Thoroughbred Certificate Law: A Proposal

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A Proposal

BY CARY ROBERTSON*

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INTRODUCTION

Not so long ago people engaged in horse racing referred to their endeavor as the "game." It was a game for the idle rich, but also for the threadbare romantic. Each was looking for the "big horse." On the one end racing had the sporting interests; on the other resided a sort of lottery mentality. Unbusinesslike motives pervaded both extremes, and beneath them ran the strong undercurrent of gambling, a force inseparable from horse racing throughout American history.¹

¹ B. Nagler, The American Horse, 88-89 (1966). In 1823, Congress adjourned on the
In those days, the likes of Elizabeth Arden and the Vanderbilts paid as they went, while the hardboots paid when they could. The most sophisticated form of purchase money loan was what racetrack-ers referred to as a "cuff deal." This arrangement allowed the purchaser to get title in a racing animal without cash payment. The buyer then promised to pay cuff, i.e., consideration contingent on future purse earnings. If the deal went sour, the track stewards, who at that time had total judicial control of racing, served to construe the contract and dispense remedies. Most of the judicial power held by stewards came, and still comes, from jurisdiction over the licenses of all participants in the sport and over the equine registration papers and horseman's accounts.2

Times have changed. Horse racing has developed a bourgeoisie, a class of owners who have outside income but not limitless wealth, a class with a reasonable expectation of profit from their investment. These owners bring from their primary businesses ideas of modern financing practices largely founded on the Uniform Commercial Code.3 Within the last thirty years, the U.C.C., true to its statement of purpose,4 has helped revolutionize, or at least regularize, the world of commerce. When these commercially-wise business people try to apply the Code to horse business they find both a set of quaint colloquial practices that have stubbornly ignored change, and an array of commercial realities that resist any rational application of the U.C.C. The legal model on which the Code was built does not cover horses the way it does widgets. A conscientious application of the law in this case is akin to wrapping a tennis racket in Christmas paper. Any solution is strained and unsatisfactory. Chances are the paper will rip.

What the Code has tried to accomplish, and has failed so miserably to do with regard to the horse business, is "to simplify, clarify and modernize the law governing commercial transactions."5 Hence, the purpose of this Article is to propose a method whereby the Code's objectives can be fulfilled in the area of the thoroughbred business as they have been in the financing and sale of widgets.

occasion of a match race between American Eclipse and Sir Henry. Perhaps $400,000 was wagered on the outcome, by a crowd estimated at 40,000 to 60,000 strong.
3 Interview with William C. Greeley, Keeneland Association, in Lexington, Kentucky (March 10, 1989) (regarding the increase in lien notices at the Keeneland Sales).
4 Uniform Commercial Code § 1-102(2)(a)-(c) (1977) [hereinafter U.C.C.].
5 Id.
I. A TITLE STATUTE FOR THOROUGHBREDS

The proposed title statute for thoroughbreds\(^6\) rests on the notion that a state can assert jurisdiction over all the foals born within its borders. From this premise flows the conclusion that if each state chose to confer a certificate of title on the thoroughbreds foaled in its territory, then all thoroughbreds would be covered by a title law, and none would be subject to more than one jurisdiction's law. To coordinate the new law with existing registration practices, the state of birth will recognize The Jockey Club as the official issuer of its certificate of title. In practice, this means that the certificate of foal registration that is presently issued to each registered thoroughbred foal will assume an additional legal effect. The state will enact a statutory scheme with the following provisions: 1) each horse will be registered once in its life in the state of its birth; 2) the certificate of title will be issued in the name of the original owner; 3) successive transfers will be executed on that document; 4) perfection of security interests will be accomplished by central filing of an equine lien statement, plus either a) notation on the certificate, or b) possession of the certificate; 5) security interests will be recorded centrally in a state office and filed by horse's name; 6) the state clerk's files will be open to the public; 7) the clerk will give notice to The Jockey Club of each filed security interest, and thereafter no duplicate certificate will be issued without consent of the secured party; and 8) The Jockey Club will be indemnified for liability arising from its performance of this additional service.

Once these provisions are enacted, the existing provisions of article 9 will govern the intricacies of secured transactions.\(^7\) One further amendment to the U.C.C. will eliminate a source of confusion caused by potentially overlapping laws, viz., the deletion of the "farm products exception" from Kentucky Revised Statutes 355.9-307(1) (KRS),\(^8\) which allows a security interest in farm products to continue after a sale in the ordinary course of business. In its inception, this provision was resisted by the drafters, but threats from the federal government, the largest farm products lender, assured its inclusion.\(^9\) In its enactment, this is one of the least

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\(^6\) The proposed statute is printed in full immediately following the conclusion of this Article.

\(^7\) See, e.g., U.C.C. § 9-103(2).

\(^8\) K.R.S. § 355.9-307(1).

\(^9\) Hawkland, The Proposed Amendment to Article 9 of the U.C.C.—Part 1: Financing the Farmer, 76 Com. L.J. 416, 420 (Dec. 1971) (these threats included enacting federal
uniformly adopted rules. In its enforcement, this rule gets bizarre and inconsistent reading in the courts. Moreover, in its present state, the farm products exception has no legal impact. The federal Food Security Act has intentionally and effectively overruled the farm products exception. Interestingly, the federal government, once the champion of the farm products exception, has now moved to eliminate it.

Though the Food Securities Act will receive further treatment later in this Article, it is worth noting here that the Act also impinges upon a forward-looking non-uniform section of our statute, KRS 355.9-307(6), which provides an exception to the farm products exception for the sale of registered horses at public auction. Unless the Act’s term “horse” can be read as not meaning “registered horse,” the Kentucky provision may as well be repealed. The federal statute totally preempts it.

In addition to the provisions already suggested, some changes in state horse racing regulations also are desirable, though it should be understood that these amendments will have a diluted effect because horses are apt to race outside their state of birth. Such regulations would only be truly effective if enacted universally. Even so, changes in Kentucky’s racing regulations would be illustrative to other states and to national racing organizations. Three additions to racing law seem especially appropriate: 1) a provision for licensing of secured parties under the state racing authority, which would place them under the authority and within the protection of the racing laws; 2) a mechanism whereby a secured party’s interest in “earnings” of the collateral can be protected in the office of the horseman’s bookkeeper by the issuance of joint checks; and 3) a similar provision for protection of “proceeds” of sale where horses

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13 2 U.S. Code Cong. & Admin. News 1212, 14 (1st Sess. 1985) provides:
   Thus, this Act would preempt state law that set as conditions for buyer protection of the type provided by the bill requirements that the buyer check public records, obtain no-lien certificates from the farm products sellers, or otherwise seek out the lender and account to that lender for sale proceeds. By contrast, the bill would not preempt basic state-law rules on the creation, perfection, or priority of security interests.
14 See 7 U.S.C. § 1631(c)(5).
are either "claimed" under the auspices of a racing association or sold at public auction.

A. Limiting the Objective

The scope of this Article will be narrow, focusing on the objectives of Article 9 secured transactions. It will also be limited to the breed of thoroughbreds. Furthermore, the scope of this proposal will be limited to Kentucky legislation. It may be argued that a unilateral law frustrates the goal of the U.C.C. by creating nonuniformity. However, two points should be kept in mind when considering this argument. First, the proposed legislation will be in the form of a model act, so that if other states should choose to pass identical legislation, the laws will not conflict, and if all states should choose to follow suit, all thoroughbreds would be covered. Second, the thoroughbred business, insofar as equine collateral is concerned, is a regional problem, not a national one. Though thoroughbreds are foaled in all fifty states, more than half of those are dropped in the five most important breeding states—Kentucky, California, Florida, New York, and Maryland. But the analysis of local concentrations of equine collateral does not stop with a mere head count.

B. Collateral Covered by a Kentucky Law

It may be argued that the adoption of a unilateral law by the Commonwealth of Kentucky will not affect enough of the national

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15 This Article does not ignore the existence of other breed registries. Rather, it defers to people more knowledgeable of the problems facing breeds such as standardbreds, quarter-horses, and Arabians, to comment on their needs. It is possible that the fundamentals of this proposal can be adapted to other breeds. In any case, the thoroughbred industry seems to be a logical starting place because the thoroughbred is the most valuable per capita. Moreover, Kentucky is the center of the thoroughbred industry; the same may not be true of other breeds.

16 The Jockey Club, Principal Rules and Requirements of the American Stud Book (1987). The Jockey Club also registers horses bred in Canada. These horses are treated the same as U.S.-bred horses, both by the industry and by the proposed title statute. Horses bred in other foreign countries receive a certificate of foreign registration when imported into the U.S. or Canada. Imported horses, unlike their Canadian counterparts, will be eligible for certificate of title in Kentucky.


18 These five states are the only states that stand at least one stallion among the top 65 living sires. Leading Active Sires-Lifetime, The Blood Horse Feb. 4, 1989, at 672. In sheer number of foals, Louisiana and Washington rank fourth and fifth nationally, while New York and Maryland follow closely. Fact Book, supra note 17, at 11.
thoroughbred population to make it worthwhile. This argument sounds reasonable to anyone unacquainted with the realities of the thoroughbred business. The difference between lending against thoroughbreds and other agricultural collateral is that horses are not fungible. Whereas cattle, cotton, and catfish are only generally identified in security agreements, horses are identified by name. Thoroughbreds and other horses may be worth anywhere from several million dollars each to a few hundred dollars. Lenders evaluate each individual horse as collateral and will loan money against that particular horse.\(^1\)

There are limitations on lenders' willingness to trade money for a security interest in thoroughbreds. The euphoria that pumped up the thoroughbred industry in the late 1970's spread to the normally conservative lending business. Banks lent vast amounts of money on helium-filled collateral and when the balloon plunged earthward in the 1980's, they were severely jarred. For this reason, many lending institutions look at thoroughbred collateral the way an acrophobe views the prospect of a parachute jump. However, some brave ones remain. Aside from the difficulties with perfection that are addressed elsewhere in this Article,\(^2\) these lenders look at thoroughbreds as reasonably sound and unusually liquid property. There are exceptions to their eagerness to lend, however. Bankers show a strong preference for horses of substantial worth and strong residual value and, considering the life span of the horse and the likelihood of fluctuations in its value, loans of short duration are also favored. This means that not all thoroughbreds will be suitable collateral, and as a practical matter far greater than twenty percent of the horses who do qualify as collateral are foaled in Kentucky.

