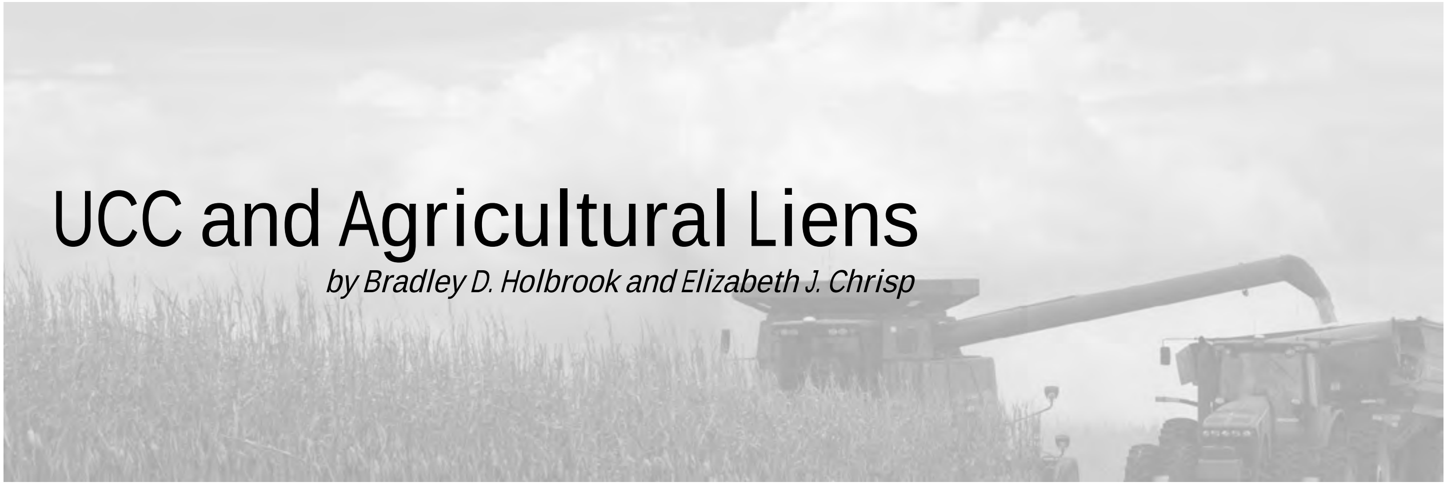

UCC and Agricultural Liens

by Bradley D. Holbrook and Elizabeth J. Chrisp

Recently, more articles and reports that focus on agriculture question the farm economy landscape and ask whether we are on the brink of the next farm crisis. The agricultural industry is a cyclical one, but does that automatically mean the challenges many faced in the 1980s are destined to resurface? Banks and other individuals involved in the agricultural community are monitoring the tides, and their changing interests may prompt (or already have prompted) requests for your legal advice. One of the challenges banks and other individuals face is sorting out the variety of public record filings related to farm transactions. Unless the bank or other individual regularly engages in farm lending, the differences between the Uniform Commercial Code ("UCC"), agricultural liens, UCC financing statements, and effective financing statements ("EFS") may not be clear. This issue is further complicated due to the fact that the different types of interests and filings may, at first glance, seem very similar. Consequently, banks and other individuals may assume they are secured in the event their farmer-debtor defaults, when, in reality, they may be left looking at empty pockets.

This article focuses primarily on the UCC and agricultural liens. UCC security interests will be discussed in some detail, but bankruptcy issues are not addressed. Practitioners should, at a minimum, have a general understanding of how the interests of banks and other individuals can be protected, especially in today's farm economy. This article explains how the agricultural market was affected in the 1980s, discusses how the UCC and federal and Nebraska law protects bankers and other individuals who support farming operations, and poses questions practitioners should consider when approached by clients involved in financing the agricultural community.

