THE IMPACT OF THE SECURED TRANSACTIONS ARTICLE ON COMMERCIAL PRACTICES WITH RESPECT TO AGRICULTURAL FINANCING

ROBERT S. HUNT† AND GLENN R. COATES*

I

INTRODUCTORY: SCOPE AND LIMITATIONS

"Agricultural financing" is a phrase of many hues; both words of the term defy precise definition. Whereas sales techniques for consumer durables are pretty much the same in Portland, Maine, or Portland, Oregon, different farm economies demand different financing methods. Thus, the stubborn facts of agriculture place an initial limitation on uniform codification. We know, however, that the draftsmen of the Secured Transactions Article were well aware of this.1 Money lenders also vary their methods from area to area, often without rhyme or reason; differing practices prevail in almost identical basic economies.2 This makes it doubly difficult to fit agriculture financing into the proposed structure of the Code. Moreover, when we speak of varying credit practices, we have said almost all we can: we actually know very little about how the garden variety of farm financing goes on throughout the country. Like many routine operations, it has gone on for generations and the law has been assuming a set of practices which may or may not have been close to the facts. Unlike the restaters of the law of future interests, draftsmen for the Commercial Code have cleansed the Augean stables without benefit of inventory.3

No one writes about farm financing in order to depict an institutional pattern.

† A.B. Oberlin, 1939; A.M. Harvard, 1940; LL.B. Yale, 1947. Instructor and Assistant Professor of Law, State University of Iowa, 1947-49; Rockefeller Research Fellow in Law, University of Wisconsin, 1940-50. Member of the Iowa bar. With firm of Pat, Hurd, and Reichmann, Chicago, Ill.

* LL.B., Wisconsin, 1949. Research Assistant in Agricultural Economics, University of Wisconsin, 1949-50; Carnegie Research Fellow in Law, University of Wisconsin, 1950-51. Member of the Wisconsin bar. Member, Guell and Coates, Thorp, Wisconsin.

1 See Gilmore, Chattel Security: II, 57 Yale L. J. 730, 786 (1948). This citation is premised on the assumption that Professor Gilmore was one of the draftsmen.

2 The authors interviewed a number of bankers from agricultural areas attending the School for Bankers at Madison, Wisconsin, in August of 1950. Different loan and security policies existed, in some cases, for substantially similar economic situations.

Every now and then a country banker describes a narrow point of technique, but to get broader significance from his discourse one has to read between the lines and assume the whole set of practices to which the new technique is incident. Until we know more we have to be selective; and, moreover, we have to rely greatly on personal interviews. Anyone who has done research in this way knows how time-consuming and oft-times fruitless it can be. Thus, this discussion necessarily omits consideration of vast and important fields of agricultural financing—the trading in livestock paper by the large Chicago credit houses, for instance—in the hope that a more detailed analysis of a particular region would be of greater value.

Therefore, the authors have focused their attention on southern Wisconsin. In so far as an area may be called "representative," this region is as much so as any. Dairy farming is predominant, but there is also considerable production of beef cattle, hogs, and tobacco. This combination assimilates to some degree both the cash-crop economy of the wheat and cotton belts, and the livestock economy of the corn belt. As part of a broader project, one of the authors interviewed a sampling of southern Wisconsin bankers, lawyers, and officials of the Production Credit Association concerning methods, devices, and techniques used in handling agricultural chattel security. We have also eliminated consideration of matters not peculiar to agricultural financing. Like everyone else, the farmer is a consumer, and he, too, buys automobiles, refrigerators, radios, and television sets. But we assume his problems in this regard are no different from those of other consumers who buy durable goods on credit. However, the line here is not sharp. The thousand dollar loan secured by a stand of corn is not earmarked: perhaps the farmer will use it to buy feed and fertilizer and perhaps he will use it to buy a new car. And who is to say which use of the money is improper? We cannot neatly separate the farmer as a consumer from the farmer as an entrepreneur.

Even with these limitations, we still have an economically important segment

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Footnotes:

4 See, e.g., Young and Graliker, Two Farm Loan Programs Benefit Both Farmer and Bank, 65 Bankers Monthly 12 (1948); Harding, Farm Equipment Credit Policies, Burroughs Clearing House, October, 1945, p. 18; id., November, 1945, p. 20; Swanzey, Agricultural Loans Increased by a Complete Farm Loan Program, 65 Bankers Monthly 583 (1947); Bird, Farm Financial Statements, Banking, February, 1946, p. 72; De Jong, Bank-Managed Farming, Banking, February, 1946, p. 47. See also Harry M. Love, Financing Truck Crops in Three Eastern Virginia Counties, Virginia Agricultural Experiment Station Bull. No. 369 (April, 1945); and Myers, Agriculture and the Security Loan, Cornell University Department of Agricultural Economics (1948).

5 One of the authors is presently engaged as a Carnegie Law-in-Action Fellow on a research program dealing with agricultural security under Professor J. H. Beuscher at the University of Wisconsin School of Law. Professor Beuscher envisages a series of studies which will portray the going ways of law rather than what the courts and commentators say are the going ways. For one example of such a study see ECKHARDT, TRANSFER OF THE FAMILY FARM (unpublished S.J.D. thesis in University of Wisconsin Law Library, 1950).

6 The author interviewed ten lawyers, ten bankers, and two officials of the Production Credit Association. Although he interrogated the parties generally as to their impressions of relevant portions of the new Code he directed most of his questions to matters of present policy and practices in exacting security for loans on agricultural chattels.

7 WILLIAM G. MURRAY, AGRICULTURAL FINANCE 11-12 (1946).
of agricultural financing secured by chattels. In 1949 a total of 2.8 billion dollars was outstanding in agricultural non-real-estate credit. But there is more involved here than cold statistics: in the case of many farmers, the burden of short-term debt spells the difference between success or failure. In addition, short-term credit, although in total amount outstanding less than long-term credit, actually represents a greater number of individual loans because each loan is smaller. Any legislation affecting that amount of credit and touching so many farmers is obviously of great importance to the nation's economy. Moreover, such short-term loans secured by chattels have assumed new prominence in southern Wisconsin. Although banks prefer to make loans on real estate, they now find themselves forced more and more to rely on personal property as security. Two factors account for this: (1) the area has the highest percentage of tenancy in the state and (2) the investment in owner-operated farms is approaching a fifty-fifty ratio between land and personal property, because of increased mechanization and the inflated price of dairy cattle.

