

State of Arkansas

76th General Assembly

Regular Session, 1987

AS ENGROSSED 2/18/87

HOUSE BILL 1601

By: Representative McGinnis AS ENGROSSED 2/25/87 AS ENGROSSED 3/24/87

"AN ACT TO AMEND ARK. STAT. 85-9-312 TO PROVIDE FOR AND ESTABLISH THE PRIORITY OF PRODUCTION MONEY SECURITY INTERESTS; AND FOR OTHER PURPOSES."

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF ARKANSAS:

SECTION 1. Subsection (2) of Section 9-312 of Act 185 of 1961 as amended, the same being Arkansas Statute 85-9-312(2), is hereby amended to read as follows:

"(2) (a) A production money security interest takes priority over a conflicting security interest in the collateral, and also in the proceeds and products of the collateral, to the extent that

(i) a financing statement covering the collateral is filed before, or within 20 days after, the debtor receives property or services the value of which is secured by the production money security interest, and

(ii) before the debtor receives such property or services, the production money secured party (A) sends a notification in writing by certified mail addressee only to the holder of the conflicting security interest if, before the date of the filing made by the production money secured party, the holder had filed a financing statement covering the same types of farm products, and (B) the notification states that the person giving the notice has or expects to acquire a production money security interest in farm products of the debtor, identifies the debtor, describes such farm products and, in the case of crops, describes the year or years in which the crops will be grown and the land where the crops are growing or to be grown, and

(iii) the holder of a conflicting security interest in the collateral who has received the notice prescribed in paragraph (ii) has not

notified the production money security interest holder within five (5) days after the receipt of the notice that the holder of the conflicting security interest will provide substantially all of the new value the debtor will require to enable production of the collateral.

Subsection (5) governs priority between conflicting production money security interests, and also priority between conflicting production and purchase money security interests; except that in the case of crops, where a production money secured party provided substantially all of the new value the debtor received to enable production of the collateral, the secured party's priority under this subsection extends to other value the secured party provided the debtor that is secured by the collateral and that was given at any time in connection with the debtor's farming activities.

(b) A production money security interest is a security interest in farm products for new value given to enable the debtor to produce or raise the collateral by

(i) paying necessary farm operating expenses, incurred while producing or raising the farm products, except that operating expenses do not include obligations owed with respect to land; or,

(ii) acquiring goods or services to be used in producing or raising the farm products, except that a security interest in farm products taken or retained by the seller, lessor, or any other supplier or financier of equipment to secure a debt owed with respect to the equipment is not a production money security interest.

Producing or raising the farm products includes any activity related to the production, raising, or marketing of the collateral.

(c) Unless otherwise agreed a security interest in farm products continues in products of the collateral; and the security interest in products is a continuously perfected security interest if the interest in the original collateral was perfected.

(d) Creating or perfecting a production money security interest shall not operate under any circumstances as a default on, an accelerating event under, or otherwise as a breach of: any note or other instrument or agreement of any kind or nature to pay debt; any loan or credit agreement; or any security arrangement of any kind or nature whether the collateral is real or personal property."

(e) All of the provisions of this subsection (2) shall cease to be in effect on July 1, 1989, except the following, which shall become effective on July 1, 1989: a perfected security interest in crops for new value given to enable the debtor to produce the crops during the production season and given not more than three months before the crops become growing crops by planting or otherwise takes priority over an earlier perfected security interest to the extent that such earlier interest secures obligations due more than six months before the crops become growing crops by planting or otherwise, even though the person giving new value had knowledge of the earlier security interest.

(f) The provisions of paragraphs (a) through (d) of this subsection shall not be applicable to national banks or state banks holding a conflicting security interest securing an obligation which originated at that bank. The following is applicable to national banks and state banks holding a conflicting security interest securing an obligation which originated in that bank: a perfected security interest in crops for new value given to enable the debtor to produce the crops during the production season and given not more than three months before the crops become growing crops by planting or otherwise takes priority over an earlier perfected security interest to the extent that such earlier interest secures obligations due more than six months before the crops become growing crops by planting or otherwise, even though the person giving new value had knowledge of the earlier security interest.

SECTION 2. The following Commentary is hereby adopted and shall be used for the interpretation of this Act:

Commentary

Arkansas Statute 85-9-312(2) is an instance of the preference which the Uniform Commercial Code gives a new-value secured party. The principle of this provision is that a person who extends credit that enables a debtor to produce new crops or raise livestock, and secures this credit with a security interest in the farm products, gets first claim to the collateral, outranking the interest of another secured party who claims the collateral merely as after-acquired property to secure a debt not directly related to the production of the farm products. So Arkansas Statute 85-9-312(2) creates an exception to the first-to-file-or-perfect rule of Arkansas Statute 85-9-312(5), as

do subsections (3) and (4) of that Statute. The purposes behind all these exceptions are the same: to enable free-market forces to operate with respect Arkansas Statute 85-9-312(2) has the effect of putting farming on a par with any other business with respect to secured financing.

The notification requirement is to protect an earlier secured party who may periodically extend credit with respect to the same farm products, such as a bank lending farm operating expenses to the debtor. See Arkansas Statute 85-9-312(3)(b). The filing requirement serves subsequent creditors by providing a means whereby they can learn of existing or expected interests in the collateral.

The holder of a production money security interest may extend value more than once with respect to the same farm products. The holder need not give the notice or make a filing each time value is extended. Rather, a single notice and filing, properly accomplished, protects the holder as to all value the holder contemporaneously and subsequently extends with respect to farm products covered by the notice and filing.

