AGRICULTURAL CREDIT AND THE UNIFORM COMMERCIAL CODE: A NEED FOR CHANGE?

Keith G. Meyer

I. INTRODUCTION

The principal nongovernmental actors in the agricultural crisis are the farmers, the lenders, and the buyers of farm products. Interestingly, all of these people at some time are creditors. For example, the elevator that buys grain generally sells some products on credit, and the farmer who sells grain on a price-later contract or a deferred payment contract is a creditor. The farmer is similarly treated when he sells grain, receives a bad check, and later learns that the goods have been sold to a third party. The Uniform Commercial Code (U.C.C.) affects all of these transactions.

Many farmers, lenders, and buyers of farm products must presently confront significant credit problems. The stakes are high. Failure means not only loss of a job or business, but also loss of self-esteem and in some cases loss of life. This stress is not limited to farmers, but also touches lenders, buyers of farm commodities, lawyers, and communities whose existence depends on agriculture.

In most instances, when an unpaid creditor and another party claim the same property, the U.C.C. settles the dispute. Creditors, debtors, and farmers who perceived an unfairness in the priority rules of the U.C.C. sought changes. Politicians, aware of the stakes, felt compelled to act. With few exceptions, no one seriously urged the permanent editorial board of the U.C.C. to examine how agricultural credit is affected by the U.C.C. Rather, state-by-state legislation has been the vehicle for significant changes in the U.C.C. Congress, however, recently federalized the farm products rule of section 9-307(1).1

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While a major focal point of conflict and legislative change is the farm products rule, other areas of the U.C.C. and the propriety of their special application to agriculture must be considered. For the purpose of examining these areas, this Article considers the problems raised when a grain storage facility (elevator or warehouse) fails and examines some unique priority problems. The Article concludes with a discussion of the farm products rule.

II. ELEVATOR FAILURE AND HOLDER OF A WAREHOUSE RECEIPT

A farmer who delivers grain to an elevator can either sell the grain or store it. If it is sold and the farmer is not paid, the farmer is an unsecured creditor. If it is stored, a bailment relationship exists between the elevator and the farmer who still owns the grain. The farmer's status becomes crucial if the warehouse fails or if the farmer defaults

on a loan and the creditor has a perfected security interest in the delivered grain.\(^2\)

Upon delivery, the farmer receives a scale ticket, which states the weight of the grain delivered. The number of bushels is computed by determining the test weight of a bushel and dividing the weight of the grain delivered. A scale ticket will not, in many cases, indicate whether the grain is to be sold or stored. On the other hand, once a warehouse receipt has been issued in the farmer’s name, it is generally clear that a bailment relationship exists.\(^3\)

Generally, a farmer who holds a warehouse receipt has a document of title, which represents title to the goods covered by the receipt.\(^4\) When an elevator fails, the farmer is an owner of grain, not a creditor of the elevator. The stored grain is not an asset of the elevator. The fact that grain is fungible and commingled in a common mass does not affect the bailment relationship.\(^4\)

Under section 7-207(2),\(^4\) the farmer who stores grain and holds a valid warehouse receipt is the owner of an undivided share of the grain in the elevator. Assuming the usual shortage that exists when an elevator fails, the farmers holding warehouse receipts will be entitled to an allocated share in the remaining grain. The farmer who does not receive all of his stored grain will have a claim against the bonding company of the elevator, but these bonds usually will not

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4. It makes a difference if the warehouse receipt is negotiable or not in some commercial transactions involving the transfer of interests in the warehouse receipts. U.C.C. §§ 7-503, 9-304 (1978). The warehouseman’s responsibility to the bailee is the same whether the receipts are negotiable or not. Id. § 7-403.


6. U.C.C. § 7-207(2) (1978) provides:

   Fungible goods so commingled are owned in common by the persons entitled thereto and the warehouseman is severally liable to each owner for the owner’s share. Where because of over issue a mass of fungible goods is insufficient to meet all the receipts which the warehouseman has issued against it, the persons entitled include all holders to whom over issued receipts have been duly negotiated.
cover all of the loss. Moreover, elevator creditors who obtained negotiable warehouse receipts through due negotiation are entitled to share with the farmers in the remaining grain even if there was not enough grain to cover the receipts when issued.

While state legislatures have responded to this problem in a variety of ways, the approaches have not focused on the U.C.C. Some amended laws regulate warehouses. Others developed so-called indemnity funds. Normally, the indemnity fund is established by assessing each bushel of grain moved into an elevator. In theory, the fund should be adequate to fully compensate any farmer who has a storage loss sustained as a result of a grain elevator failure. Critics argue that indemnity stifles competition by equalizing elevator operators since the farmer is protected regardless of the soundness of the operator with whom the farmer chooses to deal. These critics also argue that farmers should be allowed to choose whether they want to pay for insurance. Private insurance is available in some states. Interestingly, the Farm Bureau of Iowa and Minnesota offered an insurance policy for this purpose, but it was dropped for lack of interest. Many farmers oppose both insurance and the indemnity fund on the ground that farmers should not bear the cost of assuring an elevator’s solvency.

Congress has been urged to protect the farmer who stores commodities. For example, proponents suggest that the United States Department of Agriculture (USDA) pay all farmer losses sustained when a federally or comparably state licensed elevator fails. Another proposal would establish a Grain Elevator Insurance Corporation, which would give farmers protection similar to that provided by the Federal Deposit Insurance Corporation. To this effect, a bill was introduced in 1983 providing that government owned surplus commodities be given to farmers who lose grain stored in insolvent warehouses.

In 1984, Congress did pass grain warehouse amendments to the Bankruptcy Code. These amendments were touted as providing great protection to farmers, but appear to be of minor significance. Bailors not receiving complete satisfaction are merely granted a fifth level priority up to $2000.

In states without indemnity funds, farmers who stored grain in an insolvent elevator and suffered losses have sought, unsuccessfully,

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7. This was true prior to the adoption of the UCC. See, e.g., United States v. Luther, 225 F.2d 499 (10th Cir. 1955).
12. The major changes affecting elevators are found in 11 U.S.C. §§ 507(a), 557 (1982). See also id. § 546(c).
13. Id. § 507(a)(5) (1982).
to obtain satisfaction from buyers of grain from the defunct elevator. Section 7-205 provides in part: "A buyer in the ordinary course of business of fungible goods sold and delivered by a warehouseman who is also in the business of buying and selling such goods takes free of any claim under a warehouse receipt. . . ." A buyer in the ordinary course must merely act in good faith and physically receive the commodity. In addition, section 2-403(2) provides that a merchant who has been entrusted goods can transfer all the entrustor's rights to a buyer in the ordinary course.

