Note

AGRICULTURAL FINANCING UNDER THE U.C.C.

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When the 1962 Official Text of the *Uniform Commercial Code* was drafted, certain provisions were included which distinguished farm products and farm equipment from other types of collateral.[1] The Code has rejected certain preexisting state statutory and case law which had given unfavorable treatment to agricultural lenders and thus has reduced the legal risks involved in lending to the farmer. No doubt some of those rules rejected by the Code dated back to America as an agrarian society when the states' policy was to favor the farmer over the lender. All that was accomplished by such rules, however, was a reduction of available credit and loans to the farmer. In California, for example, before the Code was enacted, a security interest in crops was lost if the crop was harvested and removed from the land either with the consent of the creditor or as a result of his lack of reasonable diligence.[2] In some states if the debtor had no interest in the land a security interest would be invalid as to crops planted after creation of the security interest.[3] In other states, one could not obtain a chattel mortgage on an unplanted crop.[4] Consequently, because the farmer's collateral posed special problems for the lender, the farmer was disadvantaged because of the lenders' reluctance to finance the farmer under such restrictive laws. The purpose of this comment is to explore how the Code deals with agricultural lending and some of the practical and conceptual problems raised by the special treatment given farm collateral.[5]

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[1] *E.g.*, UNIFORM COMMERCIAL CODE §§ 9-103(2), 9-109(3), 9-203(1)(6), 9-204(2)(a), 9-204(4)(a), 9-307, 9-312(2), 9-401(1)(a) & 9-402(1) & (3) [ARIZ. REV. STAT. ANN. §§ 44-3103(B), 44-3109 (C), 44-3116(A)(2), 44-3117(B)(1), (not adopted in Arizona), 44-3128, (not adopted in Arizona), 44-3140(A)(1), & 44-3141(A) & (c) (1967), respectively]. Hereinafter, all citations to Code sections are to the particular section number of the *Uniform Commercial Code* (1962 Official Text), followed by the *Arizona Revised Statutes Annotated* section number in parenthesis.

[2] *See, e.g.*, Horgan v. Zanetta, 107 Cal. 27, 40 P. 22 (1895); Valley Bank v. Hillside Packing Co., 91 Cal. App. 738, 267 P. 746 (1928); Ramsey v. California Packing Corp., 51 Cal. App. 517, 201 P. 481 (1921). *See also* Smith, *Security Interests in Crops I*, 10 HASTINGS L.J. 23 (1958).

[3] *See, e.g.*, Alexander v. Garland, 209 Ala. 267, 96 So. 138 (1923); Steele v. Brooks, 34 Ala. App. 584, 42 So. 2d 63 (1949).

[4] Although many states had statutes which sanctioned security interests in unplanted crops, 9-204 (44-3117), Comment 6, some states did not recognize such liens. *E.g.*, Schmidt v. Plummer, 140 Kan. 436, 37 P.2d 1 (1934); Nelson v. State, 121 Neb. 658, 238 N.W. 110 (1931). *Contra*, First Nat'l Bank v. Yuma Nat'l Bank, 30 Ariz. 188, 245 P. 277 (1926).

[5] The scope of this comment will, however, be limited mainly to crops and farm equipment as they are used most by the farmer as collateral.

THE CODE SCHEME

Definitions

The Code has divided collateral into two main groups, tangibles and intangibles. All tangible personal property is divided into four classes of goods: consumer goods, equipment, farm products, and inventory.[6] Under the Code's scheme, the four categories are mutually exclusive.[7] Thus, if the collateral falls within the definition of farm products in a particular transaction, it cannot also be included in any of the other three classes for the purpose of that same transaction. Correct classification of goods is important because of the different requirements for creating security interests in the different types of collateral.

The Article 9 definition of farm products has two elements. For goods to be classified as farm products they must be (1) "crops or livestock or supplies used or produced in farming operations or . . . products of crops or livestock in their unmanufactured states (such as ginned cotton . . .),"[8] and (2) "in the possession of a debtor engaged in raising, fattening, grazing or other farming operations."[9]

Unlike the other definitions contained in section 9-109 (44-3109), the farm products definition attempts to describe the type of goods which fall within that category rather than to characterize their use.[10] However, the term "farm products" appears in only two other sections in Article 9;[11] the rest of the time the terms "crops" and "livestock" are used.[12] This is not an oversight by the drafters, since their use of "crops" and "livestock" refers to specific items, while the use of the word "farm products" was intended to be an all-inclusive reference.[13]

While the Code does not define the term "farm equipment," there are two sections which specifically refer to it.[14] A question then arises whether the debtor who purchases the equipment must be a farmer. The applicable Code sections seem to be in conflict. On the one hand, the Code definition of "equipment" would seem to indicate that the debtor does *not* have to be a farmer.[15] On the other hand, section 9-307(2) (44-

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6 9-109 (44-3109).

7 *Id.*, Comment 2. See *In re* Shepler, 54 Benks. Co. L.J. 110, 58 Lanc. L. Rev. 43, 1 UCC REP. SERV. 431 (E.D. Pa. 1962).

8 9-109(3)(44-3109(C)).

9 *Id.*

10 1 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 12.3, at 373 (1965) [hereinafter cited as GILMORE].

11 9-307(1)(44-3128(A)); 9-401(1)(44-3140(A))(Alternative No. 2).

12 *See, e.g.*, 9-204(2) & (4)(44-3117(B)) (subsection (4)(a) not adopted in Arizona) 1 GILMORE, *supra* note 10, § 12.4, at 375.

13 *I.e.*, when the terms are used they are referring to crops, for example, that are in the possession of a debtor engaged in farming operations.

14 9-302(1)(c)(44-3123(A)(3)) & 9-307(2)(44-3128(B)). *See also* 9-103(2) 44-3103(B))(commercial harvesting equipment).

15 9-109(2)(44-3109(B)) states in part: "Goods are . . . (2) 'equipment' if they are used or bought for use primarily in business (including farming . . .)." Clearly, a piece of equipment could be bought for use in farming by a nonfarmer.

3128(B)) seems to contemplate the purchaser being a farmer.[16] The former rule would appear to be the better one since section 9-307(2) (44-3128(B)) is really aimed at the special situation where the collateral is sold by the debtor to a third party. In the recent case of *Sequoia Machinery, Inc. v. Jarrett*,[17] the Court of Appeals for the Ninth Circuit rejected the argument that, in determining the place to file a financing statement, the debtor had to be a farmer in order for the equipment to be farm equipment. The court stated that "the drafters of the Code carefully avoided defining 'equipment used in farm operations' in terms of the occupational status . . . of the debtor-use[r]."[18] Under this definition of the term, the independent contractor who uses equipment on farms even though he is not a farmer would be included[19] and other debtors who buy machinery peculiar to farming operations but not for use on a farm would be excluded.[20]

Because different creation and perfection provisions apply to different classifications of goods, it is essential that the foregoing determination be made of the class of goods to which an item of collateral belongs before the creditor attempts to create and perfect a security interest in that collateral.

Creation of Security Interest in Farm Collateral

In order to create an enforceable security interest in farm products or farm equipment, four requirements must be met. First, there must be an agreement between the debtor and the creditor that the interest will attach to an asset of the debtor.[21] Second, assuming there is no change in possession of the collateral, there must be a writing evidencing the agreement in order to make the agreement enforceable against the debtor and third parties.[22] Third, the secured party must give value.[23] Fourth, the debtor must have rights in the collateral.[24]

For example, a debtor engaged in custom hay baling operations could purchase a hay baler to use in farming. The hay baler would be farm equipment without the debtor himself being a farmer.

[16] 9-307(2)(44-3128(B)) states in pertinent part: "In the case of . . . farm equipment . . . a buyer takes free of a security interest . . . if he buys . . . *for his own . . . farming operations. . . .*" (emphasis added).

[17] 410 F.2d 1116 (9th Cir. 1969).

[18] *Id.* at 1118.

[19] See note 15 *supra.*

[20] *See In re* Leiby, 58 Lanc. L. Rev. 39, 1 UCC REP. SERV. 428 (E.D. Pa. 1962).

[21] 9-204(1)(44-3117(A)). For a definition of "agreement," see 1-201(3)(44-2208(3)).

[22] 9-203(1)(44-3116(A)).

[23] 9-204(1)(44-3117(A)). For a definition of "value," see 1-201(44)(44-2208 (44)). *Cf.* Friedlander v. Adelphi Mfg. Co., 5 UCC REP. SERV. 7 (Queens County S. Ct. 1968) where the New York court held the secured party gave value when he made the first advance even though there was no binding commitment to extend anymore credit. *But see* Coogan & Gordon, *The Effect of the Uniform Commercial Code Upon Receivables Financing—Some Answers and Some Unresolved Problems,* 76 HARV. L. REV. 1529, 1550 (1963).