A rule of thumb accepted by some bankers is that to be desirable collateral a horse must be worth at least $50,000.\(^3\) Thus, this is the figure used in the following discussion. If other bankers use a substantially lower number, the conclusions will change somewhat in favor of the other forty-nine states. As the lending floor drops, more non-Kentucky-foaled collateral will meet the lending criteria.

A typical horse's life provides three expanses of time that might require investment in the form of purchase money capital: 1) the period begun by the payment of its stud fee until the time it is sold

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19 Interview with J. Keen Shackelford, equine lending officer, Bank One, Lexington, Kentucky (February 13, 1989) (regarding thoroughbred lending practices).
20 See infra notes 76-99 and accompanying text.
21 Id.
at the yearling auction; 2) the time it is bought as a racing prospect from a yearling auction until it is through with racing and is sold as a breeding animal; and 3) the time it is purchased as breeding stock until it is resold. This is not to say all horse loans fit into these precise patterns. Weanlings and two-year-olds are sold at auction; horses are sold privately and through the claim box. But the three enumerated periods are the traditional ones in the lender-borrower relationship. On the front end of each period is the borrower’s need for money and on the back end the potential sale price is ascertainable from statistics well known to the industry. This degree of certainty appeals to lenders. Even adhering to the $50,000 rule, different lender expectations and different risks arise under each of the three periods.

1. **Stallion Service Purchase Money to be Repaid in Two Years**

Lenders approached by mare owners who are requesting stallion service purchase money loans to be repaid in two years will want to require of the borrower: a) a guaranteed live foal contract, or a no-guarantee contract covered by loss-payee insurance; b) a stallion with at least two or more crops of foals on the ground; c) a contractual term that the mare be kept in Kentucky until she foals; d) mortality insurance on the foal; and e) a stallion whose median yearling sales price is $50,000 or more. The last requirement throws much light on the issue initially presented: whether a unilateral legislative action by Kentucky would have much impact on the total field of secured transactions. Here the foals would be confined to those by stallions with a $50,000 median yearling price. There are about eighty-two such stallions in the United States and only about five of these stand outside Kentucky. The mere fact that a foal’s sire stands in Kentucky does not mean that the foal’s dam will give birth there, but it appears that in seventy-six percent of the cases this is true. Among these stallions, the average foal crop size is forty, meaning that of the 3,280 foals produced by the eighty-two stallions, approximately 2,350 will be Kentucky foals. In other

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22 RACING UPDATE, INC., 1988 STUD FEE REPORT [hereinafter REPORT].
23 Id.
24 Jockey Club Statistical Services. Study of registered foals by selected stallions: Alydar, Nureyev, Seattle Slew, Private Account, Relaunch, Sportin’ Life, Clever Trick and Danzig. Totals: Kentucky foals = 1,975; non-Kentucky foals = 608.
26 I am assuming that no Kentucky foals are sired by out of state stallions. This, of course, is improbable. Inclusion of such foals would drive the percentage of Kentucky collateral even higher.
words, a Kentucky certificate of title law will cover seventy-two percent of the suitable collateral eligible for the yearling sales. However, only half of these foals will reach the yearling auctions,\textsuperscript{27} while the other half will be disposed of in another manner: some will be kept for racing by their breeders, some will be sold privately or at public auction as weanlings or as two-year-olds in training, and some will die. At least in the pre-yearling period, it would appear that the issue of secured transactions is a local rather than a national problem, best solved by Kentucky legislation.

2. Yearling Sale Purchase Money to be Repaid in Three Years

The borrower who requests a yearling sale purchase money loan to be repaid in three years wants to acquire racing stock with an idea to profit by purse earnings as well as by increasing the horse's value as a breeding prospect. A superior race record is a large factor in the value of a potential broodmare and it is simply indispensable for a stallion prospect.\textsuperscript{28} A stallion that has not raced or that has raced with little success is practically worthless on the market. The time frame for this sort of loan is between the horse's yearling and four-year-old years. At any time during that period, a male horse can, by stepping on a rock, attain his residual value of about five percent.\textsuperscript{29} On the other hand, studies of fillies sold at yearling auctions indicate that they retain at four years roughly forty-five percent of their value.\textsuperscript{30} Any race record they develop in the meantime will increase this figure, Lenders faced with this sort of proposal would want to confine their lending to fillies (and not colts) that bring more than $100,000 as yearlings (residual value of $45,000). There were, in 1987, about 303 such fillies by ninety-four United States-based stallions.\textsuperscript{31} Of these, 283 were by Kentucky sires while twenty were by nine stallions situated among the other forty-nine states (of the twenty, nine were by the now retired Northern Dancer who stood in Maryland).\textsuperscript{32} Applying the earlier seventy-six percent rule for foals born in states where they were conceived, this means that seventy percent of all potential collateral under this scenario would be covered by Kentucky certificate of title law.

\textsuperscript{27} RACING UPDATE, INC., 1987 YEARLING SALE COMPENDIUM [hereinafter COMPENDIUM].
\textsuperscript{28} Interview with Bill Oppenheim, Racing Update (February 20, 1989) (regarding the valuation of thoroughbreds).
\textsuperscript{29} Id.
\textsuperscript{30} Id.
\textsuperscript{31} Compendium, supra note 27.
\textsuperscript{32} Id.
3. Purchase Money for Retired Racing Stock to be Resold as Breeding Stock or to be Held for Production

The borrower who requests a purchase money loan for retired racing stock to be resold as breeding stock or to be held for production seeks to purchase with one of three goals in mind: a) to obtain offspring from the use of the breeding rights; b) to sell those breeding rights; or c) to hold that particular pedigree until it appreciates. Of course, some mix of these objectives is quite possible. Legally, it would not seem to matter whether the animal in question here was a stallion or mare, but as a practical matter the difference is vast.

Almost without exception, stallions of any value are syndicated. Therefore, the available interest in a stallion takes the form of a share, not outright ownership. The high-prices commanded by good stallion prospects, the ability to sire many offspring each year, and the danger of nose dives in popularity all encourage risk-spreading by way of syndication. Though other methods of achieving the same result are conceivable, syndication has the additional advantage of not being recognized as a security under federal securities laws, thereby escaping all the problems associated with registration. Security interests in syndicated stallion shares are relatively easy to perfect. The proposed certificate of title law would have no impact on current practice because shareholders never get possession of the horse’s papers. The horse would still be covered by a certificate of title—when the horse is syndicated, the syndicate will be listed as the nominal transferee, but each share would not be individually covered by a certificate of title. Though not impossible to imagine, it would be a rare occurrence in the horse business if a stallion were purchased outright from a syndicate. The spectre of corporate takeovers has not yet clouded the horizon of horse breeding. Nor as a practical matter is it likely that the shareholders would collectively put the horse, and its papers, up as collateral for a loan. The shareholders own the breeding rights individually. Whatever rights they hold collectively are relatively worthless, i.e., the right to determine the syndicate manager or the right to move the stallion from one farm to another.

33 The Thoroughbred Record, The Thoroughbred Record Sire Book (1987) [hereinafter Sire Book].
34 Campbell, Stallion Syndicates as Securities, 70 Ky. L.J. 1131 (1981-82).
35 C. Keeton, Securities Interests in Horses at 26 (1986).
If the certificate of title law leaves the field of stallion lending untouched, the status quo prevails. Kentucky law already applies to most stallion shares with minimum ($50,000) collateral qualifications. Using the rule of thumb that season prices are one-quarter of share value, only the shares of stallions with stud fees of $12,500 or more would qualify as collateral. In 1988, about 179 such stallions stood in the United States.\(^{37}\) Of these, about 140, or eighty percent, spent the breeding season in Kentucky.\(^{38}\) The U.C.C.-1 financing statements for any of the shares of these stallions were filed in various county courthouses of the Commonwealth. Actually only three of Kentucky’s 120 courthouses get much filing action because all but two of these stallions resided in either Fayette County (seventy-eight) or in two adjacent counties, namely Woodford (thirty-two) and Bourbon (twenty-eight).\(^{39}\)

An ancillary recommendation of this Article is to require central filing of stallion shares in the same place as the filing of other security interests in thoroughbreds.\(^{40}\) This idea has more than artistic appeal. At the present time, because of uncertainty as to the proper U.C.C. classification of a stallion share, lenders do not feel safe merely filing in the county of the stallion’s residence. They file in the state of the debtor’s residence as well.\(^{41}\) A central filing requirement would resolve the issue (without answering the classification question) at least insofar as Kentucky resident debtors were concerned.

Mares represent a different proposition in the lender/borrower context. They are not nearly as expensive, nor are their offspring so neatly divisible. A stallion may have as many as sixty foals in a year, while a mare produces one. Furthermore, lenders are not interested in lending money to an individual using a partial interest in a mare as collateral.\(^{42}\) As a rule, broodmares are lenders’ most favored equine collateral.\(^{43}\) A mare’s value is relatively stable because it may take many years for her to erode the expectations of her pedigree; and lenders can wield tremendous coercive force over the owner by taking possession of the papers, though this possession has legal effect only over the mare’s papers and not over the mare.

\(^{37}\) Report, supra note 22.
\(^{38}\) Id.
\(^{39}\) SUE BOOK, supra note 33.
\(^{40}\) See infra Appendix: The Statutory Scheme, K.R.S. § 355.9-401(c).
\(^{41}\) KEETON, supra note 35.
\(^{42}\) Shackelford, supra note 19.
\(^{43}\) Id.
As for the effect of a unilateral Kentucky title law on the total national mare population, statistics are hard to come by. A rough estimate would put the percentage of Kentucky-foaled mares who fit the $50,000 criterion at about sixty percent of the total brood mares. Admittedly these figures are very rough, but the conclusion is inescapable. A certificate of title law in Kentucky would cover a large majority of the individual horses and of the available lending opportunities.

Below is a breakdown of numbers of thoroughbreds suitable for collateral in a given crop of about 45,000 U.S.-bred foals.