Farmers in a number of agriculturally oriented states have urged their state legislatures to revamp Sections 7-205 and 2-403(2). Many of these proponents fail to realize the negative aspects of their proposal. First, states that restrict buyer’s protections may suffer economically as buyers shift their business to states that have not changed the rule. Moreover, such an amendment would lead buyers to larger, established warehouses and sellers, which in turn may cause smaller elevators' prices to fall. These small country elevators already face considerable economic pressure because of the deregulation of freight rates and reduced rail service.

III. ELEVATOR FAILURE AND UNPAID SELLER

A. Price-Later or Deferred Payment Contract

When an elevator fails, many farmers become unpaid, unsecured creditors. The farmer probably sold grain on a deferred payment contract or a price-later contract. Or, he may have sold grain and received a bad check. In these situations, the farmer has physically delivered his grain and transferred title upon the assurance of future payment.

With a deferred payment contract or price-later contract, the farmer might be able to reclaim the goods if he makes a timely demand (ten days after delivery or three months if there has been a written misrepresentation of solvency before delivery). If the elevator is


15. A deferred payment contract is one in which a farmer wants to sell his grain and lock in his price but defer income until the next tax year.

16. While there is no universally accepted definition of a price-later contract, it is generally thought to mean that the farmer delivers his grain, transfers title, and will set the price (and payment) in the future.

17. U.C.C. 2-702(2) (1978) provides:

Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on
bankrupt, section 546(c) of the Bankruptcy Code controls the battle. Normally, a farmer will not reclaim his goods because he is unaware of the necessity of a timely demand.

Even if the farmer makes a timely reclamation demand, his claim to the grain will fail if the grain has been sold by the elevator "[to] a buyer in the ordinary course or other good faith purchaser under ... [section 2-403]". Accordingly, the right to reclaim title is useless if the elevator has sold the farmer’s grain to a buyer in the ordinary course.

Some state legislatures have adopted varying approaches to protect the farmer in these situations. An indemnity fund provides some protection. Another approach is to require the elevator, upon the request of the farmer, to obtain an irrevocable standby letter of credit in favor of the farmer. Clearly, the farmer without some special treatment will be left to fight as an unsecured creditor upon the failure of the elevator.

B. Unpaid Seller and Bad Check

Even though a sale of grain in return for a check is treated as a cash sale, the same analysis applicable to a credit sale is relevant if the buyer is insolvent. Cash sellers’ rights are governed by sections 2-507 and 2-511. When there is no third party, the seller can reclaim the goods, subject to the ten day rule of section 2-702 dealing with credit sales. The U.C.C. changes the common-law presumption that an owner of goods does not intend to pass title until the check clears and can reclaim the goods if the check is dishonored. When payment is due on delivery, the unpaid cash seller’s ability to reclaim the goods is subject to the Article 2 rules concerning bona fide purchasers.
In a cash sale-dishonored check situation, the elevator holds voidable title but can transfer good title to a good faith purchaser for value. Consequently, the grain sold to a bona fide purchaser can not be reached. If a farmer sells grain subject to a perfected security interest without the consent of the secured party, however, the secured party could probably reach those goods held by both the elevator and a purchaser from the elevator.

C. Unpaid Seller and the Secured Party of the Buyer (Elevator)

In In re Samuels, the Court of Appeals for the Fifth Circuit held that a secured party of the buyer can be a good faith purchaser under the U.C.C., because the definition of purchaser includes a secured party. Thus, the Article 2 bona fide purchaser rules apply to the payment. These words are used as words of limitation to conform with the policy set forth in the bona fide purchase sections of this Article. Should the seller after making such a conditional delivery fail to follow up his rights, the condition is waived. The provision of this Article for a ten day limit within which the seller may reclaim goods delivered on credit to an insolvent buyer is also applicable here.

23. Id. § 2-403(1)(b) states:
A purchaser of goods acquires all title which his transferee had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good faith purchaser for value. When goods have been delivered under a transaction of purchase, the purchaser has such power even though . . . (b) the delivery was in exchange for a check which was later dishonored . . .

24. Id. § 9-307(1) states: "A buyer in ordinary course of business (subsection (9) of section 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." Id. § 9-306(2) provides: "Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor."

25. 526 F.2d 1238 (5th Cir.), cert. denied, 429 U.S. 834 (1976).
For other cases applying the Samuels rationale see Action Indus., Inc. v. Dixie Enters., Inc., 22 Bankr. 855 (Bankr. S.D. Ohio 1982); In re McLouth Steel Corp., 22 Bankr. 722, (Bankr. E.D. Mich. 1982); In re Western Farmers Ass’n, 6 Bankr. 432 (Bankr. W.D. Wash. 1980).

26. U.C.C. § 1-201(32) and (33) provide:
"‘Purchase’ includes taking by sale, discount, negotiation, mortgage, pledge, lien, issue or reissue, gift or any other voluntary transaction creating an interest in property. . . . ‘Purchaser’ means a person who takes by purchase."
"‘Good Faith’ is defined in two places in the U.C.C. Section 1-201(19) provides:
"‘Good faith’ means honesty in fact in the conduct or transaction concerned.”
Section 2-103(1)(b) states: "‘Good faith’ in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."

27. See, e.g., id. § 2-403(2).
secured party. Accordingly, the farmer cannot defeat the secured party who has perfected a security interest in the buyer’s inventory and acts in good faith.

The *Samuels* court determined that a rancher who had sold cattle and received a bad check was a creditor and had a purchase money security interest, which, if properly perfected, would give it priority over the buyer’s secured creditor. While theoretically supported by Article 9, farmers are not capable of complying with section 9-312(3), which deals with purchase money security interests in inventory. Upon delivery to the packer in *Samuels*, the cattle became the packer’s inventory. For the farmer’s purchase money security interest in this inventory to obtain priority, the farmer must satisfy the four requirements of section 9-312(3) and must obtain the signatures of the debtor (packer or elevator) on a security agreement and a financing statement. As a practical matter packers and elevators (the debtors) will not grant each seller (secured party) a perfected security interest.

In 1976, Congress amended the Packers and Stockyard Act by adding section 196(b), which requires packers to hold in trust all proceeds from the sale of livestock. This change effectively reversed

28. *Id.* § 9-312(3) states:
A perfected purchase money security interest in inventory has priority over a conflicting security interest in the same inventory and also has priority in identifiable cash proceeds received on or before the delivery of the inventory to a buyer if
(a) the purchase money security interest is perfected at the time the debtor receives possession of the inventory; and
(b) the purchase money secured party gives notification in writing to the holder of the conflicting security interest if the holder had filed a financing statement covering the same types of inventory (i) before the date of the filing made by the purchase money secured party, or (ii) before the beginning of the 21 day period where the purchase money security interest is temporarily perfected without filing or possession (subsection (5) of Section 9-304); and
(c) the holder of the conflicting security interest receives the notification within five years before the debtor receives possession of the inventory; and
(d) the notification states that the person giving the notice has or expects to acquire a purchase money security interest in inventory of the debtor, describing such inventory by item or type.

