

**Idaho Code Section 25-2001
and the
Lease or Purchase of Livestock in Idaho**

Samuel F. Parry and Randall A. Peterman

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Introduction

Livestock leases are common in agriculture and provide certain benefits to both the lessor and the lessee. For the lessor, a lease agreement may be a way to generate income and mitigate tax liability when compared to selling the same animals outright. Livestock leases also provide management flexibility to a producer by allowing him to fluctuate his stocking rate without surrendering his ownership of the livestock. For example, a rancher may lease his livestock to another producer in response to drought or financial stress.¹ The lease arrangement provides a stream of income with little to no input costs, and the lessor can retake possession when his circumstances change, subject to the terms of the lease.

For the lessee, leasing livestock may provide an opportunity to enter the livestock business without the upfront capital normally required to purchase breeding stock. A livestock lessee who is already in the business may lease additional livestock to take advantage of excess feed, or as part of a genetic development strategy.

Despite the benefits, livestock lease agreements present pitfalls for the unwary, especially when a security interest in livestock includes an interest in after-acquired livestock—such as livestock acquired by lease as we discuss here. These pitfalls can be avoided through proper recording by the lessor and adequate due diligence by any potential creditors of the lessee. Consider the following examples.

Example 1: Farmer purchases livestock with the proceeds of a bank loan from Bank, and Bank takes a properly perfected security interest in the purchased cattle by filing the necessary UCC-1F with the Idaho Secretary of State. Farmer, as lessee, then leases an additional 1,000 head of livestock from Lessor under a true lease, and Lessor inadvertently fails to perfect any interest in the leased cattle. Farmer then files for bankruptcy.

Who prevails between the Bank (holder of a properly perfected security interest) and the Lessor (who failed to record a document as required by Idaho Code Section 25-2001 below)?

Example 2: Same facts as in 1, except the Bank perfects its security interest by the filing of a UCC-1 in the “inventory” of the Farmer, rather than a UCC-1F in the “farm products” of the Farmer.

Who wins under this scenario?

¹ Producers offer their livestock for lease for many different reasons. For instance, producers who run beef cattle on federal grazing allotments sometimes face situations where the allotment is temporarily closed due to fire, drought, or overgrazing by feral horses. The producer must either find alternative feed for his cows or lease them to another producer with excess capacity until conditions allow him to retake possession.

Example 3: Same facts as in 1 and 2, but the “lease” between Lessor and Farmer is actually determined by a court to be a disguised security agreement.

Who wins in this scenario?

The Food Security Act of 1985, and Idaho’s Enactment of a Centralized UCC-1F System

Prior to 1985, Idaho, like many other states, required creditors to file a UCC-1 with the *county* to perfect a security interests in a farm product. Congress then enacted the Food Security Act of 1985 (“FSA”), which prohibited such *local* filings with the county and required all states to create one of two types of *central* filing systems for farm products. States could implement either a central system for filing financing statements, or a central system where buyers of farm products could register to receive direct notice of perfected security interests in farm products. 7 U.S.C. § 1631(e) (2020).

Absent one of those two systems, buyers in the ordinary course of business would take farm products free of any security interest even if the interest was perfected, and even if the buyer knew about the security interest. 7 U.S.C. § 1631(d). Idaho opted for a central filing system for financing statements with its Secretary of State. Under this system, secured creditors can confirm UCC filings in one centralized location rather than checking county filings in all of Idaho’s 44 counties.

Idaho’s enactment of this statute in 1985 created a totally new and different means for a creditor to perfect its security interest in a farm product. Any and all filings as to collateral *other than* farm products remained the same—perfection occurred through a UCC-1 filed with the Secretary of State in the “B” filing system. For farm products, however, perfection can only occur through an “F” filing in a totally different centralized UCC system maintained with the Secretary of State.²

As a result, and for the past 35 years, parallel UCC systems have been maintained by the Idaho Secretary of State—each of which is decidedly different from the other. As a result, statutory and administrative provisions of the “B” centralized system for collateral other than farm products, is different than similar provisions of the “F” centralized system for farm products.

Failure of a secured creditor to comply with the appropriate provisions of the correct statute can be fatal to perfection. For example, a security interest in farm equipment (not subject to a certificate of title) from a farmer must occur in the traditional “B” system, or the creditor is not perfected. A security interest in farm products must occur in the “F” system, or the creditor is not perfected.

² An argument might be made that a lease must also be analyzed under the provisions of Chapter 12 of the UCC, which govern leases. In such a case perfection issues may become even more complex, and following the “belt and suspenders” approach identified below becomes even more critical.

Perfecting Livestock Leases

Idaho Code Section 25-2001 deals with perfection of a lessor's interest in leased livestock, and apparently requires no filing of a financing statement with the Idaho Secretary of State:

25-2001. LEASES TO BE IN WRITING AND RECORDED. All leases of more than ten (10) head of livestock must be in writing and must be acknowledged in like manner as grants of real property, and recorded in the county recorder's office or offices, for the same fee as required by section 31-3205, Idaho Code; and the failure to comply with the provisions of this section renders the interest of the lessor in the property subject and subsequent to the claims of creditors of the lessee, and of subsequent purchasers and encumbrancers of the property in good faith and for value.