The approach throughout this discussion is three-fold: to examine agricultural financing practices as they now exist in certain limited fields, to note the relationship between the going ways and the present state of the law, and to inquire how adoption of the new Code will affect both the going ways and the present law.

II
SECURITY FOR PRODUCTION LOANS
A. Security Interests in Crops—Creation

Perhaps the most vexatious problem in agricultural chattel financing involves the nature of security interests in growing crops—the so-called crop-mortgage. State courts have spun a variegated pattern of doctrine, and generalization is virtually impossible. We can illustrate by noting two situations where attempts to solve the problem have evolved different sets of practices. In one, the crop concerned is the sole source of security for the loan—typically the case in loans made to tobacco farmers. In the other, the crops are merely part of the security; lending agencies require a first lien on all the farmer's personal property and they conventionally include crops either generally or specifically in the description clause. Obviously the concern of the secured lender in the two instances is different: a mortgagee with

9 Murray, op. cit. supra, note 7, at 146.
10 MURRAY, op. cit. supra, note 7, at 146.
11 To encourage borrowing on real estate, they charge only a 4 per cent rate of interest; in contrast, on loans secured by chattels they demand 6 per cent.
13 This seemed to be the universal practice among lending agencies who loaned money to tobacco farmers in the area of southern Wisconsin investigated by the author.
an inclusive clause covering all chattels, places little reliance on the crops themselves; he contemplates that the farmer may use them as feed for livestock since the livestock also are covered by mortgage; but to the lender of the tobacco farmer, the security in the crops is everything.

As a matter of practice, where the crop is the sole security, southern Wisconsin lending agencies execute the mortgage after the crop is growing, preferably just before harvest, or, in some occasions, even after harvest. In the mortgage instrument the crop is specifically described in terms of the real estate on which it is growing or, if the crop is picked, in terms of the plat on which the drying shed is located. On the other hand, when the lender includes the crop as additional security only and it is but one of many chattels covered, he may make the loan before the crops are growing or even before they are planted. In so doing, he then employs one of two rather novel devices: one is to date and file the crop mortgage after the crop has started growing, regardless of the time of execution; the second, used by the Production Credit Association and at least one finance company, is to extract from the farmer-debtor a promise to deliver a first mortgage on all crops as soon as they become growing and an irrevocable power of attorney in someone designated by the lender to execute such a mortgage if the debtor refuses or fails to fulfill his promise to do so. To understand the origins of these devices we must look at Wisconsin law.

The Wisconsin Supreme Court has never recognized the validity of a mortgage on after-acquired property, including crops to be grown;\(^\text{14}\) if the mortgage is executed before the crops are growing, the mortgagor has only a "revocable license."\(^\text{15}\) By post-dating and post-filing the mortgage, the lender hopes to hurdle this restrictive Wisconsin rule. But it is doubtful whether he succeeds: at most, he besets the mortgagor with problems of proof as to date of execution, and deters subsequent good faith purchasers and lien creditors, who rely on the record as it stands. The efficacy of the second device is equally dubious. If a promise to execute a mortgage creates no more than a "revocable license,"\(^\text{16}\) it is hard to see how a power of attorney can be given greater effect. The Wisconsin court, presumably, would not permit form to triumph so easily over substance.\(^\text{17}\)

\(^\text{14}\) Comstock v. Scales, 7 Wis. 138 (1858); Merchant's and Mechanic's Savings Bank v. Holdrcdge, 84 Wis. 601, 55 N. W. 108 (1893); Kohler Improvement Co. v. Preder, 217 Wis. 641, 259 N. W. 833 (1933). Other states have recognized the validity of such mortgages on a potential existence or equitable lien theory. Twin Falls Bank & Trust Co. v. Weinberg, 44 Idaho 332, 257 Pac. 31 (1927); Arques v. Wasson, 51 Cal. 620 (1877); Wheeler v. Becker, 68 Iowa 723, 28 N. W. 40 (1886). See generally Comment, 47 YALE L. J. 98, 99-100 (1937).

\(^\text{15}\) Chynoweth v. Tenney, 10 Wis. 397 (1860). This analogy presumably derives from the fact of a chattel mortgagee's right of entry. Exercise of the right of entry by the mortgagee, before revocation by the mortgagor, however, may result in the perfection of the lien.

\(^\text{16}\) In the leading case counsel urged the equitable lien theory but his contention was expressly rejected by the court. Id. at 403.

\(^\text{17}\) See e.g., Manufacturer's Bank of Milwaukee v. Rugee, 59 Wis. 221, 18 N. W. 251 (1884); First National Bank of Madison v. Damm, 65 Wis. 249, 23 N. W. 497 (1885); Smith v. Pflugcr, 126 Wis. 253, 105 N. W. 476 (1905). Cf. Lamson v. Moffat, 61 Wis. 153, 21 N. W. 62 (1884) (lease intended as security treated as mortgage). Conventional theory, making a power of attorney for security irrevocable, is based on the premise that a promise to execute a mortgage creates an equitable lien. Hunt v.
Thus, by permitting an interest in future crops, the Secured Transactions Article, with its emphasis on function rather than doctrine, will change the Wisconsin law relative to crop mortgages. Whereas the security interest contemplated by the Code cannot attach to the crops until they are planted or otherwise become growing, still it permits the making of the agreement prior to that time. The draftsmen, moreover, codified the better practice and case law by requiring description of the specific land on which the crops are growing. In addition, the Code imposes other limitations: if enacted it will presumably prescribe a maximum number of years after the execution of the security agreement beyond which the security interest is not effective.