30. *Id.* § 196(b) provides:
All livestock purchased by a packer in cash sales, and all inventories of, or receivables or proceeds from meat, meat food products, or livestock products derived therefrom, shall be held by such packer in trust for the benefit of all unpaid cash sellers of such livestock until full payment has been received by such unpaid sellers: *Provided,* that any packer whose average annual purchases do not exceed $500,000 will be exempt from the provisions of this section. Payment shall not be considered to have been made if the seller receives a payment instrument which is dishonored: *Provided,* that the unpaid seller shall lose the benefit of such trust, if in the event that a payment instrument has not been received, within thirty days of the final date for making
Samuels, which held that a secured party would prevail over an un-
paid seller of livestock. Section 196(b) does not apply to buyers of
grain, dairy products, or poultry. Recently, dairy farmers and poultry
producers have sought federal legislation to establish a prompt pay
system and trust fund to protect against failures of milk processors.
These groups are hopeful that Congress will act as it did in 1984 when
it amended the Perishable Agricultural Commodities Act by adding
a trust fund similar to the one created in section 196(b).

IV. PRODUCTION SUPPLIER’S PRIORITY

A limited purchase money security interest priority is given to crop
production suppliers under section 9-312(2). To qualify for this prior-
ity, the following four conditions must be met: (1) the production
crop lender must give value; (2) the purpose of the value must be
to enable the debtor to produce the crops during the current produc-
tion season; (3) the value must be given not more than three months
before the crops become growing crops; and (4) the obligation owing
to the earlier secured party must have been due more than six months
before the crops were planted.

The principle issue concerns the meaning of the requirement that
the previous obligation be “due more than six months.” Most courts
interpret the language as requiring payments to be six months in default.
In other words, if the debtor’s obligations are less than six months
overdue at the time the crops become growing crops, the crop produc-
tion lender does not have priority. Thus, this unique provision pro-
vides a very limited protection.

31. 526 F.2d at 1238.
33. U.C.C. § 9-312(2) states:
A perfected security interest in crops for new value given to enable the debtor to
produce the crops during the production season and given not more than three months
before the crops become growing crops by planting or otherwise takes priority over
an earlier perfected security interest to the extent that such earlier interest secures
obligations due more than six months before the crops become growing crops by
planting or otherwise, even though the person giving new value had knowledge of the
earlier security interest.
34. Id.
35. For a court supporting this view, see United States v. Minister Farmers Coop. Exch.,
Suppliers of fertilizer, seed, and chemicals are unhappy with the limited application of this provision. The suppliers want a super-priority for crops and livestock produced from their supplies. Unless section 9-312(2) applies, a supplier obtains priority over a prior perfected secured party only if the supplier persuades the prior secured party to sign a subordination agreement. Most suppliers, however, do not possess a perfected security interest, and thus, even if able to obtain subordination, face difficulties if the farmer files a bankruptcy petition.

In some states, suppliers have successfully lobbied the enactment of special statutory lien statutes. In 1984, Iowa enacted a statute that grants certain suppliers a special lien. This statute is replete with difficulties. Moreover, even if successfully used to defeat a prior perfected secured party, the statutory lien could probably be defeated by the farmer’s trustee in bankruptcy. Section 545(2) of the Bankruptcy Code provides that the trustee may avoid a statutory lien to the extent that the lien “is not perfected or enforceable at the time of the commencement of the case against a bona fide purchaser that purchases such property at the time of the commencement of the case, whether or not such purchaser exists.” The trustee may also implement the “strong-arm” provision of section 544(a)(1), which gives the trustee the status of a lien creditor at the date of the filing of the bankruptcy petition. If the supplier is neither a properly perfected secured party nor a lien creditor under section 9-301(3) at the filing of the petition, the trustee, as a lien creditor, could prevail.

Suppliers have also sought an amendment of section 9-312(2), which would allow a priority claim similar to that granted other purchase money security interest holders under section 9-312(4). This change, however, would have serious repercussions. First, all crop production suppliers would have to face the requirements of Article 9. Although some suppliers commonly grant credit by allowing farmers to buy on open account, few are accustomed to handling or are equipped to handle the extensive documentation required by Article 9. Second, crop production suppliers are not equipped to conduct the necessary

37. Iowa Code §§ 570A.1 to .11.
38. For a discussion of some of the problems in the Iowa statute see Salsberg and Juhl, Chapter 570A Crop and Livestock Lien Law: A Panacea or Pandora’s Box, 34 Drake L. Rev. 361 (1985).
40. Id. § 544(a)(1).
41. See supra note 33.
42. U.C.C. § 9-312(4) provides: “A purchase money security interest in collateral other than inventory has priority over a conflicting security interest in the same collateral or its pro-
credit screening and cash flow projections. Third, this change could have an adverse impact on the availability of credit to farmers. This seems particularly possible if attacks being made on the farm products rule of section 9-307(1) are successful. Banks may seek to shift all of the crop production financing responsibility to crop production suppliers. Certainly, banks would be reluctant to rely on crops as collateral since farmers could give priority to suppliers after the bank had made its loan judgments. Arguably, the expeditious and safe route for suppliers is to leave the credit business to the banks. The supplier should then enter an advance arrangement with the debtor’s bank or Production Credit Association (PCA) to ensure payment for supplies. A line of credit could then be established in the supplier’s name, or the bank could guarantee payment up to a certain amount.

V. The Farm Products Rule

A. Scope

The priority battle for farm products focuses upon the so-called farm products rule. To analyze the farm products rule, one must consider section 9-307(1) and 9-306(2). Section 9-307(1) provides:

A buyer in ordinary course of business (sub-section (9) of section 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.

Before a secured creditor can qualify for the special protection of section 9-307(1), he must establish that the collateral sold qualifies as farm products and that he has a properly perfected security interest.

The farm products rule has generated a great deal of controversy. Much of it has been spawned by section 9-306(2), which provides:

Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof, unless the disposition was authorized by the secured party in the security agreement or otherwise and also continues in any identifiable proceeds . . . .