Priority under Arkansas Statute 85-9-312(2) is not conditioned on the production money secured party being without notice or knowledge of the conflicting security interest: the production money secured party takes priority although he actually or constructively knows of it. In this respect, Arkansas Statute 85-9-312(2) is no different from Arkansas Statute 85-9-312(3) and (4).

The usual rule for determining priority between conflicting new-value interests in any kind of collateral is first-to-perfect. Accordingly, priority among production money security interests in the same farm products is usually governed by Arkansas Statute 85-9-312(5), which also governs when a purchase money security interest in livestock conflicts with a production money security interest in the animals. There is a limited exception, however, in the very last clause of Arkansas Statute 85-9-312(2)(a), which is designed to encourage a creditor with whom the debtor may have enjoyed a long relationship to continue to finance the debtor's production of crops. This exception broadens the priority of a production money secured party who substantially finances this year's crop so that his priority extends not only to the value he contributed to the current crop that is the collateral, but extends also to any other farm related debts secured by the collateral, including debts for producing crops grown in previous years.

The value that will support a production money security interest includes a loan of money by a lender or other financier or by extension of credit by a seller or other supplier of goods or services. See Arkansas Statute 85-1-201(44). A production money security interest is created for new value given in the good faith belief that the value will be used to enable the debtor to produce or raise the collateral even though the value is not in fact so used by the debtor. Conditioning the priority of a production money security interest on proof that the value was actually used in producing or raising the collateral would impose on farm lenders and suppliers unreasonable burdens of accounting and tracing.

Producing or raising farm products entails a wide range of many activities, each of which is useful or necessary to the process. Security interests based on value extended for all of these activities must qualify for the priority of this subsection so that the debtor can freely shop for enabling credit at every step of production. Thus, Arkansas Statute 85-9-312(2) deliberately defines "producing or raising farm products" broadly: any causally related activity, including activities associated with marketing the collateral.

Producing crops thus includes preparing the land for planting, cultivating or otherwise tending crops, harvesting, preparing crops for sale or storage prior to sale, storing crops prior to sale, transporting to sale, selling, or engaging in any other activity that proximately relates to the growing and marketing of crops or products of crops. Similarly, raising livestock includes feeding or grazing, fencing, providing health care, breeding, slaughtering, preparing for sale, transporting to sale, selling, or engaging in any other activity that proximately relates to the care and marketing of livestock or products of livestock.

Advances to cover current operating expenses, and to sustain the farmer and his family, are as important to producing farm products as credit extended to buy seed for the new crop or feed for the livestock. Operating expenses are the costs of doing business, i.e., the usual and necessary costs of maintaining the farming operation that produces the collateral, excluding obligations owed with respect to the farmland such as rent, mortgage principal or interest. The land itself always serves as collateral for a mortgagee or vendor of the real estate. Statutory liens on the crops commonly protect cash rent due landlords.

The financier of farm machinery or other farm equipment in a sense enables the production of crops or raising of livestock. Yet, this person has the security of a first claim to the equipment itself and as to farm products should rank below suppliers of goods, services, and money that is consumed in the production process.

The priority granted by Arkansas Statute 85-9-312(2) extends to proceeds of farm products, see Arkansas Statute 85-9-306, and also to products of the collateral including milk and eggs. Products are expressly, separately covered in the subsection, without limitation, to make clear that the production money interest itself (Arkansas Statute 85-9-312(2)(c)), and the priority of the interest (Arkansas Statute 85-9-312(2)(a)), continue in products of the collateral free from the requirements that must be satisfied under Arkansas Statute 85-9-109(3) for products of crops and livestock to be classified as farm products. Thus, under Arkansas Statute 85-9-312(2)(c) a production money security interest in crops, livestock or other farm products extends automatically to products of the collateral, even though the debtor is no longer in possession of them (compare Arkansas Statute 85-9-306(2)); and, under Arkansas Statute 85-9-312(2)(a), this continuing interest in products enjoys the same absolute priority as the production money security interest in the original collateral that is the source of the products so long as the products are identifiable as such. If products are confused with other goods and can no longer be identified, that is, their identity is lost in the mass, the security interest is not lost. Rather, the interest continues, and priority is determined, pursuant to Arkansas Statute 85-9-315. Because Arkansas Statute 85-9-315(1) provides for the survival only of perfected security interests in goods that are confused or commingled, Arkansas Statute 85-9-312(2) provides that a security interest in products is continuously perfected if the interest in the original collateral was perfected. The continuity of perfection as to both original collateral and products thereof is, however, subject to the provisions of Act 16 of the Second Extraordinary Session of 1986, compiled as Arkansas Statute 85-9-307(4) through (6), which is not repealed or otherwise affected by this Act.

The purposes behind Arkansas Statute 85-9-312(2) could be frustrated by typically unbargained-for, boilerplate language in loan agreements that could be construed to prohibit a debtor from creating production money security interests. So this sort of language is neutered. A creditor should not be

allowed through contract to accomplish a result that contravenes the policy of positive law.

SECTION 3. All laws and parts of laws in conflict with this Act are hereby repealed.

SECTION 4. EMERGENCY. It is hereby found and determined by the General Assembly that the present law relating to priority of perfected security interests in crops to secure loans for the production of such crops is in certain situations unfair and creates undue hardship on lenders; that this Act is designed to revise such law to clarify the same and to minimize the hardship created by the present law and should be given effect immediately. Therefore, an emergency is hereby declared to exist and this Act being necessary for the preservation of the public peace, health and safety shall be in full force and effect from and after its passage and approval.

/s/ Robert L. McGinnis