To perfect his interest, a secured lender must complement his security agreement with a financing statement which, in turn, must be filed in the county in which the crops are growing. In this respect an interesting problem grows out of a change made by the September, 1950, revision. In the Spring draft the codifiers had said that a lender's interest in future crops had priority as of the time he filed his financing statement. But in the change, the draftsmen substituted for time of filing, "The time when his security interest was originally perfected." What, then, will be the situation between two lenders who have executed security agreements and filed financing statements covering the same future crops? Under the definition both interests will become perfected at the same time—to wit, when the interest attaches, which, in this case, means when the crops become growing. But suppose the second lender takes his security interest on some presently existing property, and includes the future crops by way of an after-acquired property clause. Then, as to the future crops, he will prevail over the first lender because the second lender’s interest in the future crops relates back to the time his security agreement was “originally perfected.” Since the property subjected to the security interest was presently existing when the agreement was executed, his interest was “originally perfected” at the time he filed his financing statement. By the same token, the only way the first lender, seemingly, can assure his prior rights in the future crops, is to include existing property in his security agreement.

Rousmanier’s Adm’r, 8 Wall. 174 (U. S. 1823); American Loan and Trust Co. v. Billings, 58 Minn. 187, 59 N. W. 998 (1894). Where the premise falls, as in Wisconsin, the conclusion would seem also untenable.

"A security interest cannot attach until . . . the debtor has rights in the collateral . . . [T]he debtor has no rights in crops until they are planted or otherwise become growing crops . . . .” §9-203(1) and (2)(a). Unless otherwise indicated all references to the Code are to the September, 1950, Revision of the Proposed Final Draft.

"No security interest attaches under an after-acquired property clause to crops planted or otherwise becoming growing crops more than [ ] years after the security agreement is executed . . . .” §9-203(3)(a).

Last spring the draftsmen were bolder; they prescribed flatly a one year limitation on such security agreements. §9-203(3)(a), Spring, 1950, Draft.

§9-303(1)(b). The security agreement, apparently, need not be filed. Ibid.

§9-312(1), Spring, 1950, Draft.

Assuming no special circumstances are present to make §9-313(5) apply.

§9-313(2).

§9-313(2).

§9-303(1)(c).

Although this discussion is confined to crops, the problem arises whenever a security agreement is limited to after-acquired property alone. The security interest attaches when the debtor has rights in the collateral. §9-203(1).
As we have noted, the Code will have its greatest effect in states like Wisconsin where, at the present time, there is no regular device available to secure production loans on crops to be grown. In other states, presently recognizing crop mortgages, it will have the beneficial effect of creating uniformity out of a hodgepodge of limitations which presently discourage loaning agencies from dealing in crop mortgages. Not the least beneficial will be the Code’s effect in putting the United States Government in the same position as private lending institutions. In their zeal to comply with the requirements of the New Deal lending agencies, state legislatures passed enabling acts which went beyond the protection normally afforded a crop mortgagee. These acts, like other state statutes dealing with chattel security on agricultural products, presumably will be repealed by adoption of the Commercial Code.

B. Security Interests in Crops—Relations Between the Parties

Southern Wisconsin lawyers and lenders make little effort to police the use to which the debtor puts the crops securing the loan. Where the crop is simply one item in the security, the lender normally has no objections to the farmer’s harvesting the crop and using it to feed his livestock. Similarly, where the crop is raised to be sold—i.e., by tobacco farmers—the lender permits the farmer-debtor to sell it at any time, and to any purchaser he chooses. And this despite the fact that the mortgage itself prohibits such a practice and despite the fact that the lender does not usually insist that his mortgage specifically cover the proceeds of sale. At the same time, it is clear that he expects to be paid when the crop is sold, and, as a matter of practice, tobacco purchasers usually procure chattel mortgage abstracts and make out their checks both to the owner and the mortgagee.

Seemingly this technique is sanctioned by institutional practice alone; existing law casts great doubt on its validity. Giving a farmer implied authority to sell normally amounts to a waiver of the lender’s interest as against the claim of a purchaser without actual knowledge of the mortgage; record notice, relied on here by the lending agency, is not considered enough. The validity of such practice as against creditors depends on the terms of the agreement relating to disposition of the proceeds. If the mortgagee permits the mortgagor to sell the property and apply the proceeds to his own use, the mortgagee is not protected against the claim of a subsequent lien creditor. Thus, by this practice, lenders run a risk of losing the lien as against both creditors and bona fide purchasers.

87 Thus, in certain states, where crop mortgages were invalid as against lien creditors (e.g., New York), the statute made an exception of mortgages held by federal loan agencies. Other states specifically provided that perennial crops attaching themselves to the realty would, for the purpose of the enabling legislation, be considered as personalty. See generally Comment, 47 Yale L. J. 98 (1937).

88 §11-102.

89 Southern Wisconsin Acceptance Co. v. Paull, 192 Wis. 548, 213 N. W. 317 (1927). For similar holdings in other jurisdictions see Abbeville Live Stock Co. v. Walden, 209 Ala. 315, 96 So. 237 (1923); Partridge v. Minn. & D. Elev. Co., 75 Minn. 496, 78 N. W. 85 (1899). The theory is that the mortgagee, by permitting the sale, thereby substitutes the personal promise of the debtor for the security in the property.

90 Ross v. State Bank of Trego, 198 Wis. 335, 224 N. W. 114 (1929). See also Carr v. Brawley, 34 Okla. 500, 125 Pac. 1131 (1912).
Enactment of the Code would bring law and practice into harmony in so far as the debtor's use of the crop for feed is concerned. A security interest in crops is not invalidated as to creditors simply because the farmer-debtor by express agreement has the liberty to use the harvested crop for feed.\textsuperscript{31} Record notice of the secured lender's interest should be sufficient to cover the crops after harvest and while they are stored. The situation is less clear when express authority is absent. The applicable provision of the Code seems to say that to harvest and use for feed without a stipulation in the security agreement will invalidate the lender's security interest as against claims of creditors.\textsuperscript{32}

As to existing practice which permits the farmer to make an outright sale of the crops, we can only speculate as to what the Code will do. If the secured lender permits his debtor to sell the crops but provides for a lien to attach to the proceeds, then the buyer will take free of the security interest.\textsuperscript{33} And, if the lender expressly denies the debtor such freedom, his limitation will be effective;\textsuperscript{34} if the debtor sells the crop in spite of the prohibition, he must turn over any identifiable proceeds of sale to satisfy the secured lender's interest.\textsuperscript{35} It is highly doubtful that financing agencies will openly provide for their security interest to attach to the proceeds, thereby permitting the buyer to take free of the security interest. This would seem to be particularly true where purchasers—such as tobacco buyers in southern Wisconsin—continue to recognize the nuisance value of record notice which denies such freedom to sell. On the other hand, it is just as probable that the lender will continue to give his debtor-farmer implied authority to sell. Thus the lender's position seemingly is improved by the Code: he will have a lien on the proceeds and at the same time he will not be waiving his interest as against creditors.

