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Revised Article 9 and Agricultural Collateral

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Purpose and Scope of Revised Article 9

Purposes of the Revision

Article 9 of the Uniform Commercial Code, as adopted by the State of Colorado, was amended in the 2001 legislative session to adopt Revised Article 9 ("RA9"), as proposed by the American Law Institute and the Nation Conference of Commissioners on Uniform State Laws. The Colorado version of RA9 is found at CRS § 4-9-101, et seq. The uniform text of the proposed law has been adopted without significant change. This is the first major change to the rules on secured transactions since 1972, except of course for Colorado's experiments with its central filing system dealing with Effective Financing Statements under the Food Security Act of 1987.

RA9 is a comprehensive restatement of the law of security interests in personal property. It has been reorganized, renumbered and rewritten. It has been revised to make it easier to create and perfect security interests in a greater range of personal property. It has been adapted to electronic commerce by making it easier and cheaper to provided financing for small and middle-sized firms and consumers who depend upon secured financing. Finally, it has been revised to state the law of secured transactions with greater clarity, detail and precision in order to achieve greater transactional certainty.

The overall effect of RA9 is the tilting of the playing field in the of law personal property security interests in the favor of secured transactions. This is another major step away from the resistance to allowing a person to encumber his, her or its general unsecured creditors. The courts, of course, will have an impact on how RA9 takes effect, but the intent of the drafters of the uniform law is very clear, and that was to make the creation and perfection of security interests easier and more certain.

The changes made by RA9 are significant, and certainly of more impact than just on the subject of agricultural collateral. However, the changes made with respect to Agricultural Collateral and to closely related matters and concepts are sufficient for separate treatment. That will be the focus of this paper.

Scope of Revised Article 9

The scope of RA9 is discussed in Sec. 9-109. In the prior code, the scope of the law was addressed in two sections, Sec. 9-102, which stated the policy and subject matter of the law, and Sec. 9-104, which set out the transactions excluded from Article 9. To a great extent, this expansion of the scope of Article 9 makes no change in the law, but this new section does add new classifications of collateral and clarifies the applicability of Article 9 to transactions. The changes in the scope of Article 9 do affect agricultural collateral, which will be discussed in more detail below.

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New Jurisdiction Rules and Transition Rules

Where to File or Perfect

The law governing perfection and priority of security interests is one of the significant changes made by RA9. Sec. 9-301 provides, generally, that the law governing perfection, the effect of perfection or nonperfection and the priority of a security interest in collateral is, 1) while a debtor is located in a jurisdiction, the local law of the jurisdiction, and 2) while the collateral is located in a jurisdiction, the local law of that jurisdiction. That seems a simple statement and comports to the prior law, and the real change is in the provisions describing the location of the debtor, set out in Sec. 9-307.

Under Sec. 9-307, a debtor who is an individual is located at the individual's principal residence; a debtor that is an organization and has only one place of business is located at its place of business; and a debtor that is an organization with more than one place of business is located at its chief executive office. These provisions of RA9 also comport with the prior law.

The key change for most debtors is that an organization that is organized under the laws of a state is located in that state. For example, a corporation doing business in Colorado with only one place of business in Colorado but incorporated in Delaware is located, for the purpose of perfection of security interests in its property, in Delaware.

The general rule for perfection by filing is set out in Sec. 9-310(a). A financing statement must be filed to perfect all security interests and agricultural liens. This means that when perfecting security interests in most collateral for the Delaware corporation doing business only in Colorado, a financing statement must be filed in Delaware and a Colorado filing is ineffective to perfect that security interest. The practitioner should be cautious to check the particular rules in each state for filing, for example in Oklahoma the central filing office is at the Clerk of Oklahoma County, not the Secretary of State.

Transition Rules

Obviously, there are many security interests that were previously perfected by filing or other methods of perfection that will be affected by RA9. To enable secured creditors time to make changes to preserve their security interests under the new law, a set of Transition Rules are provided in Sec. 9-701, et seq.