[24] 9-204(1)(44-3117(A)).

The first and third requirements are the same for farm products and farm equipment as for any other type of collateral; but for the second and fourth requirements, there are additional requisites with which the agricultural lender must comply.

In order to satisfy the Statute of Frauds requirement, the Code requires that the debtor sign a security agreement.[25] In the case of crops the writing must contain a description of the real property on which the crops are growing or are to be grown.[26] Article 9 requires that the description of real or personal property reasonably identify what is being described.[27] Although a metes and bounds description of the realty is apparently not required by the Code,[28] there is some question as to what will satisfy the requirement of a reasonable identification. With crops, unlike other types of collateral, a general description of the crop and the realty is usually not very descriptive.[29] Therefore, the security agreement should include a reference to the contemplated crop and a legal description of the realty involved based on the United States Government Survey;[30] however, failure to include such a description should not be an inadequate description per se.

As to farm equipment descriptions, the Code does not require the so-called "serial number test" of the older chattel mortgage cases.[31] In *Mammoth Cave Production Credit Association v. York*,[32] however, the court held that merely describing the collateral as "all farm equipment" was not sufficient because it was so vague that no agreement was thereby expressed to cover tractors and other large machinery. While there must be a sufficient description to show that the parties agreed that the particular good was to be collateral, the line of reasoning in the *York* case seems to be contrary to the Code's basic philosophy of liberal construction.[33] Article 9 rejects the idea of strict rules with regard to creation of a security interest; rather, it adopts a policy that formal requirements should be reduced to a minimum.[34] On the other hand, when only certain items of equipment are to be collateral—such as two tractors—there

[25] The security agreement, as distinguished from the financing statement, only has to be signed by the debtor. National-Dime Bank v. Cleveland Bros. Equip. Co., 20 Pa. D. & C.2d 511 (Dauphin County Ct. 1959).

[26] 9-203(1)(44-3116(A)).

[27] 9-110 (44-3110) (Arizona's version adds: "except when a legal description of real estate is provided for under the provisions of subsection E of § 44-3142.").

[28] Architectural Cabinet, Inc. v. Manley, 14 Chester Cty. Rptr. 71, 3 UCC REP. SERV. 263 (Pa. Ct. C.P. 1966); OP. ATT'Y GEN. OF ILL. No. 276, 1 UCC REP. SERV. 660 (1962).

[29] In Piggott State Bank v. Pollard Gin Co., 243 Ark. 159, 419 S.W.2d 120 (1967), the Arkansas court held that a listing of crops and acreage with no description of the realty was an insufficient description.

[30] For a general discussion of the United States Government Survey, see 3 AMERICAN LAW OF PROPERTY § 12.100 (A.J. Casner ed. 1952).

[31] 9-110 (44-3110) Comment. *See* National-Dime Bank v. Cleveland Bros. Equip. Co., 20 Pa. D. & C.2d 511 (Dauphin County Ct. 1959).

[32] 429 S.W.2d 26 (Ky. Ct. App. 1968).

[33] 1-102(1)(44-2202(A)).

[34] 9-203 (44-3116) Comment 1.

should be at least a general description of the specific equipment to be included.[35]

Regarding the fourth requisite for creation of a security interest, in order for the farmer-debtor to have rights in a crop, the seed must be planted.[36] It appears, however, that the secured party could take a security interest in the seed[37] and in the crops as "after-acquired property." The creditor could thus create a security interest long before the crop is planted.[38] Likewise, in order to have the security interest attach to the young of livestock, they must be conceived.[39] Again, the secured party could take a security interest in the cow and in any after-conceived calves, and thus create a security interest before the calf is conceived. Note, however, that a security interest in livestock or in seed and in the products of the livestock or seed (as after-acquired property), does not cover the young already conceived or a crop already planted because there is no agreement that the security interest attach.

The fourth requirement poses additional problems with respect to crops. In most states no security interest attaches under an after-acquired property clause to crops "which become such more than one year after the security agreement is executed . . . ."[40] This means an agricultural lender cannot have a security interest in any crop which does not come into existence within one year after execution of the security agreement. From section 9-204(2)(a) (44-3117(B)(1)) it would appear that a crop would "become such" when it is planted or otherwise becomes a growing crop, at which time the farmer would acquire rights in it. Thus, in order for the security interest to attach to a crop under an after-acquired property clause, the farmer would have to have acquired rights in it within one year of the execution of the security agreement.

An interesting question arises in the citrus farming industry as a result of this one-year limitation on after-acquired crops. While growing crops are part of the realty until constructively severed by, *inter alia*, the execution of a security interest thereon,[41] there is some authority to the

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[35] For example, International Harvester Farm Tractor, Model No. 656, with Hydrostatic drive and power steering. In Yancey Bros. Co. v. Decho, Inc., 108 Ga. App. 875, 134 S.E.2d 828 (1964), the court held that where the serial number, which was incorrect, was eliminated, and all that was left was the date, the parties' names, and the fact that a certain piece of equipment was one of the subjects of the instrument, the description was insufficient. Thus, it is not wise to put only a serial number in the agreement as a description of the collateral; rather it is a better idea to give a general description, such as that above.

[36] 9-204(2)(44-3117(B)); United States v. Greenwich Mill & Elevator Co., 291 F. Supp. 609 (N.D. Ohio 1968).

[37] The seed, while not a crop, would be a farm product. 9-109(3)(44-3109(C)).

[38] This is true if the crop begins to grow within one year in those states with the official version of 9-204(4)(a) (not adopted in Arizona).

[39] 9-204(2)(a)(44-3117(B)(1)).

[40] 9-204(4)(a). Arizona did not adopt this one-year limitation. See discussion in text accompanying notes 46-47 *infra*.

[41] *Cf.* Penryn Fruit Co. v. Sherman-Warrell Fruit Co., 142 Cal. 643, 76 P. 484 (1904).

effect that citrus trees are not crops at any time but rather are part of the realty. In *Haines City Citrus Growers' Association v. Petteway*,[42] the Supreme Court of Florida commented:

> Growing citrus fruit crops, such as oranges, grapefruit, and tangerines, which essentially owe their annual existence to cultivation and labor . . . though products of perennial plants or trees, are chattels, while the trees themselves are part of the realty.

Assuming that the tree is not a crop, further questions are raised regarding the fruit on that tree. If the fruit is a proceed of the tree then the one year limitation would not apply because the secured party would have an interest in the fruit at the time of the execution of the security agreement.[43] It doesn't appear, however, that the fruit would fit into the "proceeds" definition since proceeds include what "is received when [the] collateral . . . is sold, exchanged, collected or otherwise disposed of."[44] On the other hand, the fruit might be termed a product of the tree, and thus could attach under an after-acquired property clause; but because of the one-year limitation on after-acquired crops,[45] the parties would have to execute a security agreement each year in order to create an effective interest in the fruit.

There is, however, an important exception to the one-year limitation. When a security interest is given by the debtor to "a real estate lessor, mortgagee, conditional vendor or other encumbrancer during the continuance of his interest in the realty,"[46] the one-year limitation does not apply. In effect, this allows a creditor in the land to obtain a security interest in any crops to be grown thereon for as long as he retains an interest in the land. Thus, the foregoing problem with the citrus trees and fruit could be solved by the secured party obtaining an interest in the land as well as in the trees and fruit.

Arizona did not adopt the one-year limitation when the Code was enacted. Consequently, any security interest in crops is good for as long as the parties so provide in their agreement. The credit position of the farmer is greatly enhanced by the deletion of the one-year limitation; he can borrow money to purchase equipment that he needs to cultivate and till the soil using the equipment and *future* crops as collateral.

The farmer also does not obtain any rights in farm equipment until he obtains a special property and insurable interest in the equipment under

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42 107 Fla. 344, 346, 145 So. 183, 184 (1932), *citing* Summerlin v. Orange Shores, Inc., 97 Fla. 966, 122 So. 508 (1929); *accord*, Twin Falls Bank & Trust Co. v. Weinberg, 44 Idaho 332, 257 P. 31 (1927).

43 9-306(3)(44-3127(C)). To obtain a security interest in proceeds, the secured party must: (1) include proceeds in the financing statement of the original collateral; or (2) perfect the security interest in the proceeds within 10 days after they come into existence.

44 *Id.* (1).

