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Legal Rights of Debtors and Creditors-- Impact of Debtor\Creditor Relationship on Personal Property

David M. Saxowsky

Eric Monson

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Department of Agricultural Economics
North Dakota State University
Fargo, ND 58105-5636

School of Law
University of North Dakota
Grand Forks, ND 58202

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This report is the third in a series dealing with legal issues that arise when farm operators experience financial stress. The preceding reports are

"Tax Implications of Liquidating a Farm Operation After the Tax Reform Act of 1986," Ag Econ Misc. Report No. 111, October 1987; and

"Legal Rights of Debtors and Creditors--Enforcing Real Estate Mortgages," Ag Econ Misc. Report No. 118, September 1988.

Single copies of these reports can be obtained at no cost from the Department of Agricultural Economics, North Dakota State University, Fargo.

This report provides general legal information and is not intended to substitute for competent professional assistance. Individuals with legal questions should seek advice from qualified counsel as to how these and other laws relate to each situation.

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Highlights

The financial stress and economic difficulties which characterized sectors of the agriculture industry during the 1980s may continue to trouble some producers into the 1990s as a result of drought and international competition. This report explains legal alternatives available to creditors for using a borrower's personal property to satisfy debt secured with personal property as well as unsecured debt.

A debt is secured when a creditor has a lien; that is, the legal right to seize and use some of the borrower's property to pay an obligation. An unsecured debt is not accompanied with a legal right entitling the creditor to seize some of the borrower's property if the obligation is not paid. Instead, a creditor must convince a court that an amount is owed, but unpaid. The creditor will then proceed to collect payment as prescribed by statute and the court.

The two most common means for a creditor to acquire a lien are 1) for the borrower to voluntarily grant a lien (a voluntary lien), and 2) for the creditor to acquire a lien according to statutory law and without the borrower's consent. This second category of liens is often referred to as statutory, involuntarily, or nonconsensual liens. The most common statutory liens that apply to agriculture in North Dakota are the agricultural supplier's lien, agricultural processor's lien, and agister's lien (which encumbers livestock being kept or fed for their owner).

The typical voluntary lien to encumber personal property is a security interest *which empowers creditors to repossess the encumbered property as long as there is no breach of the peace. The alternative for creditors is to rely on the judicial proceeding of* claim and delivery *to seize the property.*

The law specifies limitations as well as protection for debtors. For example, a debtor is not relieved of an obligation even though the debtor's assets are not sufficient to pay the obligation. Likewise, a debtor cannot give away property to frustrate a creditor's collection attempts. However, a debtor is allowed to retain exempt assets; that is, those items state statutory law specifies as beyond the reach of creditors. Exempt personal property includes the family's clothing; one year's supply of provisions for the family (including fuel); a trailer, mobile home, or $7,500 (substitute for a homestead); property valued between $5,000 and $8,000 ($2,500 for a single person); a vehicle up to $1,200 in value; and certain pensions, annuities, life insurance policies, retirement accounts, and limited payments from specified pension programs (such as social security).

Financial disputes are not limited to debtors and creditors. Creditors also compete with each other to collect their obligation from the borrower's assets. Such conflicts are resolved according to the priority of the creditors.

Few financial disputes will be litigated; instead, most culminate with the parties negotiating a settlement that is preferrable to litigation. The parties must fully understand their legal rights and the likely result of litigating (including the cost and time necessary to litigate), however, in order to recognize an acceptable settlement.

Legal Rights of Debtors and Creditors--
Impact of Debtor\Creditor Relationship
on Personal Property

David M. Saxowsky and Eric Monson[*]

The financial stress and economic difficulties which some sectors of the agricultural industry experienced during the 1980s may continue to trouble some producers into the 1990s as a result of drought and international competition. It is not uncommon that borrowers and creditors attempt to renegotiate the terms of a delinquent obligation, but with varying degrees of success. An alternative for the creditor is to attempt to collect missed payments through legal action, which can culminate in seizing and selling the debtor's assets,[1] including the borrower's personal properties such as farm machinery, equipment, livestock, stored crops, and other non-land assets.

Repossession and sale of assets by creditors may adversely impact the farm business and cause the borrower to alter or discontinue the farming operation. The negative impact may be due, in part, to the considerable sums farmers have invested in equipment, machinery, and livestock. These assets (in most cases) are essential to continue producing crops and livestock. Consequently, a legal proceeding which alters availability or ownership of personal property can have a major impact on the farm operation and firms with which it does business.

Banks and other financial institutions are not the only businesses that provide credit to farm operators. Supply firms and implement dealers frequently sell their products and services on credit, expecting payment within several months. These unpaid sellers are also the farmer's creditors and are affected by laws that delineate the procedure for collecting accounts receivable. One creditor's action may impact other creditors and influence who will be paid. There is not only a potential for disagreement between a borrower and the creditor but also among creditors. Consequently, agricultural producers and creditors need to understand how debt and financial delinquency affect a farm operator's personal property.

Most delinquent debt will not result in a court case because debtors and creditors agree to settle their dispute rather than litigate. However, debtors and creditors should recognize that the parameters for their negotiations are set by their respective legal rights and the probable outcome of a collection action. That is, if the parties do not reach a settlement, their alternative is to initiate a judicial proceeding. An understanding of their rights and the consequence of litigating (including the cost of litigation) should facilitate achieving an equitable and mutually beneficial settlement.

This report explains how creditors can use a borrower's personal property to satisfy an unpaid obligation. *Personal property* encompasses all property interests not considered *real property* (land and improvements such as buildings). Personal property can be tangible (livestock, motor vehicles, machinery, and stored crops) or intangible (savings accounts or certificates

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[*]Associate Professor, Agricultural Economics, North Dakota State University, Fargo, and Agricultural Law Student Researcher, School of Law, University of North Dakota, Grand Forks.

of deposit). This report also discusses protections for debtors to assure that creditors do not exceed their lawful rights. The first section examines unsecured debt; the latter parts discuss debt secured with personal property. The appendix contains a glossary of terms used to describe the respective legal rights of debtors and creditors.

Unsecured Debt

Debt can be categorized as *secured* or *unsecured*. A debt is secured when a creditor has the legal right to seize and use some of the borrower's property to pay an obligation. An example of a secured debt is a farmer's promise to pay the seller for a tractor purchased with the understanding that, if a payment is missed, the seller has the legal right to repossess the machine. Evidence of the creditor's legal right is a recorded *lien* (as detailed in a subsequent section).

An unsecured debt is not accompanied with a legal right entitling the creditor to seize some of the borrower's property for an unpaid debt. Instead, a creditor must convince a court that an amount is owed, but unpaid. Then, the creditor can proceed to collect payment as prescribed by statute and the court. This section addresses the legal rights of debtors and creditors when an unsecured obligation becomes delinquent. Pre-judgment attachment is explained first followed by an outline of the lawsuit and collection procedure that may be necessary to collect payment for an unsecured debt.

Pre-judgment Attachment

When a debt is unsecured, the creditor has no legal right to seize the debtor's property and must successfully sue the debtor to obtain such a legal privilege. The court will listen to both sides and determine whether the debtor has complied with the terms of the loan or credit arrangement. If there has been a default by the debtor, the court will 1) determine the amount owed, 2) order the debtor to pay the obligation, and 3) permit the creditor to direct the sheriff (but subject to judicial review) to seize the debtor's property if payment is not made.

Commencing and completing a lawsuit takes time, and creditors fear that the debtor will dispose of, move, or hide assets during this period, thereby interfering with the creditor's attempts to collect payment. Accordingly, the law has evolved to permit creditors to impose a legal claim against the debtor's property even though the court has not yet determined whether the debtor has defaulted on the obligation. This proceeding is set forth in statutory law[2] as as *pre-judgment attachment*.

A creditor must involve the court and the sheriff to complete a pre-judgment attachment; it is not a self-help measure. After a lawsuit has been filed,[11] the plaintiff (creditor) can request that the court order the sheriff to *levy* upon property of the defendant (debtor).[3] The court will not grant the request without an *affidavit* (a sworn statement) that the defendants

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[11] Pre-judgment attachment cannot be requested until the creditor has initiated a lawsuit to collect the unpaid obligation. N.D. Cent. Code §32-08.1-02.

have or are about to conceal, dispose of, or remove their property. The plaintiff (or someone on the plaintiff's behalf) must sign the affidavit, stating that they know or have reason to know the defendant has or is about to take steps to defraud the creditor.[4]

Not all lawsuits entitle the plaintiff to request pre-judgment attachment. The privilege is limited to suits in which the plaintiff is seeking a judgment for more than $50.[5] Pre-judgment attachment is not available to persons seeking specific performance of a contract or any remedy other than monetary damages. The creditor must post at least a $500 bond to compensate the debtor for all costs and damages if the court rules for the debtor.[6] However, the court must order a pre-judgment attachment once the creditor has commenced a lawsuit, filed the affidavit, and provided the necessary bond.[7]

The court order (also known as a *writ of attachment*) directs the sheriff to *levy* against (seize) enough of the defendant's property in the county to pay the plaintiff's claims.[8] The sheriff can levy against the debtor's property in several ways. One method is to physically seize the debtor's property and hold it until the court enters a final judgment. A sheriff may also levy by filing a copy of the court order with the county register of deeds. Filing provides public notification of a claim against the debtor's property and is the only method available for attaching real property.[9] The sheriff's other alternative is to disable personal property that is too bulky to move or too difficult to store. For example, a sheriff may remove an engine part from a large tractor or a propeller from a spray plane to disable it, thus seizing control of the machine. A sheriff's levy is effective until the creditor's claim has been litigated.