RA9 applies to all security interests, including those created or perfected before the effective date. This means that all new rules regarding the continuation, enforcement and notices regarding security interests must be followed regardless of when the security interest was created or perfected. *Sec. 9-702(a).* However, actions commenced prior to the effective date will be unaffected by the enactment of RA9. *Sec. 9-702(c), Morris v. GMAC (In re Ball), 281 B.R. 706 (2001).*

A security interest that is properly perfected under the prior law that would be perfected under the new law will remain perfected and unaffected by the change in the law, even if the place of filing is changed by RA9. *Sec. 9-703(a).* However, if a security interest that is properly perfected under the prior law would not be perfected under the new law, the security interest will, or has, become unperfected if unless if become perfected under the new law within one year of the effective date. *Sec. 9-703(b).* Of course, a security interest that was unperfected under the prior law remains unperfected unless perfected within one year of the effective date. *Sec. 9-704.*

The initial one-year safe harbor period has passed, leaving the immediate concern the effect of the five-year safe harbor rules. That rule is set out in Sec. 9-705(c). This safe harbor provides that security interests properly perfected under the prior law remain perfected until the earlier of when they would normally lapse (the familiar five-year lapse period), or June 30, 2006. This means that to continue an existing pre-effective date financing statement, it must be continued in accordance with the new law either during the continuation period applicable (within 6 months prior to the five-year an-

niversary of its original filing) or by June 30, 2006. For example, if a financing statement is to be continued during the period before June 30, 2006 it must be continued in accordance with RA9 and any continuance not in accordance with those rules will be ineffective.

If a financing statement that was filed before the effective date is to be amended, it must be amended in accordance with RA9. This means that any amendments to existing financing statements must be filed in the jurisdiction required by RA9, and any amendment not so filed will be ineffective. *Sec. 9-707.*

Finally, if the secured party desires, it may file a new initial financing statement at any time before a continuation is otherwise due in lieu of a continuation statement. In this case, the effectiveness of the existing financing statement is preserved, but a new continuation period is commenced from the date of the filing of the *in lieu* filing. *Sec. 9-706.*

The foregoing general rules are affected by a number of exceptions and other provisions of Sec. 9-701, et seq., and if a case arises regarding the transition rules, the practitioner should carefully review the rules with the specific facts presented in each case.

New and Changed Definitions

RA9 made a number of changes to the definitions in the old law, and had added several new defined terms. Before familiar terms are used, the practitioner should check to make sure the terms still have the same meaning as under the old law. The following is a partial list of revised and/or new terms:

Account. CRS § 4-9-102 (a)(2) provides "Account", except as used in "account for", means a right to payment of a monetary obligation, whether or not earned by performance, (i) for property that has been or is to be sold, leased, licensed, assigned or otherwise disposed of, (ii) for services rendered or to be rendered, (iii) for policy of insurance issued or to be issued, (iv) for a secondary obligation incurred or to be incurred, (v) for energy provided or to be provided, (vi) for the use of hire of vessel under a charter or other contract, (vii) arising out of the use of a credit or charge card or information contained on or for use with the card, or (viii) as winnings in a lottery or other game of chance operated or sponsored by a state, governmental unit of a state, or person licensed or authorized by operate the game by state or governmental unit of a state. The term includes health-care-insurance receivables. The term does not include (i) rights to payment evidenced by chattel paper or an instrument, (ii) commercial tort claims, (iii) deposits accounts, (iv) investment property, (v) letter-of-credit rights or letters of credit, or (vi) rights to payment for money or funds advanced or sold, other than rights arising out of the use of a credit or charge card or information contained on or for use with the card.:

This definition is to be contrasted with the prior definition of Accounts, which was contained, along with the definition of General Intangibles, in Old Article, CRS § 4-9-106. That definition was:

"Account" means any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattle paper, whether or not it has been earned by performance. "General Intangibles" means any personal property (including things in action) other than goods, accounts, chattel paper, documents, instruments, investment property, rights to proceeds or written letters of credit, and money. All rights to payment earned or unearned under a charter or other contact involving the use or hire of a vessel and all rights incident to the charter or contact are accounts"

The definition of Account has been rewritten. The term no longer applies only to rights to payment for goods and services. It now encompasses claims to payment for many kinds of property that were once defined as General Intangibles. The expansion of the Account category necessarily reduces the range of assets that qualify as General Intangibles. Once of the types of property that is specifically excluded is the right to funds advanced under a loan to a customer's deposit account. This is not a transaction giving rise to an account. See RA9-102(a)(2)(second vi).