Yes, that is right—a lessor's interest in a livestock lease can be perfected solely by the recording of an appropriate document with the *county recorder—where real property documents are normally recorded*. Failure of the lessor to comply with the statute means that his interest in the leased cattle is subordinate to the claim of any creditors of the Lessee Farmer.

A single case from Idaho confirms this outcome. In *Whitworth v. Krueger*, the bankrupt party (“B”) purchased dairy cows pursuant to a purchase contract with Seller. 98 Idaho 65, 67, 558 P.2d 1026, 1028 (1976). Seller retained a lien on the cattle and properly filed a financing statement pursuant to the UCC. *Id.* Shortly thereafter, B leased more cattle from another party (the “Lessor”). *Id.* The Lessor of the dairy cows properly filed the livestock lease with the county pursuant to I.C. § 25-2001. *Id.* at 67, 69. B defaulted under both agreements leaving Seller and Lessor to fight over who got the proceeds from the sale of the leased cows. *Id.* at 67. The Lessor lost. *Id.* at 69. The Court found that the livestock lease was covered by the U.C.C., rather than I.C. 25-2001, because—instead of a true lease—it was commercially indistinguishable from an installment sales contract. *Id.* Had the livestock lease been a true lease, the Lessor would have successfully protected his interest in the leased dairy cows by filing the lease with the county. *Id.*³

³ Two other Idaho cases interpret Idaho Code Section 25-2001, but do not seem relevant to the facts in the examples used here.

Continental Nat. Bank of Salt Lake City v. Naylor, 39 Idaho 267, 228 P. 266 (1924).

In *Continental*, a Rancher defaulted on notes held by the Bank. *Id.* at 266. The Rancher was in possession of about 1300 leased ewes that he returned to the Owner of the sheep just before the Bank foreclosed on the Rancher's outstanding debt. *Id.* at 267–68. The Bank claimed a superior interest in the ewes over that of the Owner because the Owner had not recorded the lease as required by Idaho law. *Id.* at 268. In this case, the Owner won, even though it had not properly filed the lease because the Bank was a general creditor and did not actually hold a lien on the sheep. *Id.*

Hare v. Young, 26 Idaho 682, 146 P. 104 (1915).

In *Hare*, the Rancher secured a loan from the Bank by signing a chattel mortgage on 3,000 ewes, many of which were leased. *Id.* at 105. The Bank properly filed the mortgage. *Id.* After the Rancher defaulted on the note, the Bank foreclosed and the Lessors of the sheep claimed a superior interest. *Id.* The Bank pointed out that the Lessors had not filed their lease as required by Idaho law. *Id.* The Lessors claimed that since the

This means, in **Example 1** above, the Bank properly perfected its security interest in the livestock (which is a farm product) by filing a UCC-1F, which takes priority over the unperfected leasehold interest of the Lessor under Idaho Code Section 25-2001.

In the **Example 2** above, the Bank perfected its security interest in the Livestock by the filing of a financing statement, not in the “F” system intended for farm products, but in the “B” system intended for all other types of collateral. Because under Example 2 the Bank did not properly perfect its security interest, neither the Bank nor the Lessor hold a properly perfected security interest in their respective livestock, which is fatal in a bankruptcy.

Belt and Suspenders Approach

A subsidiary issue lurks behind the scenes here, which made all the difference in the *Whitworth* case. The UCC has consistently held that, even though a security agreement from the Farmer to the Bank may look and smell and feel like a “true lease agreement,” it may in fact be a “disguised security agreement” subject to UCC filing requirements.

The test for determining whether a lease is a true lease or a disguised security agreement has evolved since *Whitworth*. The determination principally depends on the nature and amount of the payment due from the Farmer to the Lessor at the end of the lease term. Multiple tests are now found in I.C. § 28-1-203 and are paraphrased as follows. A lease will be treated as a security interest if:

- (1) The original term of the lease is equal or greater than the remaining economic life of the livestock;
- (2) The lessee is bound to renew the lease or become the owner of the livestock;
- (3) The lessee has the option to renew the lease for no additional consideration or for nominal consideration;
- (4) The lessee has the option to purchase the livestock at the end of the lease term for no additional consideration or for nominal consideration.

I.C. § 28-1-203(b) (2020).

Based on that test, under **Example 3**, the Lessor may lose out even though he properly perfected his leasehold interest in the leased livestock, if a court determines that his “lease agreement” is actually a disguised “security agreement.”

Since this issue may arise in almost any case, a “belt and suspenders” approach by the Lessor of the livestock is probably advisable as to perfection issues. That is, the Lessor should perfect any “leasehold” interest under Idaho Code Section 25-2001 with the recordation of the appropriate document with the county recorder, *and also* file a UCC-1F financing statement

lease was executed in Utah it was not subject to Idaho law. *Id.* But the court found several subsequent agreements that occurred in Idaho that brought the lease within the prevue of Idaho law. *Id.* The Lessor of the sheep lost because they did not record their security interest as required by Idaho law.

with the Secretary of State under the “F” system. By wearing “belt *and* suspenders,” the Lessor is then protected, regardless of whether a court determines the Lessor’s agreement to be a true lease or a disguised security agreement.

Such a “belt and suspenders” approach is probably advisable in all such situations. If in doubt, any lessor or secured creditor should perfect by *any and all means possible*, so as to avoid a situation where the lessor’s or secured creditor’s interest is determined by a court to be different than as represented.