Inasmuch as security agreements almost never specifically authorize sale of farm products, the crucial words in this section are “or otherwise.” Neither the U.C.C. nor its comments define “otherwise” or

33. See infra section V.D.; Methods of Dealing with the Farm Products Rule.

give any guidance to its meaning. Courts have generally considered the issue to be whether the secured party has in any way authorized the sale. If the sale was authorized, the secured party loses the right to seek redress from the buyer. While courts have imported to the U.C.C. the common law notions of waiver, estoppel, and consent, there is no definitive consensus of what constitutes authorization.

Many cases concern situations in which (1) the security agreement either specifically prohibited the sale of collateral or required the prior written consent of the secured party; (2) the debtor sold covered collateral in the past; and (3) the lender knew of the debtor’s prior sales, but made no objection to those sales and accepted either the debtor’s checks or checks payable to the debtor and endorsed by the debtor to the lender. Some courts in these circumstances have construed the prohibition literally and held that the sale of the collateral was unauthorized because the security agreement contained an express prohibition against sales. Other courts have held that no authorized sale can exist absent written consent. A number of courts, however, have held for the purchaser on the theory that the sale, in which the debtor does not remit the proceeds, was authorized by the prior course of dealing. Some courts have rejected this approach and have criticized those who ignore section 1-205(4).

45. See, e.g., In re Coast Trading Co., 36 U.C.C. REP. SER. (CALLAGHAN) 1753 (D. Or. 1983); National Livestock Credit Corp. v. Schultz, 34 U.C.C. REP. SER. (CALLAGHAN) 317 (Okla. 1982).


47. See, e.g., Citizens Savings Bank v. Sac City State Bank, 315 N.W.2d 20 (Iowa 1982).


52. Section 1-205(4) provides:

The express terms of an agreement and an applicable course of dealing or usage of trade shall be construed wherever reasonable as consistent with each other; but when such construction is unreasonable express terms control both course of dealing and usage of trade and course of dealing controls usage of trade. U.C.C. § 1-205(4) (1978).
A significant recent development concerning authorization is the Eighth Circuit Court of Appeals decision in *United States v. Missouri Farmers Association*. The court concluded that the Farmers Home Administration (FmHA) is to be judged differently from a private lender. The FmHA had a perfected security interest in crops, and FmHA instructed the debtor to sell the crops. The debtor sold the crops, but did not remit the proceeds to FmHA. FmHA sued the buyer (MFA) in conversion.

An FmHA regulation provides:

> When borrowers sell security, the sale will be made subject to the FmHA lien. The property and proceeds will remain subject to the lien until ... the sale is approved by the County Supervisor and the proceeds are used for one or more of the purposes stated in § 1962.17. Purchasers of security who inquire should be informed that the property is subject to FmHA’s lien and will remain subject to it until they deliver any proceeds in cash to the County Supervisor or make checks payable jointly to the borrower and the FmHA and the check has cleared. “Written Consent to Sell and Statement of Conditions on Which Lien Will Be Released,” will be used by the County Supervisor to give the written consent to sell when borrower or purchasers request such a statement before the date of sale. 53

These regulations were constructed to authorize sales without release of the Government’s lien.

According to the court, under Missouri law, however, a secured creditor’s consent, even conditional consent, to the sale automatically cuts off a perfected security interest. Thus, a conflict between state and federal law existed. The court held that, since there was a conflict between the federal law and the state law, federal law controlled. It relied upon *United States v. Kimbell Foods, Inc.*, 54 which held, absent a federal statute to the contrary, priority between federal and private consensual security interests is to be determined under non-discriminatory state law.

Notwithstanding the authorization issue and the question of whether the sale is one of farm products, the farm products rule presents some unusual questions. For example, suppose a bank has a properly perfected security interest in a farmer’s crops. The farmer, without the written consent of the bank as required by the security agreement, sells the crops to the local elevator, which in turn sells them to a terminal elevator. The farmer then defaults on his loan to the bank. Assuming the bank has not authorized the sale, it can successfully proceed against the terminal elevator by utilizing section 9-306(2) and

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54. 7 C.F.R. § 1962.18(b) (1985) (emphasis added).

the farm products portion of section 9-307(1). Normally, if it is not a sale of farm products, section 9-307(1) allows a buyer in the ordinary course to take free of a perfected security interest in the seller's inventory. Section 9-307(1) does not help the terminal elevator, however, even though the grain was "inventory" in the hands of the local elevator. A buyer severs a secured party's interest under section 9-307(1) only if its seller created the security interest in question. The security interest in this example was not created by the local elevator, but by the seller to the local elevator. As a practical matter, the local elevator would bear the ultimate loss. If the terminal elevator has to pay off the bank, it can successfully sue the local elevator for breach of warranty of title under section 2-312. Collection of such a judgment depends on the solvency of the local elevator.

Another interesting priority problem is raised by the following example: After harvesting a crop, Farmer, who has given PCA a properly perfected security interest in all of its crops, hires Doak Trucking to truck all of his crops ten miles to Elevator where they will be sold. Doak is instructed to have the check made out to Farmer. Doak, as Farmer and Elevator knew, had previously purchased grain from local farmers and sold it to a feedlot near the elevator. Doak delivers Farmer's grain, but indicates to Elevator in writing that it belongs to Doak. Farmer is never paid and Doak Trucking later becomes insolvent. Farmer may sue Elevator, but will probably lose. Section 2-403(2) provides that "any entrusting or possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in the ordinary course of business."56 Doak Trucking will probably be considered a merchant under section 2-104(1), and the goods were entrusted to it by Farmer who knew of Doak's occasional sales. Thus, Doak Trucking had the power to pass good title to a buyer in the ordinary course. Assuming Elevator is a buyer in the ordinary course, Farmer would lose to Elevator. In Simonds-Shields-Theyis Grain Co. v. Far-Mar-Co.,17 a case with circumstances similar to this, the court held that section 2-403(2)18 is applicable. It also indicated that the phrase in section 2-403(1), "or had power to transfer," made common-law concepts of agency and estoppel applicable when a purchase is made from an agent. In short, Farmer faces a real risk of loss here.

A priority battle may also occur if Farmer defaults on his loan to the PCA after Doak Trucking sells Farmer's crop to Elevator. Assuming the PCA had not authorized the sale in any way, PCA

58. U.C.C. § 2-403(2) (1978) states: "Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business."
should prevail in a suit against the elevator under the farm products rule of section 9-307(1). This result would not seem inconsistent with Article 2. Section 2-403(2) prevents the merchant (Doak) from transferring more title than the entruster (Farmer) had. The grain was always subject to PCA’s security interest. Subsequent purchasers from Doak (the merchant) could only get as good a title as the entruster (farmer) had. Section 2-403(4) is also relevant. It states that “[t]he rights of other purchasers of goods and of lien creditors are governed by the articles on secured transactions . . .” Comment 2 to section 2-403 provides: “As to entrusting by a secured party, subsection (2) is limited by the more specific provisions of section 9-307(1), which deny protection to a person buying farm products from a person engaged in a farming operation.” In one case, which did not concern farm products, the court held that section 2-403(2) was subject to section 9-307(1) and 9-306(2). The general thought is that Article 9 controls conflicts between Articles 2 and 9. Interestingly, PCA has more rights than its debtor had.