C. Security Interests in Livestock—Creation

In the dairy farming economy of southern Wisconsin, lenders were unanimous in their opinion that the dairy herd was preferred over all other types of property as security for agricultural chattel mortgages. There are many reasons for this: depreciation proceeds at a slow pace, resale value varies but little during the term of the loan, and, of course, the dairy herd is the primary source of farmers' income in this area.

A lender taking a chattel mortgage on a dairy herd is met at the outset with a problem in description. How shall he describe the herd so as best to protect his interest? Description by breed and by color are used uniformly, but, beyond this, it is virtually impossible to generalize. Some banks and bankers' counsel prefer to describe tested cattle individually by ear tag number. Others object to this because of the ever present danger of losing the tag. Some lending agencies describe the

\textsuperscript{31} §9-207.
\textsuperscript{32} Ibid. Yet with respect to authority to sell rather than to use for feed and as against claims of buyers rather than creditors, the Code suggests that silence implies permission. §9-307(2).
\textsuperscript{33} Ibid. Even after the crop is harvested and held for sale by the farmer who produced it, it is not classified as inventory under §9-109(4) & (5).
\textsuperscript{34} §9-306.
\textsuperscript{35} Ibid.
herd in terms of a specific number, while others simply use the generic word "all."

The question of increase is related to description. Mortgage forms used by southern Wisconsin lending agencies expressly provided for the mortgage to cover increase of the livestock. The clause makes no distinction between increase presently conceived and future increase; presumably, it is intended to cover both.

Existing law in Wisconsin supports in part the practices of lending agencies with respect to description. If the lender describes the cattle with particularity—either by ear tag number or by type and color—his interest will be covered by the mortgage. But if he simply describes the number of cattle in the herd—i.e., "twenty Guernsey cattle"—and if it turns out that the farmer in fact has twenty-five, the lender's mortgage may be void for uncertainty. By using the inclusive "all" the lender avoids this pitfall. Similarly, by using the inclusive "all" the lender purports to cover any increase to the herd purchased by the farmer after execution of the mortgage. This, like the devices used in future-crop mortgages, is an attempt to get around the strict Wisconsin rule as to the ineffectiveness of after-acquired property clauses. And it is equally doubtful whether the practice successfully skirts the rule; it may also do nothing but present the mortgagor with difficult problems of proof and deter subsequent purchasers who rely on the records.

The whole matter of increase in the herd is not clear in Wisconsin. An early case held that as between the parties a mortgage given on a single animal during the gestation period covered the increase even though the instrument itself failed to provide for it. But the court went on to say that the lien on the increase was good against third parties only while the calf followed the mother; when the animals became separated, the lien on the mother no longer imported notice of a lien on the calf. Therefore, Wisconsin lenders customarily cover increase expressly in their mortgages; they presume thereby to impute notice of a lien on the calf. Therefore, Wisconsin lenders customarily cover increase expressly in their mortgages; they presume thereby to impute notice of a lien on the mother no longer imported notice of a lien on the calf. However, still unanswered is the question of whether the mortgagee has a lien on increase not conceived when he took his mortgage. The Wisconsin court has not yet passed on this, but, in all probability, it would find that future conceived offspring came within the restrictive Wisconsin rule as to after-acquired property.

Adoption of the Code will help to clarify this mess. If the security agreement is silent as to increase, it will create no interest in offspring, presently conceived or otherwise, because the Code states that no security interest can attach until there is an agreement made that it shall attach. If the agreement describes increase

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27 See text and notes pp. 168, 169 supra.


30 Funk v. Paul, 64 Wis. 35, 40, 24 N. W. 419, 421 (1885).

31 See text and discussion pp. 168, 169 supra. But see Cahoon v. Miers, 67 Md. 573, 11 Atl. 278 (1887) (mortgagee has lien on future increase even when mortgage is silent as to increase).

32 59-203(1). In addition, the Code requires that the property be reasonably described. 59-110.
expressly, it will give the lender a valid lien on offspring presently conceived. And, finally, if the agreement contains an after-acquired collateral clause it will create a valid security interest in any increase conceived subsequent to the time of the execution of the agreement.\footnote{\textsection9-203(1), 9-203(2)(a). By definition, an after-acquired collateral clause, presumably, does not cover increase presently conceived.} Moreover, the same problem of conflicting security interests we noted with respect to interests in future grown crops is not present here.\footnote{\textsection9-313(2).} The secured lender who files first will prevail because at that time his security interest is "originally perfected" and his rights in the after-acquired collateral relate back to that time.\footnote{\textsection9-313(3).} A different problem may arise with respect to the interest of a purchase money lender whose purchase money security agreement expressly included increase. His claim as to increase presently conceived will prevail against holders who claim an interest in the same increase under an after-acquired collateral clause.\footnote{\textsection9-313(3).} But if the purchase money security agreement also contains an after-acquired collateral clause, will the purchase money lender's priority extend also to increase not presently conceived at the time he took his security interest? Presumably he should not prevail: presently conceived increase is normally a factor in the purchase price of livestock; future conceived increase is not.

\section{D. Security Interests in Livestock—Culling the Herd}

Lenders on dairy herds customarily permit the farmer to weed out diseased cattle or poor producers and substitute new stock. Some lenders insist that the proceeds of sale be applied to the loan with the understanding (explicit or implied) that they will advance money to buy replacements; and, when the cushion of security is small, they may also require a mortgage on the replacement. In a few cases the farmer-debtor must get the lending agency's permission to make any replacements; even then the farmer often substitutes without consent on the theory that the lender is no worse off if a poor producer is exchanged for a better one.