Agricultural Lien. Sec. 9-102(5) means an interest, other than a security interest, in farm products:

(a) which secured payment or performance of an obligation for:

  (i) goods or services furnished in connection with a debtor's farming operations; or

  (ii) rent on real property leased by a debtor in connection with its farming operations;

(b) which is created by statute in favor of a person that:

  (i) in the ordinary course of its business furnished good or services to a debtor in connection with the debtor's farming operations; or

  (ii) leased real property to a debtor in connection with the debtor's farming operation; and

(c) whose effectiveness does not depend on the person's possession of the personal property.

Farm Products. Sec. 9-102(34) means goods, other than standing timber, with respect to which the debtor is engaged in a farming operation and which are:

(b) crops grown, growing, or to be grown, including:

  (i) crops produced on trees, vines, and bushes; and

  (ii) aquatic goods produced in aquacultural operations;

(c) livestock, born or unborn, including aquatic goods produced in aquacultural operations;

(d) supplies used or produced in a farming operation; or

(e) products of crops or livestock in their unmanufactured states.

Farming Operation. Sec. 9-102(35) means raising, cultivating, propagating, fattening, grazing, or any other farming, livestock, or aquacultural operation.

Supporting Obligations Sec. 9-102(77) means a letter-of-credit right or secondary obligation that supports the payment or performance of an account, chattel paper, a document, a general intangible, an instrument, or investment property.

Deposit Account Sec. 9-102(29) means a demand, time, savings, passbook, or similar account maintained with a bank. The term does not include investment property or accounts evidenced by an instrument.

As Extracted Collateral

As-extracted collateral" means:

(a) oil, gas or other minerals that are subject to a security interest that:

  (i) is created by a debtor having an interest in the minerals before extraction; and

  (ii) attaches to the minerals as extracted; or

(b) account arising out of the sale at the wellhead or minehead of oil, gas or other minerals in which the debtor had an interest before extraction.

Accordingly, certain Accounts are also As-extracted Collateral. Oil, gas and other minerals that have not been severed from the ground are not personal property, but are real property. As such they are not governed by RA9, but are governed by the real estate law of Colorado. However, once severed from the ground or, in other words, once extracted, minerals become personal property and are eligible as collateral under RA9. Under terminology for secured transactions, a security interest granted in minerals "attaches" upon extraction. RA9 (a) provides that a "a security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral, unless an agreement expressly postpones the time of attachment." If a debtor has an interest in oil and has agreed to sell the olil to a buyer at the wellhead, and the debtor has conveyed to a secured party the right to the payment for the oil from the buyer, the debtor has granted a security interest in an account and in as-extracted collateral.

Chattel Paper

The definition of Chattel Paper under RA9-102(a)(11) is expanded from the prior definition of RA9-105. The prior definition concerned both a written evidence of a monetary obligation and a security interest in or a lease of specific goods. The new definition is:

"Chattel paper" means a record or records that evidence both a monetary obligation and a security interest in specific goods, a security interest in specific goods and software and license of software used in the goods, a lease of specific goods, or a lease of specific good sand license of software used in the goods. In this paragraph "monetary obligation" means a monetary obligation secured by the goods or owed under a lease of the goods and includes a monetary obligation with respect to software used in the goods. The term does not include (i) charters or other contacts involving the use or hire of a vessel or (ii) records that evidence a right of payment arising out of the use of a credit or charge card or information contained on or for use of the card. If a transaction is evidenced by records that include an instrument or series of instruments, the group of records taken together constitutes chattel paper.

The expanded definition covers transactions in which the debtor's or lessee's monetary obligation includes amounts owed with respect to software used in the goods. The monetary obligation with respect to the software need not be owed under a license from the secured party or lessor, and the secured party or lessor need not be a party to the license transaction itself. Among the types of monetary obligations that are included in "chattel paper" are amounts that have been advanced by the secured party or lessor the enable the debtor or lessee to acquire or obtain financing for a license of the software used in the goods.

