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Revisions To Article 9 Of The UCC: The Death Of 9-312(2)

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REVISIONS TO ARTICLE 9 OF THE UCC: THE DEATH OF § 9-312(2)

— by Neil E. Harl*

In 1998, Article 9 of the Uniform Commercial Code on lending with moveables as collateral underwent revision.¹ A final draft of Article 9 was approved by the American Law Institute in May of 1998 and by the National Conference of Commissioners on Uniform State Laws in July of 1998.² About 20 states have adopted the revisions, some with changes from the ALI/NCCUSL version submitted to the states. The submitted version contains several provisions that will impact, significantly, agricultural financing arrangements.

Purchase-money security interest in crops

Article 9 of the UCC has always included a provision³ making it possible for a farmer who is in default on a loan where the lender has a perfected security interest in present and after-acquired crops, to obtain production financing for a new crop.⁴ Under that provision—

“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.”⁵

The provision has been criticized by commentators who have referred to it as insignificant⁶ or so limited as to be worthless.⁷ The chief drafter of Article 9 stated that its “priority hardly seems worth having” and concluded that it “will take rank as one of the Code’s dead-letter provisions.”⁸ Notwithstanding those comments, the provision has had an impact on lenders who were inclined to deny credit and force liquidation of a borrower’s assets.

Although the statutory provision seemed relatively clear as drafted, the litigated cases to date have held that the term “due” in Section 9-312 actually means “overdue.”⁹ Efforts in the 1980s to amend the statute to preclude the courts from defining “due” as “overdue” and to make the provision more useful to heavily burdened debtors were unsuccessful.

Surprisingly, the Revised Article 9 removes Section 9-312(2) without replacing it. A provision dubbed the “Model Provisions for Production-Money Priority,” which was designed as a substitute for 9-312(2), is found in Appendix II to the Revised Article 9 but it is not being enacted into law by most of the states which have

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enacted Revised Article 9.¹⁰ As the official comment states, about Appendix II—

“This section replaces the limited priority in crops afforded by former Section 9-312(2). That priority has generally been thought to be of little value for its intended beneficiaries. This section attempts to balance the interests of the production-money secured party with those of a secured party who has previously filed a financing statement covering the crops that are to be produced. For example, to qualify for priority under this section, the production-money secured party must notify the earlier-filed secured party prior to extending the production-money credit. The notification affords the earlier secured party the opportunity to prevent subordination by extending the credit itself.”¹¹

Quite clearly, without the Appendix II provision, a number of farm debtors will be denied credit. A new value lender cannot gain priority in a new crop over the prior perfected secured creditor who has an after-acquired property clause, absent a subordination agreement. This will likely lead to more bankruptcy filings with superpriority status than possible for an alternative creditor who offers new value to the debtor.

PMSI for livestock and inventory

Ironically, the Revised Article 9 adds a new provision specifying that a purchase-money security interest in livestock (that are farm products) has priority over a conflicting security interest in the same livestock and in their identifiable proceeds.¹² It is not completely clear why a PMSI in livestock and inventory should be allowed, on a priority basis, and to deny PMSI status for a new value lender for crops.

FOOTNOTES

- ¹ See generally 13 Harl, *Agricultural Law* Chs. 117-119 (2000); Harl, *Agricultural Law Manual* § 13.01 (2000).
- ² See McEowen and Harl, *Principles of Agricultural Law* § 3.01 (2000).
- ³ UCC, Article 9, § 9-312(2). See 13 Harl, *supra* n. 1, § 118.02[3].
- ⁴ *Id.*
- ⁵ *Id.*
- ⁶ White and Summers, *Handbook of the Law Under the Uniform Commercial Code 1052* (2d ed. 1980).
- ⁷ Clark, *The Law of Secured Transactions Under the Uniform Commercial Code 8-54* (1980).
- ⁸ 2 Gilmore, *Security Interests in Personal Property* 870 (1965).
- ⁹ See, e.g., *In re Connor*, 733 F.2d 523 (8th Cir. 1984); *Decatur Production Credit Association v. Murphy*, 119 Ill. App. 3d 277, 456 N.E. 2d 267 (1983); *United States v. Minster Farmers Coop. Exch., Inc.*, 430 F. Supp. 566 (N.D. Ohio 1977).
- ¹⁰ See, e.g., H.F. 2513, Seventy-eighth Iowa General Assembly (does not include Appendix II).
- ¹¹ Official Comment to Appendix II, Model Provisions for Production-Money Priority.
- ¹² Rev. Article 9, § 9-324(d).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL-ALM § 13.03[8].*

EXEMPTIONS.

CHILD TAX CREDIT. The debtors filed for Chapter 7 on October 29, 1999 and received a discharge on February 2, 2000. The debtors' schedules did not disclose any income tax refund due for 1999, but the debtors amended their Schedule B to include a federal income tax refund of \$3,819 and amended their exemptions to include \$1,500 of the refund as a child tax credit exempt under Idaho Code § 11-603(4) as public assistance. The court reviewed the public policy and congressional purpose of the child tax credit and held that the credit was not public assistance legislation. The court noted that a denial of the exemption did not negate the congressional purpose of the credit because the debtors did receive the benefit of the credit in reducing their tax liability. However, the court held that the

credit did not have the public assistance purpose sufficient to remove the refund from the bankruptcy estate for payment of creditors. *In re Dever*, 2000-2 U.S. Tax Cas. (CCH) ¶ 50,616 (Bankr. D. Idaho 2000).

EDUCATION TAX CREDIT. The debtor filed for Chapter 7 in September 1999 and received a discharge in December 1999. The debtor had attended a university during 1999 and included a \$1,500 tax credit for college tuition under the Hope Scholarship Credit. In February 2000, the debtor amended the exemption schedule to include an exemption, under Idaho Code § 11-603(4), for \$1,500 of the 1999 tax refund. The Idaho exemption is for benefits received under public assistance legislation. The court noted that the Hope Credit was not limited to poor taxpayers and was not a refundable credit; therefore, the court held that the education tax credit was not eligible for the exemption for public assistance payments. *In re Crampton*, 249 B.R. 215 (Bankr. D. Idaho 2000).