There is every reason to believe that culling under a mortgage is workable and desirable. The farmer is in the best position to decide when to get rid of a diseased cow or a poor producer, which increase to keep and which to sell, when to place emphasis on high production or on butterfat content or on improvement in type. The lender, moreover, anticipates payment from the sale of milk rather than from the sale of the herd; he should have no objection to selling any particular cow, so long as a replacement is substituted.

But under existing law the lender constantly runs the risk of having his mortgage cover only part of the herd, and finding that many animals supposedly covered by the mortgage have been sold or otherwise disposed of. The lending agencies which the author interviewed, consequently, indicated their approval of some sort of a security device which would attach to the dairy herd as such and permit the farmer to dispose of poorer animals and replace them with better ones.

The new Commercial Code will do much to encourage such a practice. The
after-acquired property provision permits the security interest’s attaching to replace-
ments and another provision validates agreements allowing the farmer to sell or
dispose of increase and mature animals he has raised. Thus, with legitimation of
the practice of culling by the Code, we can look for its rapid adoption by lending
agencies.

A collateral problem does arise, however, under the new Code. What about
livestock purchased—rather than raised—by the farmer? Could purchased dairy
cattle, which turned out to be poor producers, be culled? Are they “farm products”
within the definition of the Code which requires them to be “in the possession of a
debtor from whose raising, fattening, grazing or other farming operations they
derive”? Conceivably they could be so classified depending upon what the codifiers
mean by such terms as “raising” and “grazing.” But if they are not called “farm
products,” then, unless they can be classified as inventory, they would not qualify
under the section permitting the farmer to cull his herd. And it is difficult to call
them inventory since they really were not originally “held . . . for sale.”

III

OTHER SECURITY ARRANGEMENTS

A. The Milk Check Assignment

The dairy economy of southern Wisconsin has given rise to a security device of
widespread usage. The farmer signs an order directing the creamery to which he
delivers his milk to pay either a fixed amount or a percentage of the proceeds from
his milk check to a named lender. The creamery, upon delivery, “accepts” the order
by signing it. The device is normally used as a vehicle for convenient repayment
of a chattel mortgage loan, secured, in most cases, by other property. Occasionally
the milk-check assignment alone is used as a security document.

In the usual case, the document involved is the milk-check assignment without
more; the farmer delivers his milk to the creamery as a matter of course. In a few
scattered instances—presumably where lenders have sought legal advice—the assign-
ment also contains in it a contract whereby the farmer agrees to sell and the creamery
agrees to buy all the milk produced by the farmer during the term of the loan.
The reason for this goes right back to the restrictive Wisconsin rule on after-acquired
property. Where there is nothing but a daily habit of delivery, there is no “fund”
presently existing which, by Wisconsin law, is capable of valid assignment. As
between the parties this device is also but a revocable license and as against such
claimants as garnishing creditors it has no validity at all. But where a valid
contract underlies the assignment—e.g., the entire output arrangement—the “fund”

§9-109(5).
§9-207.
§9-207.
§9-207.

Compare the discussion of the use of such an agreement in crop mortgages, where the crop is held
for sale, pp. 170, 171 supra.
(Emphasis supplied.)
Only after the farmer discovers they are poor producers could such cattle properly
be said to be “held for sale.”

is given a present existence which presumably is assignable and which will prevail against claims of subsequent creditors and purchasers.

Under the Code this anomaly will disappear. If there is only a habit of daily delivery, the farmer seemingly will have established an "account," which is a proper subject for a security interest. Therefore, by use of an after-acquired collateral clause there is no reason why future milk accounts cannot be covered by a security agreement. Moreover, the Code also permits a lender to have a valid security interest in a contract right. The milk-check assignment accompanied by an entire output contract would seemingly constitute such a security interest.

To perfect his interest the lender must file a financing statement. Here the Code may present some confusion: if the milk-check assignment is classified as an "account" or a "contract right" then the lender must file his statement with the Secretary of State. This is in contrast, however, with the place of filing the financing statements for almost all the other chattels involved in farm production financing. When the collateral is farm products or farm equipment, the statement need be filed only in the county of the debtor's residence or in the county where the goods are located.

Holders of security interests in future milk accounts will be entitled to priority from the date they file their statements. The difficulties of priority noted with respect to crops to be grown are not presented here: the milk check is usually in payment of milk delivered more than two weeks prior to the date of the check; thus the account is always in existence and the debtor has present rights in it. The security interest therefore attaches when the agreement is made, and the priority as to future accounts dates from the time of "original perfection" which, in this case, is identical with the time of filing.

B. Marketing Contracts

When farmers contract with co-operative marketing associations for orderly marketing of their produce, this question often recurs: what are the respective rights of the co-operative and a crop mortgagee in the particular crop to be marketed? Many state statutes, moreover, provide that the co-operative shall be entitled to specific performance of its contract. On the other hand in event of default, the mortgagee may want to take possession of the crop and sell it rather than await the marketing process of the cooperative. If the mortgage was executed and filed prior to the marketing contract, the mortgagee's right to the crop prevails. But if the contract was executed first, the question of priority depends on whether the mort-

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56 §9-302(e). The assignment will be for financing and will affect a significant part of the farmer's accounts or contract rights.
57 §9-401(a). The draftsmen have also included an optional clause: "and in addition if all the debtor's places of business are in a single county, in the office...in that county."
58 §§9-401(b). If, of course, a state should adopt the optional clause mentioned in note 57, then accounts and contract rights financing statements would also have to be filed in the county.
59 §9-203(2)(c).
60 §9-313(2).
61 See, e.g., Wis. STAT. 1949, §185.08(4); IOWA CODE, 1950, §499.9.
gagee had notice of the contract.\textsuperscript{62} Some states have solved the problem by providing for public registration of the marketing contract.\textsuperscript{63}

A similar problem arises out of canning company contracts, in which the company's right to specific performance is not always clear.\textsuperscript{64} Frequently, the canner furnishes special seed to the farmer; accordingly, he wants a security interest in the crop not only to assure delivery of the crop but also to stand behind his advances of seed. He cannot arrange for a crop mortgage in Wisconsin because he necessarily has to advance the seed before the planting season. Therefore, he has had to resort either to leasing the land and thereby making the farmer an employee or independent contractor as to the crop, or to entering into a bailment contract by which title to both the seed and the end product remains in the canner. Probably both these devices under close judicial scrutiny would be declared invalid chattel mortgages as obvious attempts to circumvent Wisconsin policy.