North Dakota statutory law provides a sheriff 10 days after the court order to execute a writ of attachment.[10] The sheriff can levy against all the defendant's non-exempt property (*exempt* property is explained in a later section) located in the county[11] and keep this property until a judgment has been entered. However, the sheriff can sell any items that are likely to depreciate in value or that are expensive to store.[12] To protect the sheriff from being liable to the defendant for improperly seizing property, North Dakota statutory law authorizes the sheriff to require that the plaintiff provide security to indemnify the sheriff if the ownership of the attached property is in doubt.[13]

Several statutory provisions protect the defendant during attachment proceedings. First, the defendant may request that the court order the plaintiff to furnish additional bond protection if the defendant is not satisfied with the amount of the original bond.[14] Second, the defendant can cause the sheriff to release the attached property by furnishing a bond sufficient to pay an adverse judgment.[15] Third, the defendant can deny the facts stated in the affidavit on which the writ of attachment is based. This denial must be provided within 10 days after the defendant is notified of the attachment and can be accompanied by a claim of undue hardship. The court must determine whether the attachment order should be vacated before it proceeds to determine the merits of the underlying lawsuit.[16] Fourth, the court may, at any time before trial, modify or vacate an order for attachment for irregularity or other cause.[17]

In addition to the protection the North Dakota statutes provide for debtors, the United States Constitution limits pre-judgment attachment. The due process clause of the first and 14th amendments have been interpreted to require that a debtor be provided notice of the attachment and an opportunity to be heard.[18] Although the constitution does not require that the notice and hearing be provided before the debtor's property is seized, these rights must be available a short time after attachment.[19]

Attachment creates a lien in favor of the creditor on the attached property. This lien relates back to when the sheriff levied against the property. If and when the creditor is granted judgment against the debtor, the creditor will be able to execute on the lien, causing the sheriff to sell the property at public auction with the proceeds going to the creditor to satisfy the judgment.[20] By comparison, if the court enters a judgment for the defendant, the plaintiff is liable for all damages suffered by the defendant as a consequence of the pre-judgment attachment.[21]

The Lawsuit

Whether or not the creditor pursues a pre-judgment attachment, the plaintiff (creditor) files a *summons and complaint* to begin the lawsuit that will determine whether the debtor has defaulted. In the complaint, the plaintiff briefly describes why and how much the defendant owes the plaintiff. An unsecured creditor's only option is to sue for breach of contract where the damages are limited to the amount owed according to the terms of the agreement plus interest.[22]

The defendant has 20 days to file an *answer*, which presents defenses and briefly explains why the plaintiff is not entitled to a judgment.[23] For example, the defendant may argue that a payment is not owed to the plaintiff at this time. If the defendant does not file an answer, the court can enter a *default judgment*, which awards the plaintiff's request, usually the right to collect payment from the debtor's assets.[24] The court's authority to render a default judgment prevents a defendant from frustrating a creditor's collection attempts by not responding to the lawsuit.

The parties will prepare for a trial or hearing on the facts after the defendant has filed an answer. During this time, the parties will have opportunities to obtain information from each other.[25] This *discovery* process is our legal system's way to compel one party of a lawsuit to provide the other party with necessary but otherwise unavailable information for its case. For example, the defendant can request a copy of the borrower's account statement if the defendant believes the plaintiff has not credited the defendant's account for all payments. If one party does not provide information requested through discovery, the court can impose sanctions against that party.[26]

Requests for information are usually written interrogatories (requiring a written response) or depositions (oral questions and oral responses given under oath and recorded). By allowing both sides to discover information, the court system minimizes delays that can result if information that was unavailable to one party is revealed for the first time at the trial.

There is also an opportunity for motions to terminate or expedite the proceeding. For example, the defendant may ask the court to dismiss the lawsuit (a *motion to dismiss*) because the complaint does not set forth a claim that can support a judgment. On the other hand, a plaintiff (after the defendant has filed an answer) may request that the court enter judgment in its favor (a *motion for summary judgment*) because it is clear from the complaint and answer that the plaintiff will prevail at a hearing. A summary judgment will be granted only if the judge finds that "there is no genuine issue as to any material fact."[27] This is often the case in a collection action when there is no question that the debtor did not fulfill the obligation. The court will have to rule on each motion the parties raise and argue.

If a lawsuit involving an unpaid debt reaches the trial stage, a judge will usually decide without a jury, even though either side generally can request a jury trial.[28] The cost and uncertainty of a jury trial is often sufficient reason for the parties to have the judge decide whether the defendant has defaulted on an obligation to the plaintiff.

Enforcing a Judgment

If the judgment is in favor of the plaintiff (either after a trial or following a default judgment), the next stage is for the plaintiff to collect the payment. An initial step in the collection process is to file the judgment, which provides public notice that a judgment has been rendered for the plaintiff and against the defendant.[29] In North Dakota (as well as in most other states), a *judgment lien* is automatically imposed on the debtor's real estate after a judgment for the creditor has been filed.[30]

A judgment lien encumbers the debtor's real property in the county where the court is located. Creditors also can file a copy of the judgment in other counties and thereby impose a similar lien on other land the debtor owns.[31] This lien inhibits selling or transferring the property until the judgment is satisfied. A judgment lien endures for 10 years and can be renewed.[32] It attaches not only to real estate the debtor owns at the time of judgment but also encumbers any land the debtor subsequently acquires in a county where the judgment has been filed.[33]

Although the judgment lien encumbers the defendant's real property, state law requires that the judgment be collected from the defendant's personal property first. The plaintiff will be allowed to enforce the judgment lien only when there is insufficient personal property.[34] The procedure for collecting the judgment from the defendant's property is a *writ of execution*; that is, an order from the court, signed by the judge, instructing the sheriff to levy against (seize) enough of the defendant's property to pay the judgment.[35] However, state law also allows a sheriff to levy against a defendant's personal property as soon as the sheriff receives a copy of the judgment.[36] The sheriff must provide written notice to the debtor (or an agent for the debtor) before seizing property.[37] The notice must inform the debtor that any claim to *exempt* property must be made within 10 days.[38]

Exempt Property

State statutory law defines exempt property as those items beyond a creditor's reach. The purpose of exempting property from seizure for payment of debt is to leave the indebted person with sufficient resources to survive and financially rebuild. The major exemption provided by North Dakota law is the homestead exemption, which is defined as the person's house and the land upon which it is situated, not to exceed $80,000 in value after subtracting liens or encumbrances.[39] However, the homestead is real property and beyond the scope of this discussion.

Personal property that is exempt under state law includes family pictures, a sitting place in a house of worship, burial plots, the family Bible and books not to exceed $100 in value, the family's clothing, and one year's supply of provisions for the debtor and family, including fuel.[40] Insurance proceeds resulting from the coverage of these items also is exempt. The law permits a trailer or mobile home to be substituted for a homestead. These items are referred to as absolute exemptions.

The head of a household also may exempt crops from 160 acres, except for production costs.[41] An alternative for the head of a household is to exempt personal property up to a value of $5,000, rather than the crops from 160 acres.[42] Another alternative is to select books and instruments up to $1,500 in value, household furnishings up to $1,000 in value, livestock and implements not exceeding $4,500 in value, and tools of the trade or books of a profession up to a value of $1,000.[43]

A single person does not have these alternatives but may exempt personal property with a value of $2,500 in addition to the absolute exemptions.[44]

North Dakota residents may exempt $7,500 in personal property rather than use the homestead exemption. This alternative translates into $15,000 for a married couple living in the state since each would be considered a resident.[45] Each resident also may exempt 1) a vehicle up to $1,200 in value; 2) pensions, annuities, life insurance policies, and retirement accounts (none of which may exceed $100,000 and the aggregate may not exceed $200,000); and 3) the right to receive limited payments from specified pension programs (such as social security) and certain legal actions.

Levying Against Property Possessed by a Third Party

The discussion thus far has assumed that the sheriff would be levying against assets owned and possessed by the debtor. However, if someone else possesses some of the debtor's assets, the sheriff still may levy against the property through a process known as *garnishment*.