<table>
<thead>
<tr>
<th>Period</th>
<th>Kentucky Foaled</th>
<th>Non-Kentucky Foaled</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Service Contract to Yearling Sales</td>
<td>1,175</td>
<td>465</td>
<td>72%</td>
</tr>
<tr>
<td>2. Yearling Sales to Four-Year-Old Years</td>
<td>214</td>
<td>89</td>
<td>70%</td>
</tr>
<tr>
<td>3. Broodmares:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. Pedigree</td>
<td>428</td>
<td>188</td>
<td>71%</td>
</tr>
<tr>
<td>b. Stakes winners</td>
<td>80</td>
<td>155</td>
<td>34%</td>
</tr>
<tr>
<td>Total number of horses involved</td>
<td>1,897</td>
<td>897</td>
<td>68%</td>
</tr>
<tr>
<td>Percent of total horses that are Kentucky foaled</td>
<td>= 1,975</td>
<td>= 69%</td>
<td></td>
</tr>
</tbody>
</table>

Once again, the total number of horses is not the full story. Many of these horses are worth far in excess of $50,000 and it would seem reasonable to believe that Kentucky foals represent an even greater percentage of these higher-priced thoroughbreds. If so,

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44 This figure is based on the idea that approximately two-thirds of all fillies that retire to the broodmare ranks with a value in excess of $50,000 acquired at least that much of their value through their pedigrees, independent of their race record. The other one-third attained the $50,000 plateau primarily by superior racing performance. If 70% of the former group are Kentucky-foaled and 34% (about 80 of the 235 fillies from each U.S. crop who win at least one $25,000 stakes race in North America—computed from 1982 statistics) of the latter group are Kentucky-foaled, then the percentage of mares affected by Kentucky certificate of title law would be about 60%. To avoid overlap between the well-bred fillies and the top race fillies, it was assumed that 30 of the former group were also part of the latter group.

45 Fact Book, supra note 17, at 11.

46 Includes 5% of all stakes winning fillies.

47 "Stakes winners" refers to winners of at least one stakes race worth $25,000 or more. This figure does not include the 5% of stakes winners that also have pedigrees.

48 This number is less than the total number of lending opportunities because most of the 820 fillies in group I appear again in the next two periods, i.e., all of the 303 fillies in group 2, and all but the stakes winners in group 3.
then the dollar value of available collateral would concentrate even more heavily in Kentucky foals. Consequently, even more than sixty-eight or seventy percent of the actual lending dollars may be available for Kentucky foals.

One type of financing that the foregoing treatment has ignored is the horse business equivalent of inventory financing. For example, assume a breeder, perhaps a sales consignor, wants to finance a number of similar horses that are individually valued at below $50,000; the breeder may be able to make an attractive offer to the bank. The traditional loan periods would not differ from those outlined above, nor would the fact that the bank would look at the collateral value of each individual horse. The difference is that the horses would jointly and severally act as collateral for the total loan balance. This is a relatively typical arrangement\(^49\) and it does not fit into the analysis outlined for loans covering individual horses. The underlying rule in this quasi-inventory financing is that the cheaper the horses, the more of them a single borrower must own.

II. CURRENT U.C.C. PERFECTION METHODS AS APPLIED TO THOROUGHBREDS

To be enacted, the thoroughbred title statute must overcome considerable legislative inertia. Is all the effort justified? Embedded in this issue is a more fundamental question—what is wrong with the present law? The next section of this Article addresses these issues and outlines the ways in which various equine interests are perfected under Kentucky’s version of the U.C.C.

The following analysis pays close attention to the interests of lenders not because they are inherently sympathetic characters in the drama of finance but because they hold the purse strings. Thus, the thoroughbred title statute is intended to be lender-friendly—to make secured parties more secure. Only in this way can the thoroughbred industry compete for a larger share of lending dollars. If more money flows into the industry, it will benefit everyone from the breeder to the hotwalker. But, first the initial transaction, the extension of credit and the execution of the security agreement, must take place. What is the likely response when a borrower offers horses as collateral? Lenders’ answers will be guided in part by how much confidence they place in the statutory scheme that covers the transaction.

\(^{49}\) Shackelford, \textit{supra} note 19.
Lenders have two basic concerns in any secured transaction: can they protect their security interest against the debtor and can they maintain priority against a third party creditor? The first concern is largely an issue of proper drafting and of the sufficiency of the collateral. Article 9 of the U.C.C. governs the second issue, that of perfecting and maintaining perfection of security interests.

A. Code Analysis for Perfection

The analysis for perfecting a security interest in collateral, whether it be refrigerators or racehorses, takes four steps: 1) determine the method of perfection under U.C.C. 9-304; 2) characterize the collateral under U.C.C. 9-109; 3) determine where to perfect the security interest under 9-401; and 4) determine how to maintain that perfection under U.C.C. 9-103. In application, this framework is fraught with traps for the unwary thoroughbred lender, as outlined below.

1. Method of Perfection

Perfection can be accomplished by several methods under the Code, depending upon the type of collateral. Article 9 provides for security interests in a broad range of collateral, including article 2 "goods," as well as instruments, documents of title, and general intangibles. The first analysis a lender must make is to classify the collateral under the categories set out in sections 9-302 and 9-304. The major issue will be whether horses are goods that may be perfected by filing, under 9-302, or by possession, pursuant to 9-305.

Support for the notion that horses are "goods" comes from North Ridge Farms, Inc. v. Trimble, a Kentucky opinion stating that "[a] thoroughbred horse has been defined as goods." The opinion cites Keck v. Wacker as authority for this conclusion. While the court in Keck never explicitly states that horses are "goods," it is implicit in the court's application of U.C.C. Article 2. Article 2 applies only to "transactions in goods." Despite the

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50 U.C.C. § 9-102(1).
51 North Ridge Farms, Inc. v. Trimble, 37 U.C.C. Rep. Serv. 1280, 1286 (Ky. Ct. App. 1983) (holding that a fractional interest in a syndicate agreement was properly characterized as goods).
53 Id.
54 K.R.S. § 355.2-102.
shaky underpinnings of the conclusion in *North Ridge*, the result seems sound. Horses fall comfortably into the Code's definition of "goods," i.e., "all things which are movable at the time the security interest attaches."\(^{55}\)

Assuming that thoroughbreds are goods, the Code provides three separate methods of perfection in three sets of circumstances: (1) if the horse is in the debtor's possession, the Code requires the filing of a financing statement;\(^{56}\) (2) if the horse is in the secured party's possession, the possession acts as perfection;\(^{57}\) and (3) if the horse is in the possession of a bailee, perfection may be accomplished by the bailee's receipt of notification of the security interest.\(^{58}\) This final method effectively creates a bailment relationship between the secured party and the bailee with respect to the goods.

The second option, possession of the collateral, is not well suited to the thoroughbred business. Horses generally need to be in the hands of the debtor, either to be mated and to reproduce or to be trained and raced. Possession of a thoroughbred will result in expenses of anywhere from five hundred to several thousand dollars a month.\(^{59}\) Thus, holding a depreciating asset is obviously unattractive to the lending community. As an attempt at quasi-possession, lenders have adopted the practice of taking possession of a horse's certificate of registration. Where the horse is not racing, meaning that the certificate must be with the horse, this method's effectiveness relies on its coercive force over the debtor. Combined with The Jockey Club's Lien Registry, which effectively prevents the issuance of a duplicate certificate,\(^{60}\) possession of the certificate assures the secured party that the debtor will not sell the horse. Of course, the lender relying on this method alone, in the absence of a proper filing, would not be protected from a sale to a bona fide purchaser.

In *Lee v. Cox*,\(^{61}\) a Tennessee district court was confronted with conflicting interests in eight registered Arabians. Cox sold the horses to Lee, holding their registration certificates conditional on final payment; Lee went bankrupt. The bankruptcy judge ordered Cox to turn over the certificates to Lee because the mere retention of

\(^{55}\) U.C.C. § 9-105(1)(h).
\(^{56}\) U.C.C. § 9-302(1)(a).
\(^{57}\) U.C.C. § 9-305.
\(^{58}\) U.C.C. § 9-304(3).
\(^{59}\) Survey of Central Kentucky farms and New York based thoroughbred horse trainers by the author, 1986.
\(^{60}\) Jockey Club Lien Registry Packet.
the certificates did not create a security interest in the horses. On appeal, the district court agreed, holding that since the registration certificates did not fall under certain enumerated exceptions, Cox could have perfected a security interest in the Arabians only by filing a financing statement. However, the Court did find that possession of the certificates was effective to perfect an interest in the certificates themselves.

The clear implication of this opinion is that a horse's registration certificate represents an interest separate from the horse. Lenders with this knowledge must protect themselves by perfecting a security interest in both the horse and in the certificate. However, the proper method of perfection with respect to the certificate cannot be ascertained under the Code so long as the registration certificate is undefined. Lee says that possession will suffice, but In re Blankinship-Cooper, Inc. suggests that possession may not be available as a method of perfection.

Neither case gives much help to a lender who wants to perfect a security interest in a thoroughbred certificate without possession, i.e., by filing. The cases have eliminated every classification under which this would be required or permitted except the classification "goods." A reasonable conclusion from Lee is that a certificate, being a separate interest from the horse, is nothing more than paper and ink like a library book. The fact that it had value only to a limited segment of the population would not change the conclusion that it would be "goods" in the hands of the debtor and would be perfectible by possession or by filing.

The lender's mantra is: If you can perfect by two methods, do both. If you're not sure filing will work, file anyway. And if you're not sure where to file, file everywhere. With respect to a certificate

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62 Id.
63 U.C.C. § 9-305 (a security interest in letters of credit, goods, instruments, negotiable documents of title, and chattel paper may be perfected by possession).
65 Estate of Levis v. Blankinship-Cooper, Inc., 39 U.C.C. Rep. Serv. 1008, 1013 (Bankr. N.D. Tex. 1984). The two cases are not irreconcilable. Blankinship-Cooper relied heavily on the rules of the American Quarter Horse Association, which differ both from those of its Arabian counterpart, and also from The Jockey Club Rules. The A.Q.H.A. states that it, rather than the horse owner, is the owner of the certificate. Therefore, possession would be ineffective against the horse owner. If the two opinions cannot be further reconciled, it is because Blankinship-Cooper misses the argument that is implicit in Lee. The Texas case agrees with its Tennessee predecessor that certificates cannot be perfected by possession as "instruments" under U.C.C. 9-305, but then fails to recognize or address whether perfection was available under U.C.C. 9-302(1)(a), which only requires that the certificates qualify as "collateral."
of registration, this rule would be well followed. Lee leaves a faint trail, and Blankinship-Cooper may be confined to its facts. In conclusion, insofar as the horse is concerned, it can confidently be classified as "goods." The only step remaining before perfecting a security interest is to determine to which subclass of goods it belongs. Enacting a Kentucky certificate of title law would eliminate any need to classify the horse and/or its certificate. Perfection would be accomplished by filing.