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1980s Farm Crisis

Following revolutionary advances in the agricultural industry and Soviet purchases of American grain, commodity prices increased in the 1970s.[1] Then, in 1979, the Federal Reserve tightened monetary policy, yielding double-digit interest rates not seen since the Civil War era.[2] National farm debt rose from approximately $12.5 billion in 1950 to fifteen times that amount in 1984.[3] Those factors, along with President Carter's embargo on farm products to the Soviet Union, a decline in commodity prices, and two droughts, spurred an estimated 300,000 defaults of farmer loans by the end of the decade.[4] Stark decreases were felt by millions of farms, and the economic downturn radiated to banks and storefronts on Main Streets across the Midwest.[5]

Farming Today

On a national scale and adjusting for inflation, this year's farm debt is "at the highest levels since the nation's agricultural crisis in the 1980s, when scores of rural banks failed."[6] Nebraska is facing grim reports as well. "Recent findings from the University of Nebraska-Lincoln Nebraska Farm Real Estate Market Survey for 2016 indicate that as of February 1, 2016, the weighted average farmland value declined by about 4 percent over the prior 12-month period to $3,115 per acre . . . mark[ing] the second consecutive year of lower weighted average farmland values in Nebraska."[7] Two major contributing factors weighing down 2016 agricultural land values are current crop and livestock prices.[8] For example, the value of cow-calf pairs have declined approximately 10 percent from 2015.[9] Declining commodity prices have also fueled lower cash rental rates for cropland and pastures across the state, varying from 2 to 17 percent lower than previous years.[10]

Decreasing farmland values, commodity prices, and cash rental rates signal lower farm incomes, sparking loan demand. Unfortunately, however, non-renewals are also on the rise. According to the Federal Reserve Bank of Kansas City, in the first quarter of 2016, 66 percent of Nebraska bankers indicated that farm loan demand is on the rise and almost all reported a decline in farm income from a year ago.[11] As a result, farmers that banks have previously backed during the not-so-distant surge in the farming market are now required to put more cash down or are being turned away.[12] This year, almost 15 percent of Midwest bankers report that the weakening farm economy and increased problems with repayments on loans resulted in their denial of more than 10 percent of applications for farm operating loans as compared to only 5 percent of bankers who denied at that rate in 2015.[13]

UCC Security Interests in Farm Products

Bankers and other individuals who support farming operations often take a security interest in the farmer-debtor's farm products to protect their investments or goods and services that have been provided. According to the UCC, "farm products" include crops, livestock, supplies used or produced in a farming operation, and the products of crops or livestock in their unmanufactured state.[14] To perfect its security interest, a secured party ordinarily files a UCC-1 financing statement. Priority battles are determined largely by the first-to-file rule, although there are special rules governing purchase-money security interests ("PMSI").[15]

Under the UCC, a buyer in the ordinary course of business ("BIOC") will generally take free of a security interest created by the seller, even if the security interest is perfected and the buyer knows of its existence. A key exception, however, applies to a BIOC of farm products. A buyer of farm products, who purchases from an individual engaged in farming operations, is excluded from the UCC's general take-free rule.[16]

Agricultural Liens

An agricultural lien is different from a UCC security interest, but the two are often confused. While both may secure payment or performance of an obligation related to farm products, a security interest arises through voluntary agreement, whereas an agricultural lien is purely nonconsensual—meaning created by statute rather than by agreement—and nonpossessory. An "agricultural lien" is defined as follows:

> [A]n interest in farm products:
>
> (A) which secures payment or performance of an obligation for:
>
> (i) goods or services furnished in connection with a debtor's farming operation; or
>
> (ii) rent on real property leased by a debtor in connection with its farming operation;
>
> (B) which is created by statute in favor of a person that:
>
> (i) in the ordinary course of its business furnished goods or services to a debtor in connection with a debtor's farming operation; or
>
> (ii) leased real property to a debtor in connection with the debtor's farming operation; and
>
> (C) whose effectiveness does not depend on the person's possession of the personal property.[17]

The facts of each case should be analyzed to determine whether the client secured payment or performance of an obligation for goods or services connected to the debtor's farming operation and whether such occurred in the ordinary course of business.

In Nebraska, agricultural liens also include the interests of various middlemen involved in the farming community, such as co-ops, warehouses, veterinarians, and seed dealers. Specifically, agricultural liens in Nebraska include artisans' liens, threshers' liens, veterinarians' liens, petroleum products liens, fertilizer and agricultural chemical liens, seed or electrical power and energy lines liens, agisters' liens, liens for feed, feed ingredients, and related costs, and agricultural production liens.[18] The corresponding set of statutes for each type of lien may impose additional requirements before the supplier can claim an interest. For example, there may be notice requirements[19] or the time for filing may vary from thirty days to six months after services are rendered.[20]

Agricultural liens are included in the scope of the UCC for perfection and priority. Accordingly, lien priority is generally dictated by the UCC's first-to-file rule.[21] A priority conflict between two unperfected secured creditors is governed by the date the agricultural lien becomes effective or the date the security interest attached.[22] Unperfected agricultural lien holders may also be subordinate to judgment lien creditors who become such before the unperfected agricultural lien holder perfects.[23]

An exception to the UCC's first-to-file rule can arise, however, if the statute creating the agricultural lien so provides. An example would include any possessory agricultural lien, such as an artisan's lien where the artisan retains the property until charges are paid.[24] In some measure, a possessory agricultural lien may be treated with the same priority of a PMSI. After all, the farmer-debtor often could not produce his or her farm products without third parties providing the needed goods or services on credit.