A final section 9-307(1) problem concerns farmer trade-ins. Suppose PCA creates and properly perfects a purchase money security interest in Farmer Jones’ combine. Two years later Jones trades the combine in on a new one that he buys on time from an implement dealer. The dealer properly perfects its security interest on the day of the sale. One month after the trade-in the dealer sells the old combine to Farmer McDonald. Five months later Jones defaults on his loan to PCA and on his installment contract with the dealer. Can PCA replevy the old combine from McDonald? Does PCA have any claim against the new combine?

If PCA did not authorize the trade-in under section 9-306(2), PCA can replevy from McDonald. Although the combine was inventory in the hands of the dealer, Farmer Jones, rather than the dealer, created the security interest; and the “his seller” requirement of section 9-307(1) is not satisfied. As a practical matter PCA is not likely to seek redress from McDonald if the dealer is solvent. If it did, however, McDonald

59. *Id.* § 2-403(1) states:
A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good faith purchaser for value. When goods have been delivered under a transaction of purchase the purchaser has such power even though
(a) the transferor was deceived as to the identity of the purchaser, or
(b) the delivery was in exchange for a check which is later dishonored, or
(c) it was agreed that the transaction was to be a “cash sale”, or
(d) the delivery was procured through fraud punishable as larcenous under the criminal law.
has a section 2-312 breach of warranty of good title cause of action against the dealer.

PCA can sue the dealer for conversion of the old combine as long as PCA did not authorize the sale. Even though Farmer Jones sold the old combine to the dealer when he traded it in, section 9-307(1) will not help the dealer because the dealer is not a buyer in the ordinary course since Farmer Jones was not in the business of selling combines.\textsuperscript{60}

PCA might also be able to claim the new combine in the hands of Farmer Jones, but only to the extent of the used combine's value at trade in. The new combine qualifies as proceeds of the used combine, and PCA's purchase money security status would continue since section 9-312(4) provides that "[a] purchase money security interest . . . has priority over a conflicting security interest in the same collateral or its proceeds" if properly perfected. The dealer also holds a purchase money security interest in the new combine. Consequently, there are two purchase money security interests. Since the dealer and the PCA are secured creditors of equal status, the first-to-file rule under section 9-312(5)(a) governs. This result is not unfair to the dealer who could have checked the filed financing statements before making the trade.

B. Reasons For and Against the Rule

The farm products rule has generated controversy and litigation. The proponents of the rule advance a number of arguments. First, buyers are financially sophisticated and are, or should be, aware of the need to check readily available financing statements. Second, levelers need the farm products rule. Farm and ranch operations are cyclical in nature and have no steady flow of income. Most products come into existence at one time of the year and often are sold in a large unit. Agricultural lenders recognize this and generally expect payments only when products are sold. Thus, the lender has all its expectations and security tied up in one asset. Some have suggested that a farm products sale is like a bulk sale and should be treated differently as are bulk sales under Article 6. The Federal Government through the Farmers Home Administration and the Commodity Credit Corporation lends large amounts to farmers; it needs the farm products rule.

If the rule were totally eliminated, the lender would lose substantial protection. Moreover, the lender could no longer dictate that potential buyers name the lender as joint-payee of the check when the debtor sells products subject to a perfected security interest. Also, the lender could not determine potential buyers since grain and livestock can be transported out of local areas without buyer registration. This

\textsuperscript{60} See id. §§ 1-201(9), 9-307(1).
is in marked contrast to the present U.C.C. notice filing system that allows the buyer to determine who might have a security interest.

If the lender could not identify buyers, the lender would obviously not be named as a joint-payee on the check. Thus, the lender would have to establish procedures to assure that the proceeds from the sale of the collateral would be identifiable as required by section 9-306(2). The contrast between farm products proceeds and those in other businesses is striking. In other businesses, particularly those dealing with expensive goods, the proceeds will consist of chattel paper, which is fairly easy to police and identify. For the farm lender to ensure identifiable proceeds, however, it must prevent the farmer from commingling the proceeds with other funds. This is difficult since farmers are generally paid by a check, which is deposited in a general checking account. This can be deadly for a lender if an insolvency proceeding is started. Under section 9-306(4)(d)(ii) the secured creditor’s claim to cash or deposit accounts containing commingled funds is limited to any cash proceeds received by the debtor within ten days before the insolvency proceeding was instituted. Under 9-306(4)(d)(ii) a perfected security interest in proceeds is limited to a perfected security interest in only those cash and bank accounts that have been commingled with such proceeds within ten days before filing the bankruptcy petition.

The Court of Appeals for the Ninth Circuit considered section 9-306(4)(d) in In re Gibson Products. In that case a secured party claimed a $20,000 bank account in which only ten dollars had come from the sale of the secured party’s collateral during the ten days prior to the bankruptcy petition. The court held that under section 9-306(4)(d) a secured party has a claim to all of the proceeds deposited in a commingled account during the ten days preceding bankruptcy so long as the party can show that the debtor deposited some proceeds from the sale of its collateral in the commingled account during the time period. The court, however, allowed the secured creditor to

61. See id. § 9-105(1)(b). Chattel paper is defined in the Uniform Commercial Code as follows:

A writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods, but a charter or other contract involving the use or hire of a vessel is not chattel paper. When a transaction is evidenced both by such a security agreement or a lease and by an instrument or a series of instruments, the group of writings taken together constitutes chattel paper.

62. Id. § 9-306(4)(d). For purposes of the Uniform Commercial Code, insolvency occurs when either the debtor ceases to pay its debts in the ordinary course of business, is unable to pay his or her debts as they come due, or is insolvent under federal bankruptcy law. Id. § 1-201(23).

63. 543 F.2d 652 (9th Cir. 1976), cert. denied, 430 U.S. 946 (1977).