2. Characterization of the Collateral

U.C.C. 9-109 says that "goods" are either (1) consumer goods, (2) equipment, (3) farm products, or (4) inventory. However, goods can fall into different classes at different times. These four groups are intended to be "mutually exclusive." The question presented is how to fit all goods into one of the four categories. Such a determination has two dimensions. On one axis is the actual type of goods, and on the other is the "use to which the property is put." The type of goods will be decisive if the goods are farm products, in which case "they are neither equipment nor inventory." In other borderline cases, the second factor, the debtor's use, "should be considered determinative."

The problem in characterizing horses is not that they do not fit under U.C.C. 9-109, but rather that they often fit too well—they fit more than one of the four categories or else they will not stay put in one of them. Thus, a closer look at the four classifications follows.

a. Consumer Goods

Thoroughbreds may become consumer goods under certain circumstances. For example, participants in local horse shows are using thoroughbreds "primarily for personal . . . purposes." This fact may have implications in the commercial lending field, because just such a participant could cut off the security interest in a horse if he

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45 U.C.C. § 9-109(4). Comment 2 notes that "a radio is inventory in the hands of a dealer and consumer goods in the hands of a householder."
47 U.C.C. § 9-109(3).
49 U.C.C. § 9-109(1).
or she should buy the collateral in the ordinary course of business.\textsuperscript{72} But as primary collateral, consumer goods have no place in this discussion.

b. \textit{Farm Products}

Of the three remaining classifications of goods, "farm products" will be addressed first, because the Code grants this category of goods priority treatment: "If goods are farm products they are neither equipment nor inventory." And what are farm products? They are "livestock" or "products of . . . livestock in their unmanufactured states"\textsuperscript{73} when "they are in the possession of a debtor engaged in raising, fattening, grazing or other farming operations."\textsuperscript{74} In other words, they are horses in the possession of a farmer.

The Code suggests a two prong test: 1) if the collateral is livestock, then it is a farm product, 2) unless its owner is not a farmer, in which case it is either equipment or inventory. Assuming that no problem arises in classifying a thoroughbred at any period in its life as livestock, the only issue becomes whether or not the owner is engaged in farming. Under normal perceptions of farmers, this is not so difficult a question. Most farmers probably live in the same county as their crops. If you go to their place of business, they are recognizable as the people riding the tractors. Not so in the thoroughbred business. Most horses on farms in Kentucky do not belong to the farm owner; in fact, most of these horses do not even belong to Kentucky residents.\textsuperscript{75} The horse farm owner, the person most identifiable as a farmer, may not even own any collateral that is livestock. So how far will the law stray from the prototype? Is a thoroughbred owner engaged in farming operations merely by boarding his or her horses at an unrelated horse farm? Logic may require a negative answer. The test set up by the Code is not whether the livestock resides in an agricultural setting, but whether the owner is engaged in farming. Ownership of livestock, it is clear, will not suffice to make it "farm products," and the horse farm owner, not the thoroughbred owner, is the person "engaged in farming operations" in the example above. This logic may not be persuasive to a court and even if it were, the outcome would be fact specific. On

\textsuperscript{72} U.C.C. § 9-307(1); see also U.C.C. § 1-201(9) for a definition of "buyer in the ordinary course of business."
\textsuperscript{73} U.C.C. § 9-109(3).
\textsuperscript{74} Id.
\textsuperscript{75} FACT BOOK, supra note 17, at 13.
this issue, one troublesome case comes out of Kentucky. In *In re Tinsley & Groom*, the court suggests that being "engaged in farming" operations applies only to the specific collateral. In that case, a farmer raised grain in Trigg County and stored it himself in Christian County. The bankruptcy court held that, when stored, this grain "changed classification from farm products to inventory." This case could be interpreted to say that when the thoroughbred owner above puts his or her two-year-olds on the van for shipping they may change from "farm products" to "equipment" en route.

Another type of owner, quite prevalent in the thoroughbred business, is even less clearly defined as "engaged in farming." The so-called "pinhooker," who purchases horses with intent to resell, e.g., weanlings for resale as yearlings, might seem to be literally engaged in farming, but analogous cases undermine any confidence one might have in this result.

The two foregoing examples rest in the middle of a continuum between the racing breeder and the pure race horse owner who buys and sells geldings through the claim box. When discussing the racing breeder, the earlier assumption that thoroughbreds equate to livestock must be abandoned. The Code commentary states that "[p]roducts of . . . livestock, even though they remain in the possession of a person engaged in farming operations, lose their status as farm products if they are subjected to a manufacturing process." Whether or not a process is "manufacturing" must be determined by its close connection to farming. Examples of close connectedness are boiling of maple sap and pasteurizing milk. On the other end of the scale, an extensive canning operation is a manufacturing process. The accuracy of determining whether a racehorse is a manufactured farm product will depend upon how close these analogies fit the training that the horse undergoes. Is schooling a horse in the starting gate at Belmont Park more like pasteurizing a pail of milk or canning a crop of beans? In the absence of a ready

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77 Id. at 93 (once grain was stored, the debtor was no longer "engaged in farming").
78 See United States v. Hext, 444 F.2d 804 (5th Cir. 1971) (buyers of ginned cotton from a plantation owner who also operated his own gin not purchasing from a person "engaged in farming"); Farmers State Bank v. Webel, 446 N.E.2d 525 (Ill. App. 1983) (farm owner who bought shoats and held them for resale was not "engaged in farming").
80 Id.
81 Id.
answer, it could be argued that the breaking and training process costs a good deal of money; it is done by specialized personnel and often in a nonagricultural setting.

On the other extreme is the pure race horse owner. Racing stock in his or her hands will not be farm products; therefore it will either be "inventory" or "equipment".

c. Inventory

If racehorses can ever be inventory, that would be their classification in the hands of pure race horse owners. The fact that their major stock in trade is the claiming horse that regularly appears with a price tag and a "for sale" sign makes their horses look like goods that "are held by a person who holds them for sale,"\(^2\) i.e., inventory. The other time in a horse's life when it might fit the classification of inventory would be the young horse in the hands of the previously mentioned pinhooker. In either context, the most confusing aspect of the classification system is that in the second race at Aqueduct or the Tuesday session of the Keeneland fall sales, horses that are indistinguishable to the racing patron or buying public are seen quite differently through the eyes of the law. In fact, three horses standing side by side in the starting gate may have three separate classifications, with the third being "equipment."

d. Equipment

Thoroughbreds will be "'equipment' if they are used or bought for use primarily in business.'\(^3\) Additionally, equipment is a catchall category for those horses that do not fit into one of the other three categories.\(^4\) To be equipment, a race horse cannot also be a farm product. In dictum, the *North Ridge* court asserted that if a horse is "used in connection with racing, it would not [be] a farm product as defined by the statute."\(^5\) This conclusion is not inescapable, nor is it clearly intended to be a sweeping statement free of the facts surrounding this particular stallion, Affirmed (who was raised and raced by Harbor View Farm and then sold to a breeding syndicate

\(^2\) U.C.C. § 9-109(4). Official Comment 3 to this section provides that "'[t]he principal test to determine whether goods are inventory is that they are held for immediate or ultimate sale. Implicit in the definition is the criterion that the prospective sale is in the ordinary course of business.' Id.

\(^3\) U.C.C. § 9-109(2).

\(^4\) Id.

before retirement), nor does it carry any explanation as to what characteristic caused him to flunk the farm products test. Yet the statement is there, inviting further inquiry into the characterization of race horses.

An Illinois bankruptcy decision, In re Bob Schwermer & Associates, Inc.,86 met the issue head-on. In this case the court assumed that the debtor's racing string was "livestock," but cited abundant authority for the proposition that "[i]n cases where livestock is owned by persons not engaged in farming the animals are not considered farm products."87 Relying on the debtor's affidavit, which stated that he was not a farmer and that he purchased the horses "for business purposes, as race horses," the court held that "[o]n the basis of clear statutory language, case law and the facts of this case it must be concluded that the horses are equipment."88

The Schwermer court was not confronted with the case where the debtor does not use the horse as he initially intended. The issue then becomes whether the actual use or the intended use controls. For instance, if several race fillies were injured and the debtor had sent them to be bred, would those fillies then be "farm products"? The Code leaves this question unanswered, saying the horses are equipment "if they are used or bought for use"89 as race horses. The most desirable result is the one that "removes from creditors the burden of constantly monitoring the use of collateral."90 Intended use at the time of attachment should control.91 But the cases do not all reach this result.

e. Conclusion

The lender who wants to take thoroughbreds as collateral must first classify the horses in one of three categories. The task is both formidable and uncertain. Furthermore, even if the collateral never leaves the jurisdiction, the lender may need to be constantly vigilant as to the status of both the borrower and horse. Under Kentucky certificate of title law, lenders would need only to ascertain two facts, both of which are conclusively determined by a look at The

87 Id. at 1404.
88 Id.
89 U.C.C. § 9-109(2).
90 J. White & R. Summers, supra note 11, at 944-45.
Jockey Club certificate of foal registration: 1) whether it is a thoroughbred, 2) whether it was foaled in Kentucky.

3. Where to File

Determining where to file requires a close look at U.C.C. 9-401. Actually, the Code suggests three alternative versions of 9-401 and the Kentucky legislature adopted a fourth. In effect, the KRS edition says that the proper place to file a financing statement covering goods of any kind is in the county of the debtor's residence. But if the debtor is not a Kentucky domiciliary, then one must look further. UCC-1 financing statements covering "farm products" and "consumer goods" should be filed in the county where the goods are kept, while those relating to "equipment" and "inventory" should be filed with the Kentucky Secretary of State. Considering the fact that half of all thoroughbred broodmares, stallions, foals, yearlings, and lay-ups "kept" in Kentucky are owned by nonresidents, the statutory scheme sets up a bipartite filing system. For half the thoroughbred collateral in Kentucky, lenders will be safe filing at the courthouse of the debtor's residence. For the other half, it is probably not safe for lenders to guess whether they are dealing with "farm products" or "equipment/inventory." They will need to file both with the secretary of state and in the county where each horse is boarded. The clerk in any of these jurisdictions must file financing statements by debtor name.