Two other noteworthy differences between the UCC and agricultural liens include filing and proceeds of the collateral. First, the UCC generally requires filing where the debtor is located to perfect a security interest in goods. An agricultural lien, however, is perfected by filing in the state where the collateral is located, not where the debtor resides.[25] Second, an agricultural lien remains only with the collateral, not the proceeds of the collateral.[26] Once a financing statement for an agricultural lien is filed, it "remains effective with respect to collateral that is sold, exchanged, leased, licensed, or otherwise disposed of and in which a security interest or agricultural lien continues, even if the secured party knows of or consents to the disposition."[27] Thus, a new financing statement or an amendment is not required for an agricultural lien holder to remain perfected in collateral, as long as the lien holder does not consent to the disposition free of the agricultural lien. But some statutory liens, such as a petroleum products lien and fertilizer and agricultural chemical liens, may attach to proceeds.[28] Hence, the corresponding set of statutes for each lien should be reviewed not only to determine whether additional measures are required for perfection, but also whether the lien's statutory language may yield more favorable end results for the perfected lien holder.

Food Security Act of 1985

As stated in the UCC security interest section above, a BIOC of farm products under the UCC is not allowed to take free of a security interest created by the seller. The Food and Security Act of 1985 ("FSA"),[29] however, preempts that exclusion under certain circumstances.[30] The FSA provides as follows:

> Except as provided in subsection (e) of this section and notwithstanding any other provision of Federal, State, or local law, a buyer who in the ordinary course of business buys a farm product from a seller engaged in farming operations shall take free of a security interest created by the seller, even though the security interest is perfected; and the buyer knows of the existence of such interest.[31]

Subsection (e) then describes the conditions under which the buyer takes the purchased farm product subject to a security interest created by the seller. A farm-product buyer will take subject to a security interest if: (1) the buyer receives from the secured party or seller written notice which meets certain requirements within one year before the sale and the buyer has failed to perform the payment obligations; or (2) the state in which the farm product is produced has a federally approved central filing system and the buyer failed to register prior to purchase of the farm products and the secured party filed an effective financing statement covering the farm products sold; or (3) the buyer receives from the Secretary of State written notice which specifies the seller and the farm product being sold as being subject to an effective financing statement or notice, and the buyer does not secure a waiver or release of the security interest.[32] Therefore, under the FSA, there are two types of states: those that have a certified system for the registration of security interests in farm products separate from the regular recordation of UCC financing statements ("Clear Title States") and those without a certified system ("Direct Notice States").

Today, Nebraska is one of nineteen Clear Title States.[33] Nebraska fully adopted the FSA[34] and was one of the first states to pass enabling legislation creating a central filing system.[35] This central filing system received federal certification in December 1986.[36] Thus, under Nebraska's central filing system, an agricultural lien holder should file a UCC financing statement *and* an effective financing statement ("EFS") with the Secretary of State to notify other buyers of their lien status.[37]

EFS and the UCC financing statement have some similarities—i.e., both will lapse within five years unless continued within six months of lapse[38]—but again, there are notable differences.[39] If an EFS is completed in writing, as opposed to electronically submitted, it must be "signed, authorized, or otherwise authenticated by the debtor."[40] An EFS must also include the approved unique identifier of the debtor, each county in Nebraska where the farm product is produced or located, the crop year (unless every crop of the farm product in question, for the duration of the effective financing statement, is to be subject to the particular security interest), and further details of the farm product if needed to distinguish from other security interests.[41]

Next Steps – Be Prepared

Practitioners dealing with the UCC and agricultural liens for banks and other individuals should be able to identify the client, ascertain what rules apply, and ask preliminary questions at the outset. First, identify the client. As stated above, clients may include co-ops, warehouses, veterinarians, and seed dealers, just to name a few. If the client may be dealing with an agricultural lien issue, determine the status of the client. The client may be unperfected, perfected, or have possession of the farm product(s). Status should be discussed with the client and verified by the practitioner. Practitioners may request the Secretary of State's annual "master list" of security interests, which is updated quarterly,[42] but the more prudent researcher would search the UCC and EFS databases on the Secretary of State's website.[43] Online searches ensure that all filings, even those after the most recent quarterly update, would be disclosed.