Garnishment allows a creditor with a judgment to collect money from a third person who owes money to the debtor or possesses the debtor's property.[46] The process involves the court ordering a third party, who is indebted to the debtor or who possesses the debtor's property, to identify the debtor's property. After reviewing the information, the court may order the third party to deliver the property to the sheriff. Any property provided will reduce the third party's obligation to the debtor. Garnishment is the proceedure whereby a creditor can seize a portion of the debtor's wages as

they are earned, or levy against a debtor's checking, savings, or other bank accounts.

Sale of Levied Property

Tangible personal property that the sheriff has seized (either as a prejudgment attachment or postjudgment levy) will be sold with the proceeds used to pay the debtor's obligation.[17] The sale will be by auction[18] and must be advertised once a week for two weeks.[19] The debtor may attend the sale, bid for the property, and direct the order in which the property will be sold.[50] Proceeds from the sale will be disbursed in the following order: pay the cost of the sale, satisfy the judgment, and satisfy other outstanding executions with any remaining funds returned to the defendant.[51]

After the sale has been completed, the sheriff reports to the court so the judge can confirm that the execution complied with the law.[52] A writ of execution can be returned to the originating court after 60 days if the defendant has no property to levy against.[53] To assure that the sheriff will attempt to collect the judgment, statutory law renders the sheriff liable for refusing or neglecting to enforce a writ of execution.[54]

Deficiency

A debtor is not relieved of the obligation even if the sheriff returns the writ of execution unfulfilled because of insufficient assets to satisfy the judgment. The debtor remains legally obligated to pay the debt, and the creditor can rely on the judgment to support subsequent attempts to collect the unpaid amount. A judgment remains valid for 10 years,[55] and the creditor can renew the judgment for another 10 years.[56] During this time, the creditor may continue to request writs of execution to collect any *deficiency* until the judgment is paid.

An alternative to requesting additional writs of execution is for the creditor to enforce the judgment lien that encumbers the debtor's real property. As indicated in a preceding section, if the sheriff is unable to fulfill a writ of execution from the debtor's personal property, the creditor can enforce the judgment lien.[57] This procedure is similar to executing a judgment to foreclose a real estate mortgage; that is, the sheriff levies against the land, advertises it,[58] sells it, and reports to the court. Details of this procedure are explained in Ag Econ Misc Report No. 118, entitled "Legal Rights of Debtors and Creditors--Enforcing Real Estate Mortgages."

A debtor who cannot accumulate the resources to satisfy the debt may initiate a bankruptcy proceeding and may be relieved of any further obligation to repay the debt.[59] A detailed explanation of bankruptcy is beyond the scope of this report.

This portion of the report reviewed the procedure a creditor must follow to collect payment of an unsecured debt. The next sections explain how a creditor can collect payment for a debt that is secured by personal property.

Secured Debt

A debt is secured when the creditor has the legal right to seize and use some of the borrower's property to pay an obligation. This legal right is a *lien*, and the property that the creditor can seize is described as *encumbered*. The two most common ways a creditor can acquire a lien are 1) for the borrower to voluntarily grant a lien (a *voluntary lien*) and 2) for the creditor to acquire a lien according to statutory law and without the borrower's consent. This second category of liens is often referred to as *statutory liens*, *involuntarily liens*, or *nonconsensual liens*. The next section briefly introduces involuntary liens. Subsequent sections focus on voluntary liens and enforcing liens that encumber personal property.

Involuntary Liens

Creditors who do not ask borrowers to grant a lien still can secure the obligation if statutory law provides for an involuntary lien. Such liens are considered involuntary because they do not arise from an agreement between the debtor and creditor; instead, the lien is imposed regardless of the debtor's preference. Only credit transactions that fit the specifications set forth in the statutes are entitled to involuntarily liens. Likewise, an involuntary lien does not automatically arise just because the credit transaction fits the legal specifications. The creditor must complete the steps the statute requires. Failure to comply with the statute means an involuntary lien will not arise and the obligation will remain unsecured. If the debtor defaults, the unsecured debt could be collected as described in the preceding sections.

The most common statutory liens that apply to agriculture in North Dakota are the *agricultural supplier's lien*,[50] *agricultural processor's lien*,[51] and *agister's lien*.[52] These liens protect unpaid creditors such as harvesters of crops and sellers of farm supplies by giving them the right to seize the debtor's property if the obligation is not paid.

Processor's liens are available for any person who threshes, combines, dries, or harvests any crop or agricultural product.[53] The processor must file a verified (notarized) statement with the register of deeds in the county where the product was grown within 90 days after the processing is completed.[54] The statement must indicate 1) the debtor's name and address, 2) the creditor's name and address, 3) the agricultural product that is being encumbered and the location where the product was grown, and 4) the price (or value) of the processing activity. A processor's lien encumbers the crop or agricultural product that has been processed but is void if the lien encumbers anything other than the commodity that was processed.[55]

Any person who furnishes supplies used to produce crops, agricultural products, or livestock can use a supplier's lien.[56] Supplies include seed, petroleum products, fertilizers, farm chemicals, insecticides, hay, feed, pasturage, veterinary services, or the service of delivering or applying supplies. To obtain a supplier's lien, the creditor must file a verified statement in the register of deeds office where the product was grown within 120 days after the supplies are sold or services are rendered.[57] A firm supplying or delivering petroleum products has 180 days to file.[58] The statement must indicate 1) the debtor's name and address, 2) the creditor's name and address, 3) the agricultural product that is being encumbered and its

location, and 4) what supply was furnished and its value. A supplier's lien encumbers the crop, livestock, or agricultural product that was produced with the supplies.

An agister lien is available to any person who wishes to secure payment for feeding, herding, pasturing, or ranching livestock. The supplier's lien overlaps with the agister lien for persons who supply feed, hay, and pasturage. To obtain an agister lien, the agister must give written notice to prior lienholders within 10 days of receiving the livestock[69] and file a verified statement within 90 days.[70] The statement has to indicate 1) the number and description of the animals, 2) the name of the person for whom the livestock are being kept, and 3) the price of keeping the animals. An agister lien encumbers the livestock that are being kept or fed.

Once filed, an agricultural lien is effective from the date processing was completed, supplies were furnished, or services were performed. However, creditors who want to assure a debt is secured usually request that the debtor voluntarily grant a lien, as described in the next section. Enforcement of involuntary liens is described in a subsequent section.

Voluntary Liens

A voluntary lien means the borrower agrees that the creditor should have a legal right in some or all of the borrower's personal property. Evidence of this legal right can be the creditor's possession of the property. This approach, however, prevents the borrower from using the property, which would be unacceptable if the item is critical to the borrower's business. The alternative (and more common approach) is to use written documents as evidence that the borrower has provided the creditor a lien against the borrower's property.

The first document is a *loan agreement* (or *note*[71]) in which the creditor and borrower set forth the terms of the loan. This document includes a statement that the borrower is indebted to the creditor and specifies when payments will be made, what interest rate is being charged, and any other terms upon which the parties agree. The loan agreement establishes the borrower's legal obligation to pay the creditor.

The second document is a *security agreement*[72] and is the legal instrument in which the borrower provides the creditor a lien against the borrower's property. Restated, a security agreement documents that a borrower has transferred to the creditor the legal right to have the borrower's property sold or used to satisfy a debt. A security agreement must be signed by the debtor and include a description of the collateral (including the real estate description if the collateral is a growing crop or crop to be grown).[73] A lien that arises from a security agreement is a *security interest*[74].

Signing the document is not the only requirement for an effective security interest. In addition, the creditor must have given some value to the borrower (either in the form of a cash loan or a credit sale), and the debtor must have some legal right in the property that will be encumbered.[75] The security interest is described as having *attached* when the three conditions have been met; that is, when a security agreement has been signed,

value has been given, and the debtor has a legal interest in the encumbered property.

Security Agreement Provisions

A security agreement is a contract or agreement between the lender and borrower. Consequently, various clauses or provisions can be included to reach the objectives of both parties. Since lenders generally prepare (or draft) the documents, the agreements often favor the creditor. There are legal limits, however, as to what can be included in an agreement. For example, 1) the agreement cannot violate other laws;[76] 2) it will not be enforced if its terms are unconscionable or if one party took unfair advantage of the other party's weaker bargaining position;[77] and 3) the agreement will be interpreted against the drafter (again, usually the lender) if the language of the agreement is ambiguous.[78]

Other provisions can be incorporated into the security agreement. For example, a creditor's security interest can encumber the specified collateral, plus any income or *proceeds* that arise from the sale or other disposition of the collateral.[79]

Likewise, if the security agreement explicitly extends to *after-acquired* property, the security interest encumbers collateral a borrower has at the time a security agreement takes effect and similar properties the borrower acquires later.[80] For example, a creditor will have a security interest in livestock purchased or born after entering into a security agreement if it provides that the creditor's security interest will encumber all the debtor's livestock, including after-acquired livestock.