The Code's choice of law rules put another wrinkle in the initial perfection picture by saying that the proper place to perfect a security interest in "mobile goods" is in the debtor's state of residence. So a security interest in a thoroughbred that is deemed to be a "mobile good," notwithstanding the fact that it is "kept" in Kentucky per KRS 355.9-401, will be perfectible only under the law of the owner's state of residence. The prudent lender will file a third financing statement there.

A more troublesome situation arises when a prospective lender looks at a particular horse as collateral for a loan. Before loaning money against a horse, common practice in the lending community requires that lenders conduct a lien search. But under the debtor-

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92 **FACT BOOK, supra** note 17.
93 U.C.C. § 9-103.
94 *Id.* at subsection (3)(b).
95 Shackelford, *supra* note 19.
name index, they must first ascertain every person who might have created an adversary interest in the horse, because only then can they discover that person's status under U.C.C. 9-401. No single source of such information is available. Therefore, it is difficult for lenders to ascertain with certainty if their search has been comprehensive.

The present statutory scheme allows for thoroughbred filings in any one of 126 counties and twice in Franklin County (as well as once or twice in a foreign jurisdiction). The potential for lender uncertainty is very real, but as a practical matter, the vast majority of the filings done in Kentucky are filed in a handful of counties in central Kentucky, because either the debtor or the horse is there. The statute protects a lender from crises arising during the period of the loan, but is less help in providing notice to the lender of adverse interests that exist prior to the time of attachment. Furthermore, lenders must be ever vigilant to protect their interests if the horse is moved across the state border. A thoroughbred title law would provide filing by horse's name for all thoroughbreds residing in the state; all state-foaled thoroughbreds also will be covered, no matter where their location. The need to file in two courthouses and the need to search in many will be eliminated.

4. Maintaining Perfection

Once the lender has properly perfected a security interest in a horse, his or her worries are not over. Two types of events impose new filing requirements on the debtor. First, the place of filing in the state may change because of a reclassification of the goods (either because of manufacturing or of change to different use or because the debtor moves). Second, the place of filing may move, with the horse, to another state.

The first problem has been virtually eliminated by a sensible addition to the Kentucky version of U.C.C. 9-401, which shifts the burden of surveillance over the collateral (placed on the lender by the U.C.C.) to third parties. The Kentucky version says that, once properly perfected, the security interest does not become unperfected by virtue of changes in locality or classification.96

The second problem remains. U.C.C. 9-103 governs the choice of law rules for the interstate movement of goods. To comply with the provisions of this section, the lender must determine whether

96 K.R.S. § 355.9-401(c)(3).
the horse is "ordinary goods," bringing it under subsection (1) or if it is "mobile goods," meaning that it is of a type "normally used in more than one jurisdiction," bringing it under subsection (3).\textsuperscript{97}

a. \textit{Ordinary Goods}

The Code defines "ordinary goods" by exclusion. They are not certificated, not "mobile goods," and not minerals.\textsuperscript{98} If ordinary goods subject to a security interest are moved to another state, the security interest becomes unperfected four months after the goods' arrival in the second state. The secured party can avoid this result by taking legal action, e.g., by filing, in the second state. In other words, if Lady Golconda is sent out of Kentucky to be bred to Buckaroo in Florida, four months could easily expire before a veterinarian pronounced Lady Golconda in foal. A security interest filed in Kentucky covering Lady Golconda would become unperfected before her intended return.

b. \textit{Mobile Goods}

On the other hand, if Lady Golconda is found to be a type of horse (a broodmare) that is normally used in more than one jurisdiction, then the law of New York (the residence of the mare's owner) applies both to perfection and the effect of perfection. The movement of the mare becomes irrelevant, and the domicile of the debtor controls. Four months after the owner's departure for her new home in Texas, the security interest in Lady Golconda becomes unperfected.\textsuperscript{99} In analyzing thoroughbred collateral under the "mobile goods" definition, it would seem that racehorses are clearly mobile and that stallions are clearly not. In between these two extremes are broodmares, sucklings, yearlings, and stallion shares, any one of which a court might find falling on one side or the other of the ordinary goods-mobile goods fence. So a particular horse may spend his or her life jumping back and forth.

It is worth noting that the particular debtor's use of the collateral is not a factor under U.C.C. 9-103(3), as it was under U.C.C. 9-109. How that type of collateral is normally used in the horse industry controls the definition of "mobile goods." The prudent lender, having perfected in the debtor's state of residence, will

\textsuperscript{97} U.C.C. § 9-103.
\textsuperscript{98} Id. at (1)(a).
\textsuperscript{99} Id. at (3)(e).
therefore follow up by making tri-annual checks on the debtor’s address.

c. **Conclusion**

As long as horse transport companies keep their fleets rolling and their interstate permits current, equine lenders constantly face loss of perfection in their collateral, either because it is “ordinary goods” or because it is “mobile goods.” Vigilance against this threat is essential. However, both the definitions of “ordinary goods”\(^1\) and that of “mobile goods”\(^2\) expressly exclude goods that are covered by a certificate of title. Insofar as Kentucky-foaled collateral is concerned, the thoroughbred title statute will eliminate the results mandated by subsections (1) and (3) of U.C.C. 9-103.

When thoroughbreds become “goods covered by a certificate of title,” they will fall under subsection (2) of U.C.C. 9-103. This provision generally is used in the automobile context and therefore is highly developed to handle conflict of law issues. Using the foregoing example of Lady Golconda leaving Kentucky for Florida, it will be clear how the U.C.C.’s multi-state provisions would handle the transaction. Subsections (a) and (b) of Florida’s U.C.C. 9-103 grant full faith and credit to Kentucky’s law governing perfection (and conflict of law rules) as the state issuing the certificate of title—there is no question of New York law applying. Subsection (b) further provides that when Lady Golconda is removed from Kentucky, the initial perfection remains effective indefinitely unless she is re-registered or her certificate of title is surrendered to Florida authorities. Assuming that Florida has not yet enacted a certificate of title law for thoroughbreds, Lady Golconda’s owner could not re-register the mare in or surrender her certificate to Florida, so the Kentucky perfection would continue. On the other hand, assuming that Florida enacted a replica of the Kentucky act, then Florida would not register horses, only The Jockey Club would, and registration would follow Jockey Club rules, not state rules. The Jockey Club has no provision for re-registration of horses except horses imported from foreign countries.\(^3\) Therefore, no danger from re-registration would exist. Furthermore, the statute would forbid Flor-

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\(^{1}\) U.C.C. § 9-103(1)(a).

\(^{2}\) U.C.C. § 9-103(3)(a).

ida to issue a new certificate of title to Lady Golconda because she was not foaled in Florida.

An alternate provision of U.C.C. 9-103 covers the case where Foolish Pleasure, Florida foaled and owned, races and then retires, before syndication to Fayette County, Kentucky. Subsection (c) of U.C.C. 9-103 applies where the goods come from a non-certificating state to a certificate of title jurisdiction. The section says that if Kentucky issues a certificate of title to Spend a Buck, then prior security interests may become subordinated to ones arising in Kentucky. But Kentucky’s title law would not allow Spend a Buck to be titled in Kentucky because he was not foaled there.

The harder case will arise for a Kentucky-foaled horse registered and subjected to a security interest prior to Kentucky’s enactment of the title law. This sort of horse may be granted an amended title under the statute, and may in fact be ‘‘brought into this state while a security interest therein is perfected in any manner under the law of the jurisdiction from which the goods are removed.’’ The statute accounts for this type of horse by requiring as a prerequisite to issuance of an amended title that the secured party apply and assert his or her interest in the horse and that the security interest be noted on the amended certificate.

Interstate transactions that cause problems for lenders will be much less troublesome if Kentucky adopts a certificate of title law. This law will not interfere with existing security interests in non-Kentucky foaled horses nor will it complicate matters for interests in Kentucky foals registered before the enactment of the statute. Furthermore, if another state chooses to follow this law as a model, the statutes will mesh neatly.

III. THE FOOD SECURITY ACT

Any proposed enactment affecting secured transactions in horses must be sensitive to the Food Security Act of 1985 (the "Act"). A portion of that act, embodied in 7 U.S.C. § 1631, preempts state law on the issue of security interests passing with sale of the covered goods. Formerly, the governing law was U.C.C. 9-307(1), the "farm products exception," or nonuniform treatments of that section adopted by various states.

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103 U.C.C. § 9-103(2)(d).
105 QUINN, supra note 10.
The farm products rule contemplates two situations. First, it applies to the circumstances as they existed at the time the Act became effective (December 23, 1986). Second, it allows for a different set of rules to apply if and when states create a so-called “central filing system” approved by the Secretary of Agriculture. Leaving the central filing provisions for later, the thrust of the law is the fundamental rule of U.C.C. 9-307(1): buyers in the ordinary course of business take goods free of security interests created by the seller.

The exception provided by the Act arises when the buyer has actual notice of an unsatisfied adverse interest. A troublesome aspect of the Act is its silence on whether the security interest must also be perfected under existing state law to achieve validity against the buyer, or whether mere notice is sufficient. Unlike the rest of commercial law, the burden rests on the secured party to notify potential buyers, not on the buyer to search the filing system.

In defense of the Act, it enables the secured party to obtain a list of potential purchasers and states that “[a] security agreement . . . may require the person to furnish to the secured party a list of the buyers, commission merchants and selling agents to or through whom the person . . . may sell such farm product.” Additionally, the Act provides that a debtor who makes a noncompliant sale of the collateral “shall be fined $5,000 or 15 percentum of the value or benefit received for such farm product described in the security agreement, whichever is greater.” In practical terms, this section allows the sale of collateral to a non-listed buyer in the ordinary course and that sale will be free of the security interest. Lenders who lose their security interest in the collateral will find little comfort in the fact that the farmer is subject to a fine. Even more distressing is the fact that the statute does not specify to whom the fine will be paid. If courts decide that the Department of Agriculture receives the money under a judgment, lenders, having lost their collateral, may furthermore find that they have lost their priority to the very agency that is purportedly protecting them.

