



Financing the Farm

A law bulletin series on legal arrangements for farm financing

September 2019

Secured Transactions

Peggy Kirk Hall, Associate Professor

Evin Bachelor, Law Fellow

OSU Agricultural & Resource Law Program

It's common for a lender to require a farmer to put up "collateral" to secure a loan. This gives the lender financial security if the farmer defaults on the loan. We call this type of arrangement a "secured transaction." This bulletin explains secured transactions and what a beginning farmer should understand before entering into one.

What is a secured transaction?

A secured transaction is a legal arrangement in which a party receives a **security interest** in a piece of **collateral** to secure the payment of a loan. We refer to the farmer who is offering the collateral in exchange for a loan the **debtor** and the lender who is giving the loan and taking a security interest the **secured creditor**. If the debtor fails to pay a secured creditor, the secured creditor may repossess or take control of the collateral property.

A secured interest is similar to a mortgage, but instead of involving real estate as collateral, secured transactions use personal property as the collateral.

When do farmers use secured transactions?

In farming, perhaps the most common uses of secured transactions are when a farmer takes out a loan for an equipment purchase or for operating funds. A lender usually secures such loans by taking a security interest in the farmer's equipment, livestock, crops, inventory, or other type of personal property. Sometimes, the security interest is in the same equipment being purchased with the loan, referred to as a "purchase money security interest." Other times, a farmer might tap into the equity in other collateral to secure a loan for a new purchase or operating monies.

A farmer may also grant a security interest in the same collateral to different creditors, as long as there is equity in the collateral to satisfy the financial assurance of all creditors.



THE OHIO STATE UNIVERSITY

COLLEGE OF FOOD, AGRICULTURAL,
AND ENVIRONMENTAL SCIENCES



USDA United States
Department of
Agriculture
National Agricultural Library

*This bulletin is based upon work supported by the **National Agricultural Library, Agricultural Research Service, U.S. Department of Agriculture**. The information contained in this bulletin is provided for **educational purposes only**. It is **not legal advice**, and is not a substitute for the potential need to consult with a competent attorney licensed to practice law in the appropriate jurisdiction.*

How does a secured transaction work?

Article 9 of the **Uniform Commercial Code (UCC)**, which all states have adopted, regulates secured transactions that use personal property as collateral. This means that the laws regarding secured transactions are uniform across the states.

The UCC first lays out the types of personal property that can be used as collateral, and the rules can vary depending upon the type of collateral. Most commonly used in farming situations are “**goods**,” which broadly includes “all movable things” and “**farm products**.” Together, these definitions apply to the following goods that can serve as collateral under the UCC:

- Equipment, machinery and fixtures that can be severed from real estate;
- Crops growing, grown, or to be grown, even if produced on trees, vines, or bushes;
- Livestock and animals, born and unborn;
- Supplies used or produced in a farming operation;
- Aquatic goods produced in aquaculture and algacultural produced in algaculture;
- Products of crops or livestock in their unmanufactured states;
- Standing timber that is to be cut under a contract and minerals such as oil and gas;
- Consumer goods used for personal or household purposes.

In addition to the goods and farm products above, the UCC can also apply to **inventory**, which extends to goods leased, held for sale or lease, furnished under a contract or service, or consisting of raw materials, works in process or materials used or consumed in a business. A debtor can also use the **proceeds** from any sale or trade of the

above types of collateral and **checking, savings and other financial accounts** as collateral for a secured transaction.

Once the parties identify and understand the type of collateral to be used to secure a loan, a creditor must follow the UCC provisions in order to create the security interest and become a secured creditor. A creditor does so by complying with the laws for **attachment and perfection** of the security interest.

Step one, **attachment**, requires a creditor to “attach” its security interest to the farmer’s collateral, which involves:

1. The creditor must give something of value to the farmer, which is typically a loan of money;
2. The farmer must have legal rights in the collateral;
3. The farmer must sign a written **security agreement**, which typically occurs at the same time that the farmer signs the loan documents. A security agreement is not required if the creditor maintains possession of the collateral, however. The security agreement must describe the collateral. Farmers should note that the description of the collateral can have significant implications. A description might contain very broad terms such as “all farm products” or “all crops.” A description using “after acquired” or “future and present” language could extend to goods obtained or produced after entering into the security agreement. An attorney’s review of the collateral description can be very helpful to ensure that it’s not more broad than necessary to secure the loan.

Step two, **perfection**, requires a creditor to put other creditors on notice of the security interest so

that the interest is valid against other creditors. There are several ways to “perfect” a security interest:

1. The usual method is by filing a **financing statement** with the Secretary of State or county records office in the jurisdiction where the farmer is located. Most states now provide for electronic filing of financing statements. A financing statement must include the names of the debtor and creditor and a description of the collateral. A financing statement remains valid for five years, but the creditor may file a **continuation** to extend the financing statement for additional five-year periods.
2. By taking **possession or control** of the collateral.