RA9 also contains definitions for Electronic Chattel Paper, which is chattel paper that is stored in an electronic medium. Tangible Chattel Paper is the traditional written chattel paper. The purpose of these definitions is to ease the transition to electronic commerce. Tangible Chattel Paper can be converted into Electronic Chattel Paper, or records may be initially created and "authenticated" in electronic form.

Instrument.RA9-102(a)(47) defines "Instrument" as "means a negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease, and is of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment. The term does not include (i) investment property, (ii) letters of credit, or (iii) writings that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card."

Promissory Note.

RA9-102(a)(65) defines "Promissory Note" as "means an instrument that evidences a promise to pay a monetary obligation, does not evidence and order to pay, and does not contain an acknowledgment by a bank that the bank has received for deposit a sum of money or funds."

This is a new definition for the UCC. It was required by the inclusion of sales of promissory notes within the scope of RA9. In specifically excludes checks and deposit receipts.

General Intangibles; Payment Intangibles.

RA9-102(a)(42) defines "General Intangible" as "means any personal property, including things in action, other than accounts, chattel paper, commercial trot claims, deposit accounts, letters of credit, money, and oil, gas, or other minerals before extraction. The term includes payment intangibles and software."

§ 9-102(a)(42) defines "Payment Intangible" as "means a general intangible under which the account debtor's principal obligation is a monetary obligation."

RA9-102(a)(51) defines "Letter-of-credit Right" as "means a right to payment or performance under a letter of credit, whether or not the beneficiary has

demanded or is at the time entitled to demand payment or performance. The term does not include the right of a beneficiary to demand payment or performance under a letter of credit."

Supporting Obligation

RA9-102(a)(77) defines "Supporting Obligation" as "means of letter-of-credit right or secondary obligation that supports the payment or performance of an account, chattel paper, a document, a general intangible, on instrument, or investment property."

This new term covers the most common types of credit enhancements. Special note should be taken of the rules governing obtaining control of a letter-of-credit right wet out in § 9-107.

Commercial Tort Claims.

RA9-102(a)(13) defines "Commercial tort claim" as "means a claim arising in tort with respect to which:

(a) the claimant is an organization; or

(b) the claimant is an individual and the claim:

  (i) arose in the course of the claimant's business or profession; and

  (ii) does not include damages arising out of personal injury to or the death of an individual.

This is a new term in the UCC. Although security interests in commercial tort claims are within the scope of RA9, this Article does not over-ride other applicable law restricting the assignability of a tort claim. A security interest in a tort claim also may exist if the claim is proceeds of other collateral.

Account Debtor.

RA9-102(a)(3) defines "Account Debtor" as "means a person obligated on an account, chattel paper, or general intangible. The term does not include persons obligated to pay a negotiable instrument, even if the instrument constitutes part of chattel paper."

Under prior RA9, an account debtor was a person "who is obligated on an account, chattel paper or general intangible" This change, with respect to a person who is obligated to pay a negotiable instrument, even if it is a part of chattel paper, means than the rules in §§ 9-403, 9-404, 9-405, and 9-406, dealing with the rights of an assignee and duties of an account debtor, to not apply to an assignment of chattel paper in which the obligation to pay is evidenced by a negotiable instrument. Rather, the assignee's rights are governed by Article 3 of the UCC, except that Promissory Notes, including negotiable promissory notes, are governed by § 9-406(d).

Secured Party.

Under RA9-102(a)(72), "Secured Party" means:

(a) a person in whose favor a security interest is created or provided for under a security agreement, whether or not any obligation to be a secured is outstanding.

(b) a person that holds an agricultural lien;

(c) a consignor;

(d) a person to which accounts, chattel paper, payment intangibles, or promissory notes have been sold;

(e) a trustee, indenture trustee, agent, or other representative in whose favor a security interest or agricultural lien is created or provided for; or

(f) a person that holds a security interest arising under Section 20401, 2-505, 20711(3), 2A-508(5), 4-210, or 5-118.

The new definition reflects the fact that consignment are now brought under RA9, and that agricultural liens are also now covered. It also clarifies that status of representative parties as appropriate secured parties.