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107 7 U.S.C. § 1631(c)(2).
108 U.C.C. § 9-307(1).
110 7 U.S.C. § 1631(e).
The Act affects horizontal uniformity among the states but leaves untouched the vertical problem of each state’s relationship with its citizenry. The Act explicitly recognizes the anachronistic farm products exception. Though it smooths some of the uncertainty about choice of law, it places a permanent preemptive wrinkle in the U.C.C. The states are now foreclosed from pursuing what many commentators consider to be the most enlightened approach to the problem—simply treating farm products like other collateral.\textsuperscript{113} As long as farm products are excepted, “all of the special code rules on inventory are . . . inapplicable to this important collateral.”\textsuperscript{114}

Three approaches can be taken to the federal preemption issue with regard to an equine certificate of title law. First, Kentucky can stipulate that the Act applies to certificated thoroughbreds and accordingly can incorporate the provisions of 7 U.S.C. § 1631 in its own legislative scheme. Second, the legislature can make the argument that the Act does not legitimately apply to thoroughbreds and can pass legislation that ignores the Act. Finally, if the Secretary of Agriculture does not agree with the second argument, then Kentucky may argue that the proposed filing system meets the requirements of the Act.

The Act provides guidelines for states wanting to enact compliant central filing system legislation.\textsuperscript{115} This option shifts some of the burden for protecting the security interest from the lender to the purchaser. Purchasers must register with the state filing office in order to take farm products free of a security interest.\textsuperscript{116} Having registered, the purchaser then receives lists of farmers whose products are subject to security interests. The receipt of such a list is conclusive proof of notice, and if the buyer purchases products from farmers on the list, the security interest survives the transfer.\textsuperscript{117}

The Act further requires that the filing system accommodate: 1) filing of financing statements;\textsuperscript{118} 2) master lists kept by type of farm product with sublists organized by debtor name, by social security number, by county, and by crop year;\textsuperscript{119} and 3) master lists of registered buyers and the types of products to be purchased. A

\textsuperscript{113} Hawkland, supra note 9, at 420.
\textsuperscript{114} Id. at 418.
\textsuperscript{115} 7 U.S.C. § 1631(c)(2).
\textsuperscript{116} 7 U.S.C. § 1631(c)(2)(D).
\textsuperscript{117} 7 U.S.C. § 1631(c)(1)(d).
\textsuperscript{118} 7 U.S.C. § 1631(c)(2)(A).
\textsuperscript{119} Id. at (D).
provision is also made for the distribution of these lists to the proper recipients.  

Since the Act applies only to an "agricultural commodity . . . used or produced in farming operations that is in the possession of a person engaged in farming operations," a state filing system may cover only one of the many secured transactions that may affect a particular horse. During its life, the only "disposition" of a horse that necessarily fits the Act's definition of "farm product" would occur when the horse is sold by its breeder. Thereafter, the goal of protecting secured parties in a multitude of potential subsequent transactions will be served only by collateral state legislation. This solution inevitably will result in confusion. The following hypothetical illustrates the dilemma facing the parties.

Packwood, a resident of Providence, Rhode Island, is a partner in a prosperous law firm in Boston. He races a small string of horses on the New York-Florida circuit. When one of his fillies retires, he sends her to Kentucky to be bred and as a rule he sells these fillies in foal the next November at the Keeneland sales. To fill the empty stall at the race track, Packwood sends his trainer Lazaro Lukas to the yearling sales to find a replacement. Packwood's bank, Liberal Loan Co., which funds these purchases, has read U.C.C. 9-103 and is willing to take on the burden of filing to perfect its security interest. Not being certain whether race horses are "ordinary goods" under U.C.C. 1-103(1) or "mobile goods" under U.C.C. 1-103(3), Liberal Loan files in Nassau County, New York each spring (within four months after the stable comes north) and in Dade County, Florida each fall (when the string goes south), and also at the debtor's place of business (Boston). To be sure it has covered all bases, it also files a UCC-1 financing statement in Providence. When a fifty million dollar malpractice action threatens to devastate Packwood's firm one winter, Liberty Loan takes comfort that its collateral is secure. Meanwhile, facing mounting legal fees, Packwood orders Lukas to sell one of his fillies. D. Wayne Barrera, a sophisticated buyer, calls the Dade County clerk who alerts him to the security interest. He calls Liberal Loan which

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121 7 U.S.C. § 1631(c)(5) provides that:
The term "farm products" means an agricultural commodity such as wheat, corn, soybeans, or species of livestock such as cattle, hogs, sheep, horses, or poultry used or produced in farming operations, or a product of such livestock in its unmanufactured state . . . that is in the possession of a person engaged in farming operations (emphasis supplied).
verifies that it has a security interest in the filly that collateralizes a $100,000 loan. With this knowledge Barrera starts to back out on the deal, but Packwood assures him that he will take half of the $200,000 purchase price and liquidate the loan the next day, which in fact is the day he sails for Buenos Aires with $200,000, less first class fare, in his steamer trunk. Armed with a copy of White and Summers, Liberal Loan descends on Barrera's barn at Hialeah, Florida ready to make conclusory assertions about "notice" and "perfection." But Barrera's lawyer just happens to be standing in the tack room with his own copy of 7 USC under his arm. He gives a short dissertation on the supremacy clause, followed by a recitation of U.S. Code's definition of farm products, i.e., horses in the possession of a person engaged in farming operations, followed by a summary of section 1631(d) of the Act, which states that a buyer of such farm products, even one with notice, takes free of any security interest.

Can Liberal Loan win on the issue of whether Packwood's breeding of mares qualifies as engaging in "farming operations"? Though the Act is too new to have generated much case law, cases interpreting who is a farmer and who is not under the U.C.C. go both ways. The point is that the Code and the Act may characterize the same collateral differently. The Code would apply a two-step test: 1) whether the horses are farm products and then 2) whether they are in the possession of a farmer. By contrast, the Act eliminates the first step, making horses per se farm products. Consequently, racehorses must be covered by two laws of perfection, one for the owner who also engages in farming operations, and the other for owners who do not. The legislative burden facing a state that wants to incorporate these two real situations under one law becomes enormous. Certainly this was not the intent of the Congress when it enacted the Act.

A. The Act May Exempt Thoroughbreds

A single argument underlies Congress' initiative in enacting the Act. Congress perceived that measures were needed to protect purchasers of "commodities" from the uncertainty created by the

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122 Id.
123 See supra notes 75-78 and accompanying text.
124 7 U.S.C. § 1631(a) and (c)(5).
The perceived need does not apply to thoroughbreds. While horses are specifically mentioned in the particular provision of the Act, and while horses may at some level be fungible commodities, thoroughbreds neither meet the definition of "commodity," nor do they fit the legislative intent of the Act. The case law reveals no case in which U.C.C. 9-307 was applied to thoroughbreds. Furthermore, in more than 1,000 pages of legislative history, which addresses every commodity from apricots to wool, the only reference to horses is simply a reiteration of the language of the statute.

In fact, the Act is actually a reaction to an earlier federal mistake. The loudest supporter of the original "farm products exception" was the federal government. The nation's largest agricultural lender was speaking to protect its interests. When the drafters sought to modernize the 1972 version of the Code by recognizing farmers as no different from other business people, the federal government fought the move and finally threatened to enact preemptive legislation or else to withhold farm credit. Then, in 1985, Congress moved to disinherit the very child that it had fathered in 1962 and adopted in 1972. The resulting custody battle presages no happy ending. Neither the states that bore the ugly child nor its natural sire, the U.S. government, want to support it. However, this misses the present point: the federal government's actions never had anything to do with the thoroughbred business. The initiative to protect the government's farm lending dollars did not arise from the insecurity relating to thoroughbred loans. Nor was the Act passed to address problems created by the thoroughbred industry. Though the legislative history of the Act specifically cites U.C.C. 9-307 as the source of concern, no case law can be cited to show that thoroughbred lenders have suffered in the application of that section. Nor can the case law be adduced to prove that horse loans have been the subject of judgments prejudicial to lenders.

In fact, the presence of the word "horses" in the statute is most likely a response to pressures from the horse industry to have its product included, not because the industry wants inclusion under

125 U.S. CODE CONG. & ADMIN. NEWS, supra note 13.
126 7 U.S.C. § 1631(c)(5).
127 7 U.S.C. § 1631(c)(5).
128 See, e.g., United States v. McClesky Mills, Inc., 409 F.2d 1216 (5th Cir. 1969), in which the Farmers Home Administration had a security interest in a farmer's peanut crop that followed the peanuts into the silos of the purchaser mill.
129 Hawkland, supra note 9.
the protection of the provisions, but rather because of a real concern that horses be counted wherever agricultural legislation is the subject. Mainly for tax reasons, the horse industry declines any opportunity to distinguish itself from other farm based endeavors for fear of losing its recognition as a fundamentally agricultural enterprise.

A certificate of title law would accomplish the goals of the Act in protecting buyers and lenders of covered goods by providing a mechanism of notice, which is specific to each item of collateral and directed to the people with a true interest. In the process, horses need not lose their agricultural nature in the application of other law.

An inescapable fact is that the Act specifically recognizes "horses" as "farm products"; and equally inescapably, federal law is pre-emptive. But Congress, or at least the Secretary of Agriculture, should recognize that the Act was not intended to include thoroughbreds under its coverage of "commodities." Furthermore, the provisions of the Act are inapplicable to the realities of the thoroughbred business. The most telling criticism of the characterization of thoroughbreds as commodities is that they are not fungible. They are individually identified and evaluated. Additionally, they are undeniably mobile. The assumptions that a grain farmer in Iowa is unlikely to transport his grain to Los Angeles for sale, that his product will be unidentifiable once sold, or that he will not sell his crop for the personal use of a doctor in Dubuque, are all based on financial or physical reality. None of these assumptions make sense when applied to a farmer raising thoroughbreds in Des Moines.

B. The Title Statute Can Satisfy the Act

The Act was not intended to apply to collateral such as thoroughbreds and literal application of the Act to thoroughbreds produces undesirable results. Still, it would take an act of some heroism for the Secretary of Agriculture to declare a thoroughbred horse exemption to the Act. However, the title statute provides two appealing reasons for the Secretary to remove the thoroughbred from the Act's coverage.

First, the Secretary may find appeal in the argument that once titled by state law, farm products that are certificated should be exempt from coverage by the Act. This argument can be sustained by recognition that the Act covers no other products that are certif-
icated. Furthermore, the Act has left the U.C.C. to deal with “equipment” used primarily for farming.\textsuperscript{131} Certain of these goods are certificated, which may be a reason for their exclusion from the Act. In fact, the Act draws a narrower definition for “farm products” than the U.C.C., by excluding “supplies . . . used in farming operations,”\textsuperscript{132} while the Act covers only “agricultural commodities . . . used . . . in farming operations.”\textsuperscript{133} The Act, then, makes no attempt to reiterate the scope of the U.C.C. coverage for “farm products.” For instance, nitrogen fertilizer seems to fall under the U.C.C. definition of “farm products” but not under the coverage of the Act. The fact that Congress chose a narrower definition when it obviously felt free to vary the definition set out by the Code suggests that it purposefully chose not to expand coverage to farm supplies or farm equipment, including various certificated goods like farm trucks.