45 See note 40 and accompanying text *supra*.

46 9-204 (44-3117), Comment 6.

section 2-501(1)(a) (44-3249(A)(1)).[47] Unlike crops under the official text[48] there is no one-year limitation on after-acquired farm equipment.[49] However, the parties must truly agree that the security interest is to attach to such later-acquired equipment; if the after-acquired clause "seems more like a provision inserted by an over-anxious lending officer to encompass as much security as possible,"[50] the security interest will not attach.

Brief mention should be made of purchase money loans. While the first, second, and fourth requirements for obtaining a security interest in farm products and/or farm equipment are the same for the purchase money security interest, the requirement of giving value has some ramifications in the purchase money context. The creditor must give present value which enables "the debtor to acquire rights in or the use of collateral if such value is in fact so used."[51] An example may make the requirement clear. Suppose Fred Farmer needs a new tractor and goes to ABC Implement Co. where he decides on a particular model. Since Fred does not have the required cash, he finances it through a loan from *X* Bank. *X* Bank may either pay *ABC* in cash or promise to pay in the immediate future. Thus, *X* Bank's loan has enabled Fred to obtain the tractor, and consequently, the bank has a purchase money security interest in the tractor. Note the two requirements: (1) present consideration must be given by the creditor to the seller,[52] and (2) the value advanced must be used by the debtor to purchase the collateral.[53]

While most purchase money security interests in agricultural lending will be in farm equipment, livestock and supplies, it may be possible to obtain such an interest in crops. For example, a lending institution may obtain a purchase money security interest in young citrus trees or seed which the farmer plants. The lender can then obtain an interest in the resulting crops through inclusion of a provision covering products of the collateral. The differences between the ordinary loans and the purchase money loan are not too significant as far as creation of the interest is concerned; however, the differences can be important for perfection[54] and priority[55] purposes.

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[47] *In re* Pelletier, 5 UCC REP. SERV. 327 (D. Me. 1968). The court said that the rights were obtained by the debtor in the mobile home when the contract of sale was made.

[48] See text accompanying note 40 *supra.*

[49] 9-204(3)(44-3117(C)); *In re* Particle Reduction Corp., 5 UCC REP. SERV. 242 (E.D. Pa. 1968); Mammoth Cave Prod. Credit Ass'n v. York, 429 S.W.2d 26 (Ky. Ct. App. 1968).

[50] Mammoth Cave Prod. Credit Ass'n v. York, 429 S.W.2d 26, 29 (Ky. Ct. App. 1968).

[51] 9-107 (44-3107(2)).

[52] *Id.*, Comment 2.

[53] *Id.*, Comment 1.

[54] See text accompanying notes 76-79 *infra.*

[55] See text accompanying notes 120-21 & 141-42 *infra.*

Perfection

Upon the creation of the security interest the next step is to "perfect" that interest to prevent other creditors and purchasers from obtaining a better right to the collateral. Generally, to perfect a security interest, a financing statement must be filed in a public place.[56]

A financing statement must conform to certain requisites in order to effect perfection.[57] The basic requirement is that the signatures and addresses of *both* the debtor and the secured party must be on the financing statement.[58] Second, there must be a general description of the collateral covered by a security agreement;[59] and when the security interest is in crops, the financing statement must include a description of the real estate.[60] Like the security agreement requirement, the description in the financing statement must reasonably identify the collateral.[61]

Once the financing statement has been drawn according to the requirements of section 9-402 (44-3141), the secured party must determine the proper place or places in which to file. The purpose of filing the financing statement is to inform any interested party that a security interest has been created and to provide a source for the details of the transaction.[62] The Code provides a scheme of notice filing in different locations depending on the type of collateral.[63]

In Arizona, the place to file when the collateral is farm products and/or farm equipment is in the office of the county recorder in the

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[56] 9-302(1)(44-3123(A)). This section gives the general rule and then enumerates certain instances when filing is not required.

[57] The submission of a nonconforming financing statement, even if made in good faith, is not a valid perfection, and will allow third party interests to take priority. *In re* Smith, 1 UCC REP. SERV. 589 (E.D. Pa. 1961); OP. ATT'Y GEN. OF CAL., 3 UCC REP. SERV. 96 (1965). Note, however, that minor errors will not void the financing statement. 9-402(5)(44-3141(E)).

[58] 9-402(1) (44-3140(A)).

Signature: Thompson v. United States, 409 F.2d 1075 (8th Cir. 1969); *In re* Beard, 4 UCC REP. SERV. 1080 (E.D. Tenn. 1967); *In re* Carlstrom, 3 UCC REP. SERV. 766 (D. Me. 1966); *In re* Causer's Town & Country Super Mkt., 2 UCC REP. SERV. 541 (N.D. Ohio 1965); *In re* Murray, 2 UCC REP. SERV. 667 (D. Ore. 1964); OP. ATT'Y GEN. OF N.M., No. 62-3, 1 UCC REP. SERV. 732 (1962). *Contra*, Alloway v. Stuart, 385 S.W.2d 41 (Ky. Ct. App. 1964); Bank of N. Am. v. Bank of Nutley, 94 N.J. Super. 220, 227 A.2d 535 (1967); Strevell-Patterson Fin. Co. v. May, 77 N.M. 351, 422 P.2d 366 (1967).

Address: *In re* Pelletier, 5 UCC REP. SERV. 327 (D. Me. 1968); *In re* Bengtson, 3 UCC REP. SERV. 283 (D. Conn. 1965); *In re* Smith, 1 UCC REP. SERV. 589 (E.D. Pa. 1961).

[59] 9-402(1)(44-3141(A)).

[60] *Id.*, Comment 1. *See also* 9-203 (44-3116). Failure to include a description of the real estate is not a minor error within the meaning of 9-402(5) (44-3141(E)) and the security interest is not perfected. *In re* Mount, 5 UCC REP. SERV. 653 (S.D. Ohio 1968).

[61] See text accompanying notes 26-30 *supra*. Note, however, that a financing statement cannot expand the security interest created by the security agreement, but it can contract that which will be perfected. *See In re* Platt, 58 Berks. Co. L.J. 86, 3 UCC REP. SERV. 275 (E.D. Pa.), *vacated on other grounds*, 257 F. Supp. 478 (1966).

[62] Plemens v. Didde-Glasser, Inc., 244 Md. 556, 224 A.2d 464 (Ct. App. 1966).

[63] 9-401 (44-3140) (Arizona has adopted alternative No. 2 for subsection (1)).

county where the debtor is a resident.[64] In addition, when the collateral is crops, the secured party must file in the "county where the land on which the crops are growing or to be grown is located."[65] However, two questions arise when the debtor is not an individual farmer but a corporation or partnership engaged in farming operations. First, the relevant language of section 9-401(1) (44-3140(A)), which states:

> The proper place to file . . . is as follows: (a) when the collateral is equipment used in farming operations, or farm products, or accounts, contract rights or general intangibles arising from or relating to the sale of farm products *by a farmer* . . . . (emphasis added),

seems to indicate that the debtor must be an individual farmer.[66] Thus, a corporation or partnership engaged in farming operations would not be included within subsection (1) of 9-401 (44-3141(A)) and the creditor would have to file in the office of the secretary of state.[67] On the other hand, as Professor Gilmore has recently indicated,[68] "by a farmer" would seem to refer only to "accounts, contract rights and general intangibles" and thus, the creditor of a corporation or partnership engaged in farming could file locally where the collateral was "equipment used in farming operations, or farm products."

Assuming that such a creditor would file "in the county of the debtor's residence," the second question that arises is where is the corporate or partnership debtor's residence? For example, if the debtor corporation has its chief place of business in Phoenix, in Maricopa County, but conducts farming operations in Yuma County, where should the secured party file the financing statement if he lends money for the Yuma farming operations? The most likely finding would be a residence in Phoenix.[69] If that is the debtor's residence and if the security interest

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[64] *Id.* (1)(44-3140(A)).

[65] *Id.*

[66] 1 GILMORE, *supra* note 10, § 18.2.2, at 521 states:
> Since in its 'official' version, the provision [9-401(1)(a) (44-3140(A)(1))] applies only to debtors who are individual consumers or who are farmers, the term 'residence' is appropriately used instead of 'place of business' or the like.

[67] 9-401(1)(3)(44-3140(A)(3)).

[68] In response to a letter from James M. Bush of Evans, Kitchel & Jenckes, Phoenix, Arizona, in which Mr. Bush asked Professor Gilmore if "by a farmer" modified only "accounts, contract rights or general intangibles," Professor Gilmore seemed to indicate that the assumption that 9-401(1)(a) applied only to individual farmers was erroneous. Letter from Grant Gilmore to James M. Bush, May 8, 1969.