Default

Default occurs when a farmer violates the terms of the loan agreement, such as by failing to make payments. A default triggers the secured creditor’s right to collect against the collateral.

If the security interest is in physical property, the secured creditor has the right to possess the property. However, state laws usually prohibit a creditor from “breaching the peace” to claim the collateral. If violence might occur, the creditor must seek judicial approval of the possession.

Redemption from default

Despite a default, the debtor may have a right of **redemption**. This is a debtor’s right to bring their debt current by paying off the missed payment, along with interest, expenses, and any legal fees. The UCC allows debtors to redeem their collateral by paying off the missed payment along with any expenses and attorney’s fees, but they must do so

before the secured creditor takes possession of the collateral, disposes of it, or has accepted the collateral.

States may vary on the extent of a debtor’s right to redeem, with more protections going to consumers purchasing consumer goods. Even if your state has adopted the Uniform Commercial Code, you may want to consult with an attorney to understand how default and redemption operate in your state.

Priority rules for multiple security interests in collateral

When two or more secured creditors claim a valid security interest in the same piece of collateral, the UCC establishes which creditor has first **priority** to the collateral. Priority rules establish a creditor’s place in line to recover or make a claim against the collateral.

Priority is based upon whether the creditors have attached and perfected their interests relative to one another. If one creditor has completed the step of attachment but another creditor has not yet attached to the collateral, then the creditor with the attached interest will have priority in claiming against the asset. If both creditors have attached to the collateral, but only one has perfected its interest, then the creditor with a perfected interest will have first priority to the collateral. If both creditors have completed attachment and perfection of their security interests, then the creditor who completed perfection at the earliest date has first priority to the collateral.

One trump card in secured transactions, however, is the **purchase money security interest** (PMSI) mentioned earlier. A creditor with a PMSI who

perfects by filing a financing statement within 20 days of the date that the farmer took possession of the collateral purchased under the loan will have first priority over other creditors claiming an interest in the collateral, such as a creditor that attached to the collateral by way of an “after acquired” clause in a financing statement, explained above.

Another exception to the UCC’s priority rules regards **statutory liens**, which could have priority over a perfected security interest. State statutory lien laws may address agricultural liens, landlord liens, crop input liens and harvester’s liens, and may grant priority to these types of liens over a UCC secured interest. Consult with an attorney in your state to understand the types of liens recognized by state law and how they interact with other security interests in collateral.

Additionally, the federal **Food Security Act** creates another exception to the UCC priority rules. The law states that an “ordinary buyer of farm products” who purchases farm products from a seller engaged in farming receives the farm products free of any security interests. For example, a milk buyer who purchases milk from a dairy farmer can receive and resell the milk even if a creditor holds a perfected security interest in the milk. However, the secured creditor may notify the buyer of the security interest and provide instructions for payment to the secured creditor. When this occurs, the buyer of farm products must give the secured creditor its share of the payment.

Public records of secured transaction filings

States maintain public records of the UCC financing statements filed by creditors. These public records allow other creditors to conduct

research on a farmer to determine other secured interests in a farmer’s collateral. Many states maintain the records in an electronic database that is readily available to all and allows creditors to file their financing statements electronically. Check with your Secretary of State or similar state agency to locate your state’s UCC filings.

Other titles in the *Financing the Farm* law bulletin series

To continue to learn more about common legal documents for farm financing arrangements, see our law bulletins on *Mortgages*, *Promissory Notes*, *Installment Contracts* and *Leasing Arrangements*.

References and Resources

Christie M. Hayes & Leslie MacRae, “What Every Farmer Should Know About Secured Transactions,” *The Agricultural Law Resource and Reference Center*, PENN STATE LAW (June 2004) https://pennstatelaw.psu.edu/file/aglaw/Secured_Transactions_Art_9.pdf.

“Finance and Credit,” THE NATIONAL AGRICULTURAL LAW CENTER, <https://nationalaglawcenter.org/research-by-topic/finance-credit/>.

Phillip L. Kunkel, Jeffrey A. Peterson & Jessica A. Mitchell, “Security Interests in Personal Property,” *Farm Legal Series*, UNIVERSITY OF MINNESOTA EXTENSION (June 2015) <https://conservancy.umn.edu/bitstream/handle/11299/199829/contracts-notes-and-guaranties.pdf>.

Uniform Commercial Code Article 9 – Secured Transactions, *Legal Information Institute*, CORNELL LAW SCHOOL, <https://www.law.cornell.edu/ucc/9>.