A second approach to gaining an exemption for titled thoroughbreds is provided by the Act itself, which defines “central filing system” as “a system for filing effective financing statements or notice of such financing statements on a statewide basis and which has been certified by the Secretary of . . . Agriculture.”\textsuperscript{134} To qualify as a “central filing system,” a proposal must then meet a two-pronged test: (1) it must be a statewide program, and (2) the Secretary of Agriculture must approve it. Congress goes on to say that “the Secretary shall certify such system if the system complies with the requirements of this section.”\textsuperscript{135} In other words, a state can be assured of satisfying the second test by using the structure set out in the section. The model specifications are therefore a restriction on the freedom of the Secretary to deny a compliant proposal.

The restriction does not reduce the secretary’s discretion to approve a noncompliant proposal. To conclude otherwise would be to eliminate totally the first prong of the test and to rewrite the statute to define a central filing system as one that has been certified by the Secretary of Agriculture. Under this incorrect reading, applicants would be limited to proposals that reprinted the requirements of the section, and certification by the Secretary of Agriculture would be reduced to a formality. This reading defeats the intent of

\textsuperscript{131} See U.C.C. § 9-109(2).
\textsuperscript{132} U.C.C. § 9-109(3) (emphasis supplied).
\textsuperscript{133} 7 U.S.C. § 1631(c)(5) (emphasis supplied).
\textsuperscript{134} 7 U.S.C. § 1631(c)(2).
\textsuperscript{135} Id. (emphasis added).
Congress to delegate authority to the Secretary in order to fulfill its legislative purpose, i.e., protection for purchasers of farm products.

A complete reading of this section admits that Congress intended each state to address the peculiarities of its own agricultural industries and to adapt a central filing system to those needs, limited only by the requirement that the Secretary of Agriculture certify that the proposal fulfills the intent of Congress. The Kentucky thoroughbred title statute meets congressional intent to protect purchasers of that particular agricultural item. In fact, this proposal gives more protection to more purchasers than would a statute that slavishly adhered to the specifics of the Act.

In the event that the Secretary of Agriculture will neither exempt certificated goods from coverage of the Act nor waive certain of the specifications for a proposed central filing system, the proposal can be amended to include all of the specifications of the Act without compromising the mechanics of the title statute. The problems with this approach will be manifest in the potential burden on the filing system, especially the requirement relating to registration and notification of buyers and agents. If every licensed owner who is eligible to claim a thoroughbred in the United States used this machinery to protect his or her interests at the claim box, the number of notifications that the Secretary of State would be required to distribute would be phenomenal. If a lender’s only protection came from its prerogative to require the borrower to produce “a list of the buyers . . . to . . . whom [he or she] may sell such farm product,” the burden on the borrower also would be overwhelming. Over 5,000 owners in Kentucky alone are licensed and eligible to claim horses that run in this state. The number of licensed owners in every racing state where Kentucky-bred horses race is much higher.

The intent of Congress that each state should design a custom model central filing statute is manifested in the structure of the Act. Each substantive provision of the Act is written in the alternative. The first option applies as of the Act’s effective date, December 23, 1986, when no state had yet sought approval of its own system. The alternative provision in each subsection, typically beginning, “in the case of a farm product produced in a State that has established a

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136 Id. at subsections (A) - (F).
137 Id. at subsection (E).
138 Id. (emphasis added).
central filing system,'" makes clear that a different set of rules applies when and if a state chooses to adopt a central filing system. Basically, the statute provides a federal scheme, as a threshold and a first alternative, and then allows the states to adopt their own laws to achieve the same effect. The only real difference between the two alternatives is that the first puts the onus on lenders to publicize their security interests to the proper parties. Under the state central filing system alternative, the burden shifts to the buyer and agent. Here, buyers and agents must make their notification needs known to the Secretary of State, or else they will take subject to existing security interests.

The equine title statute will similarly place the buyer or agent at peril if he or she fails to heed notice of a security interest. The main difference will be that notice is particular and direct. Rather than receiving a list of all filed security interests that they then must cross-reference to the horse in question, buyers will merely do what they would need to do anyway, i.e., look at the certificate of registration. Under any system of notification, the buyer must still look at the certificate in order to ascertain: 1) if the horse is registered, 2) if the certificate belongs to the horse in question, and 3) if the seller is listed as the owner. Lesser inspection would amount to negligence.

CONCLUSION

Horse owners, like other business people, need an effective means by which to borrow money on their collateral. At the present time, the mechanisms provided by the U.C.C. and the restrictions arising from the Act limit the availability of money to thoroughbred owners. These two bodies of law were not intended to have this effect. On the contrary, both laws have the objective of greasing the wheels of commerce. But, because thoroughbred horses are so mobile, because thoroughbred owners have varieties of investment intent, and because the thoroughbred industry is localized, these laws have overlooked the needs of this specialized industry. In effect, the Code and the Act have ground the flow of equine capital to a crawl.

If the thoroughbred business wishes to modernize with regard to the capital market, then it must take the legislative initiative. By

141 Id. at § (g)(2). This subtle difference will not be lost on the lending community.
enacting a unilateral law, Kentucky accomplishes two objectives. First, it can remove the statutory obstacles for as much as seventy percent of the available collateral. Second, it can set the tone for other states to follow. An additional benefit of such legislation will be to make the produce of Kentucky more attractive to lenders as potential collateral. Thus, Kentucky foals will gain a competitive edge with lenders.

The statute that follows is an attempt to address the shortcomings of the U.C.C. while working within its structure. The proposal is not intended to be either all-inclusive or exclusive of alternative solutions. It awaits the criticism of the industry’s leaders.
APPENDIX: THE STATUTORY SCHEME

A. Amendments to Current Provisions of K.R.S. Chapter 355

355.9-401(1). Place of Filing

The proper place to file in order to perfect a security interest is as follows: . . . (c) [present subsection (c) becomes subsection (d)]

When the collateral is a thoroughbred horse titled subject to Section 355.9-601 of this Act or other thoroughbred horse subject to this Article, or when the collateral is a share in a syndicated thoroughbred stallion which stands in this state, then in the office of the County Clerk of Fayette County;


(1) A buyer in the ordinary course of business (subsection (9) of KRS 355.1-201) other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence.

B. Additional Part Under K.R.S. Chapter 355

PART 6

TITLING OF THOROUGHBRED HORSES AND PERFECTION OF SECURITY INTERESTS THEREIN

355.9-601. Definitions

(1) "Clerk" means the state official responsible for the central recording of interests in thoroughbreds titled under state law.

(2) "Document of transfer" means a notarized bill of sale or judicial order which names as transferor a person with title in the horse and names as transferee a person with a right to title in the horse.

(3) "Kentucky foal" means a thoroughbred whose certificate of foal registration indicates Kentucky as the state "foaled in."

(4) "Ordinary course of business" as applied to sales means a "claim" at a parimutuel thoroughbred race meeting licensed by a
state racing authority, or a public sale conducted by an organization engaged in the business of selling thoroughbreds at public auction.

(5) “Purse earnings” means the net amount (gross earnings less jockey fees and other debits customarily made against earnings) credited to the horseman’s account upon the determination that the finish of a race is official. The right to proceeds arises in the earnings for each of a horse’s races at the time when a positive credit is made to the horseman’s account.

(6) “Registration” means the process by which The Jockey Club verifies the identity and pedigree of a horse prior to issuance of a certificate of foal registration or certificate of foreign registration.

(7) “Thoroughbred” means a horse registered by The Jockey Club or eligible for registry under Jockey Club Rules.

(8) “Transfer officer” means the person empowered by a sales company or racing association to sign transfers on behalf of that organization.

355.9-602. THOROUGHBRED HORSE REGISTRATION AND TITLING

(1) The Commonwealth of Kentucky recognizes The Jockey Club as the official registrar for thoroughbreds foaled in this state, and recognizes the certificate of foal registration as the official document of registration for such foals.

(2) A valid certificate of foal registration issued to a horse by The Jockey Club bearing the inscription “Official Certificate of Title - Commonwealth of Kentucky” shall represent certificate of title and shall be irrebuttable evidence of certification in Kentucky.

(3) Such certificate will constitute Kentucky certificate of title, vesting title in the issuee or in the last transferee noted on such Certificate, subject to K.R.S. 355.9-604 and 355.2-403. No certificate which has not been so inscribed by The Jockey Club will constitute certificate of title under this Part.

(4) No horse foaled in any state or territory of the United States other than Kentucky will be eligible to be titled in Kentucky, but Kentucky will recognize the validity of a certificate of title granted by another state to a thoroughbred foaled in that state.

(5) Under this statute, The Jockey Club is an agent for the Commonwealth for the limited purposes enumerated by this statute.

(6) Any person who wrongfully or in violation of any Kentucky law or Jockey Club rule forges, converts or alters a Kentucky certificate of title or stallion service certificate covering a Kentucky foal or makes a knowing misrepresentation in the application for such documents is in violation of this statute and is subject to a
fine of not more than $____. Any person damaged by such violation will have a civil cause of action.

355.9-603. DUTIES OF THE CLERK

(1) The Clerk shall accept filings complying with this Article and will record such security interests and other instruments, including lis pendens, leases, liens and contracts of sale, which relate to ownership or title of thoroughbreds subject to section 355.9-401(1). The Clerk shall take possession of and file any instrument or affidavit submitted to him as evidence of an interest in such thoroughbred. The Clerk shall not accept or record any filing which presents inconsistent assertions or incomplete facts regarding the ownership or identity of a horse.

(2) The Clerk shall keep an alphabetical file for all living thoroughbreds titled by the state of Kentucky and shall keep separate files for recording filings on non-titled thoroughbreds and stallion shares subject to section 355.9-401(1).

(3) The files shall be open to the public, but any search must be preceded by a request indicating the horse or owner name to be searched and the identity and address of the party for whom the search is being made. At the conclusion of any search, the Clerk will mail a written report of the results of that search to the interested person. The Clerk may charge a fee for such report.

(4) The Clerk shall notify The Jockey Club with respect to a horse titled in Kentucky whenever a security interest is perfected or terminated or whenever the Clerk transfers a horse subject to section 355.9-604.