[69] One writer on the law of corporations states that "[t]he 'residence' of a corporation within the meaning of the chattel mortgage acts, is its principal office or principal place of business, as designated by the articles of incorporation." 8 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 4048 (1966) (footnotes omitted). The Attorney General of Kentucky has expressed the opinion that the county of a corporate or partnership debtor's residence is the county where the debtor has its principal place of business and it not necessarily the county the articles of incorporation designate as its principal place of business or where the individual partners reside. OP. ATT'Y GEN. OF KY., 1 UCC REP. SERV. 705 (1963). To avoid the risk of error in determining residency, the secured party should file in *all* relevant counties.

covers crops, then the secured party must file in both the Maricopa and Yuma County Recorders' Offices—in Maricopa County because that is the county of the debtor's residence and in Yuma County because that is the county where the land on which the crop is to be grown is located. Where dual filing is required, failure to file in both places renders the security interest unperfected[70] unless the competing third party creditor had actual knowledge of the contents of the financing statement.[71]

If it is possible, the secured party's interest should be perfected the moment it attaches. If the secured party has filed prior to attachment of the security interest,[72] perfection will occur when attachment occurs.[73] As an illustration, suppose a lender takes a security interest in a crop yet to be planted, and files prior to planting; since the debtor does not have rights in the crop until it is planted, the security interest has not attached. When the crop is planted, the interest will attach and become perfected at the same time. This procedure will prevent most other parties from perfecting their interest prior to the lender.[74] However, if it is not possible to file prior to attachment, then the secured party should file as soon after attachment as possible.[75]

Unlike security interests for ordinary loans, there are certain situations in which a financing statement does not have to be filed to perfect a purchase money security interest. One such situation is a purchase money security interest in farm equipment having a purchase price "not in excess of $2,500."[76] Thus, when the debtor purchases a tractor for $2,500 or less and gives a purchase money security interest therein nothing more is required to perfect that interest.[77] In relying on such perfection, however, the secured party must be aware of two potential problems: (1) it is the purchase price, not the amount of the security interest that must be $2,500 or less;[78] and (2) if the collateral is to become a fixture—for example, a

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[70] *In re* Hyde, 6 UCC REP. SERV. 979 (W.D. Mich. 1969); *In re* Komfo Prod. Corp., 247 F. Supp. 229 (E.D. Pa. 1965); *In re* Federal Wholesaler Meats & Frozen Foods, Inc., 5 UCC REP. SERV. 639 (Wis. Cir. Ct. 1968).

[71] 9-401(2)(44-3140(B)). Note that where the collateral is farm equipment or farm products other than crops, there is no dual filing requirement. When the debtor is a resident of Arizona, a financing statement has to be filed in the county of the debtor's residence. If the debtor is not a resident, then the financing statement must be filed in the county where the goods are kept. *Id.* (1).

[72] A security interest attaches when (1) there is an agreement, (2) the secured party gives value, and (3) the debtor has rights in the collateral.

[73] 9-303(1)(44-3124(A)).

[74] Under the first to file rule of 9-312(5)(a)(44-3133(D)(1)) the party who files his financing statement first has priority over other secured parties with a security interest in the same collateral regardless which interest attached first. However, where section 9-312(2) (not adopted in Arizona) is applicable (see text accompanying notes 113-18 *infra*) this will not necessarily give the first to file priority. Likewise, where section 9-312(4)(44-3133(D)) (see text accompanying notes 119-23 *infra*) applies.

[75] 9-303(1)(44-3124(A)).

[76] 9-302(1)(c)(44-3123(A)(3)).

[77] However, certain buyers under 9-307(2) may take superior rights. See text accompanying note 142 *infra*.

[78] In Mammoth Cave Prod. Credit Ass'n v. York, 429 S.W.2d 26, 28 (Ky. Ct.

pump to be attached to a well on the real estate—then the Code requires that the security interest be perfected by filing a financing statement in the proper place since there is a possibility of competing interests from parties holding separate interests in the realty.[79]

THE ESSENCE OF THE PROBLEM—PRIORITY

The law of secured transactions is essentially one of priorities.[80] Although a security interest may be created and perfected, it may still be subject to the interest of third party claimants—realty creditors, purchasers, general lien creditors, and other secured parties.

The Secured Party versus The Realty Claimant

Prior to the Code, it was the general rule that a chattel mortgage on crops took priority over an earlier mortgage on the real property, provided the mortgagor was still in possession when the chattel mortgage was executed.[81] Likewise, under the Code a real estate mortgage encumbrancing only the land will not create a security interest in the crops growing or to be grown thereon because a mortgage on the land does not create a security interest in the personalty.[82] Thus, under Article 9, the secured party with a perfected security interest in crops takes priority as to such crops over the earlier realty mortgagee. In order for the realty mortgagee to obtain a valid security interest in the crops to be grown on the land, he would have to include specific provisions in the mortgage creating such an interest.[83] As was noted previously,[84] a security interest can attach to crops to be grown on the land more than one year after the security interest is created when given in conjunction with a loan on the real estate evidenced by a mortgage, deed, contract of sale, or lease.[85]

Under Arizona law prior to the adoption of the Code, when a farm

App. 1968) the court held that the purchase price, which is "the cash amount paid or agreed to be paid, plus the agreed value of any merchandise traded," as opposed to the difference between the value of the goods and the down payment, must not be in excess of $2,500. Thus, where the debtor made a down payment of $975 on farm equipment which had a total sales price in excess of $2,700, a purchase money security interest therein would require a filed financing statement to perfect.

[79] 9-401(1)(b)(44-3140(A)(2)). In Arizona that would be in the office of the county recorder.

[80] R. SPEIDEL, R. SUMMERS & J. WHITE, TEACHING MATERIALS ON COMMERCIAL TRANSACTIONS 424 (1969).

[81] See Annot., 47 A.L.R. 772 (1927).

[82] *See* 1-201(44) (44-2208(44)) which defines security interest as "an interest in *personal property* or *fixtures* which secures payment or performance of an obligation." (emphasis added). *See also In re* Royer's Bakery, Inc., 58 Lanc. L. Rev. 405, 1 UCC REP. SERV. 570 (E.D. Pa. 1963).

[83] *I.e.*, the mortgagee and the debtor would have to have an agreement in writing, included in the realty mortgage, that a security interest attach to the crops; see 2 GILMORE, *supra* note 10, § 32.4.

[84] See text accompanying note 46 *supra*.

[85] 9-204(4)(a) (not adopted in Arizona).

was leased and the lessee-debtor fell behind in his rent payments, the lessor's lien upon the crops and other personalty[86] was superior to any lien created after the commencement of the landlord-tenant relationship by the tenant under a chattel mortgage.[87] Since the Code expressly excludes landlord's liens from its coverage,[88] such a lien would be governed by the applicable state law as it existed prior to the adoption of the Code.[89] Presumably then, the landlord's lien on crops would have priority over the secured party's subsequent security interest in the same crops. Note, however, that the landlord's priority depends on the secured party obtaining his security interest subsequent to the commencement of the landlord-tenant relationship. If the secured party perfects his interest before the lease commences, then the secured party's interest would be superior to the landlord's lien.[90]

A third problem with respect to priorities between a secured party and realty claimants arises when the debtor-farmer sells his farm with a preexisting security interest in the crops thereon. Although the vendee may have no actual notice of the security interest, and it is not disclosed by the vendor-debtor, the vendee does have constructive notice of the security interest, if perfected, because the financing statement is a public record.[91]

The realty purchaser dealing with an Arizona title company would definitely receive notice of an existing security interest in crops because the title companies consider such security interests an encumbrance of the realty.[92] While of practical worth, this is not legally accurate since a party with a security interest in crops has no legal interest in the land; the definition of security interests would not encompass the real estate.[93] If the debtor defaults and the crop is insufficient to pay the remaining indebtedness, the secured party must proceed against the debtor personally for the deficiency. The only way that the secured party could reach the realty of the debtor would be to get a judgment against the debtor-farmer and record the abstract thereof in the county recorder's office in all the counties in which the debtor-defendant has real property; after recorda-

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[86] ARIZ. REV. STAT. ANN. § 33-362(A) & (C) (1956) provide in part:

A. The landlord shall have a lien on all property of his tenant not exempt by law. . . .

. . . .

C. The landlord shall have a lien for rent upon crops grown or growing upon the leased premises. . . .

[87] Gila Water Co. v. International Fin. Corp., 13 F.2d 1 (9th Cir. 1926) (construing Arizona law).

[88] 9-104(b) (44-3104(2)).

[89] 9-102(2) & (3)(44-3102(B) & (C)).

