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Purchase Money Security Interests in Livestock Under Revised Article 9

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Revised Article 9 (“RA9”) of the Uniform Commercial Code 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 its 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. ❖

Purchase
Money
Security
Interests in
Livestock
Under Revised
Article 9