If you determine that the client is an agricultural lien holder and has filed a UCC filing statement and/or EFS, ask yourself whether it: (1) was filed in the proper place;[44] (2) contains accurate information;[45] and (3) is still effective.[46] Once those questions can be answered, determine whether other parties involved may have superior status. Remember to check the enabling statute; it may provide superior priority language.

Even if you conclude that the client is unperfected, you should consider whether the client can become perfected by filing or by other means. If other options are available, you could protect the client in a future priority battle if another unperfected secured party has interest in the same farm products, collateral, or (to the extent applicable) proceeds of the collateral. Of course, this general framework is only representative of some cases, and you should always make an independent determination whether other issues may be at play. Additionally, after screening the case, you may determine that the client is unperfected, cannot be perfected, and may not recover anything from the farmer-debtor due to the long-existing line of superior creditors.

Conclusion

Although the degree of the farm economy downturn may still be up for debate, the fact is that downward trends have been reported. Lawyers across Nebraska should be prepared to handle the changing needs of those clients involved in farm operations, because the UCC, agricultural liens, the FSA, and UCC and EFS records, although seemingly similar, operate differently.

Endnotes

1 *Id.*

2 *Id.*; *see also* Barry J. Barnett, *The US Farm Financial Crisis of the 1980s*, 74 Agric. Hist. 366 (Spring 2000).

3 *1980's Farm Crisis*, *supra* note 1.

4 *Id.*

5 *Id.*

6 Huffstutter & Madden, *Tightening Credit Heralds More Pain in U.S. Farming Downturn*, Reuters (Feb. 22, 2016), http://www.reuters.com/article/us-usa-farming-banking-idUSKCN0V-V0UR.

7 *2016 Nebraska Farmland Values and Rental Rates*, Cornhusker Econs., Neb. Inst. of Agric. & Nat'l Res. (Aug. 3, 2016), http://agecon.unl.edu/cornhusker-economics/2016-nebraska-farm-land-values-rental-rates; *see also* Cowley & Clark, *Farm Debt Accumulating*, Fed. Res. Bank of Kansas City (May 12, 2016), https://www.kansascityfed.org/research/indicatorsdata/agcredit-survey/articles/2016/5-12-2016/farm-debt-accumulating (stating that in 2016, "about half of [Tenth] District bankers indicated they expect further declines in nonirrigated and irrigated farmland values"); Huffstutter & Madden, *supra* note 7 (noting that "[l]and prices dropped as much as 10 percent in parts of Iowa, the top U.S. corn producer").

8 Huffstutter & Madden, *supra* note 7.

9 *Id.*

10 *Id.*

11 Cowley & Clark, *supra* note 8.

12 *Id.*

13 Kauffman & Clark, *Ag Credit Conditions Deteriorate Further*, Fed. Res. Bank of Kansas City (Aug. 11, 2016), https://www.kansascityfed.org/research/indicatorsdata/agcreditsurvey/articles/2016/8-11-2016/ag%20credit%20conditions%20deteriorate%20further.

14 Neb. Rev. Stat. U.C.C. § 9-102(a)(34).

15 *Id.* § 9-322; *id.* § 9-324. A PMSI can be in goods, which includes equipment, inventory, and farm products. A PMSI is created when a seller sells good on credit and takes a security interest in those goods, or a lender lends money to purchase a particular good, the money lent is used to purchase the good, and the lender takes a security interest in that good. A PMSI in consumer goods—goods used for personal, family, or household use—is automatically perfected, but all other PMSIs must be perfected within thirty days after the debtor receives delivery of the good to retain a perfected PMSI status. *Id.* § 9-317(e).

16 *But see infra* Food Security Act of 1985.

17 Neb. Rev. Stat. U.C.C. § 9-102(a)(5).

18 *Id.*

19 Neb. Rev. Stat. § 52-1402 (providing for an additional notice requirement for agricultural production liens).

20 *Id.* § 52-501(2) (filing must occur within 30 days for thresher's lien); id. § 52-902 (filing required within six months for petroleum products lien).

21 Neb. Rev. Stat. U.C.C. § 9-322(a).

22 *Id.* § 9-322(a)(3) ("The first security interest or agricultural lien to attach or become effective has priority if conflicting security interests and agricultural liens are unperfected.)