[90] *Cf.* Buerger Bros. Supply Co. v. El Rey Furniture Co., 45 Ariz. 1, 40 P.2d 81 (1935), where the court indicated notice of security interest would be essential.

[91] *In re* Carlstrom, 3 UCC REP. SERV. 766 (D. Me. 1966).

[92] Interview with Jack Williams, former title examiner for Tucson Title Ins. Co., in Tucson, Ariz., March 24, 1970.

[93] 1-201(37) (44-2208(37)). *See also* 9-102 (44-3102), Comment 4.

tion, a general lien would attach to the realty.[94] However, if the secured party followed this procedure after the debtor had sold the land, it would not be possible to levy on the land unless the conveyance was fraudulent.[95]

Collateral that is to attach to the realty presents another problem for the secured party. For example, if the debtor-farmer wishes to replace a pump on one of his irrigation wells he may finance such a purchase through a bank with the latter taking a security interest in the new pump. While the Code leaves it to prior state law to determine whether and when goods become fixtures,[96] the secured party's interest must attach to the good prior to its becoming a fixture else the secured party's interest will be subject to the interest of a prior realty mortgagee.[97]

In the recent case of *Honea v. Laco Auto Leasing, Inc.*,[98] the New Mexico Court of Appeals considered a similar situation. In that case the debtor leased a farm from the plaintiff. Having insufficient funds, the debtor arranged to "lease" pumps and motors, to be installed by a pump equipment company, from the defendant. The defendant, the debtor and the pump equipment company agreed that the latter would install the pumps and motors, and if the debtor was satisfied, the defendant would pay the pump company for them. The debtor defaulted on both the farm rental payments and the pump "rental" payments, and the defendant removed the pumps and motors. The plaintiff sued defendant for conversion. The trial court held that since the "leases" were intended as security interests and since the defendant did not advance any money until after the pumps and motors became fixtures, the plaintiff took priority as to the pumps because he was a prior realty claimant. The court of appeals, while assuming that the pumps and motors were fixtures, stated that it made no difference for the disposition of the case whether they were fixtures because the security interest attached prior to affixation. The court found that the defendant's promise to pay was value and thus when the pumps were installed the security interest attached.

Note that to have priority over prior interests in the realty the secured party does not have to perfect before the pump is affixed to the realty; the interest has only to attach prior to affixation.[99] However, the

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94 ARIZ. REV. STAT. ANN. § 33-961(B) (1956).

95 ARIZ. REV. STAT. ANN. §§ 44-1001 et seq. (1967).

96 9-313(1)(44-3134(A)). *See* Gomez v. Dykes, 89 Ariz. 171, 359 P.2d 760 (1961) (the three determinative elements of fixtures), *quoting* Fish v. Valley Nat'l Bank, 64 Ariz. 164, 170, 167 P.2d 107, 111 (1946). *See also In re* Hein, 60 F.2d 966 (N.D.N.Y. 1931), where the court held that an electric pump installed on a farm, in the place of the original pump, and used as an integral part of the same water supply system was a fixture.

97 9-313(2)(44-3134(B)), Comment 3. If there are no prior executed mortgages covering the real estate and the secured party does not file prior to the chattel attaching to the realty, the secured party's interest will be subject to a *subsequent* claimant who qualifies under subsection (4).

98 80 N.M. 300, 454 P.2d 782 (Ct. App. 1969).

99 9-313 (44-3134), Comment 3.

secured party must perfect its interest by filing to protect its priority against certain subsequent encumbrancers.[100]

Although a pump would be farm equipment[101] and although generally a purchase money security interest in such equipment does not require filing for perfection,[102] when the equipment is to become a fixture, sections 9-302(1)(c) (44-3123(A)(3)) and 9-401(1)(b) (44-3140 (A)(2)) require filing to perfect. Interesting problems arise, however, where the pump is bought for use as farm equipment and then later becomes a fixture. For example, suppose a pump company sells *X* a pump worth less than $2,500, attached to a gasoline motor. The pump company's security interest would be a purchse money interest and would not need to be filed. Assume that *X* uses the pump and motor to operate a sprinkler system to irrigate his bermuda grass crop. Assume further that six months later *X* attaches the pump to a well so that it then becomes a fixture. Does the pump company now have to file a financing statement in order to perfect its interest? Although type of collateral is determined at the time the security interest is created, it can be argued that it is the secured party's duty to police the collateral in order to detect changes in its use. While this places a burden on the secured party, it would be more equitable than allowing the interest to remain perfected against a subsequent realty claimant who has no knowledge nor notice of the security interest.[103] Therefore, to protect himself, the secured party should perfect his interest by filing a financing statement in the "office where a mortgage on the real estate concerned would be filed or recorded."[104]

If a security interest attaches after the collateral has become a fixture, the interest is, with three exceptions, prior to subsequent interests in the realty[105] and subordinate to all prior interests in the realty.[106] The three exceptions are a subsequent purchaser of the realty for value, a subsequent judicial lien creditor, or a prior creditor with an encumbrance of record that makes a subsequent advance. However, if such persons had knowledge of the security interest or the purchase was made or the judicial lien was obtained or the subsequent advance was made or contracted for after the interest was perfected, they would not take priority.[107]

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100 *Id.* *See* text accompanying notes 104-06 *infra.*
101 9-109(2)(44-3109(B)).
102 9-302(1)(c)(44-3123(A)(3)).
103 See text accompanying note 106 *infra.*
104 9-401(1)(b)(44-3140(A)(2)).
105 9-313(3)(44-3134(C)) (Arizona's version varies from the Official Text in that the subsequent parties described therein do not have constructive notice by the filing of a financing statement unless the affected real estate is described. *See* 44-3142(E).
106 9-313(3)(44-3134(C)). *See* State Bank v. Kahn, 58 Misc. 2d 655, 296 N.Y.S.2d 391 (1969).
107 9-313(4)(44-3134(D)). Note that under Arizona's version of 9-403(5) (44-3142(E)) the three classes of persons described in 9-313(4)(44-3134(D)) will

If, for example, the holder of a prior realty mortgage of record makes a binding contract for subsequent advances before the secured party's interest is perfected but after it is created, then such prior real estate mortgage would have priority over the secured party.

Practical problems may arise when the collateral is unplanted citrus trees. Assuming that such trees would be fixtures when planted,[108] and assuming further that the secured party would have priority over realty claimants, the secured party may encounter difficulty realizing on the collateral. Under the provisions of the Code, the secured party would have to reimburse any party with an interest in the realty, other than the debtor, for the cost of repair of any physical injury to the land in removing the collateral, not including reimbursement for diminution in realty value due to the collateral being removed.[109] Moreover, the damage to the trees would be very extensive. Thus, while the lender may have a perfectly valid and enforcable security interest in the trees, the sevrance from the land may cost more than the amount of the indebtedness.[110] In this situation, it would be better if the secured party could obtain an interest in the land as well as an interest in the trees.[111] However, if this is impossible the secured party might reduce his claim to judgment and proceed against the debtor by way of judicial procedure.[112] In this way, the secured party could reach the realty so that he would not have to remove the trees.

The Secured Party versus Non-Realty Claimants

The secured party faces a variety of potential priority problems from other parties claiming an interest in the specific collateral. As the discussion below will illustrate, priority depends on which party is claiming the interest and the type of interest being claimed.

Secured Parties

Section 9-312(2) provides a special rule with respect to priorities be-

not be considered to have notice and will thus take priority unless the financing statement "contains a legal description of the real estate affected thereby."

108 It is clear that young trees would be fixtures as they would fit the three-pronged test: (1) annexation to the realty; (2) adaptability or application as affixed to the use for which the real estate is appropriated; and (3) intent to make the chattel a permanent accession to the freehold. Gomez v. Dykes, 89 Ariz. 171, 359 P.2d 760, 762 (1961), *quoting* Fish v. Valley Nat'l Bank, 64 Ariz. 164, 170, 167 P.2d 107, 111 (1946). *See also* People v. Church, 57 Cal. App. 2d 1032, 1050, 136 P.2d 139, 148 (1943), where the court observed that "growing trees, shrubs and other plants are generally considered a part of the realty to which they are attached by their roots. . . ."

109 9-313(5)(44-3134(E)).

110 *Cf.* Heller v. Amawalk Nursery, Inc., 253 App. Div. 380, 2 N.Y.S.2d 196 (1938). The New York court denied respondent's motion to remove nursery stock from a nursery because the damage to the realty would have been too detrimental.

111 9-501(4)(44-3147(D)).