Debtor

RA9-102(a)(28) defines "Debtor" as means"

(a) a person having an interest, other than a security interest or other lien, in the collateral, whether or not the person is an obligor;

(b) a seller of accounts, chattel paper, payment intangibles, or promissory notes; or

(c) a consignee

Deposit Account.

RA9-102(29) means a demand, time, savings, passbook, or similar account maintained with a bank. The term account includes investment property or accounts evidenced by an instrument.

Obligor.

RA9-102(a)(59) defines "Obligor" as "means a person that, with respect to an obligation secured by a security interest in or an agricultural lien on the collateral, (i) owes payment or other performance of the obligation, (ii) has provided property other than the collateral to secure payment or other performance of the obligation, or (iii) is otherwise accountable in whole or in part of payment or other performance of the obligation. The term does not include issuers nominated persons under a letter of credit."

Attachment and Perfection

The general rules of attachment and perfection of security interests have not changed with RA9. These rules are spelled out in Part 2 of RA9. Generally, a security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral, unless an agreement expressly postpones the time of attachment. *Sec. 9-203(a).*

A security interest is enforceable against the debtor and third parties with respect to the collateral only if:

(1) value has been given;

(2) the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and

(3) one of the following conditions is met:

(a) the debtor has authenticated a security agreement that provides a description of the collateral and, if the security interest covers timber to be cut, a description of the land concerned;

(b) the collateral is not a certified security and is in the possession of the secured party under Sec. 9-313 pursuant to the debtor's security agreement;

(c) the collateral is a certified security in registered form and the security certificate has been delivered to the secured party under Sec. 8-301 pursuant to the debtor's security agreement; or

(d) the collateral is a deposit account; electronic chattel paper; investment property; or letter-of-credit right, and the secured party has control under Sec. 9- 104, 9-105, 9-106 or 9-107 pursuant to the debtor's security agreement.

The general rule for the perfection of security interests and agricultural liens is that perfection is made through a filing of a financing statement in the central filing office of the jurisdiction. *Sec. 9-310(a).* Sec. 9-310(b) contains a long list of exceptions which should be carefully reviewed by the practitioner. The general rule for the assignment of interests in a security interest remains true under RA9, that a filing is not required to continue the perfected status of the security interest in the assignee.

Under Sec. 9-302, while farm products are located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of an agricultural lien on farm products. This is a new choice of law provision regarding agricultural liens on farm products. *See, Official Comments, Comment 2.*

Particular Issues Related to Agricultural Collateral

Agricultural Liens

The new definition of agricultural liens refers only to nonpossessory liens. Agricultural liens are liens arising under other state law and not under Article 9, and are not security interests as defined by Article 9. The creation of the lien is accomplished according to the other law authorizing the lien and it is enforced and becomes unenforceable under that law. However, to maintain the priority of the lien against third parties, the lien must be perfected by filing a financing statement pursuant to RA9.

Two of Colorado's statutory liens in the agricultural arena are useful in demonstrating the operation of this provision; the agister's lien under CRS Sec. 38-20-202, and the harvester's lien under CRS Sec. 38-24.5-101. The agister's lien is a possessory lien, in that the right to the lien requires that the person feeding the livestock must remain in possession of the livestock. Accordingly, the agister's lien is not an agricultural lien under RA9 and perfection under RA9 is not required or effective to preserve the lien.

On the other hand, a harvester's lien is a nonpossessory lien against the harvested crops. The lien is created by taking the steps provided by the statute and must be enforced as provided by that statute. However, in order for the harvester's lien to be effective against third parties, it must be perfected by filing a financing statement at the Colorado Secretary of State's office.

Purchase Money Security Interests in Livestock

RA9 has changed the rules on the relative priority of purchase money security interests ("PMSI") in livestock.