355.9-604. TRANSFER OF TITLE

(1) Transfers of titled thoroughbreds shall be accomplished by recording the transferee's name, address and the date the transfer was signed on the first clean line on the transfer section of the horse's certificate. The transfer is not effected to vest title in the transferee unless signed by an authorized person as provided in subsections (2) and (3) of this section.

(2) Transfers in the ordinary course of business can be accomplished where a person has possession of the certificate and the sale takes place in the ordinary course of that person's business. In such case, the person or the transfer officer of that organization may effect a transfer by signing the certificate in his official capacity.

(3) Transfers other than those in the ordinary course of business may be signed by either:
(a) the Kentucky Clerk, or the Clerk of another state which has enacted a thoroughbred title statute, provided the transferor provides proof of ownership.

(i) by being named as “issuee” of the certificate on which no subsequent transfer has been recorded, or else

(ii) by being named the last transferee on the certificate combined with evidence of uncontested ownership. Such evidence is the following:

(A) the certificate reflects that the transfer was signed by a state Clerk, or

(B) the transfer is verified by an evident document of transfer, or

(C) the certificate reflects that the horse has not been transferred within one year, and

(b) the transferor, provided a notarized bill of sale is affixed to the certificate. Such transfer is only effective between the parties to the transfer.

(4) A previously ineffective transfer may be legitimized by compliance with the provisions of subsection (3)(a) of this section.

(5) Any person knowingly participating in a transfer of a horse certificated under Part 6 of this Article and which violates the provisions of this Act will be subject to a fine of not more than $355.9-605. ISSUANCE OF CERTIFICATES OF TITLE WHERE A SECURITY INTEREST EXISTS—ORIGINAL, AMENDED AND DUPLICATE CERTIFICATES OF TITLE

(1) An amended certificate of title is any certificate of registration previously issued by The Jockey Club which The Jockey Club has amended with the inscription “Official Certificate of Title—Commonwealth of Kentucky.”

(2) A horse foaled in Kentucky whose certificate of foal registration was issued prior to the enactment of this statute and who is subject to a security interest of which The Jockey Club has a recorded lien notice, may be issued an amended Kentucky certificate of title provided that the secured party complies with the provisions of subsection (4) of this section.

(3) A thoroughbred foaled in a foreign country may be issued an amended Kentucky certificate of title, provided the horse

(a) has been imported into the United States,

(b) has been registered by The Jockey Club,
(c) is owned by a citizen and domiciliary of the U.S.,
(d) is not titled in another jurisdiction, and
(e) is subject to a security interest of which The Jockey Club has a recorded lien notice.

(4) The Jockey Club may issue an amended Kentucky certificate of title for an eligible horse if the secured party submits to The Jockey Club:

(a) a formal application for Kentucky certificate of title, including but not limited to
   (i) proof of ownership,
   (ii) an affidavit of the secured party stating that the horse is free of adverse security interests,
   (iii) signatures of the owner and the security party,
   (b) the horse's Jockey Club Certificate, and
   (c) a fee prescribed by The Jockey Club.

(5) In the process of issuing original, amended, corrected or duplicate Kentucky certificates of title for horses in which The Jockey Club has recorded notice of a security interest, or in other cases where Jockey Club Rules or the notation provisions of K.R.S. 9-604(3)(a) require surrender of the certificate to The Jockey Club or Clerk, the secured party will have a right to delivery of the certificate.

355.9-606. Perfection of Security Interests in Thoroughbreds

(1) A security interest in a horse titled under this statute becomes perfected at the time an equine lien statement (subject to the provisions of K.R.S. 355.9-607) is filed in the office of the Clerk. This subsection is subject to the provisions of K.R.S. 355.9-303(1).

(2) Unless the security agreement expressly states otherwise, a perfected security interest covers the named horse, proceeds therefrom, purse earnings thereof, and any fetus conceived or existing therein during the effective period of the perfection. Perfection in a mare is not effective with respect to any foal born to her which is itself subject to certificate of title.

(3) Perfection of a security interest in a thoroughbred titled in this state is effective (subject to the provisions of K.R.S. 9-403(2)) provided that either

   (a) the certificate of title is in the possession of the secured party (subject to the provisions of K.R.S. 355.9-608), or
   (b) a lien notation is placed on the certificate by the Clerk (subject to the provisions of K.R.S. 355.9-609).
This subsection is subject to the provisions of K.R.S. 355.9-303(2).

(4) In the case of a Kentucky foal which is eligible for registration, but for which no registration has been issued, a security interest may be perfected by filing an equine lien statement and proof of possession of the stallion service certificate by the secured party. An equine lien statement for such foal may be filed at any time between July 15 of the year of its conception up to and including December 31 of the year of its birth, and is effective as of the date of filing provided that the foal is born in Kentucky.

(5) A security interest in a thoroughbred not titled under this statute, but for which the proper place of filing is the state of Kentucky, shall be perfected by filing an equine lien statement with the Clerk. Security interests in thoroughbreds perfected by other means prior to the enactment of this statute will remain perfected, but are not subject to continuation statements after the enactment of this statute.

(6) The filing fee for an equine lien statement covering a horse titled or a foal subject to title under the statute will be $100. Each additional equine lien statement filed at the same time under the same security agreement will carry a filing fee of $40. Filing fees for equine lien statements covering shares in syndicated stallions or other collateral not titled under this statute will be determined by reference to K.R.S. 355.9-403(5).

355.9-607. 
EQUINE LIEN STATEMENT

(1) An equine lien statement shall contain the same information as that provided for in K.R.S. 355.9-402, and include the official name of the horse, or if unnamed, its sex and the name of its dam, and if registered, the state of foaling and Jockey Club registration number. In addition, the statement shall reflect whether the Clerk made a notation of the lien on the certificate of title.

(2) At the time the equine lien statement is filed, the secured party shall submit to the Clerk either: a) The Jockey Club certificate, or b) a photostatic copy of the front and transfer section of such certificate. In the case of a security interest in a foal which is eligible for registration but for which no registration has been issued, the secured party shall submit a) the stallion service certificate or a copy thereof, and b) the secured party’s affidavit as to the borrower’s ownership in the foal.

(3) The Clerk will not accept for filing an equine lien statement containing information which conflicts with the submitted certificate or affidavit.
(4) Upon filing an equine lien statement, the clerk will notify The Jockey Club of the existence of the security interest in that horse.

(5) Any person who knowingly prepares for submission or negligently submits incorrect information to the Clerk is in violation of this statute and is subject to a fine of not more than $____.

355.9-608. PERFECTION BY POSSESSION

(1) Actual notice of the existence of a security interest in a horse subject to Kentucky certificate of title may be given and will be deemed to have been received when

   (a) a search for the certificate of title would have disclosed that it was in the possession of the secured party, or
   (b) in the case of a security interest in a Kentucky foal which is eligible for registration but for which no registration has been issued, a search for the stallion service certificate would have disclosed that it was in the possession of the secured party.

(2) Where an application has been submitted to The Jockey Club giving rise to a right to delivery of a certificate in the secured party pursuant to K.R.S. 355.9-605(5), the certificate is deemed to be in the possession of the secured party from the time the application or certificate was mailed until the time it was delivered to the secured party or the time notice of waiver of the secured party's right to delivery is given.

355.9-609. PERFECTION BY NOTATION

(1) Actual notice of the existence of a security interest in a horse subject to Kentucky certificate of title may be given and will be deemed to have been received when inspection of the certificate of title would have revealed a notation of the security interest complying with the provisions of subsection (2) of this section.

(2) Notation by the Clerk on the Kentucky certificate of title is sufficient for perfection if on the first clean lines of the certificate's transfer section the following information is recorded:

   (a) in the "TRANSFERRED TO" space, "Security interest in horse, proceeds and race earnings";
   (b) in the "ADDRESS" space and in the space directly below it, name and address of the secured party;
   (c) in the "DATE" space, the date of notation; and
   (d) in the "SIGNED" space, the signature and title of the Clerk.
(3) No more than one active security interest may be perfected by notation on the certificate of title.

(4) The right of a secured party to have a lien notation placed on the Kentucky certificate of title arises at the time of filing for titled thoroughbreds, but no such right accrues upon the perfection of security interests in non-titled horses.

355.9-610. EFFECT OF ACTUAL NOTICE

A person receiving notice from the Clerk or secured party that a security interest has been perfected, is estopped from denying notice of a security interest in that horse.

355.9-611. LIEN TERMINATION

(1) Upon receipt of a lien termination statement complying with section 355.9-404(1) of this Article, the Clerk must, in addition to the requirements of subsection (2) of that section, notify The Jockey Club of the termination of the security interest, and if a notation has been placed on the certificate the Clerk shall upon presentation of the certificate record on the first clean spaces of the certificate’s transfer section the following information:

(a) in the “TRANSFERRED TO” space, the words “Security Interest Terminated”;
(b) in the “DATE” space, the date of termination;
(c) in the “SIGNATURE” space, the signature and title of the Clerk.

(2) In the event that a horse subject to a security interest is sold in the ordinary course of business as defined in section 355.9-601(4), the Commonwealth recognizes the power of the Transfer Officer to terminate the security interest in the horse, provided

(a) the transfer officer signs to execute a termination before making the transfer of the horse; and
(b) such officer notifies the association bookkeeper that a security interest continues in the proceeds of sale.

Such officer may record on the certificate the same information required of the Clerk in terminating security interests.

(3) Within ten (10) days after any transfer, claim or sale, the Clerk shall notify the secured party who shall file a lien termination statement within 30 days of such notice.
355.9-612. Payment Obligations

Payment obligations incurred by persons holding proceeds as a result of the disposition of a thoroughbred in the ordinary course of business will be satisfied by the issuance of a draft in the amount of net proceeds payable jointly to the owner and a secured party with a perfected security interest.

355.9-613. Authority Vested for Administration of System

(1) (a) The public protection and regulation cabinet shall have full responsibility and authority for day-to-day administration of the thoroughbred title system described by this section; and

(b) may request the assistance of any department, bureau of state government, or the state racing commission in carrying out the responsibilities under this section; and

(c) may delegate responsibility for administration to the County Clerk of Fayette County.

(2) The department of information systems shall assure to the extent feasible, daily, year-round information support for law enforcement agencies, racing commissions and associations, sales companies, purchasers and secured parties nationwide.