64. Id. at 654.

65. Id. at 657.
keep only ten dollars because the debtor had derived the other money from the sale of collateral not covered by the security agreement, and therefore, the other money was considered a voidable preference under the old bankruptcy act since the interest in the other money arose within ninety days of bankruptcy. 66 Apparently, the same result would occur today under the current bankruptcy law. 67 Moreover, the secured party has no control over when the farmer files for bankruptcy since an involuntary bankruptcy petition cannot be filed against a farmer. 68

Finally, assuming that a change of section 9-307(1) would substantially increase the lender’s risk, the lender would simply pass this cost to farmers by restricting availability of credit, requiring more collateral, requiring guarantors, and raising service charges. This would then pressure the federal government to increase its loans since the Farmers’ Home Administration’s current requirements are that borrowers are eligible only if credit is otherwise not available. 69

Buyers and commission agents argue that the farm products rule is unjustified. The lender’s risk has, in effect, been shifted to the buyer. The free flow of commerce principle, which is recognized in other sections of the U.C.C. and is the basis for the ordinary buyer taking free of a prior perfected security interest, 70 applies as well to the inventory of the appliance store. Agriculture should be treated like any other business. The farm lender, like other lenders, is protected by its security interest in proceeds; requiring purchasers of farm products to check the appropriate records is costly and impractical, especially when farmers provide buyers no warning of sale dates. This is a particular problem for the livestock industry since many packers buy from multistate areas and are required to pay before the close

66. Id. at 656-57.
68. 11 U.S.C. §§ 101(17)-(18), 303 (1982). See In re Johnson, 13 Bankr. 342, 346-47 (Bankr. D. Minn. 1981) (when court granted involuntary bankruptcy petition due to default by debtor, debtor cannot later argue that the bankruptcy court’s finding that he was not a farmer was incorrect). See also Pearson, Is a Man Out Standing in His Field a Farmer for Bankruptcy Purposes?, 5 J. Agric. Tax’n & Law 305 (1984) (discusses who is a farmer for purposes of the federal bankruptcy code).
70. See, e.g., U.C.C. §§ 2-403(2) (entrusting possession of goods to a merchant who deals in goods of the kind gives the merchant power to transfer all rights of the entruster to a buyer in the ordinary course of business); 5-114 (issuer’s duty and privilege to honor letters of credit); 6-110(2) (purchaser for value in good faith and without notice of a defect by reason of transferee’s non-compliance with the requirements of Article 6 takes free of the defect); 7-205 (buyer in the ordinary course of business of fungible goods sold and delivered by a warehouseman who is also in the business of buying and selling such goods takes free of any claim under a warehouse receipt even though it has been duly negotiated); 7-502 (rights acquired by due negotiation of warehouse receipts); 8-301 (purchaser of a security acquires the rights in the security that
of the next business day. Small buyers argue that the rule is particularly unfair to them since they do not have the profit margin and financial resources to absorb the loss. While many have insurance, such insurance is costly and often impossible to obtain. Finally, buyers complain that the threat of a lawsuit lingers long after they have purchased the farm products subject to a perfected security interest. Because most claims against buyers are based on conversion, this threat is extinguished only after the tort statute of limitations runs.22

C. State Legislative Reactions to Farm Products Rule

States' reactions have varied. At one extreme, California has eliminated the rule; more than twenty other states have adopted less drastic modifications.

1. California

Not surprisingly, California's reaction is aberrant. California has relatively few buyers of crops such as vegetables, grains, nuts, and fruits, and many of its farmers are members of cooperatives that have mandatory marketing contracts requiring that all commodities be sold to the cooperative. Moreover, many lenders will not extend credit unless the debtor, prior to planting and the loan, has a buyer committed to buy the crop at harvest. Lenders also require a written assignment of the crops' proceeds that authorizes the buyer to make direct payment to the lender. Normally, the lender forwards the crop assignment to the buyer who must acknowledge and agree to send the crop proceeds directly to the lender in the amount stipulated in the assignment. Thus, California lenders had little reason to quarrel with the rescission of the farm products rule.

2. Other States

Some states require the secured party to provide actual notice to the buyer to preserve the farm products rule.23 The secured lender

is to obtain a list of potential buyers from the farmer-debtor. The farmer's incentive to sell only to listed buyers is that he commits a crime if he sells to an unlisted buyer.

Other states require the buyer to obtain a statement of existing security interests from the farmer-seller in lieu of searching for filed financing statements. 74 A number of states, however, exempt commission agents, auctioneers, stockyards, or some combination of the three from being subject to the security interest. 75 Delaware requires all buyers to register with the Secretary of State, and if the secured party wants protection it must notify the buyers of its interest. 76

One of the most recent changes occurred in Iowa. 77 The change is particularly noteworthy inasmuch as Iowa has central filing and a system of providing almost instantaneous access to filed financing statements showing all perfected security interests to which a farmer-seller's farm products were subjected. Iowa did two things: It changed the definition of buyer in the ordinary course 8 and modified the farm products rule. The modification provides that a buyer in the ordinary course takes free of a perfected security interest created by his seller unless: (1) Buyer receives prior written notice of the security interest; or (2) Buyer purchases the farm products outside the seller's trade area; or (3) Buyer's principal place of business is located outside seller's trade area. Seller's trade area is defined as the county where seller resides, the county contiguous to the county where the seller resides, or one that corners upon the county of residence. 79

This new Iowa law has produced a paperwork mess. Lenders—unsure of the preciseness required by the new law, uncomfortable with the idea of notifying a select group of buyers, and unwilling to accept a debtor-supplied list—have engaged in mass notification.

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78. Section 554.9307(1) was amended in 1985 to read, in part, as follows: "For purposes of this section, a buyer or buyer in ordinary course of business includes any commission merchant, selling agent, or other person engaged in the business of receiving livestock as defined in Section 189A.2 on commission for or on behalf of another." Iowa Code Ann. § 554.9307(1) (West Supp. 1985).
79. Id.
sending borrower lists to every conceivable buyer of farm products.

The deregulation of rail freight rates under the Staggers Act of 1980 has encouraged farmers to sell to buyers located many miles from home, thus increasing the number of possible buyers. A rail carrier is authorized under 49 U.S.C. § 10713 to enter into contracts with purchasers of rail service. This has had an impact on commodity prices. For example, larger elevators can negotiate low freight rates and are consequently able to offer substantially higher prices than the small elevators that cannot get favorable freight rates or no longer have access to a rail line.