Before July of 2001, the claim of a secured party who held a perfected PMSI in livestock would trump the claim of a secured party who held a security interest perfected by an earlier-filed financing statement in the same debtor's livestock. This contest would usually be between a lender who held a purported first and prior secured claim with a blanket lien on, for example, "all cattle", and a seller retaining a lien on particular cattle sold to the debtor who then defaults. Under the old rules, the PMSI would win the contest even if the PMSI secured party knew of the earlier perfected security interest. The blanket lender's hope would be that the seller could not qualify as a properly perfected PMSI holder under the strict definitions applied to that term. The definition of a PMSI, under both the old law and RA9, in plain English, is a security interest in goods actually purchased or acquired with the value given in order to enable the debtor to acquire the rights in such goods. The value given could have been money from a lender or possession from a seller, so long as the value was actually used to acquire the interest in the collateral. If the PMSI was perfected by filing within 20 days of the time the debtor took possession of the livestock, the PMSI would have priority over the prior perfected security interest.

Over the almost 40 years since the adoption of the UCC, this rule has generated numerous lawsuits and many law review articles. It has also caused a great deal of anguish and confusion among lenders, sellers of livestock and the sellers' lenders. Legal commentators have routinely criticized the rule as being a trap for the unwary, and a trap even for the cautious lender who could not be on the farm all of the time. RA9 has changed this situation largely by applying to livestock financing the rules for PMSI claims in inventory financing. The key differences between the old rule and the new rule are: 1) a requirement for providing advance notice to the earlier perfected secured party; 2) a requirement for perfection of the PMSI when the debtor receives possession of the livestock; and 3) continuing priority in the proceeds and products of the livestock secured by the PMSI.

Under RA9 [C.R.S. § 4-9-324(d) and (e)], a perfected PMSI in livestock that are farm products has priority over a conflicting security interest in the same livestock, and, except as otherwise provided in § 9-327, a perfected security interest in their identifiable proceeds and identifiable products in their unmanufactured states also has priority if: 1) the PMSI is perfected when the debtor receives possession of the livestock; 2) the PMSI secured party sends an authenticated notification to the holder of the conflicting security interest; 3) the holder of the conflicting security interest receives the notification within six months before the debtor receives possession of the livestock; and 4) the notification states that the person sending the notification has or expects to acquire a PMSI in livestock of the debtor and describes the livestock. The provisions set out in 2 through 4 above apply only if the holder of the conflicting security interest had filed a financing statement covering the same

type of livestock: 1) if the PMSI is perfected by filing, before the date of filing; or 2) if the PMSI is temporarily perfected without filing or possession under §9-312(f) [temporary perfection for goods or documents made available to the debtor for sale, exchange or shipment] before the beginning of the 20-day period thereafter. The exception noted above in §9-327 is for proceeds deposited in a depository account in which a perfected security interests exists under that section.

Now all of that is a mouthful, but what it means is that before a PMSI can trump the first priority claim of a lender with a properly perfected blanket lien on all of a common debtor's livestock, the blanket lender must have received notice from the secured party claiming the PMSI, within six months before the possession by the debtor of the livestock in which the PMSI is claimed, that the new secured party has or expects to have a PMSI in certain specifically described livestock, and the PMSI must be perfected when the debtor receives possession of the livestock. The notice required by RA9 is to be sent to the address of the secured party as shown in the recorded financing statement. This notice will allow the blanket lien holder to protect its interests by implementing the appropriate controls in its loan and collateral requirements. It also provides certainty for the PMSI lender financing livestock or a seller of livestock retaining a lien by making certain that the otherwise senior lender is aware of its interests in the particular livestock. RA9 extends additional protection for a properly perfected PMSI by continuing its priority in the proceeds and products of the livestock.

In order to take full advantage of this new rule, a secured lender with a blanket lien on "all livestock" or "all cattle" should update its loan servicing procedures to pay special attention to the receipt of any such notices. Once such a notice is received, the lender should take measures to ensure that its collateral is segregated from the PMSI collateral or otherwise separately identified, or that the loan balance or borrowing base is appropriately adjusted.

For a PMSI secured party seller or lender, it will no longer be enough simply to retain or take a security interest in the new livestock going onto the farm and to file its financing statement within 20 days thereafter. The PMSI secured party must now ensure that proper notice is given to and received by the holder of the earlier perfected security interest and that it's financing statement is filed, practically speaking, before the livestock is delivered to the debtor.

