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Security Interest—Grace Period Examined: *North Platte State Bank v. Production Credit Association*, 189 Neb. 44, 200 N.W.2d 1 (1972)

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SECURITY INTEREST—GRACE PERIOD EXAMINED

North Platte State Bank v. Production Credit Association,
189 Neb. 44, 200 N.W.2d 1 (1972)

Section 9-312 of the Uniform Commercial Code determines the priority of conflicting security interests¹ in the same collateral. Generally, the first security interest filed² is superior to all others. An exception is allowed for a purchase money security interest³ per-

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1. NEB. REV. STAT. § 90-1-201(37) (UCC Reissue 1971) defines "security interest" as "an interest in personal property or fixtures which secures payment or performance of an obligation."
 2. The Uniform Commercial Code sets out the method by which a financing statement is filed. NEB. REV. STAT. § 90-9-401 (UCC Reissue 1971) states that for any type of collateral other than unharvested crops and goods which will become fixtures, the proper place of filing is in the county of the residence of the debtor. If the debtor is a nonresident of the state, the county in which the goods are located at the time the security instrument is executed is the proper place of filing. If the debtor intends to immediately move and keep the collateral in another county, then a filing should also be made in the second county.

NEB. REV. STAT. § 90-9-403 (UCC Reissue 1971) provides that a filing is complete when a financing statement is presented and either the filing fee is tendered or the statement is accepted by the filing officer. A filed financing statement is effective for a period of 5 years. If the maturity date of the obligation is less than 5 years, then the filing is effective until the maturity date. If a secured party wishes to extend the period of effectiveness, he may do so by filing a continuation statement.

NEB. REV. STAT. § 90-9-402 (UCC Reissue 1971) allows a financing statement to be filed before a security agreement is made. Also, a financing statement must: (1) be signed by the debtor and the secured party; (2) give the address of the secured party; (3) give the mailing address of the debtor; and (4) contain a statement describing the types, or items of collateral.

3. NEB. REV. STAT. § 90-9-107 (UCC Reissue 1971) provides two situations from which a purchase money security agreement may arise. First, a seller of the collateral may take a purchase money security interest to secure all or part of the sale price. Second, a person other than the seller may acquire a purchase money security interest by giving value to enable the debtor to acquire rights in or the use of collateral if such value is actually used to acquire rights or use of the collateral.

It is possible for two or more purchase money security interests to be created in one transaction. If a seller were to take a purchase money interest to secure part of the price and if a third party were to

fect⁴ within ten days of the debtor receiving the non-inventory goods.⁵ In *North Platte State Bank v. Production Credit Associa-*

advance the remainder of the purchase price and retain a purchase money security interest, then there would be two purchase money security interests in the same collateral. The Code does not state a method by which a conflict between these two identical interests would be resolved.

4. The Uniform Commercial Code states the methods by which security interests in different types of collateral are "perfected." NEB. REV. STAT. § 90-9-303(1) (UCC Reissue 1971):

A security interest is perfected when it has attached and when all the applicable steps required for perfection have been taken. Such steps are specified in sections 9-302, 9-304, 9-305 and 9-306. If such steps are taken before the security interest attaches, it is perfected at the time when it attaches.

NEB. REV. STAT. § 90-9-302(1) (UCC Reissue 1971):

A financing statement must be filed to perfect all security interests except the following:

- (a) a security interest in collateral in possession of the secured party under section 9-305;
- (b) a security interest temporarily perfected in instruments or documents without delivery under section 9-304 or in proceeds for a ten day period under section 9-306;
- (c) a purchase money security interest in farm equipment having a purchase price not in excess of twenty-five hundred dollars; but filing is required for a fixture under section 9-313 or for a motor vehicle required to be licensed;
- (d) a purchase money security interest in consumer goods; but filing is required for a fixture under section 9-313 or for a motor vehicle required to be licensed;
- (e) an assignment of accounts or contract rights which does not alone or in conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts or contract rights of the assignor;
- (f) a security interest of a collecting bank (section 4-208) or arising under the article on sales (see section 9-113) or covered in subsection (3) of this section.