North Dakota has modified the application of after-acquired clauses for crops. A security interest can attach only to the next maturing crop.[81] This limitation was imposed so a creditor cannot encumber a farmer's crop production for several years into the future and thereby restrict the borrower's capacity to use future crops to acquire operating capital for the coming years. The limitation does not apply, however, if the crop lien secures the purchase price or rental payment of land.[82] Furthermore, a security interest can extend into the future to protect additional loans or future advances.[83]

A security agreement may require the debtor to gather the collateral after default and make it available to the creditor at a designated place that is convenient to both parties.[84]

Several clauses may appear in both the note and security agreement. For example, an *acceleration* clause allows creditors to require all payments for the debt (including future payments) to be paid immediately if the debtor has defaulted.[85] By accelerating a debt, a creditor may sue to collect the entire debt after a borrower misses a payment rather than only the missed payments. Likewise, the agreements may include provisions allowing a creditor to 1) require that the debtor provide *additional collateral* or 2) *discontinue a line of credit* if there has been a default.[86] Default is discussed more fully in a subsequent section.

The North Dakota Century Code allows agreements to include a *waiver of defenses against assignees*,[87] for example,

A farmer purchases a tractor, on credit, from an implement dealer who guarantees the tractor for one year. The dealer assigns the loan to a local bank (that is, the assignee) to which the farmer will make the remaining payments.

The tractor breaks down within the first year, but the dealer refuses to make the necessary repairs. If the security agreement contains language that the farmer agrees to not assert defenses against an assignee, the farmer must continue to pay the bank. In other words, the farmer, by agreement, has waived the right to stop payment, a right the farmer normally would have if the dealer fails to meet the warranty obligation. The farmer's alternatives, in such a case, are to negotiate a settlement with the dealer or to bring suit against the dealer for breach of contract to cover the cost of the repair. But the farmer must continue to pay the bank.

Financing Statement

A third document is the *financing statement*, which is used to "inform the world" that the creditor has a lien against the borrower's property. This document is filed at a government office (either the register of deeds or the secretary of state)[89] and its contents become public information. A creditor is described as having *perfected* the security interest by filing the financing statement. The content of a financing statement must include

a. Debtor's name, mailing address, social security number or tax identification number, and signature;
b. Creditor's name, and address;
c. A statement indicating the types or describing the items of collateral (a description of the real estate is necessary if the collateral is a growing crop or crop to be grown).[90]

Filing a financing statement is a more common means of providing notice of a lien than having the creditor possess the collateral.[90]

By having the contents of a financing statement available to the public, anyone interested in purchasing personal property from the debtor/seller can determine if the item is encumbered. If it is encumbered, the prospective buyer knows that a creditor has the right to seize the property if the debtor/seller does not pay the creditor. With this information, the buyer can decide whether to 1) purchase from the indebted seller and take the chance the creditor is not paid, 2) negotiate to pay the creditor directly, or 3) not purchase the item. Lenders who may be willing to extend credit only if the borrower has equity that can be encumbered also use this public information. The importance of a financing statement is illustrated in a later section that addresses conflicts among creditors which arise when a debtor does not have enough resources to pay all obligations.

Default

Like unsecured obligations, the debtor is in default of a secured debt when a scheduled payment is missed. However, for voluntary liens, the security agreement allows the parties to define other defaults. A partial list of conditions that may be a default includes bankruptcy, insolvency,

default on another obligation to the creditor, false representation, death of the debtor, failure to maintain the collateral or property insurance, diminished collateral value, failure to keep proper reports, sale of collateral, nonpayment of taxes, or illegal use of the collateral.[91] Conditions which constitute default in a security agreement are limited only by the imagination of the drafter and rules of law.[92]

Insecurity also could be defined as a default; that is, if the creditor is concerned about being paid, the loan would be considered in default. This concept is more difficult to implement than most other measures of default. For example, a court can determine whether a debtor has filed bankruptcy, missed a payment, sold collateral, failed to pay taxes, or failed to maintain insurance on the collateral. By comparison, courts have more difficulty determining whether a creditor was justified in feeling insecure.[93]

To protect debtors from creditors who claim they are insecure about repayment, state law requires that creditors exercise their discretion only if the creditor in good faith believes that the prospect of payment is impaired.[94] It is the debtor's responsibility to demonstrate that the creditor lacked good faith.

Following default, creditors often accelerate the debt, demand additional collateral, or discontinue the borrower's line of credit (as discussed in a previous section). If the debtor cannot cure the default, creditors generally initiate a collection procedure. Just as there are differences between the imposition of a voluntary lien and an involuntary lien, so there is a difference in the collection process. The following discussion addresses collection of a debt secured with a voluntary lien since it is the more common procedure.

Creditor Repossession

During the 1960s and 1970s, nearly all states (including North Dakota) adopted statutory law that would reduce the time and cost of collecting a secured debt. To reach this goal, the statutes permit secured creditors to seize the encumbered personal property rather than rely exclusively on the judicial system. Consequently, when a debtor defaults, the creditor has the right to take possession of the collateral.[95] The creditor can use this *self-help* remedy only if the collateral can be seized without a *breach of the peace*.[96]

The statutes do not define a breach of the peace. However, courts have ruled that the use of force or violence to retake property generally will be considered a breach of the peace. Threats or intimidation may constitute constructive force and breach the peace, even though physical force is not exerted.[97] A repossession made with help from a sheriff who does not have a warrant has been considered to have breached the peace.[98] Creditors anticipating or encountering difficulties must rely on the judicial system to repossess the collateral.

Lawful acts of repossession include driving a car from a parking lot or away from the front of the debtor's house, or disconnecting a tractor from a trailer, while in a parking lot, and driving the tractor away.[99]

Judicial Repossession by a Claim and Delivery Action

Creditors unable to repossess the encumbered personal property without breaching the peace must rely on the court system to seize the item. This procedure, a *claim and delivery*, allows a creditor to request delivery of the encumbered personal property after initiating a lawsuit to repossess it.[100]

The plaintiff requests delivery of the property by 1) preparing an affidavit stating that the plaintiff is entitled to possess the property[101] and 2) requesting that the sheriff seize the property from the debtor and deliver the property to the plaintiff.[102] The plaintiff also must 1) provide a bond to compensate the debtor if the court determines the plaintiff is not entitled to the property[103] and 2) have a court order authorizing delivery, coupled with notice to the debtor of a hearing on an *order to show cause*.[104] An order to show cause requires the debtor to appear in court to explain why the encumbered property should not be seized. The court will order the property delivered to the creditor if the debtor does not attend the hearing or fails to adequately explain why the property should not be seized.

The debtor can 1) request that the court increase the amount of the bond if the debtor feels it is inadequate[105] or 2) provide a bond of equal value and retake possession of the property.[106] The law provides that the sheriff 1) can use force to seize concealed property,[107] 2) must safeguard the property and deliver it after being paid for his expenses,[108] and 3) has to report to the court.[109] The lawsuit culminates with findings of 1) whether the plaintiff or debtor is entitled to the property and 2) whether either party is entitled to damages from the other as a result of the lawsuit.[110]

Even if the plaintiff succeeds in acquiring possession of the property, the underlying debt remains unpaid. The next step in the process is for the creditor to dispose of the encumbered assets. A creditor's alternatives for disposing of the property (which are described in the next section) is the same whether the property was possessed through self-help or a claim and delivery action.

Creditor's Disposition of the Collateral

A secured creditor may sell or lease the collateral after it has been repossessed.[111] Creditors who decide to sell the property are required to provide the debtor with reasonable notice of the time and place of the sale, and the sale must be completed in a commercially reasonable manner.[112] This limitation prohibits a creditor from selling the collateral for a low price but does not require that the creditor sell at the price the debtor may suggest. Selling the collateral in the usual manner and market for that good or selling it at the current market price is evidence that the sale was made in a commercially reasonable manner.[113] The fact that a better selling price could have been obtained at a different time or using a different method is not sufficient to establish that the sale was unreasonable.[114] However, the sale can be stopped if the creditor does not proceed in a commercially reasonable manner.[115]

Once the collateral has been sold, the creditor may retain enough proceeds to cover the expenses (including legal costs) of retaking, selling, and preparing the collateral for sale and enough proceeds to satisfy the

debt.[116] Surplus proceeds may be distributed to other secured creditors if those creditors provide a written demand to the creditor who is enforcing its security interest.[117] The creditor must return any remaining proceeds to the debtor,[118] who remains liable for any unpaid balance if there are not enough proceeds to repay the creditor.[119] Such a *deficiency* is considered unsecured and must be collected like any other unsecured claim, as described in preceding sections.

A creditor's alternative to selling the collateral is to propose retaining it in satisfaction of the obligation.[120] The creditor has to send written notice of such a proposal to the debtor. If the debtor objects within 21 days after the notice was sent, the creditor must sell the property in the manner described in the preceding paragraphs.