112 *Id.* (1). When the secured party reduces his claim to judgment, the lien relates back to the date of the perfection of the security interest. *Id.* (5).

tween competing security interests in the same crops;[113] it is, however, somewhat limited in scope. Under this subsection, a lender who gives new value—in the form of money, supplies, or even presumably, machinery or equipment—to the debtor-farmer to enable him "to produce the crops during the production season" and who takes and perfects a security interest in crops, is given priority over earlier secured lenders whose obligations are due more than six months before the crops become growing crops.[114] This means that the debt of the subordinate lender must be overdue for at least six months before the crops become growing crops "by planting or otherwise." It appears that the last quoted phrase was included to encompass crops which do not require planting to become growing, *e.g.*, fruit on a citrus tree.

An illustration of section 9-312(2) may be in order. Suppose that on January 1, 1968, the *A* Company leases a farm for five years to *F* for $10,000 per year. The lease agreement, which is intended by both parties to be a security agreement,[115] says that "all crops now growing or to be grown on the said farm for the duration of the lease are covered by this security agreement." A financing statement is properly filed. The rent is due December 31 for each preceding year and *F* pays all the 1968 rent but only one-half of the 1969 rent. Thus, on January 1, 1970, *A's* rent is overdue in the amount of $5000. Suppose further that on July 4, 1970, more than six months after *A's* 1969 rent payment became due, *F* plants a grain crop on part of the farm. Needing fertilizer for the crop, he procures it from XYZ Fertilizer Corp. on July 3 giving a security interest in the crop to be planted on July 4. *XYZ* files a financing statement on July 3, and its interest is perfected on July 4, when the grain crop is planted. Under section 9-312(2), although *XYZ* knew of *A*'s prior interest, *XYZ* has priority because it gave new value for the production of a crop during the growing season and the crop became growing more than six months after *A*'s loan became due.

On the other hand, if *A's* obligation had been due less than six months before the crops became growing, or if *XYZ* had sold the fertilizer more than three months before the crop became a growing crop (even though it was for the production of the particular grain crop) *XYZ* would have lost its priority under section 9-312(2).

The apparent purpose of this subsection is to give the lender advancing new value[116] to the farmer to enable him to grow a crop a first priority in that particular crop over other security interests which attach under

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113 9-312(2) (not adopted in Arizona).

114 *Id.*

115 A cash rent form lease containing an agreement that crops grown on the leased land are to be security for the performance of all covenants contained in the lease is a security agreement within the meaning of 9-105(1)(h) (44-3105 A (8)) and within the policy and scope of Article Nine. OP. ATT'Y GEN. OF MINN., No. 373 b-17, 3 UCC REP. SERV. 998 (1966).

116 See text accompanying note 123 *infra* for definition of "new value."

after-acquired property clauses. In this sense, section 9-312(2) is much like the other purchase money priority subsections of section 9-312.[117] When the fact situation in a given case is such that section 9-312(2) is not applicable, presumably the general priority rules apply.[118]

Interesting problems arise where there are two or more parties claiming priority under subsection (2). Conceptually, there could be two identical interests under this subsection. Two secured parties could both give value to the farmer to enable him to *produce* the crop. For instance, assume that a bank loans $500 to the farmer to enable him to produce a grain crop. The bank obtains a security interest in the crop and perfects by filing on June 1, 1970. Two days later a fertilizer company sells $500 worth of fertilizer to the same farmer to enable him to produce the same grain crop. It takes a security interest in the crop and perfects by filing on June 3, 1970. Four months later when the grain is harvested it is worth only $800. Since both parties have given new value to the debtor-farmer to enable him to produce the grain crop, both parties would appear to have a security interest within the meaning of section 9-312(2). Thus, each party would have priority over earlier secured parties whose obligations became due more than six months before the grain crop was planted. However, as between themselves would subsection (2) apply? Even though both parties have enabled the farmer to produce the particular crop, section 9-312(2) would not apply because it does not speak in terms of priority between two such parties. Thus, they would have to turn to the general priority rules of subsection (5). Under the first to file rule, the bank would have priority.

In Arizona section 9-312(2) was deleted when the Code was adopted. A question thus arises as to which priority subsection applies when two secured parties advance new value to enable the farmer to produce a crop. There are three possible alternatives: subsections (3), (4), and (5) of section 9-312 (44-3133(B), (C) & (D)). Even though in laymen's terms crops would be the farmer's inventory, the Code's definition of farm products clearly excludes this possibility;[119] consequently, the priority of the transactions would not be governed by subsection (3).

On the other hand, since crops are "collateral other than inventory," subsection (4) may apply if one of the secured parties has a purchase money security interest and if that interest is perfected before the debtor "receives possession of the collateral or within ten days there-

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117 9-312(3) & (4)(44-3133(B) & (C)).

118 9-312(5)(44-3133(D)) states in part:

> In all cases not governed by other rules stated in this section (including cases of purchase money security interests which do not qualify for the special priorities set forth in subsections (3) and (4) of this section), priority between conflicting security interests in the same collateral shall be determined as follows . . . .

119 1 GILMORE, *supra* note 10, § 12.3, at 373.

after."[120] When a lender gives new value to a farmer to enable him to produce a crop, the transaction would seem to create a purchase money security interest because it is enabling the debtor to acquire rights in the collateral.[121]

Problems arise, however, with the "receives possession" language of section 9-312(4) (44-3133(C)). For example, when would a farmer receive possession of a cotton crop,—when it was planted, when the seed germinated, or when the plant first emerged? Perhaps the best determination would be when it was planted because that is when the farmer obtains rights in the crop.[122] In addition, it would be a very difficult task to determine when the seed had germinated because different seeds and different weather conditions would vary the time from cases to case. Likewise, it would be too difficult to determine when the plant had emerged. Thus, it appears that subsection (4) would be applicable only in the limited situation where the secured party had perfected his purchase money security interest prior to planting or within 10 days thereafter.

Subsection (5) applies only when no other subsection of section 9-312 governs. Where the secured party has advanced the debtor present value to enable him to grow a crop, subsection (5) would be applicable only where the perfection requirement of subsection (4) is not met.

However, in Arizona when the purchase money interest is not in the crop itself, but rather in the seed, fertilizer, or citrus tree, it becomes necessary to determine what type of an interest the secured party has in order to determine priority. If the interest is non-purchase money, then subsection (5) would apply to determine the appropriate priorities; but if it is a purchase money interest then subsection (4) may be applicable. Before it can be determined whether the interest is purchase money, it must first be ascertained whether present value was given. In this regard the Code states:

> Where a secured party makes an advance, incurs an obligation . . . or otherwise gives new value which is to be secured in whole or in part by after-acquired property his security interest in the after-acquired collateral shall be deemed to be taken for new value . . . if the debtor acquires his rights . . . in the ordinary course of his business.[123]

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120 9-312(4)(44-3133(C)).

121 *See* 9-107 (44-3107).

122 9-204(2)(a)(44-3117(B)(2)).

123 9-108 (44-3108). There is an additional argument which may be made under 9-315 (44-3136), which would give priority to the secured party with an interest in fertilizer or seed. Under that section, a perfected security interest in goods which subsequently becomes a part of a mass or product continues and has priority in the resulting mass or product if

(a) the goods are so *manufactured, processed, assembled* or *commingled* that their identity is lost in the product or mass; or

(b) a financing statement covering the original goods also covers the product into which the goods have been *manufactured, processed* or *assembled* (emphasis added).

It is at least arguable from this section that a perfected security interest in

Assuming there is an after-acquired property clause, it would thus appear that where there was a purchase money security interest in seed, fertilizer, or unplanted citrus trees the interest in the resulting crop would be a purchase money interest and would be governed by subsection (4) if the interest is perfected prior to the debtor's possession or within 10 days thereafter *and* if the crops become growing by "planting or otherwise."

A purchase money security interest in farm equipment would clearly come under subsection (4). Where such an interest is taken in farm equipment having a purchase price not in excess of $2,500, a filed financing statement is not required for perfection; and under subsection (4) such an interest would take priority over another interest covering after-acquired property. Suppose, for example, that a bank has a non-purchase money security interest covering "all tractors now owned by the debtor and all tractors hereafter acquired." Suppose further that the debtor-farmer purchases, a used $2,100 tractor from a farm equipment dealer. The debtor puts $500 down and finances the balance from the equipment dealer; the dealer would have a purchase money interest in the tractor. Under section 9-312(4), the dealer would have priority over the bank since the former's purchase money interest would be perfected without filing at the time the debtor received possession of the tractor.