NEB. REV. STAT. § 90-9-204(1) (UCC Reissue 1971):

A security interest cannot attach until there is agreement (subsection (3) of section 1-201) that it attach and value is given and the debtor has rights in the collateral. It attaches as soon as all of the events in the preceding sentence have taken place unless explicit agreement postpones the time of attaching.

5. NEB. REV. STAT. § 90-9-312(4) (UCC Reissue 1971):

A purchase money security interest in collateral other than inventory has priority over a conflicting security interest in the same collateral if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within ten days thereafter.

(Emphasis added.)

NEB. REV. STAT. § 90-9-301(2) (UCC Reissue 1971) has a similar ten day grace period whereby a purchase money interest can become

tion,⁶ the Nebraska Supreme Court held the ten day grace period begins when possession is received, rather than when the purchaser technically becomes a "debtor" of the purchase money creditor. This decision, though in direct conflict with other authority, is proper because it assures the certainty of security interests in non-inventory collateral. This note will concentrate on the Nebraska decision that the North Platte State Bank's purchase money security interest did not have priority under UCC 9-312(4) because it was filed two months after the debtor received possession of the collateral.⁷

The *North Platte* decision affects farmers, ranchers and their creditors. The priority of inventory purchase money security interests is governed by UCC 9-312(3). This does not cover the priority of purchase money security interests which arise from a purchase by a farmer or rancher for his agricultural enterprise. Such purchases would probably fall within the definition of "farm

superior to lien creditors and transferees in bulk.

NEB. REV. STAT. § 90-9-312(3) (UCC Reissue 1971 covers purchase money security interest priority for inventory goods and it makes no provision for a ten day grace period. The history of this provision and the grace period is discussed in 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 29.5 at 799 (1965).

Neb. Rev. Stat. § 90-9-301(1) (UCC Reissue 1971):

(1) except as otherwise provided in subsection (2), an unperfected security interest is subordinate to the rights of

(a) persons entitled to priority under section 9-312;

(b) a person who becomes a lien creditor without knowledge of the security interest and before it is perfected;

(c) in the case of goods, instruments, documents, and chattel paper, a person who is not a secured party and who is a transferee in bulk or other buyer not in ordinary course of business to the extent that he gives value and receives delivery of the collateral without knowledge of the security interest and before it is perfected;

(d) in the case of accounts, contract rights, and general intangibles, a person who is not a secured party and who is a transferee to the extent that he gives value without knowledge of the security interest and before it is perfected.

6. *North Platte State Bank v. Production Credit Ass'n*, 189 Neb. 44, 200 N.W.2d 1 (1972).
7. The Nebraska Supreme Court stated an additional basis for the decision which is not covered by this note. Only purchase money security interests can become superior to prior perfected security in the same collateral. Before the *North Platte State Bank* could acquire a purchase money security interest, it had to advance money or credit to enable the buyer to acquire "rights" in the goods. The court decided that the buyer, Gerald Tucker, had all "rights" in the goods before the bank made its advance. Hence the buyer did not use the advance to acquire any "rights" in the goods and the bank never obtained a purchase money security interest. Thus, the prior security interest held by the PCA was superior to the security interest held by the *North Platte State Bank*. *Id.* at 52, 200 N.W.2d at 6.

products”⁸ rather than “inventory.”⁹ Thus purchase money security interests arising from a purchase for an agricultural enterprise would be considered non-inventory and governed by UCC 9-312(4) as a non-inventory purchase money security interest. Since the *North Platte* decision interprets UCC 9-312(4), it also affects credit purchases for farm and ranch operations.

The Production Credit Association (PCA) made several operating loans to Gerald Tucker, a Nebraska rancher. A security agreement¹⁰ with an after-acquired¹¹ property clause was properly executed and filed when the first advance was made in 1967. The security agreement was to attach to all livestock then owned or to be acquired in the future by Tucker.

In November 1968 Tucker entered into an oral contract to purchase seventy-nine cattle at 225 dollars per head from D.H. Mann. These were delivered on November 30, 1968, to a trucking company hired by Tucker, and promptly transferred to the Tucker ranch. Mann failed to retain a security interest in the cattle.