Foreclosure of Liens on Personal Property

Another alternative for a secured creditor is to *foreclose* the lien that encumbers the personal property. This foreclosure is a judicial process and is the only procedure for enforcing involuntary liens. Foreclosure of a personal property lien will lead to a judicial sale of the assets, similar to the procedure for selling property that has been levied against during collection of an unsecured debt.[121]

This procedure also provides that the court may issue a warrant ordering the sheriff to seize the encumbered property before final judgment if the plaintiff, by affidavit, states there is reason to believe seizure is necessary to prevent the property from being removed, destroyed, or concealed.[122] If the judge issues a warrant, the sheriff will serve a copy of the warrant and affidavit to the debtor.[123] The debtor then has 10 days to file a *special answer*.[124]

Filing a special answer entitles the debtor to a trial to determine whether the property should be seized.[125] The debtor may deny that the collateral is in danger of disappearing and claim that seizure of the property will cause undue hardship. The court must consider any undue hardship on the defendant that will result from a seizure of the property.[126] If the court finds in favor of the debtor, the warrant will be dismissed.

The sheriff may seize the property if the debtor does not file a special answer within the 10 days.[127] Likewise, the sheriff may seize the property at the time the warrant is served if the collateral is perishable or if the judge has determined that the collateral is likely to be removed, destroyed, or concealed.[128]

Irrespective of when the sheriff seizes the encumbered assets, a judgment allowing the plaintiff to foreclose the lien also must include an order for the sale of the property.[129] As mentioned in other sections, the debtor remains liable if sale proceeds are not enough to repay the creditor. Such a *deficiency* is considered unsecured and must be collected like any other unsecured claim.

Debtor's Rights

North Dakota laws, like those of all other states, do not limit debtors to the protections provided in the statutes that outline collection procedures. This section reviews some statutes which define additional legal rights for debtors. For example, a debtor may argue that a creditor's lien is no longer valid if the creditor took the collateral when the security agreement did not allow repossession.[130]

Another argument that North Dakota debtors have raised is that the payment is not due at this time, relying on a statute enacted during the depression of the 1930s. This statute is commonly referred to as the *confiscatory price defense* and grants state courts additional discretionary authority if the price of farm products is less than the cost of production or if a foreclosure would have the effect of confiscating a debtor's property.[131] The added authority permits the court to extend the time for completing a collection action.

The confiscatory price statute, as currently written and interpreted, does not resolve all the issues that may arise. For example, what conditions must be met for the statute to be triggered? These include defining cost of production and price of farm products. How can courts exercise their authority if the law has been triggered? What must the debtor do during the period of delay? It is clear, however, that by raising the defense, a debtor prevents a judge from granting a summary judgment.[132] Instead, a trial must be held to determine whether the conditions exist for triggering the statute.

North Dakota's department of agriculture has established an agricultural *mediation* service to help farmers and creditors resolve credit problems.[133] Either a farmer or a creditor can request mediation. Since this is a voluntary program, both parties must consent to mediation. A creditor who does not consent to mediation will not be precluded from initiating collection action. This is different than a few other states in which mediation is mandatory.[134]

As described in a preceding section, state law *exempts* certain property from the reach of creditors. For North Dakota residents, these exemptions include a residence in which the debtor has no more than $80,000 equity (or a mobile home or $7,500 in personal property), a vehicle of no more than $1,200 value, and approximately $8,000 in other personal property. However, exempt personal property can be levied upon and sold if the debt being collected was incurred to purchase the property.[135] Debtors are allowed to convert unencumbered non-exempt assets into exempt assets to maximize the benefit of the exemption law.[136]

Debtors have legal rights and protection after encumbered property has been seized. A major privilege is the debtor's *right of redemption*, which permits the debtor to re-acquire the property by paying the entire debt plus the creditor's sale and legal expenses.[137] The redemption period for personal property expires upon the foreclosure sale or after the debtor fails to object to a creditor's intent to retain the property in full satisfaction. The debtor may redeem the collateral any time before the creditor sells the collateral.

Priority Among Creditors

The discussion thus far has explained the relation between a debtor and creditor. However, sometimes disputes arise among creditors who are seeking to satisfy their claims against a debtor from the same property. Time is an important consideration in resolving these issues. Generally, the first creditors to take steps to protect themselves will have *priority* and be paid first. For example, if both claims are unsecured, the first creditor to levy against the property will have the legal right to be paid first. The time a levy was imposed is the critical factor in such cases, because unsecured creditors have no claim against specific assets of the debtor until the sheriff completes the levy. For the same reason, a creditor holding a secured debt has priority over an unsecured creditor.

Time also is important when two creditors have liens encumbering the same property. As explained in previous sections, acquiring a lien against the debtor's property involves two facets. The first facet is obtaining an interest in the debtor's property; the second is providing notice that the creditor has a lien against the debtor's asset. Generally, priority is given to the creditor who first completes both facets.

Both steps occur simultaneously either when an unsecured creditor has the sheriff levy against the debtor's assets or when a creditor files a verified statement to impose a statutory lien. With voluntary liens, the two facets appear as distinct steps. The first step is to *attach* the property. The creditor and debtor execute a security agreement whereby the creditor acquires an interest in the debtor's property. The second step is to *perfect* the security interest by filing a financing statement. This filing determines the relationship between this creditor and others who claim an interest in the debtor's asset. As a result, a creditor who attaches a security interest but does not perfect may lose priority to another creditor who subsequently completes a levy or files a financing statement. Creditors are usually careful to complete both steps as soon as possible.

Disputes among creditors of the same priority generally are resolved by giving priority to the creditor who is first in time.[138] For example, the first creditor to attach a security interest will prevail in a dispute between two secured but unperfected creditors. This criterion also resolves disputes between perfected creditors. This is why personnel at the public office where financing statements are filed note the date and time of filing on the document.

The procedure for resolving disputes among creditors varies, depending on their respective legal rights. For example, in a claim and delivery action, a second creditor who asserts a legal right to the property the sheriff is seizing can file an affidavit and bond to stop delivery to another creditor.[139] Similarly, a creditor with priority can sue a subordinate creditor for *conversion*; that is, selling the collateral but not paying the priority creditor the amount of its lien.[140] Creditors with a lien subordinate to the one being enforced can protect their interest by exercising their right of redemption[141] or by requesting to be paid from surplus sale proceeds.[142]

Purchase Money Security Interests and Future Advances

There are exceptions, however, to the general rule that the first creditor to perfect will be entitled to the highest priority. One exception addresses the conflict that arises between a creditor who provided capital for the debtor's acquisition of some asset and an existing creditor whose after-acquired clause also encompasses the acquired asset. Generally, the law gives priority to the creditor who provided the new credit. The second creditor's lien is considered a *purchase money security interest* because the security interest results from having provided the money to purchase the asset.

For example, a bank executes a security agreement with a borrower and files a financing statement that encumbers all of the borrower's machinery and vehicles, including all after-acquired vehicles. Subsequently, a local dealer sells a truck to the borrower and agrees to be paid in installments. Even if the dealer completes the security agreement and files a financing statement to encumber the truck, the bank's security interest would appear to have priority because it was perfected first. Accordingly, the dealer may be reluctant to sell the truck for fear that the bank may use it to fulfill its claim and leave the dealer unsecured. To reverse this outcome, the law provides that a creditor who extends new credit will have a purchase money security interest and priority over existing liens if a financing statement is filed within 20 days after the borrower takes possession of the collateral.[14]

A similar exception is available for creditors who perfect a security interest after agreeing, in writing, to extend a line of credit (that is, make *future advances)*. These creditors will have priority over subsequent lienholders even though the funds are actually advanced to the debtor after the later liens have arisen.[14] This priority is limited to the amount loaned or to the amount specified in the security agreement, whichever is less.[15]

Priority of Involuntary Liens

Filing a verified statement for an involuntary agricultural lien, as described in a previous section, not only grants the creditor a lien against the debtor's property but also gives the creditor priority over other secured parties. This is another exception to the general rule that the first creditor to acquire a lien will have priority and is intended to encourage creditors to extend credit when it is economical for a borrower to finish a product, for example,

> A farmer's ripe crop is encumbered by a local bank's security interest which had been granted by the farmer as collateral for a loan. A problem arises if the amount owed the bank is more than the value of the crop and the farmer does not have enough funds to pay harvest costs. In such a situation, a custom operator may be willing to harvest the crop only if there is an opportunity to be paid from the crop proceeds. Only by granting processor liens priority over the bank's security interest can the custom operator be confident of being paid.
>
> The bank also benefits (even though some crop proceeds are used to pay the custom operator) because the bank would receive nothing from an unharvested crop. By granting priority to processors, the law

encourages a ripe crop to be harvested (rather than left in the field) as long as the value of the crop exceeds harvesting costs.