As was the case before this change in the law, the party seeking to enforce a PMSI against common livestock will have the burden of proving that its PMSI meets the strict application of the exception to the general rule that the first to file or otherwise perfect has priority. However, once that priority is gained by the PMSI secured party, RA9 extends that priority for the proceeds and products of the livestock. This extended priority applies only to proceeds not deposited in a depository account subject to a "control agreement" and to products of the livestock in their unmanufactured state.

This resolution to a long-standing problem in livestock financing should go a long way in clarifying the relative priority of conflicting claims to livestock owned by a common debtor, reducing the amount of litigation resulting from such conflicting claims, allowing better prediction of outcomes for livestock lenders and their lawyers and restoring fundamental fairness to the regulation of these conflicting interests. Of course the courts have not yet addressed this change in the law, but there is precedent arising from similar contests in inventory financing to which courts may look for guidance.

Security Interests in Proceeds vs. Security Interests in Depository Accounts.

The inclusion of depository accounts to the list of possible original collateral sets up some interesting conflicts. Under Sec. 9-104 a security interest in a depository account is perfected by the secured party having "control" of the account. There are three ways to gain control of an account. First, if the bank that holds the account is the secured party, it automatically has control. Second, the secured party can become the customer of the bank where the depository account is located; that is, it becomes the owner

of the account. Third, the secured party, the debtor and the depository bank can enter into a control agreement, granting control of the account to the secured party.

The conflict that these two provisions set up is the battle over proceeds of collateral when the proceeds are deposited in a bank that is not the secured party on the collateral producing the proceeds, but where the depository bank also has a security interest in the account to secure its own loans to the common debtor.

Under 9-315, a secured party's security interest continues in and attaches to proceeds of collateral, unless the secured party has authorized the sale free and clear of its lien. That is limited however, in two ways. If the proceeds are commingled with other property and the proceeds are not goods, then to the extent the secured party can identify the proceeds through tracing the secured party's interests in the money can be preserved. That of course requires the tracing of the proceeds, which may be difficult and subject to controversy.

The second way the right to proceeds is limited is that if the original security interest does not cover proceeds of the collateral and that security interest is not perfected, the security interest lapses on the 21st day after the security interest attaches to the proceeds.

Suppose a debtor common to a lender providing production financing and a bank holding a deposit account of the common debtor, which bank is also providing financing to the common debtor. Then suppose the debtor sells collateral and deposits the proceeds in the account at the bank. Finally, suppose a bankruptcy filing by the common debtor, and the ensuing contest between the lender claiming a continuing security interest in the proceeds and the bank claiming a security interest in the funds in the depository account.

I know of no cases addressing this potential dispute, but I think the results would be very fact-specific and a general rule, except as et out by RA9, would be difficult to fashion. However, a practitioner representing the lender rather than the bank would be advised to attempt to resolve the question ahead of time by obtaining control of the depository account.

Recent Cases

- *Zink v. Vanmiddlesworth, 300 B.R. 394 (D.C., N.D.N.Y., 2003).* Under New York law, creditor with purchase-money security interest in livestock must have perfected its interest prior to debtor's taking possession, and must have given appropriate notice in timely fashion, in order for its interests to have priority over conflicting interest, not only in proceeds of original livestock, but in original livestock as well.
- *In re Stout, 284 B.R. 511 (D. Kan., 2002).* Interest of Chapter 12 estate in proceeds of crops planted prepetition was free and clear of any lien or claim of creditor; creditor's security interest prior to enactment of revised Article 9 did not attach to crops, because security agreement did not describe lands upon which debtors' crops were growing, and security interest could not be "saved" by enactment of revised Article 9, since drafters of uniform law and Kansas legislature did not intend to cure defective pre-enactment attachments by enactment of revision.
- *In re Damrow Cattle Co., Inc., 300 B.R. 479 (BR,D. Neb., 2003).* Attachment of security interests, perfection and sales of farm products free and clear of liens under Nebraska law.
- *Dean v. Hall, 2003 WL 21650145 (E.D.Va.)).* Landlord's lien under Virginia law is agricultural lien and must be perfected in accordance with Virginia's Revised Article 9. ❖