The farmer-debtor may sometimes choose to insure his crops. What, then, is the status of the secured parties when the crop is destroyed and there is an existing, valid insurance policy payable to the debtor? In *Quigley v. Caron*[124] the debtor had insured his potato crop against fire. After fire had destroyed the crop, the secured party claimed a security interest in the insurance proceeds arguing that they were identifiable proceeds from a sale, exchange, or other disposition of the collateral.[125] The Supreme Judicial Court of Maine held that there had not been a voluntary disposition and thus the Code was inapplicable.[126] Thus, the secured parties must look to other property of the debtor to satisfy their claims.

The secured party who has a priority interest in the damaged or destroyed crop can obtain a judgment, if the debtor defaults, and retain his priority position since the lien of the levy on other property of the debtor will relate back to the time when the secured party obtained his perfected interest. Thus, he will still have priority over the other secured parties who were junior to him at the time his security interest was per-

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seed or fertilizer, which later produces a crop, has priority over other interests in that crop. The big problem however, is that it is hard to imagine that a crop is "manufactured, processed or assembled" from seed or fertilizer.

124 — Me. —, 247 A.2d 94 (1968).

125 9-306(1)(44-3127(A)).

126 For other cases where the courts have held insurance not to be proceeds, see *In re* Levine, 6 UCC REP. SERV. 238 (D. Conn. 1969); Hoffman v. Snack, 113 Pitt. L.J. 206, 2 UCC REP. SERV. 862 (Pa. Ct. C.P. 1964); Universal C.I.T. Credit Corp. v. Prudential Ins. Corp., 101 R.I. 287, 222 A.2d 571 (1966).

fected.[127] He would not, however, be prior to third parties with pre-existing claims in the debtor's *other* collateral. Since the secured party has an insurable interest in his debtor's collateral[128] he may recover from his insurance company if he chooses to insure the collateral.

Purchasers From the Debtor

The general rule of the Code is that, absent authorization by the secured party, "a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof by the debtor . . . ."[129] Exception is made for sales of inventory by the businessman; the buyer in the ordinary course[130] takes free of the security interest even though the security interest is perfected.[131] However, the buyer who buys farm products in the ordinary course from a farmer does not come within the exception,[132] and the secured party has priority over such a purchaser.[133] Two recent cases, however, raise interesting questions as to buyers of farm products from the debtor-farmer.

In *Clovis National Bank v. Thomas*,[134] the Supreme Court of New Mexico held that a security interest in cattle could be waived by the secured party's acquiesence in the sale of the cattle over a course of dealing and by the secured party's reliance on the honesty of the debtor to bring in the proceeds of the sale. This action by the bank, the court reasoned, constituted authorization of disposition; thus section 9-306(2) (44-3127 (B)) was applied to avoid the exception to section 9-307(1) (44-3128 (A)).[135]

However, in the later case of *Vermillion County Production Credit Association v. Izzard*,[136] the Court of Appeals of Illinois rejected the defendant-buyer's argument that the secured party waived its security interest in the debtor's corn crop by including in the security agreement a right to proceeds and after-acquired property. The defendant contended

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127 9-501(5)(44-3147(E)). See 2 GILMORE, *supra* note 10, § 43.7, at 1209.

128 *E.g.*, Famers' & Merchants' Bank v. Hartford Fire Ins. Co., 43 Idaho 222, 253 P. 379 (1926); Lewis v. Guardian Fire & Life Assur. Co., 181 N.Y. 392, 74 N.E. 224 (1905).

129 9-306(2)(44-3127(B)).

130 For a definition of "buyer in ordinary course," see 1-201(9) (44-2208(9)).

131 9-307(1)(44-3128(A)), Comments 1 & 2.

132 *Id.* This section states in part: "A buyer . . . other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller. . . ."

133 *See, e.g.*, United States v. McClesky Mills, Inc., 409 F.2d 1216 (5th Cir. 1969); United States v. Greenwich Mill & Elevator Co., 291 F. Supp. 609 (N.D. Ohio 1968).

134 77 N.M. 554, 425 P.2d 726 (1967).

135 It is interesting to note, however, that the New Mexico legislature subsequently amended their section 9-306(2) provision by insertring the following: "A security interest in farm products and the proceeds thereof shall not be considered waived by the secured party by any course of dealing between the parties or by any trade usage." N.M. STAT. ANN. § 50A-9-306(2) (Supp. 1969). A similar provision was inserted in 1-205 (N.M. STAT. ANN. § 50A-1-205 (Supp. 1969)).

136 111 Ill. App. 2d 190, 249 N.E.2d 352 (1969).

that the inclusion of these provisions in the agreement amounted to action by the secured party authorizing "sale, exchange or other disposition" under section 9-306(2) (44-3127(B)) because the latter party was giving his implied consent to sell the collateral. The court found no such consent by the secured party; rather, they said, it was a protective device against the insolvency or bankruptcy of the farmer.[137]

The two cases can be easily reconciled. In *Clovis National Bank* there was a definite course of dealing between the secured party and the debtor which had impliedly given the latter the authority to sell the collateral. In *Izzard*, on the other hand, the secured party only had taken a security interest in proceeds and after-acquired property; there was no course of dealing between creditor and debtor. Clearly, more than the inclusion of proceeds and after-acquired property is required to waive a security interest in the collateral and give authorization for sale. In fact, it is very likely that the secured creditor would want an interest in the collateral and proceeds in case the collateral could not be traced after an unauthorized sale. Furthermore, the act of creating a security interest in proceeds as allowed under section 9-306(2) and (3) (44-3127(B) & (C)) should not constitute a waiver of rights in collateral which are also given by the Code.

However, the protection granted to farm financiers by section 9-307(1) (44-3128(A)) has been severely criticized. One writer[138] has suggested that once the farm products exception was removed, the troublesome farm products definition could also be removed because there is only one other section which uses that term and it is used there only in a non-technical sense.[139] This might help the purchaser of farm products but it would not help the farmer in his quest to obtain needed financing. Since farm collateral is more difficult to police, it is submitted that the farm products definition is a necessary provision to adequatey protect the agricultural financier and to insure adequate financing for the individual farmer.

Another interesting problem is raised by the "Protection of Buyers of Goods" section.[140] Does the buyer from one who purchased from the debtor-farmer take free of the security interest or does he, too, come within the 9-307(1) (44-3128(A)) exception? For example, if *F* has given a valid enforceable security interest in his cotton crop, which has been perfected by filing, to ABC Production Credit Association, then *X*, a buyer in the ordinary course of business from *F*, would not in the absence of a waiver by the secured party take free of *ABC's* security interest.

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137 For another recent case following this same line of reasoning, see Overland Nat'l Bank v. Aurora Coop. Elevator Co., 186 Neb. 843, 172 N.W.2d 786 (1969).

138 Comment, *"Farm Products" Under The UCC—Is a Special Classification Desirable?*, 47 TEXAS L. REV. 309, 315 (1969).

139 9-401 (44-3140).

140 9-307 (44-3128).

But what about *Z* who buys from *X* in the ordinary course of *X*'s business without knowledge of *ABC*'s security interest? *Z* did not buy "from a person engaged in farming operations" and thus one could argue that *Z* may take free of the security interest. On the other hand, section 9-307(1) (44-3128(A)) indicates that a buyer takes free of a security interest only if the security interest was *created by his seller*; since *X* did not create the security interest, *Z* cannot take free of a prior security interest.

Therefore, the apparent meaning of section 9-307(1) (44-3128(A)) is that a secured party's security interest in farm products remains valid against third party purchasers, fourth party purchasers, and so on. Arguably, then, there are shirts hanging in men's shops and lettuce on display in grocery stores still subject to a security interest created in the original crop.

The purchase money security interest in farm equipment, on the other hand, may be lost to the good faith purchaser if the lender has not, prior to the sale, filed a financing statement even though his security interest may be perfected under section 9-302(1)(c) (44-3123(A)(2)).[141] Suppose *F* buys a tractor from ABC Equipment Company for $2,200 through financing made available by the latter. *ABC* gets a purchase money security interest in the tractor which is perfected without filing by virtue of section 9-302(1)(c) (44-3123(A)(2)). If *F* sells the tractor to his neighbor *Y*, who purchases it to use on his farm, *ABC* will lose its security interest because a financing statement was not filed prior to the sale. If, however, *ABC* files a financing statement prior to *Y's* purchase, *Y* takes subject thereto.[142]

Unperfected and Unsecured Creditors That Obtain Interests in the Collateral

Generally speaking, a secured creditor takes priority over unsecured creditors who have obtained a lien on the collateral[143] and unperfected secured parties in the same collateral.[144] However, problems arise when

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[141] *Id.* (2).

[142] *Id.*:

> [I]n the case of farm equipment having an original purchase price not in excess of $2500 . . . a buyer takes free of a security interest even though perfected if he buys without knowledge of the security interest, for value and for his own . . . farming operations *unless prior to the purchase the secured party has filed a financing statement covering such goods.* (emphasis added).