23 *Id.* § 9-317(a). A "'[l]ien creditor' means: (A) a creditor that has acquired a lien on the property involved by attachment, levy, or the like; (B) an assignee for benefit of creditors from the time of assignment; (C) a trustee in bankruptcy from the date of the filing of the petition; or (D) a receiver in equity from the time of appointment." *Id.* § 9-102(52).

24 *Id.* § 9-322(g) ("A perfected agricultural lien on collateral has priority over a conflicting security interest in or agricultural lien on the same collateral if the statute creating the agricultural

lien so provides."); Neb. Rev. Stat. § 52-201 (providing that an artisan "shall have the right to retain such property until such charges are paid"); *Bellamy's Inc v. Genoa Nat'l Bank* (*In re Borden*), 361 B.R. 489, 493, 498 (8th Cir. B.A.P. 2007) (holding that possessory artisan's lien has priority over a previously perfected security interest in the same goods).

[25] Neb. Rev. Stat. U.C.C. § 9-302; *id.* § 9-316, ex. 10.

[26] *Id.* § 9-315(a).

[27] *Id.* § 9-507.

[28] Neb. Rev. Stat. § 52-901; *id.* § 52-1101.

[29] 7 U.S.C. § 1631.

[30] *See Lisco State Bank v. McCombs Ranches, Inc.*, 752 F. Supp. 329 (D. Neb. 1990); 9 C.F.R. § 205.211 (1991) (intent behind federal act was to preempt state laws reflecting the "'farm products' exception").

[31] 7 U.S.C. § 1631(d). Similar to the UCC, Nebraska defines farm product as, "an agricultural commodity, a species of livestock used or produced in farming operations, or a product of such crop or livestock in its unmanufactured state, that is in the possession of a person engaged in farming operations." Neb. Rev. Stat. § 52-1308. The Nebraska statute, however, also provides a non-inclusive list of what constitutes a farm product, ranging from bees and emu to walnuts and embryos or genetic products. *Id.*

[32] 7 U.S.C. § 1631(e).

[33] *Clear Title (Central Filing Systems)*, U.S. Dep't of Agric., Grain Inspection, Packers & Stockyards Admin, https://www.gipsa.usda.gov/laws/cleartitle.aspx (last updated Nov. 16, 2015).

[34] Neb. Rev. Stat. § 52-1318.

[35] *Id.* §§ 52-1301 to -1321 (codifying the central filing system); *see also Lisco State Bank*, 752 F. Supp. at 336 (D. Neb. 1990). In conjunction with Nebraska's establishment of a central filing system, section 9-307(1) was amended to refer to the possibility that farm product buyers may be subject to security interests under the central filing system statutes.

[36] *Lisco State Bank*, 752 F. Supp. at 336 (quotation omitted).

[37] *See Damrow Cattle Co. v. First Nat'l Bank of Omaha* (*In re Damrow Cattle Co.*), 300 B.R. 479, 486 (Bankr. D. Neb. 2003) (noting that bank perfected its security interest in farm products by filing a UCC financing statement and an EFS).

[38] Neb. Rev. Stat. § 52-1307(6); Neb. Rev. Stat. U.C.C. § 9-515.

[39] Neb. Rev. Stat. § 52-1307(3).

[40] *Id.* § 52-1307(3).

[41] *Id.* § 52-1307(4).

[42] *See id.* § 52-1312(3).

[43] *Uniform Commercial Code*, Neb. Sec'y of State, http://www.sos.ne.gov/business/ucc/index.html (last visited Sept. 9, 2016).

[44] *See supra* note 26 and accompanying text.

[45] *See* Neb. Rev. Stat. U.C.C. § 9 338. For example, an agricultural lien that was perfected by filing and contains incorrect information "is subordinate to a conflicting perfected security interest in the collateral to the extent that the holder of the conflicting security interest gives value in reasonable reliance upon the incorrect information." *Id.* § 9-338(1).

[46] *Id.* § 9 515 ("Upon lapse, a financing statement ceases to be effective and any security interest or agricultural lien that was perfected by the financing statement becomes unperfected, unless the security interest is perfected otherwise. If the security interest or agricultural lien becomes unperfected upon lapse, it is deemed never to have been perfected as against a purchaser of the collateral for value."). Thus, if the agricultural lien holder allows a financing statement to lapse it is both prospectively and retroactively invalid against a purchaser for value.