A month and a half after Tucker received possession of the cattle, he drew a check on the North Platte State Bank for the purchase price. The payee of the check, D.H. Mann, deposited it in

8. NEB. REV. STAT. § 90-9-109(3) (UCC Reissue 1971): provides that goods are

“farm products” if they are crops or livestock or supplies used or produced in farming operations or if they are products of crops or livestock in their unmanufactured states . . . and if they are in the possession of a debtor engaged in raising, fattening, grazing or other farming operations. If goods are farm products they are neither equipment nor inventory.

9. NEB. REV. STAT. § 90-9-109(3) (UCC Reissue 1971) provides that goods are

“inventory” if they are held by a person who holds them for sale or lease or to be furnished under contracts of service or if he has so furnished them, or if they are raw materials, work in process or materials used or consumed in a business. Inventory of a person is not to be classified as his equipment.

10. NEB. REV. STAT. § 90-9-105(h) (UCC Reissue 1971) defines “security agreement” as “an agreement which creates or provides for a security interest.”

11. NEB. REV. STAT. § 90-9-204(3) (UCC Reissue 1971) declares that “[a] security agreement may provide that collateral, whenever acquired, shall secure all obligations covered by the security agreement.” NEB. REV. STAT. § 90-9-108 (UCC Reissue 1971) generally validates such after-acquired property clauses. NEB. REV. STAT. § 90-9-204(4) (UCC Reissue 1971) limits the application of after-acquired property clauses in certain instances. No such security interest attaches to crops which come into existence more than one year after the security agreement is executed unless the security agreement is given in conjunction with a lease or a land purchase or improvement transaction evidenced by a contract, mortgage or deed of trust.

his account at the drawee bank. The North Platte State Bank returned the check to Mann for lack of funds. On January 30, 1969, Tucker arranged a loan with the North Platte State Bank for the amount of the check. The bank honored the check the next day. Six days after the loan and a security agreement were executed, the bank filed its purchase money security interest in the seventy-nine head of cattle. When Tucker defaulted on his obligation, PCA took possession of all the cattle on the Tucker ranch.

There were two conflicting security interests in the seventy-nine head of cattle. The PCA claimed that its security interest containing an after-acquired property clause had priority over the purchase money security interest held by the North Platte State Bank. This suit was to determine which of these two security interests in the seventy-nine head of cattle was superior.

There are three dates which are important in understanding the *North Platte* decision: (1) November 30, 1968, when the buyer received possession; (2) January 30, 1969, when the security agreement was executed; (3) February 5, 1969, when the purchase money security interest was perfected by filing.

UCC 9-312(4) allows a purchase money security interest in non-inventory goods to become superior to prior security interests if perfected within ten days after the *debtor* receives possession of the collateral.¹² The problem posed in *North Platte* was when the ten day grace period began. Did the ten day period begin on November 30, 1968, when Tucker received the cattle or on January 30, 1969, when Tucker and the North Platte State Bank executed the security agreement creating the purchase money security interest? If the possession date, November 30, 1968, marked the beginning of the grace period, the bank did not perfect its purchase money security interest within the ten day period. Thus the bank's security interest would be subordinate to the prior interest held by PCA. If the security agreement date, January 30, 1969, marked the start of the grace period, the bank perfected its purchase money security interest within the ten day period. Hence it would be superior to the prior interest held by PCA.

The bank assumed, since its purchase money security interest was filed within ten days after the security agreement, the purchase money security interest created by that agreement should

12. NEB. REV. STAT. § 90-9-312(4) (UCC Reissue 1971):

A purchase money security interest in collateral other than inventory has priority over a conflicting security interest in the same collateral if the purchase money security interest is perfected at the time the *debtor receives possession of the collateral or within ten days thereafter.*

(Emphasis added.)

have priority. The bank argued Tucker would have to owe payment on the purchase money obligation before he was a "debtor"¹³ under UCC 9-312(4).¹⁴ Thus when a purchase money agreement arises after possession, the ten day grace period should begin on the later date when the security agreement is executed.