Processor liens have priority over all other liens or encumbrances regarding the encumbered crop.[45] A supplier's lien has priority over all other liens or encumbrances against the crop except for the processor's lien.[46]

Since an agricultural lien is effective from the date of processing, supplying, or performing, the first person to extend credit will have priority if more than one agricultural lien of the same type is filed. For example, if a supplier sells seed on credit and another person delivers it, both are eligible for a supplier's lien. If both file a valid statement, the seller will have priority because the seed sale was completed before the delivery occurred. However, this contradicts the practice of granting priority to the last creditor to assure a product is finished when it is economical to do so.

An agister lien has priority over all other liens encumbering the livestock except for processor's or supplier's liens.

To summarize, agricultural liens (processor's lien, supplier's lien, and agister lien) have first priority; purchase money security interests, second; perfected security interests and completed levies, third; secured but unperfected security interests, fourth; and unsecured claims, fifth.

Priority Between a Creditor and Other Parties

Previous sections have addressed the relationship 1) between a creditor and the debtor, 2) between a creditor and a third party that possesses the debtor's property, and 3) among creditors competing to have their debt paid from the debtor's assets. This section examines the potential for disagreement between a creditor and others who think they now own property that the debtor had owned. Included in this group are persons who have purchased property or received a gift from the debtor.

The general rule is that someone who *buys* encumbered property takes the property subject to existing liens;[48] that is, an unpaid creditor of the seller can seize the property from the buyer even though the buyer has paid the entire purchase price to the seller. For example, a neighbor buys a tractor from a farmer and pays the purchase price at time of delivery. The tractor can be taken from the buyer, however, if the seller has not paid a creditor who perfected a security interest in the tractor before the sale. The neighbor, before buying the tractor, should have checked the public record (at the register of deeds office of the debtor's residence or the office of the secretary of state[49]) to determine if a financing statement had been filed to provide notice that the tractor was encumbered.

After the seller's creditor repossesses the property, the buyer's remedy is to demand that the seller return the purchase price (the buyer's claim against the seller at this point would be considered the same as an unsecured debt). This remedy may be of little practical value to the buyer because the seller often lacks the assets to refund the payment.

The general rule that one buys subject to existing security interests has several exceptions. One exception is that a buyer is not subject to a security interest that has not been perfected.[50] A second exception is that the lien is not enforceable against a buyer if the creditor agrees to the sale.[51]

State law specifies another exception to the general rule; that is, a lien is not enforceable against a buyer if the item being purchased is considered part of the seller's inventory.[52] For example, consumers can purchase household appliances from the local store without concern as to whether the bank has a lien against the inventory. This exception does not apply, however, if the buyer is acquiring the entire inventory as part of purchasing the business.

Since 1986, federal statutory law (which is supreme to state law according to the U. S. Constitution) has specified that a lien against a farmer's inventory of *farm products* (crop and livestock) will be treated like the household appliance the consumer buys. That is, buyers of farm products (such as elevators and livestock buyers) are not subject to a perfected security interest or any other lien that encumbers the commodity.[53] The law prior to 1986 was the opposite, and buyers of farm products might pay for commodities twice: once when they bought them from the farmer and a second time when the farmer's unpaid but secured creditor demanded delivery of the commodities or to be paid their value.

The federal law allows states to select one of two options to allow secured creditors to enforce a security interest against a farm product buyer. One option is to require that creditors notify potential farm product buyers before the sale if the creditor intends to enforce the lien. North Dakota has chosen the other option of establishing a *central notice system* (CNS) whereby a creditor can file an *Effective Financing Statement* (EFS) with the secretary of state.[54] Under this system, farm product buyers register with the CNS to regularly receive a list of all farmers whose secured creditors have filed an EFS against the borrower's commodities. With this information, a buyer knows whether the commodity being purchased is encumbered. Accordingly, buyers acquire the farm products free of a creditor's security interest if 1) the most recent CNS list does not indicate that and EFS covers the commodity or 2) the buyer issues a check that is jointly payable to the farmer and secured creditor. An EFS differs slightly from a financing statement, even though they both contain similar information.

A creditor with an involuntary lien will not have priority over a farm product buyer even though a verified statement or financing statement containing the proper information has been filed in the correct county. Like a creditor with a security interest, the lienholder must <u>also</u> file with the North Dakota CNS to be able to enforce the lien against a buyer.

Before 1986, buyers of farm products successfully released themselves from a creditor's lien by arguing that the creditor implicitly agreed to the sale.[55] An unanswered question at this time is whether such an argument will protect a buyer from a lien even though the creditor has complied with the federal and state laws for enforcing the lien against the farm product buyer.

Endnotes

1. Martian v. Martian, 339 N.W.2d 849 (1987).

2. N. D. Cent. Code *chap.* 32-08.1 (Supp. 1991).

3. N. D. Cent. Code §32-08.1-02 (Supp. 1991).

4. N. D. Cent. Code §32-08.1-03 (Supp. 1991).

5. *Id.*

6. N. D. Cent. Code §32-08.1-05 (Supp. 1991).

7. N. D. Cent. Code §32-08.1-02 (Supp. 1991).

8. N. D. Cent. Code §32-08.1-02 (Supp. 1991).

9. N. D. Cent. Code §32-08.1-09 (Supp. 1991).

10. N. D. Cent. Code §32-08.1-07 (Supp. 1991).

11. N. D. Cent. Code §32-08.1-10 (Supp. 1991).

12. N. D. Cent. Code §§32-08.1-13 and 32-08.1-12 (Supp. 1991).

13. N. D. Cent. Code §32-08.1-11 (Supp. 1991).

14. N. D. Cent. Code §32-08.1-06 (Supp. 1991).

15. N. D. Cent. Code §32-08.1-14 (Supp. 1991).

16. N. D. Cent. Code §32-08.1-17 (Supp. 1991).

17. N. D. Cent. Code §32-08.1-16 (Supp. 1991).

18. *See* Sniadach v. Family Finance Corporation, 395 U.S. 337 (1969); Fuentes v. Shevin, 402 U.S. 67 (1972); Mitchell v. W.T. Grant Co., 416 U.S. 600 (1974); North Georgia Finishing, Inc. v. Di-Chem Inc., 419 U.S. 601 (1975).

19. See *Mitchell v. W.T. Grant Co.*, 416 U.S. 600 (1974).

20. N. D. Cent. Code §32-08.1-21 (Supp. 1991).

21. N. D. Cent. Code §32-08.1-19 (Supp. 1991).

22. N. D. Cent. Code §32-03-10 (1976).

23. N.D.R.Civ.P. 12(a).

24. N.D.R.Civ.P. 54(c) & 55.

25. N.D.R.Civ.P. 26 through 37.

26. N.D.R.Civ.P. 37.

27. N.D.R.Civ.P. 56(c).

28. N.D.R.Civ.P. 38(b).

29. N.D.R.Civ.P. 58

30. N. D. Cent. Code §28-20-13 (1991).

31. *Id.*

32. N. D. Cent. Code §§28-20-13, -21, -22, and -23 (1991).

33. N. D. Cent. Code §28-21-06 (1991); Zink v. James River National Bank, 224 NW 901 (ND 1929); and Aberle v. Merkel, 291 NW 913 (ND 1940).

34. N. D. Cent. Code *Id.*

35. *Id.*

36. N. D. Cent. Code §28-21-05.1 (1991)

37. N. D. Cent. Code §28-21-12 (1991).

38. *Id.*

39. N. D. Cent. Code §47-18-01 (Supp. 1991).

40. N. D. Cent. Code §28-22-02 (1991).

41. *Id.*

42. N. D. Cent. Code §28-22-03 (1991).

43. N. D. Cent. Code §28-22-04 (1991).

44. N. D. Cent. Code §28-22-05 (1991).

45. N. D. Cent. Code §28-22-03.1 (1991).

46. N. D. Cent. Code §32-09.1 (Supp. 1991).

47. N. D. Cent. Code §28-21-11 (1991).

48. N. D. Cent. Code §28-23-07 (1991).

49. N. D. Cent. Code §28-23-01 (1991).

50. N. D. Cent. Code §28-23-07 (1991).

51. N. D. Cent. Code §28-23-09 (1991).

52. N. D. Cent. Code §28-23-13 (1991).

53. N. D. Cent. Code §28-21-07 (1991).

54. N. D. Cent. Code §28-21-19 (1991).

55. N. D. Cent. Code §28-21-01 (1991).

56. N. D. Cent. Code §§28-20-21, -22, -23, and -35 (1991); 100 NW2d 153 (ND 1959).

57. N. D. Cent. Code §28-21-06(1) (1991).

58. A sale of levied land must be advertised once a week for three weeks before the sale. N. D. Cent. Code §28-23-04 (1991).

59. N. D. Cent. Code §28-20-30 (1991).

60. N. D. Cent. Code *chap.* 35-31 (1987 and Supp. 1991); Norwest Bank-Jamestown v. Ostlund Chemical Co., 46 Bankr 266 (1984).