The Code proposes a solution to this problem. If the co-operative or canning company advances seed or financial aid, it can provide for a security interest in the crop to secure payment. Priority between the contracting purchaser and other secured lenders will be determined accordingly by the filing provisions of Article 9.\textsuperscript{65} The contractual agreement may also provide for a security interest to secure the obligation of the farmer to deliver the crop.\textsuperscript{66} As such, it is also subject to the provisions of Article 9.

A possible difficulty, in so far as co-operatives are concerned, is that their contracts are usually for periods longer than one year. Although the draftsmen have left the period blank for which a security agreement in crops may be executed, conceivably, many state legislatures will limit the period to a year.\textsuperscript{67}

Even though a contract for delivery of the crop has no ancillary security agreement, the contracting purchaser may still find protection of his interest under the provisions of Article 2 on Sales.\textsuperscript{68} It is highly unlikely, however, that these provisions will replace existing state statutes which relate to filing of co-operative marketing agreements.

C. Security in Machinery

As a matter of almost universal practice, a farmer's machinery is conventionally included in the general mortgage on the farmer's personality.\textsuperscript{69} Many lenders, however,

\textsuperscript{62} Kansas Wheat Growers' Ass'n v. Floyd, 116 Kan. 522, 227 Pac. 336 (1924); Kansas Wheat Growers' Ass'n v. Loehr, 118 Kan. 248, 234 Pac. 962 (1925); Tobacco Growers' Coop. Ass'n v. Patterson, 187 N. C. 252, 121 S. E. 631 (1924); Arnold v. Peasley, 128 Wash. 176, 222 Pac. 472 (1924).


\textsuperscript{64} For a discussion of the issues involved, see Comment, [1949] Wis. L. Rev. 800.

\textsuperscript{65} §§9-301, 9-302, 9-313.

\textsuperscript{66} "A 'security interest' means an interest in property which secures performance of an obligation." (Emphasis supplied.) §1-201(36), Spring, 1950, Draft.

\textsuperscript{67} §9-203(3)(a).

\textsuperscript{68} §2-107(2)(b), Spring, 1950, Draft. The buyer, as under existing law, will apparently be entitled to specific performance under proposed section 2-716. The comment thereunder recognizes that output and requirement contracts involving a particular or peculiarly available source or market constitute the typical specific performance situation today.

\textsuperscript{69} On farm equipment credit policies generally see Harding, supra note 4.
ever, do not favor lending money on the security of machinery alone. Depreciation is very rapid and the market for used farm machinery is limited. A few lenders purchase conditional sales contracts covering farm machinery with recourse against the vendor. They conventionally make attempts to refinance the purchase in an agreement which includes other property.

Machinery is described normally by type, brand name, and model. On new machinery the serial number is usually included; few lenders, however, include the serial number on used machinery.

Under the new Commercial Code, the problem of classification probably would not be difficult. There seems little doubt but what it would be classified as "farm equipment." A close case, as the draftsmen point out, would be a farmer's jeep—presumably it could be classified as either "farm equipment" or as "consumer goods." In one aspect "farm equipment" is treated almost identically with "consumer goods": this is with respect to filing provisions; documents for neither farm equipment nor consumer goods need be filed when given to secure purchase money. The security holder is protected against claims of third parties without filing. The draftsmen were sure to make clear that the purchase money security interest may be acquired not only by the immediate lender but by a third party as well. This seems to settle any doubts anyone might have had as to whether a purchase money mortgage could run in favor of a third party.

D. Security in Feeds and Fertilizers

An interesting problem of classification presents itself in dealing with feeds and fertilizers. If the feed is grown on, or the fertilizer derived from, the farm-debtor's own operations, then, under the Code, they are classified as farm products. But, if they were purchased by the farmer, would they become inventory under the definition of Section 9-109(5) as "raw materials, work in process, or materials used or consumed in business"? This distinction has more than academic significance; different filing provisions govern "inventory" and "farm products." Yet, it seems clear that no matter from where derived, feeds and fertilizers should be classified as "farm products"; the same policies which underlie designating a floating stock of goods as inventory, do not obtain in dealing with feeds and fertilizers. Here, as in other...
instances, the Code presents an artificial distinction with respect to the derivation of the particular chattel—different consequences follow depending on whether the chattels were raised by the farmer or purchased by him.

E. Landlord-Tenant Security Arrangements

Up to this time we have been discussing security for production loans. But landlords also extract security agreements to assure payment of rent. Commonly, security provisions are inserted in the lease in the form of a reservation of title by the landlord to all crops grown during the term of the lease. Under the Wisconsin Constitution the term may be as long as fifteen years; normally, however, it is only a year. Leases with this security provision are usually filed with the chattel mortgage records in the county.

The usual crop-share lease in the area, however, has no security provisions. Under this agreement, where landlord and tenant each own an undivided one-half interest in the farm personalty, a lender financing the tenant conventionally takes a mortgage on the tenant’s undivided one-half interest.77

A landlord finds himself in better position to protect his security interest than a crop mortgagee; his reservation of title to crops is not invalidated by the Wisconsin rule prohibiting a mortgage on crops not in being.78 The court reasoned that the owner of the soil may contract for the title to the crops to remain in him.79 It is as though the owner of the reversion has simply withheld some of the normal leasehold rights by so contracting with the tenant. But the court suggested that when the crops were severed, the landlord might be estopped from asserting his interest against a bona fide purchaser for value without knowledge of the landlord’s rights.80

The landlord is said to make the tenant his agent by implication for the purpose of selling the crop. Although the Wisconsin statutes do not specifically provide for filing,81 the court’s language as to rights of innocent third parties probably established the practice.