[143] Under 9-301(1)(44-3122(A)) a perfected security interest is held to be superior to the rights of an unsecured lien creditor, even one without knowledge. *E.g.*, General Motors Acceptance Corp. v. Statsky, 60 Misc. 2d 451, 303 N.Y.S.2d 463 (1969); William Iselin & Co. v. Burgess & Leigh, Ltd., 52 Misc. 2d 821, 276 N.Y.S.2d 659 (1967); Stumbo v. Paul B. Hult Lumber Co., 251 Ore. 20, 444 P.2d 564 (1968).

[144] *E.g.*, Hillman's Equip., Inc. v. Central Realty Inc., — Ind. App. —, 242 N.E.2d 522 (1968); McDonald v. Peoples Auto. Loan & Fin. Corp., 115 Ga. App. 483, 154 S.E.2d 886 (1967).

the secured party is not perfected and a third party obtains an interest in the collateral. The most common example is a creditor who becomes a lien creditor, as defined by the Code,[145] without knowledge of the secured party's interest while the latter is unperfected. Under the Code, such a lien creditor's rights are superior to those of the unperfected secured party.[146]

Another unsecured creditor who may take priority over the secured party is the person who obtains a farm service lien. When a person furnishes labor, machinery, or equipment and the land is thereby improved or prepared for planting, he obtains a lien upon any crop grown upon the land.[147] While the Code expressly excludes from its scope those liens which are not covered by section 9-310 (44-3131),[148] Arizona has held that the liens of laborers and materialmen who have enhanced the value of the land are to be jealously protected.[149] By analogy, it would seem that a farm service lien, which lasts for six months after it is filed,[150] would have priority over even a perfected security interest because his labors have enhanced the value of the collateral.

CONCLUSION

The Code has given the agricultural lender added protection which in turn has provided marginal-risk farmers with much-needed financing. The Code's basic philosophy of making it less difficult to create and perfect a security interest has likewise resulted in more protection for the lender and more loans for the debtor.

On the other hand, the Code priority provisions are an interrelated, cross-referenced body of law, the operation of which can create considerable confusion. Perhaps an all-encompassing illustration may help to show the priorities relative to each other. Suppose that *F*, a farmer, has the following transactions:

1. In September of 1962, *F* borrows $100,000 from *X* to finance the purchase of a farm and lemon trees to plant thereon. *F* gives *X* a chattel mortgage on the trees and the fruit to be grown along with a mortgage on the land. When the Code is adopted in Arizona in 1968, the parties executed a proper security agreement and properly filed a financing statement covering the trees and the crops as after-acquired property. The debt was payable as the rate of $10,000 on January 1 of each year for the coming years.

2. Needing money for general financing, *F* goes to *B* Bank on June

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145 9-301(3) (44-3122 C).
146 *Id.* (1)(b).
147 ARIZ. REV. STAT. ANN. § 33-901 (1956).
148 9-104(c) (44-3104(3)).
149 Wylie v. Douglas Lumber Co., 39 Ariz. 511, 9 P.2d 256 (1932); Arizona Eastern R.R. v. Globe Hardware, 14 Ariz. 391, 129 P. 1104 (1913).
150 If not foreclosed within six calendar months, it is forfeited. ARIZ. REV. STAT. ANN. § 33-904 (1956).

1, 1968. *B* loans *F* $10,000 and, noting *X's* prior realty mortgage, takes a mortgage on *F's* farm and citrus trees plus a security interest covering "all crops now growing or hereafter grown." The loan is due in istallments of $5,000 on January 2, 1969; $2,500 on June 1, 1969; and the remaining $2,500 on January 2, 1970. A proper financing statement and mortgage were filed.

3. On March 1, 1970, *F* borrows $5,000 from *C* Production Credit Agency to purchase fertilizer for his 1970 lemon crop. *C* has a purchase money security interest in the fertilizer; it also takes an interest in the 1970 lemon crop as after-acquired property and perfects both interests by filing a proper financing statement.

4. On April 1, 1970, *F* contracts to sell his farm to *P* for $150,000 cash. *P* is to take possession of the farm on June 1, 1970.

5. On April 30, 1970, *F* contracts to sell the 1970 lemon crop for $14,000 to Moonsmack, Ltd.

Assume that *F* makes the $5,000 payment to *B* on January 2, 1969 but does not pay the $2,500 payments on June 1, 1969, and January 1, 1970, and *B* reduces its claim to judgment and a lien on November 15, 1970. The 1970 lemon crop, which began growing on March 25, is ready to be picked. It is now June 2, 1970, and *F* has left for Brazil along with the $150,000 from *P* and the $14,000 he got from Moonsmack. *P* is claiming the land, the trees, and the lemon crop. The priorities to the different collateral are as follows:

Trees—Since *X* had a security interest in the trees before they attached to the realty, his security interest would have priority over *B's* subsequent judicial lien and *P's* subsequent purchase of the realty because *X's* interest was perfected at the time the judicial lien was obtained and at the time when the purchase was made.[151]

1970 Fruit Crop—All five parties would be competing for priority in the 1970 lemon crop: *X* under an after-acquired property clause; *B* Bank under an after-acquired property clause; *P* as the purchaser of the land; *C* under a crop production type loan; and Moonsmack under an executory contract of purchase. The order of priorities would be different in Arizona than in states adopting the special priority provision relating to crops.[152]

For the reasons enumerated below, in Arizona the order would be: (1) *C*; (2) *X*; (3) *B*; (4) Moonsmack; (5) *P*. In the states where section 9-312(2) is intact, the fourth and fifth priorities would be the same, but *X* would be prior to *C*, *B* would be prior to *C* to the extent of $2,500, and *X* would be prior to *B*.

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151 See text accompanying notes 105 & 107 *supra*.
152 9-312(2) (not adopted in Arizona).

Any existing perfected security interest in the crops would be prior to *P's* interest because he would have constructive notice.[153] Moonsmack's interest would also be subject to any security interest in the fruit because it was a purchaser of farm products and would thus come within the section 9-307(1) (44-3129(A)) exception.[154]

The real competing security interests would be those of *C, X* and *B*. In Arizona, even though *C's* interest in the crop would be under an after-acquired property clause, it would still be a purchase money interest,[155] and thus since *C* perfected its interest within 10 days after the debtor received possession of the crop and since the crop became a growing crop within a reasonable time after the value was given[156] section 9-312(4) (44-3133 C) would apply to determine priorities. That subsection gives *C*'s purchase money security interest priority over *B*'s and*X*'s interests because their interests attached under after-acquired property clauses of pre-existing debts and are, therefore, non-purchase money interests.[157] As between *B* and*X*, the general priority rules of section 9-312(5) (44-3133 (D)) would apply. Since both perfected by filing, subsection (5)(a) would give *X* priority as he filed before *B*. The split would be $5,000 to *C*, $9,000 to *X* and nothing to *B*.

In states adopting subsection (2) of 9-312, *C*'s interest would be subject to *B*'s to the extent of $2,500. Since the January 2, 1970, installment was not overdue by more than six months on March 25, the day the fruit became growing, subsection (2) would not give *C's* production loan priority over the January 2 installment.[158] Subsection (5)(a) would thus apply as to this installment and give priority to *B*.[159] The other $2,500 installment, which was due on June 1, 1969, was more than six months overdue on March 25 and thus *C's* interest would have priority under subsection (2). As between *X* and *C*, subsection (2) also would not give *C* priority because *X's* $10,000 annual installment was not more than six months overdue at the time the crop became growing. Thus, subsection (5)(a) must be looked to again; under that subsection, *X's* interest would take priority as he filed first. And as between *B* and *X*, the first to file rule would likewise apply and *X* would have priority. Thus, the 1970 lemon crop would be divided up as follows: the first $10,000 would go to *X*; the next $2,500 would go to *B;* and the remaining $1,500 would go to *C*.

As can be seen from the foregoing illustration, priority is a very complex problem. The Code draftsmen, however, have done a lot toward

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153 See discussion in text accompanying notes 91-95 *supra*.
154 9-307(1)(44-3128(A)); see text accompanying notes 132-33 *supra*.
155 See text accompanying note 123 *supra*.
156 See text following note 123 *supra*.
157 9-107 (44-3107), Comment 2.
158 See text accompanying notes 114-16 *supra*.
159 See text accompanying note 118 *supra*.

eliminating some of the confusion by the promulgation of an all-encompassing scheme; now it is up to the Bar and the courts to keep the confusion from becoming greater.