61. N. D. Cent. Code *chap.* 35-30 (1987 and Supp. 1991); Mace v. Cole, 198 NW 816 (ND 1924).

62. N. D. Cent. Code *chap.* 35-17 (1987 and Supp. 1991); Mead v. Bockorny, 191 NW 626 (ND 1922).

63. N. D. Cent. Code §35-30-01 (Supp. 1991).

64. N. D. Cent. Code §35-30-[illegible] (Supp. 1991).

65. N. D. Cent. Code §35-30-01 (Supp. 1991).

66. N. D. Cent. Code §35-31-01 (1987).

67. N. D. Cent. Code §35-31-02 (Supp. 1991).

68. *Id.*

69. N. D. Cent. Code §35-17-02 (1987).

70. N. D. Cent. Code §35-17-04 (Supp. 1991).

71. N. D. Cent. Code §47-14-01 (1978).

72. N. D. Cent. Code §41-09-05(1)(l) (Supp. 1991).

73. N. D. Cent. Code §41-09-16(1)(a) (Supp. 1991).

74. N. D. Cent. Code §41-01-11(37) (1991).

75. N. D. Cent. Code §41-09-16(1) (Supp. 1991); Armstrong v. State Bank, 754 F2d 778 (8th Cir. 1985).

76. N. D. Cent. Code §9-08-01 (1987); School District No. 61 v. Collins, 41 NW 466 (ND 1889).

77. N. D. Cent. Code §§9-03-02, -03, and -11 (1987).

78. N. D. Cent. Code §9-07-19 (1987).

79. N. D. Cent. Code §§41-09-16 and 41-09-27 (1983 and Supp. 1991).

80. N. D. Cent. Code §41-09-17 (Supp. 1991).

81. N. D. Cent. Code §35-05-01.1 (Supp. 1991).

82. *Id.*

83. *Id.*

84. N. D. Cent. Code §41-09-49 (1983).

85. 69 Am. Jur. 2d *Secured Transactions* 322 (1973)

86. 69 Am. Jur. 2d *Secured Transactions* 323 (1973).

87. N. D. Cent. Code §41-09-19 (1983).

88. N. D. Cent. Code §41-09-40 (Supp. 1991).

89. N. D. Cent. Code §41-09-41 (Supp. 1991).

90. N. D. Cent. Code §41-09-26 (Supp. 1991).

91. 69 Am. Jur. 2d *Secured Transactions* 553, 321 (1973).

92. *Id.*

93. 69 Am. Jur. 2d *Secured Transactions* 323 (1973).

94. N. D. Cent. Code §41-01-18 (1983).

95. N. D. Cent. Code §41-09-49 (1983).

96. *Id.*

97. *See* 69 Am. Jur. 2d *Secured Transactions* 597 (1973) (cited cases provide examples of intimidation considered to be a breach of the peace).

98. *Id.*

99. *Id.*

100. N. D. Cent. Code §32-07-01 (1976).

101. N. D. Cent. Code §32-07-02 (1976).

102. N. D. Cent. Code §32-07-03 (1976).

103. N. D. Cent. Code §32-07-04 (1976).

104. N. D. Cent. Code §32-07-02(6) (1976).

105. N. D. Cent. Code §32-07-05 (1976).

106. N. D. Cent. Code §32-07-06 (1976).

107. N. D. Cent. Code §32-07-08 (1976).

108. N. D. Cent. Code §32-07-09 (1976).

109. N. D. Cent. Code §32-07-10 (1976).

110. N. D. Cent. Code §32-07-12 (1976).

111. N. D. Cent. Code §41-09-50(1) (Supp. 1991).

112. N. D. Cent. Code §41-09-50(3) (Supp. 1991); American State Bank v. Hewson, 411 NW2d 57, 60 (ND 1987).

113. N. D. Cent. Code §41-09-53(2) (1983).

114. *Id.*

115. N. D. Cent. Code §41-09-53(1) (1983).

116. N. D. Cent. Code §41-09-50(1) (Supp. 1991).

117. N. D. Cent. Code §41-09-50(1)(c) (Supp. 1991).

118. N. D. Cent. Code §41-09-50(2) (Supp. 1991).

119. *Id.*; Massey-Ferguson Credit v. Orr, 420 NW2d 1, 2 (ND 1988).

120. N. D. Cent. Code §41-09-51(2) (1983).

121. N. D. Cent. Code §32-20-05 (Supp. 1991).

122. N. D. Cent. Code §32-20-02 (Supp. 1991).

123. *Id.*

124. N. D. Cent. Code §32-20-04.1 (Supp. 1991).

125. N. D. Cent. Code §32-20-04.1 (Supp. 1991).

126. N. D. Cent. Code §32-20-04.2 (Supp. 1991).

127. N. D. Cent. Code §32-20-02 (Supp. 1991).

128. *Id.*

129. N. D. Cent. Code §32-20-05 (Supp. 1991).

130. N. D. Cent. Code §35-01-20 (1987); Everett v. Buchanan, 8 NW 31, 37 (ND 1881).

131. N. D. Cent. Code Chap. 28-29 (1991); Federal Land Bank v. Lillehaugen, 404 NW2d 452, 456 (ND 1987).

132. Federal Land Bank v. Halverson, 392 N.W.2d 77 (N.D. 1986).

133. N. D. Cent. Code §6-09.10-03 (Supp. 1991).

134. Minnesota is one of several states which imposed mandatory mediation upon agricultural lenders during the 1980s.

135. N. D. Cent. Code §28-22-14 (1991).

136. House Report No. 95-595, 95th Cong., 1st Sess. 360-1 (1977); legislative history for 11 U.S.C. §522(b).

137. N. D. Cent. Code §41-09-52 (1983).

138. N. D. Cent. Code §41-09-33(5) (Supp. 1991).

139. N. D. Cent. Code §32-07-10 (1976).

140. N. D. Cent. Code §32-03-23 (1976).

141. N. D. Cent. Code §41-09-49 (1983).

142. *See* note 117, *supra*; N. D. Cent. Code §41-09-50(1)(c) (Supp. 1991).

143. N. D. Cent. Code §41-09-33(4) (Supp. 1991).

144. N. D. Cent. Code §35-01-05.2 (Supp. 1991).

145. N. D. Cent. Code §41-09-17(3) (Supp. 1991).

146. N. D. Cent. Code §35-30-03 (1987).

147. N. D. Cent. Code §35-31-03 (1987).

148. N. D. Cent. Code §41-09-27(2) (1983).

149. N. D. Cent. Code §41-09-40(1)(c) (Supp. 1991).

150. N. D. Cent. Code §41-09-22(1)(c) (1983).

151. N. D. Cent. Code §41-09-27(2) (1983); Benson County Co-op Credit Union v. Central Livestock Assn., 300 NW2d 236, 241 (ND 1980).

152. N. D. Cent. Code §41-09-28(1) and (2) (Supp. 1991).

153. 7 U.S.C. §1631 (1988).

154. N. D. Cent. Code §41-09-28(9) to (13) (Supp. 1991).

155. Benson County Co-op Credit Union v. Central Livestock Assn., 300 NW2d 236 (ND 1980), United States v. Central Livestock Assn., 349 F.Supp 1033 (D.N.D., S.E. Div. 1972); N.D. Cent. Code §41-09-27(2) (1983).

156. N. D. Cent. Code *chap* 13-02.1 (1991).

Appendix

GLOSSARY

Acceleration: Clause that may be included in loan agreement as well as security agreement allowing the creditor to require that all payments for the debt (including future payments) be paid at this time if the debtor has defaulted.

Affidavit: A written statement declared under oath and used to present evidence.

After-acquired Property Clause: Clause in security agreement which extends the security interest so it encumbers the collateral a borrower has at the time a security agreement takes effect, and similar properties the borrower acquires at a later time.

Agister's lien: Statutory lien available to any person who wishes to secure payment for feeding, herding, pasturing, or ranching livestock.

Agricultural Processor's Lien: Statutory lien available to any person who threshes, combines, dries, or harvests any crop or agricultural product.

Agricultural Supplier's Lien: Statutory lien available to any person who furnishes supplies used producing crops, agricultural products, or livestock. Supplies include seed, petroleum products, fertilizers, farm chemicals, insecticides, hay, feed, pasturage, veterinary services, or the service of delivering or applying the supplies.

Answer: A defendant's written response to the plaintiff's summon and complaint in which the defendant presents defenses and briefly explains why the plaintiff is not entitled to a judgment.

Attachment: Refers to when a security agreement becomes effective; the time when a creditor legally acquires a security interest in the debtor's property. Occurs after 1) there is a security agreement, 2) the creditor has given the debtor something of value (such as loan proceeds or sold an item on credit), and 3) the debtor has an ownership interest in the property that will be encumbered.

Breach of the Peace: Creditor's unacceptable use of force or violence to retake the debtor's property.

Claim and Delivery Action: Judicial proceeding wherein a creditor, after initiating a lawsuit to repossess collateral, requests that the court order the sheriff to seize and deliver the encumbered personal property. The alternative when other procedures to seize collateral will result in a breach of the peace.