The Nebraska Supreme Court did not accept the bank's argument. It held that Tucker became a "debtor" under UCC 9-312(4) when he became obligated to a secured party having an interest in disputed collateral. Thus when Tucker owed payment to the PCA, he was a "debtor."¹⁵ As a result the ten day grace period began when Tucker received the cattle, not when he executed the security agreement with the bank.¹⁶ Since the bank's purchase money security interest was not filed until almost two months after the cattle were delivered, it was not superior to the prior security interest containing an after-acquired property clause held by the PCA.¹⁷

The Ninth Circuit Court of Appeals was presented with this problem in *Brodie Hotel Supply, Inc. v. United States*.¹⁸ The court held the ten day grace period began when the security agreement was executed because the purchaser was not a "debtor" under UCC 9-312(4) until he owed payment to the purchase money creditor. Lyon, the purchaser, had taken possession of the goods on June 1, 1964. On November 2, 1964, he borrowed money from the National Bank of Alaska and as security gave a chattel mortgage¹⁹ covering the goods in his possession. The bank promptly filed its security interest. On November 12, 1964, Brodie, the owner of the

13. NEB. REV. STAT. § 90-9-105(d) (UCC Reissue 1971) defines "debtor" as "the person who owes payment or other performance of the obligation secured." When there are two or more obligations involved, is a person a "debtor" when the first obligation is executed or when the second obligation is executed? The definition is of little assistance in interpreting the meaning of "debtor" as used in UCC 9-312(4).

14. 189 Neb. at 52, 200 N.W.2d at 6.

15. *Id.* at 53, 200 N.W.2d at 6.

16. *Id.* at 52, 200 N.W.2d at 8.

17. *Id.* at 52, 200 N.W.2d at 8.

18. *Brodie Hotel Supply, Inc. v. United States*, 431 F.2d 1316 (9th Cir. 1970). See also Kennedy, *Secured Transactions*, 27 BUS. LAW 755, 768 (1972); 49 N.C.L. REV 849 (1971).

19. NEB. REV. STAT. § 90-9-102(2) (UCC Reissue 1971):

This article applies to security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security. This article does not apply to statutory liens except as provided in section 9-310.

goods, and Lyon made a purchase contract. Lyon received a bill of sale covering the goods and in return gave Brodie a chattel mortgage. Brodie filed this security interest ten days after making the security agreement. The court said Brodie's purchase money security interest was superior to the bank's prior security interest even though the purchase money security agreement and filing occurred months after the purchaser had obtained possession of the goods.

It is interesting to note that the Court in *North Platte State Bank* stated (1) that the *Brodie* case was inapposite on the facts, and (2) that the correct result was achieved in the *Brodie* case because the purchase money security interest was filed within ten days after the purchaser received possession of the goods.²⁰ Both conclusions are incorrect.

In both the *North Platte* and *Brodie* cases the security agreement and the filing occurred long after the purchaser had obtained possession of the collateral. Under similar facts, the courts arrived at opposite results. The *North Platte* decision gives a broad definition to the term "debtor" and starts the ten day period on the date of possession. The *Brodie* decision narrowly defines "debtor" and thus starts the ten day period on the date the purchase money security agreement is executed where the agreement follows possession by the purchaser.

The *North Platte* decision assures the certainty of security interests in non-inventory collateral. A purchase money security interest will become superior to prior interests, regardless of when the purchase agreement arises, only if it is filed within ten days after the purchaser receives possession of the collateral. Thus, if a secured party checks the public record ten days after the debtor receives possession, and discovers no conflicting security interest, he can be assured that a purchase money security interest will not later arise and become superior to his prior security interest.

The *North Platte* decision increases the certainty of most security interests at the expense of non-inventory purchase money security interests. Secured parties, who receive a non-inventory purchase money security interest to secure payment of the debtor's obligation, must take extra precaution to perfect their interest by filing within ten days after the debtor receives possession of the goods. Then secured parties holding purchase money security interests in non-inventory goods will have taken maximum advantage of the protection the UCC extends to security inter-

20. 189 Neb. at 55, 200 N.W.2d at 7.

ests. If a secured party fails to do this, he runs the risk of obtaining a purchase money security interest subordinate to prior security interests in the same collateral. In the final analysis, the extra burden placed upon purchase money security interests is small compared with the benefit of assuring the certainty of security interests in non-inventory collateral.

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