal UCC has greater appeal. Also, financial institution regulators are playing an increasingly bigger role in determining whether loans are classified as secured or unsecured for auditing purposes. The check collection process that was formerly governed by Article 4 of the UCC has been

173. See 11 U.S.C. §§ 507(a)(5), 546(d), 557 (1988).

174. See *supra* text accompanying notes 91-114.

175. See *supra* text accompanying notes 91-122.

176. *E.g.*, ILL. ANN. STAT. ch. 114, para. 701-12 (Smith Hurd 1988); IOWA CODE ANN. § 542 (West 1989); OKLA. STAT. ANN. tit. 9, § 41 (West 1989). These funds work basically in the same manner. The plan is funded by a monetary assessment levied upon each bushel of grain delivered to a grain dealer. When the fund reaches a certain level, no more assessments are made until the fund falls below the stated amount. The theory is that the fund should be adequate to fully compensate any farmer for losses sustained as a result of the failure of the grain dealer. The difficulty is that some of the funds only cover stored grain, not unpaid sellers who sell grain on a "price later" or deferred payment contract. Most cover sellers who receive bad checks. Many do not cover transactions involving federally licensed elevators.

almost totally preempted by The Expedited Funds Availability Act promulgated by Congress in 1988.¹⁷⁷ This Act empowered the Federal Reserve Board to promulgate regulations governing check collection. Thus, a federal agency controls this area, and the system seems to be working surprisingly well.¹⁷⁸ There are obvious problems with giving an agency this kind of power, but problems currently exist with the application of Article 9. These problems include: 1) a lack of uniformity regarding both provisions and interpretation; 2) the inability to change or fine-tune statutes quickly, and changes are made by people who have little or no understanding of Article 9 or the process; and 3) the lack of quick and consistent answers from the court process. Also, the regulations dealing with check collection are far superior to what many state legislatures have done and continue to do under Article 9. It must be remembered that Congress created a mess in 7 U.S.C. § 1631 (farm products rule). However, the difficulties of section 1631 are in large part explained by the fact that it was developed by an agricultural committee that apparently had no real understanding of Article 9. Federalizing Article 9 could cause more docket problems for the federal courts, but if a federal agency is involved, the number of cases reaching the federal courts should not be overwhelming. Finally, some have argued that if the UCC is revised to cover agricultural liens, there is a substantial risk that state legislatures will change fundamental Article 9 policies that have worked well in the nonagricultural areas in order to facilitate the protection of the family farmer.¹⁷⁹ These people apparently have no problem with a federal law dealing with liens on farm products because they are convinced that uniformity cannot be obtained at the state level.¹⁸⁰

177. 12 U.S.C. § 4001-4010 (1988). See also Regulation J, 12 C.F.R. pt. 210 (1990).

178. 12 U.S.C. §§ 4001-4010. For a thoughtful article about federalization of the UCC, see Rubin, *Uniformity, Regulation, and Federalization of State Law: Some Lessons from the Payment System*, 49 OHIO ST. L.J. 1251 (1989).

179. Letter from John D. Berchild, Jr. to David A. Lander (Mar. 18, 1991) (discussing Article 9 and agricultural liens). John Berchild is a partner in a large Los Angeles, CA law firm and a member of the ABA Committee considering whether Article 9 should be changed.

180. *Id.*