The net result of the new Iowa law coupled with the deregulation of freight rates is the receipt by Iowa auction houses and elevators of borrower lists covering debtor farmers from all regions. For example, a large livestock auction barn in Southern Iowa had received, as of early October, more than ten thousand names. The lists cover farms from three states. The new law has not only caused paperwork problems for the buyers, but buyers have had to explain why they were issuing joint payee checks to many farmers. 80

D. Methods of Dealing with the Farm Products Rule

1. Permanent Editorial Board of the Uniform Commercial Code

Many are dissatisfied with both the substance of the farm products rule and the confusion being caused by the many nonuniform amendments to the rule. If uniformity is a goal, the two obvious choices of bodies to reevaluate the rule are the Permanent Editorial Board of the U.C.C. (Board) and Congress. The Board is the better choice: it is free of most political pressures, and the present agricultural credit crisis requires not only an analysis of the farm products rule but all other U.C.C. sections that have an impact on agriculture. 81

The Board appointed a subcommittee in 1985 to make recommendations concerning the farm products rule. Possible approaches include: (1) eliminating the rule; (2) keeping the rule but requiring central filing for perfection of farm products that allows quick and easy buyer access to the filed information; (3) retaining the rule but applying it only to those buyers and commission merchants who are given actual notice by the lender/seller; and (4) requiring federal filing that allows easy and quick buyer access to filed information. Before the Board could thoroughly consider these and other possibilities, Congress passed a statute preempting the states. 82

80. Des Moines Register, pp. 1F & 4F (Oct. 6, 1985).
81. Examples of the latter are §§ 7-205 and 2-403(2), 7-207(2), 9-312(2), and 9-306(4), which are discussed in parts I, II and III of this Article.
2. Congress

Packers, the National Cattlemen’s Association, other livestock organizations, and the Grain and Feed Dealers National Organization lobbied Congress to change the farm products rule. In addition to arguing the rule is substantively poor, the proponents of federal action stressed the need for uniformity since farm products are constant subjects of interstate trade. Packers, market agencies, and dealers purchasing livestock have a peculiar problem in that under the Packers & Stockyard Act they must pay for their purchases within twenty-four hours. This, they argued, makes it impossible to verify the existence of security interests because many buy from producers located in different states. Filing rules vary from state to state and many filing officers will not provide information over the phone.

The opponents of federal intervention forwarded a different argument. Traditionally, commercial transactions have been regulated by the states. The mere nonuniformity of section 9-307(1) does not justify federal legislation; many sections of the U.C.C. exhibit state-by-state peculiarities. For example, more than twenty states have amended section 2-315, which deals with implied warranties when livestock is sold. At least three different filing rules are in effect. There is also a split in the states concerning whether a farmer is a merchant. Some states still have the 1962 version of the U.C.C. Finally, farmers are upset about sections 2-403 and 7-205, which provide that farmers cannot retrieve their stored grain, sold by the storing warehouse, from a good faith purchaser or buyer in the ordinary course if the warehouse fails to pay the farmer. State legislatures have been asked to reverse this rule and will be asked again to change the rule. If farmers are unsuccessful at the state level, they would surely seek federal legislation to change section 9-307(1). Consequently, the only way to create a uniform law would be for Congress to enact a federal U.C.C.

3. Congress’ Response

The proponents of federal change prevailed. In section 1324, a provision buried in the 1985 Farm Bill, Congress changed most state and federal law dealing with the sale of farm products subject to a perfected security interest. This change is important not only because it changes the law, but because it shows that Congress is willing to regulate creditor/debtor problems that have been typically left to states.

Under U.C.C. sections 9-307(1) and 9-306(2), the secured lender

83. Id. § 1324.
84. Id.
85. See supra note 21.
who does not authorize the sale can successfully sue the buyer in conversion when the farmer sells farm products and does not remit the proceeds of the sale to the lender. Consequently, upon default of the debtor, the buyer must pay twice. In many states, commission merchants are also liable in this situation.

One of the strongest arguments justifying federal involvement is the nonuniformity of state treatment of the sale of farm products subject to a perfected security interest. However, the promulgated statute does not even mention uniformity; instead, it states in section 1324(a) that purchasers' exposure to double payment constitutes a burden and obstruction to interstate commerce in farm products, and section 1324 is intended to eliminate this burden.

The major purpose of section 1324 is to protect both commission merchants selling farm products subject to perfected security interests and buyers of farm products subject to perfected security interests. The Act permits individual states to choose by December 24, 1986 between two alternative methods of dealing with the sale of farm products subject to a perfected security interest. It provides that buyers buy free of a perfected security interest unless the buyer receives written notice from the lender or the seller, or, in the alternative, the state adopts a new and different central filing system in which the Secretary of State will provide those who register or request it with financing statement information. Congress apparently hoped to simplify the law and make it uniform. It appears Congress failed.

a. Definitions

(1) Buyer in the Ordinary Course

The new legislation is replete with U.C.C. terminology. Yet, in most instances, Congress prescribed different meanings. Two examples are "buyer in the ordinary course" and "farm products." Congress defined a buyer in the ordinary course to be: "A person who in the ordinary course of business buys from a person engaged in farming operations who is in the business of selling farm products." Thus, any one buying from a farmer, such as a feedlot buying grain, a processor buying commodities, or a packer buying livestock, is a buyer in the ordinary course. A farmer buying feeder cattle from a rancher in the cow-calf business also seems to be a buyer, but what about the farmer who buys from a commission merchant or from a person who is only in the business of selling cattle, not fattening them? The key question becomes whether the goods are farm products.

86. Food Security Act, supra note 82, §§ 1324(j), 1324(e)(1), (2).
87. Id. § 1324(c)(1).
The U.C.C. definition's of buyer in the ordinary course is: "A person who in good faith and without knowledge that a sale to him is in violation of the ownership rights or security interest of a third party . . . "88 In the federal definition, knowledge of a security interest is not mentioned. The knowledge requirement of the U.C.C. definition, however, is seemingly incorporated in Congress' section 1324(d), which states:

Except as is provided in subsection (e) [notice alternatives] and notwithstanding any other provision of Federal, State or local law, a buyer who in the ordinary course of business who buys a farm product from a seller engaged in farming operations shall take free of a security interest created by the seller even though the security interest is perfected; and the buyer knows of its existence.90

Under both statutory schemes, knowledge is defined to be actual knowledge.90 Subsection (d), with the exception of the beginning clause, is similar to U.C.C. section 9-307(1), which states:

A buyer in ordinary course of business [subsection (9) of section 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.