Presumably, the Code will cover such a title retention lease.82 It will be subject to the filing provisions of Article 9 and priority will be determined accordingly. Such a security interest can attach to all crops grown during the term of the lease even though this may exceed the time for which other security agreements can be made.83 But such an interest may become subordinate to the interest of a lender whose loan enables the debtor to produce the crop to the extent that the security

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77 The Production Credit Association also requires that the landlord agree in writing that his interest in the property is an undivided one-half interest and that he will consent to a division in the event the tenant defaults on the mortgage.
78 Layng v. Stout, 155 Wis. 553, 145 N. W. 227 (1914).
79 Id. at 556, 145 N. W. at 228.
80 Id. at 557, 145 N. W. at 228.
81 Wisconsin statutes do provide for the filing of a “cropper’s contract” however. Wis. Stats., 1949, §241.03. If a contract is not filed, each party is conclusively presumed to have an undivided half-interest in the crop.
82 The Secured Transactions Article applies to any transaction intended to create a security interest in goods. Goods, moreover, include growing crops. §§9-102(a), 9-105(e).
83 §9-203(3)(a).
interest described in the lease secures rent more than six months due at the time the
farmer plants the crop.\footnote{179} The production loan, however, must be made either during
the particular production season or not more than three months before the crop is
planted.\footnote{180} The usual fifty-fifty crop-share lease without an agreement for a security
interest will presumably be unaffected by the Secured Transactions Article.

Section 9-104(b) excludes landlords' liens from the provisions of the Article. One
is constrained to wonder why; the draftsmen gave us no hint in their comments.
Conceivably, they exempted the statutory landlord's lien for the same reason they
exempted mechanics' and materialmen's liens.\footnote{186} But this does not explain why they
took the common law landlord's lien from out of the terms of the Act. There
seems little point in preserving old notions of distraint or the statute of Anne in a
modern piece of legislation and the reasons sounding in policy why the landlord
should be treated as a favored creditor are unclear.\footnote{187} Preservation of the priority of
his lien has been justified on the theory that unless he is assured of this security,
he would require intolerable exactions from the tenant in giving him the lease.\footnote{188} It
is hard to gather proof for this theory.

The statutory landlord's lien seems to be of great importance in the southern
states where it plays an integral part in the agricultural economy.\footnote{189} Some states,
North Carolina, for example, provide by statute for a similar lien granted to suppliers
of goods—a so-called "agricultural lien." Under the new Code, the struggle for
priority between these two lien-holders apparently will go un unabated since both
liens seem to qualify under the exemptions of Sections 9-104 and 9-311.\footnote{190} A few
southern states have witnessed judicial truncating of the superiority of the landlord's
lien recently.\footnote{191} One limitation on the landlord's priority has been where crops or
goods were acquired by a bona fide purchaser holding under uniform negotiable
warehouse receipts. The question arises whether the landlord's lien is exempted also
from the Documents of Title Article of the Code. Presumably not; holders of

\footnote{179} 9-313(5).
\footnote{180} Ibid.
\footnote{186} See Note, Landlord's Liens in Bankruptcy, 29 Va. L. Rev. 643-6 (1943). The same tenderness is
observable in the sections permitting the landlord's security interest in crops to extend beyond the time
limit imposed on other security agreements. See note 83 supra. On landlord's liens generally, see 9
A. L. R. 300, 305 (1920) and 96 A. L. R. 249, 251 (1935). As to priorities between landlord's liens
and chattel mortgages see 37 A. L. R. 400 (1925) and 52 A. L. R. 935 (1928). See also, Smith, Priority
\footnote{187} See Note, 29 Va. L. Rev. 643, 646 (1943).
\footnote{189} For discussions of statutory liens in various southern states see Comment, Statutory Liens on Crops—
Rent Notes, 20 N. C. L. Rev. 216 (1942) (North Carolina); Darden, Situations Affecting the Validity
of the Landlord's Agricultural Lien, 21 Miss. L. J. 253 (1950) (Mississippi); Recent Case Note, 49
Harv. L. Rev. 144 (1935) (South Carolina).
\footnote{190} Section 9-104 reads in parts as follows: "This Article does not apply . . . (b) to a landlord's lien
or a lien on real estate or, except as provided in Section 9-311 on priority of statutory or common law
liens, to a lien given by statute or other rule of law for services or material . . ." Section 9-311 reads
in part as follows: "Where a person in the ordinary course of his business furnishes services or materials
with respect to goods subject to a security interest a lien given by statute or rule of law for such materials
or services takes priority over a perfected security interest unless the lien is statutory and the statute ex-
pressly provides otherwise."
\footnote{188} See Darden, supra note 89, at 253 et seq.
warehouse receipts, duly negotiated, covering agricultural goods seemingly will take free of claims arising from a landlord's lien.\textsuperscript{92} This brings up the question of "croppers contracts."\textsuperscript{93} Are they affected by the new Commercial Code? Since a cropper's contract is neither fish nor fowl, we might find particularization under the Code difficult; courts have called the legal relationship everything from a partnership to landlord-tenant, to master-servant, to tenants in common, to licensor-licensee.\textsuperscript{94} Would a cropper qualify under the state law as a party having a lien on crops for services and thereby take priority over a perfected security interest?\textsuperscript{95} On the other hand, would the other party to the cropping agreement qualify as a landlord for the purposes of Sections 9-104 and 9-311? And, finally, what would a legislative pronouncement that a cropping contract is \textit{sui generis} do toward defining rights of holders of perfected security interests in crops subject to the cropping agreement?\textsuperscript{96} These problems, perhaps, the draftsmen rightly felt are better left in the courts.

IV

ARRANGEMENTS FOR FUTURE ADVANCES

Largely as a result of the impetus provided by the Production Credit Associations, financing agencies more and more attempt to satisfy a farmer's entire credit needs by making advances as needed and accepting payment as the farmer can make it. The practice, commonly referred to as a "budget loan," gives considerable freedom to the farmer in making substitution in his property or selling his produce, and at the same time provides that newly acquired property will be covered by the security instrument.\textsuperscript{97}

We have noted how the after-acquired property problem is handled generally in Wisconsin.\textsuperscript{98} The Production Credit Association also uses the following device in administering its budget loans. The PCA gives a bank draft in blank to a farmer needing money to purchase cattle or equipment. When he buys the goods he negotiates the draft to the seller with the sales price inserted. The seller then makes out the bill of sale directly to the Production Credit Association. The farmer takes the goods from the seller but does not get title to them until he executes a supplemental mortgage covering them to the Association which then delivers up the bill of sale.