Central Notice System: A filing system established by the state and certified by the United States Department of Agriculture that secured creditors use to notify buyers of farm products that the farmer's commodity is encumbered.

Confiscatory Price Defense: North Dakota statute that grants state courts additional discretionary authority if the price of farm products is less than the cost of production or if a foreclosure would have the effect of confiscating a debtor's property. The added authority permits the court to extend the time for completing a collection action.

Conversion: A legal proceeding in which one party claims that another has wrongfully used or sold property of the complaining party.

Creditor: Person or entity who has loaned money, sold property, or provided a service on the basis that payment will be completed at a later time. Someone who is owed a payment.

Debtor: Person or entity who has borrowed money or purchased property or services but is not expected to complete payment until a later time. Someone who owes a payment.

Default: Circumstance in which a party to a contract has violated a term in the agreement. For example, a debtor's failure to complete a payment by the time specified in the loan agreement violates that contract and is considered a default. After default, the nondefaulting party may take action (including initiating a lawsuit) against the defaulting party to recover any loss due to the default.

Default Judgment: A court decision in favor of the plaintiff because the defendant failed to file an answer to the summons and complaint within the specified time (usually 20 days).

Defendant: The person against whom a plaintiff has initiated lawsuit.

Deficiency: The amount a debtor still owes to a creditor after property upon which the creditor had a lien has been sold and the proceeds used to pay the creditor. Deficiency arises only when proceeds from the sale of encumbered property are less than the amount of the debt.

Deficiency Judgment: Recognition by a court that a deficiency remains after the encumbered property of the debtor has been sold and the proceeds paid to the creditor. After a deficiency judgment, the creditor may proceed against additional property of the debtor to collect the remaining indebtedness.

Discovery: Process in the legal system that compels one party of a lawsuit to provide the other party with information that is otherwise unavailable to the first party but is necessary for its case.

Effective Financing Statement: The document secured creditors file to notify buyers of farm products that the farmer's commodity is encumbered.

Encumbrance: A lien.

Encumbered Property: Property that has a lien imposed upon it.

Execution: Procedure to enforce a judgment whereby the sheriff is instructed to seize property of the debtor to satisfy the unpaid obligation. The seized property usually is sold with proceeds (minus cost of sale) remitted to the creditor.

Exempt Property: Property that, according to state law, cannot be seized to satisfy the debtor's obligations.

Financing Statement: A statement filed for public record in the office of the county register of deeds or the secretary of state listing the debtor's property upon which a creditor has imposed a security interest. Filing a financing statement perfects the security interest.

Foreclosure: A legal procedure to terminate a debtor's equitable redemption right. Generally, it is used in reference to a state court proceeding wherein the debtor is declared delinquent in making payments to a creditor and encumbered property is ordered sold with the proceeds used to satisfy the debt.

Fraudulent Conveyance: Any property transfer by a debtor whereby the debtor did not receive a reasonable equivalent value in exchange and the debtor's remaining assets are unreasonably small in relation to the debtor's business or transactions, or in relation to obligations the debtor is about to incur.

Garnishment: A judicial process that allows a creditor with a judgment to collect money from a third person who owes money to the debtor or possesses the debtor's property.

Insecurity Clause: A clause in a security agreement or loan agreement defining default to include whenever the creditor is concerned about being paid.

Involuntarily lien: Same as a statutory lien.

Judgment Lien: A lien automatically imposed upon all the debtor's real property after a state court determines that the debtor is indebted to the creditor. The lien encumbers only real property in the county in which the court is located, but the lien can be imposed on real property in other counties by recording the judgment in the other counties.

Levy: A court order directing the sheriff to seize property of the defendant (debtor).

Lien: The right of a creditor to have property sold or otherwise used to satisfy the debtor's obligation to the creditor. The right to have the encumbered property used to fulfill an obligation secures payment of the debt. Although the right is held, it can be exercised only if the debtor does not meet the terms of the obligation.

Lienholder: Any person or entity whose debt is secured by a lien on the debtor's property. Any creditor who has the right to have a debtor's property sold or otherwise used to satisfy a debt.

Line of Credit: An agreement by a lending institution to advance additional funds to a borrower at a future time.

Loan Agreement: An agreement between a debtor and creditor wherein the debtor promises to repay the debtor. The loan agreement contains the terms of the understanding, such as due dates for payments, rate of interest, and obligation for the creditor to extend additional credit at a future time.

Mediation: Debtor and creditor, meeting with a third party, to resolve their differences through negotiation, rather than litigation. States have established programs to provide mediators and encourage mediation.

Motion for Summary Judgment: After the defendant has filed an answer, the plaintiff may request that the court enter judgment in its favor because it is clear from the complaint and answer that the plaintiff will prevail at a hearing; a summary judgment will be granted only if the judge finds that "there is no genuine issue as to any material fact."

Motion to Dismiss: Defendant's request that the court dismiss the lawsuit because the complaint does not set forth a claim that can support a judgment.

Nonconsensual lien: Same as a statutory lien.

Note: Same as a loan agreement.

Order to Show Cause: A judicial order requiring a party to a lawsuit to appear in court to explain why the court should not rule in favor of the other party; for example, the court will order that the encumbered property be delivered to the creditor if the debtor does not attend the hearing or fails to adequately explain why the property should not be seized.

Perfection: The act of a creditor providing public notice that the creditor has a security interest in the debtor's property and that the creditor is entitled to have the property or its proceeds returned to the creditor if the debtor fails to fulfill the secured obligation.

Personal property: All property interests not considered real property. Can be tangible (such as livestock, motor vehicles, machinery, and stored crops), or intangible (such as savings accounts or certificates of deposits).

Plaintiff: The person who initiates a lawsuit against a defendant.

Pre-judgment Attachment: Judicial procedure permitting plaintiffs to impose a legal claim against and seize property of the defendant even though the court has not determined whether the defendant is liable to the plaintiff. For example, pre-judgment attachment protects creditors from debtors' disposing of, moving, or hiding assets during litigation.

Priority: Determining which creditor is entitled first to proceeds from sale of encumbered property. Creditors without priority will receive only the amount that remains (if any) after fulfilling obligations of creditors with priority.

Proceeds Clause: Clause in security agreement that extends the security interest to encumber any income that arise from the sale or other disposition of the collateral.

Purchase Money Security Interest: A security interest that arises automatically for a person who sold on credit or furnished cash for the purchase of property. A purchase money security interest is considered perfected for 20 days after the debtor acquires possession of the property. It is an acknowledgment by the law that filing to perfect takes some time and that the person who extended credit for the purchase of the property will retain priority as long as the security interest is perfected within a reasonable length of time.

Real property: Land and improvements, such as buildings.

Redemption: The right of a debtor (and subordinated creditors) to re-acquire property that has been seized to satisfy the claim of a secured creditor. The right to redeem farmland generally expires one year after the date of foreclosure sale. The right to redeem personal property terminates upon the sale or acceptance of the property as fulfilling the debt. The amount that must be paid to redeem personal property is all obligations secured by the property.

Secured Creditor: A creditor with a lien upon the debtor's property. Usually refers to creditors with security interest in personal property.

Secured Debt: Debt in which the creditor has the legal right to seize and use some of the borrower's property to pay the obligation.

Security Agreement: A written contract between the debtor and creditor wherein the debtor grants the creditor a lien on some property. Usually used in reference to a security interest.

Security Interest: Refers to a lien a debtor grants upon personal property, such as livestock, equipment, crops, and inventory.

Statutory Lien: A lien that automatically arises according to state law rather than by agreement. These liens generally arise when goods or services, sold on credit, benefits or improves specific property of the debtor. The lien encumbers the improved property. State law usually requires the creditor to file a notice with the county register of deeds to establish a statutory lien. Examples are mechanic's lien, repairman's lien, agricultural supplier's lien, and agricultural processor's lien.

Summons and Complaint: The document with which a plaintiff initiates a lawsuit. Contains a description of why the defendant is liable to the plaintiff.

Unsecured Debt: Debt in which the creditor has no legal right to seize and use some of the borrower's property to pay the obligation. A creditor must convince a court that an amount is owed, but unpaid, and collect payment as prescribed by law.

Voluntary Lien: A lien that arises from an agreement between the debtor and creditor wherein the debtor grants a lien to the creditor. The lien, in conjunction with a promise to repay a debt, is in exchange for a creditor's provision of a cash loan or other extension of credit. Also referred to as a consensual lien.

Waiver of Defenses against Assignees: An agreement in which a debtor has waived the right to stop payment if the original creditor had assigned its rights to collect payment to a third party. Even if the original lender has breached the original agreement, the debtor must continue to pay the assignee.

Writ of Attachment: Court order directing the sheriff to levy on (seize) enough of the defendant's property in the county to pay the plaintiff's claims.

Writ of Execution: Court order, signed by the judge, instructing the sheriff to levy against (seize) enough of the defendant's property to pay the judgment.