community BANKER

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Welcome to the latest issue of the COMMUNITY BANKER.

The Community Banker is prepared by attorneys at Olson & Burns P.C. to provide information pertaining to legal developments affecting the field of banking. In order to accomplish this objective, we welcome any comments our readers have regarding the content and format of this publication. Please address your comments to:

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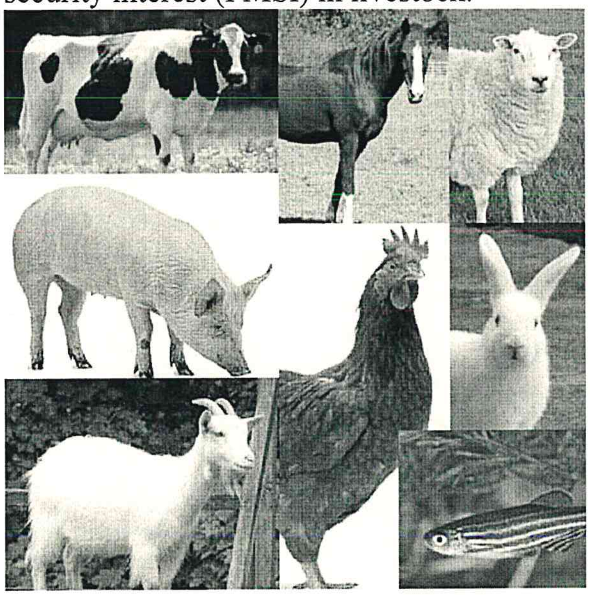
Obtaining a Purchase Money Security Interest "Superpriority" in Livestock

Under Article 9 of the Uniform Commercial Code, the first-in-time perfected secured party is ordinarily King of the Priority Hill; with few exceptions, the secured creditor that perfects its interest first will prevail over all other claimants to the same property of the debtor. This priority system rewards the prudent creditor who wins the computerized race to the Secretary of State's filing office and is first to give notice to the world of its security interest. One of the few exceptions to the "first in time, first in right" rule is the superpriority provided to the lender with a perfected purchase money security interest (PMSI) in livestock.



N.D.C.C. § 41-09-44 (U.C.C. § 9-324) permits a purchase money livestock lender to prime a prior perfected non-purchase money security interest livestock lender if four conditions are met. Lenders with a perfected PMSI in livestock can have priority over conflicting security interests in the same livestock, their proceeds, and unmanufactured products. The overarching requirement is that the loan is providing money for the purchase of the livestock. The PMSI is a powerful tool that enables lenders to take priority over the holders of prior perfected security interests that cover the same collateral.

In order to be "purchase money," two requirements must be met: **a)** the lender gives new value (a loan), and **b)** the new value enables the debtor to acquire an interest in livestock. In other words, for a PMSI to arise, the value provided by the lender must be used to purchase, or enable the debtor to purchase or acquire rights in, all or part of the collateral.

NOTE: The critical prerequisite for a PMSI is that the debtor must have actually used the loan money to acquire his interest in the livestock. How can the lender prove that? Ideally, the lender should give the loan proceeds directly to the seller of the livestock to remove all doubt that the value enabled the debtor to "acquire" rights in the collateral. If the debtor has already made a deposit or partial payment to the seller, it is advisable that the lender pay the seller in full and the seller should then refund the deposit or partial payment to the debtor rather than for the lender to directly refund the debtor.

Not surprisingly, because N.D.C.C. § 41-09-44 (U.C.C. § 9-324) is an exception to the long-standing and favored "first in time, first in right", the law demands strict adherence to additional steps from a lender seeking a PMSI "superpriority" in livestock. Briefly, those mandatory steps are: **a)** The purchase money security interest must be perfected already when the debtor receives possession of the livestock; **b)** The purchase money lender must have sent an "authenticated" (signed) notification to the holder of any pre-existing, conflicting security interest; **c)** The notification must state that the purchase money lender "has or expects to acquire" a purchase money security interest in the livestock; and **d)** The holder of the previously-filed security interest must receive the notification within six months *before* the debtor takes possession of the livestock. *See* N.D.C.C. § 41-09-44(4) (U.C.C. § 9-324).

The Necessary Steps for Obtaining a Purchase Money Security Interest, Fleshed Out

1. **The PMSI in livestock must be perfected** (*i.e.*, value given, security agreement, filed financing statement) as to the livestock when the debtor receives possession of the livestock.

In general, a security interest in farm products is subject to the same creation, perfection and priority rules that apply to other types of tangible collateral. The creation of a security interest in livestock occurs with the execution of a security agreement and the filing of a financing statement, both describing "livestock" as part of the collateral being obtained. A lender perfects its security interest in farm products by filing a Central Notice System (CNS) financing statement through the Secretary of State's computerized Central Indexing System. Created under the Food Security Act of 1985, a CNS filing gives notice of perfected liens filed against farm products; a party taking a security interest in farm products *must* make a CNS filing (rather than filing a general UCC-1 such as is filed to perfect equipment).

In sum, the lender must have given value, have a security agreement granting a security interest in the livestock, and the lender must have properly filed a CNS filing financing statement covering the livestock *before* the truck delivers the cattle or hogs or chickens to the debtor's farming operation.

NOTE: Filing *after* the debtor takes possession does not mean that the purchase money lender is unperfected; instead, it means that the "first to file or perfect" rule of priority will apply and the lender will be subject to earlier-filed security interests. The lender won't get its PMSI superpriority in the livestock, their proceeds, and their unmanufactured products.

2. **The law requires that a purchase-money secured lender send a notification** to the holder(s) of a competing security interest in the livestock. How does the lender find these competing interests? First, file a CNS financing statement. Next, run a search to identify other secured creditors – for example, those creditors who have an earlier security interest in "all livestock." The through-date of the UCC records should be after your filing date. The purchase-money secured lender has now identified the other secured parties via the search.

3. **The purchase-money secured lender must send a signed, written notice** to the earlier-filed secured creditor(s), which notice must describe the livestock collateral and state that the purchase money lender has, or expects to acquire, a purchase money security interest in the described livestock. N.D.C.C. § 41-09-44(4)(b) & (d). Do not do this by email!

NOTE: The purchase money lender should send the notice by certified mail, return receipt requested, in order to document the competing lender's receipt of the notice. Send the notice to the competing lender at the address shown on that lender's financing statement filed with regard to the debtor.

4. **The earlier-filed secured competing lender must have received the notice within six months** *before* the debtor takes possession of the purchase money livestock collateral (*i.e.* the notification is effective for deliveries of livestock for 6 months). In order to obtain priority, the PMSI lender must show that the competing lender received the notification before the debtor received the

livestock.

NOTE: The failure to comply with applicable notice requirements will not cause the purchase money lender to be unperfected; it will mean that the "first to file or perfect" rule will apply between the purchase money lender and the competing lender that did not receive the required notice.

NOTE: The requirements for written notice (items 3 and 4, above) apply only when the competing lender has filed a financing statement covering livestock *before* the purchase money lender files its own financing statement. If a competing lender has not filed a financing statement by this time, the purchase money lender can obtain priority without sending the written notice to the competing lender. *See* N.D.C.C. § 41-09-44(5).