The liberal after-acquired provisions of the Code should encourage the use of the budget loan. No longer will the lender have to run the risk of losing his lien on replacement property, nor will the farmer have to incur the bother of executing a supplemental mortgage on each acquisition.

\textsuperscript{92} 57-502.
\textsuperscript{93} See, on croppers contracts, Bowdle, \textit{Cropping Agreements}, 19 U. of Cin. L. Rev. 121 (1950); 1 Tiffany, \textit{Real Property} \textsuperscript{78} (Jones, 3d ed. 1939); 36 Harv. L. Rev. 209 (1922). As to necessity of filing see note 81 \textit{supra}.
\textsuperscript{94} Bowdle, \textit{supra} note 93, at 122-130.
\textsuperscript{95} \textsuperscript{94} \textsuperscript{94} \textsuperscript{94} \textsuperscript{94}
\textsuperscript{96} Bowdle, \textit{supra} note 93, at 130-131.
\textsuperscript{97} For description of "budget loan" operation, see Evens, \textit{Balanced Farming}, Burroughs Clearing House, August, 1946, p. 17.
\textsuperscript{98} See text and notes, pp. 168-169, 172-173 \textit{supra}.
The future advance problem is handled by a clause in the mortgage reciting that the property described shall secure certain executed notes and all future advances up to a named sum. A few agencies, by far the minority, provide for all future advances without naming a maximum figure. It is difficult to ascertain the reasons for the closed end future advance clause in Wisconsin practice. The only limitation placed by the Wisconsin court on the priority of future advances as against third parties is that the mortgage must indicate that future advances are contemplated. Possibly the agencies believe that by naming a top figure they will have priority for this specific sum even though they receive notice of an advance by another lender. Wisconsin courts have never decided the issue precisely, but decisions in other jurisdictions will not support such a belief. Optional advances made by a first mortgagee are subordinated to the lien of a second mortgagee if the advances are made after the first lender has received actual notice of the second incumbrance. But the issue is whether the advances are optional or obligatory and not whether a top sum is named.

The basic difficulty in future advance clauses involves the methods by which third parties can find out the amounts of the obligations secured. Must they determine this by looking at the record and, if so, is it sufficient if the record merely directs them to other sources of information?

The filing provisions of the Code are based on the notion that notice filing is adequate. The filed statement need only inform the record searcher of the existence of a security interest in the property described; the amount of the obligation is not an essential part.

The Code expressly approves provisions for future advances in the security agreement and confers priority for all advances dated from the time that the security interest is originally perfected. This changes existing law which gives priority only for advances made prior to actual notice of a second incumbrance, unless the first lender is obligated to make the additional advances. Such a change may work harshly against some debtors. If the first lender takes a security interest in all of the debtor's property to secure present and future advances but refuses to make an additional advance, a second lender is not in a position to advance the debtor additional credit even though the debtor has adequate security. The debtor's hope for additional financing depends upon his ability to find some lender who will advance sufficient credit to pay off the first lender and meet the debtor's additional need.

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99 Carter v. Rewey, 62 Wis. 552, 22 N. W. 129 (1885); First National Bank of Madison v. Damm, 63 Wis. 249, 23 N. W. 497 (1885); Shores v. Doherty, 65 Wis. 153, 26 N. W. 577 (1886).
100 Davis v. Carlisle, 142 Fed. 106 (8th Cir. 1905); Frye v. Bank of Ill., 11 Ill. 367 (1849); Boswell v. Goodwin, 31 Conn. 74, 81 Am. Dec. 169 (1863); Whelan v. Exchange Trust Co., 214 Mass. 121, 100 N. E. 1095 (1913); Elmendorf-Anthony Co. v. Dunn, 10 Wash. 2d 29, 116 P.2d 253 (1941). See also LEONARD A. JONES, THE LAW OF CHATTEL MORTGAGES AND CONDITIONAL SALES §97 (Bowers, 6th ed. 1933); 14 MINN. L. REV. 695 (1930); JONES, Mortgages Securing Future Advances, 8 TEX. L. REV. 371 (1930).
101 §9-403.
102 §9-203(5).
103 §9-313(1).
It seems safe to say that within the limits of this investigation, adoption of the Secured Transactions Article of the new Commercial Code will encourage and abet present practices rather than generate new ones in the field of agricultural finance. This is entirely salutary, for it was the law and not the going ways which had got out of kilter. Secured financing practices, not inherently undesirable, presently of dubious validity and sometimes done surreptitiously, may now be brought out into the open, and will be given full legal effect. Farmers may properly sell their crops or cull their herds and lenders need not worry about losing their liens, or about impairing of their security. By virtue of its liberal provisions, the Code legitimates the milk-check assignment, which will give the dairy farmer his best source of personal property to put up for security and will at the same time protect any lender who holds the assignment.

Article 9 would be worth passing if it did no more than straighten out the after-acquired property tangle. The Commercial Code draftsmen have not unraveled it completely, but they have done so much that it is hard to criticize them for not doing more. Under the Code, only in one situation does the issue still plague us: where goods not in being, and they alone, are the subjects of the security agreement. We noted an example in the conflicting interests of secured lenders in future grown crops.

In another particular the draftsmen fell a little short of the mark. The Code presents, if not a distinction, at least an ambiguity with respect to goods or property raised entirely by the farmer and the same type of goods or property purchased by him. The problem is at bottom one of classification: whether one class of goods will be called farm products and the other inventory. The distinction, if one exists, is, at least in the dairy farming region of southern Wisconsin, an artificial and an unfortunate one. The chattels perform the same function; they should be treated the same.

We cannot commend too highly the conception and the approach of the draftsmen: to codify in terms of function rather than doctrine; to avoid using terminology encrusted with the patina of generations. This is the great virtue of the Code, and it is also its great deterrent, perhaps. For—and this is the question on everyone's lips—how long will it take a profession—not noted for its eager acceptance of change—to digest this 12 course dinner? We can only hope the magnitude of achievement does not scare lawyers and legislators away. For, to repeat, at least in the Secured Transactions Article, the Code will help bring farm law and farm financing practices together. Someone once said the glory of the common law was that it was born of and never strayed far from the facts of life. There is no reason why that encomium should not also be voiced of a statute.