Comment 2 to U.C.C. section 9-307(1) explains the U.C.C.'s approach to knowledge of a perfected security interest when it provides:

The buyer in ordinary course of business is defined as one who buys "in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party." This section [9-307(1)] provides that such a buyer takes free of a security interest, even though perfected, and although he knows the security interest exists. Reading the two provision together [1-201(9) and 9-307(1)], it results that the buyer takes free if he merely knows that there is a security interest which covers the goods but takes subject if he knows, in addition, that the sale is in violation of some term in the security agreement not waived by the words or conduct of the secured party.91

Congress apparently chose a different approach in that buyers will take free under the lender notice alternative of subsection (e) if the buyer "received" written notices from the lender or seller,92 or, under alternative two, if seller "receives" notice of the security interest from the secretary of state.93 By negative implication, it seems that a buyer who has actual knowledge that the sale of the farm products is in

88. U.C.C. § 1-201(9) (1978).
89. Food Security Act, supra note 82, § 1324(d). Commission merchants are treated the same as buyers. Id. § 1324(g).
90. U.C.C. § 1-201(25); Food Security Act, supra note 82, § 1324(e)(6).
91. U.C.C. § 9-307(1) comment 2.
92. Food Security Act, supra note 82, § 1324(e)(1)(A) (emphasis added).
93. Id. § 1324(e)(3)(A).
violation of a specific term in a security agreement would still take free of the security interest unless the buyer has received the type of notice required under subsection (e). Thus, a significantly different definition is used. Finally, what constitutes receipt is left to the law of the state where the buyer resides. 94 Ironically, Congress left this to state law even though one of the major reasons for federal legislation is to provide a uniform rule concerning the sale of farm products.

(2) Farm Products

Congress defined farm products in a slightly different manner from the manner in which the U.C.C. does in section 9-103(3). Congress’ definition provides:

An agricultural commodity such as wheat, corn, soybeans, or a species of livestock such as cattle, hogs, sheep, horses, or poultry used or produced in farming operations, or a product of such crop or livestock in its unmanufactured state (such as ginned cotton, wool-clip, maple syrup, milk, eggs), that is in the possession of a person engaged in farming operations. 95

This definition has three parts: (1) the goods must be crops or livestock or supplies used or produced in farming operations or . . . a product of crops or livestock in their unmanufactured states; (2) the goods must be in the possession of a person; (3) this person must be “engaged in farming operations.” These requirements are not self-defining, particularly “possession” and “farming operations.” 96 Remember, if the goods are not farm products, they will be inventory and the buyer is not subject to this rule and will take free of any security interest. Accordingly, the literature concerning the definition of farm products under the U.C.C. is relevant. 97 Yet, if any state definition of farm products deviates from this definition, the federal rule controls. For example, Kansas’ version of section 9-307(1) exempts milk, cream and eggs from the coverage of the farm products rule. 98 Under either alternative, lenders taking security interests in milk, eggs, and cream would appear to have more protection under section 1324 than they presently do under state law.

b. Buyer notice of security interests: two alternatives

The general rule provides, except as provided in subsection (e), that a buyer of farm products takes free of a perfected security in-

94. Id. § 1324(f).
95. Id.
96. If the goods are not farm products, they are inventory [U.C.C. § 9-109(4) (1983)], and the buyer in ordinary course takes free of a perfected security interest.

terest created by his seller even though the buyer knows of its existence and state law provides otherwise. Had Congress stopped with a simple repeal of the farm products rule, farm products would have been simply treated like inventory. However, Congress added subsection (e), which apparently represents Congress' attempt to satisfy its various constituents or the strong bank and buyers' lobbies.

Under subsection (e), a buyer of farm products takes subject to a security interest created by the seller if appropriate notice was received from the lender or seller or, if the state has a central filing system, the buyer has received the appropriate notice from the secretary of state. Notably, subsection (e) uses the term "secured party," rather than "perfected secured party. To be sure, subsection (d) refers to a perfected security interest; subsection (e) is an exception to it. The importance of the omission is that an unperfected secured party could arguably win against a buyer who received the appropriate notice. The result would normally be different under the U.C.C.\textsuperscript{99} If there is a conflict between the U.C.C. and section 1324, section 1324 controls because it purports to preempt state law dealing with sales of farm products.

Except the determination of what constitutes receipt of notice and when a state opting for the "central filing system" must distribute the notice, Congress has preempted the states from legislating in this area. Congress clearly has the power under the commerce clause of the Constitution to legislate in this area. Moreover, Congress made clear it intended to preempt state action, which it has the power to do under the supremacy clause of the Constitution. Consequently, states cannot attempt to require more in the way of protection for buyers or lenders in this area.\textsuperscript{100} States must adopt one of the notice alternatives of section 1324.

An issue related to preemption is whether the state or federal courts will interpret the law. Under the statute, the states can only choose: (1) between notice alternatives developed in detail by Congress; (2) what constitutes receipt; and (3) if the "central filing system" is chosen, what constitutes regular distribution of the list of lenders by the secretary of state. Also, Congress directed the Secretary of Agriculture to promulgate regulations. Arguably the law is federal. In that event, all actions relating to the law would be brought in a federal court. The issue of when and whether Congress may preempt the states and yet require them to apply and interpret laws developed by Congress is beyond the scope of this paper.\textsuperscript{101}

\textsuperscript{101} See supra note 100 and accompanying text.
(1) Notice Provided by the Lender or Seller

As indicated, the states have a choice of two notice systems and must choose by December 24, 1986. The first system provides that if the buyer receives, within one year before the sale, a proper written notice from the lender or seller and the buyer does not comply with payment instructions in the notice, the buyer takes subject to a perfected security interest in farm products created by the seller.

The lender must provide the notice to the buyer. How does the lender know which buyer must be notified? This alternative provides that the secured party may require a debtor granting a security interest in farm products to provide a list of buyers which will be incorporated into the security agreement.\textsuperscript{102} If the debtor sells to an unlisted buyer and neither notifies the lender seven days before the sale nor remits the proceeds within ten days after the improper sale, the farmer shall be fined $5,000 or fifteen percent of the value of the farm products, whichever is greater.\textsuperscript{103} Congress chose to rely on farmers to supply the list of potential buyers, assuming that the threat of a fine would produce an accurate and complete list of possible buyers. It seems unrealistic that a financially strapped farmer, who believes that all he needs is some time and is inclined to do some double dealing to gain the time, will be deterred from selling to someone not on the list. Congress also seems to have made the farmer’s noncompliance a federal crime in that the term “fine” is used, rather than using the term “civil penalty.”\textsuperscript{104} An interesting criminal procedure question may be raised in some states where it is a state crime when a farmer sells, without permission, farm products subject to a security interest and does not remit the proceeds. It also could provide problems for lenders trying to determine the status of their collateral since the farmer could refuse to talk, relying on the fifth amendment of the United States Constitution.

Certainly, lenders operating under this alternative will be concerned about the farmer’s selling to unlisted buyers, because this sale makes the lender an unsecured creditor whose only remedy is to sue the farmer, who will probably be judgment-proof. This could potentially require bank examiners to take the position that loans relying solely on farm products are unsecured loans. Accordingly, lenders will consider ways to protect themselves. One possibility is to notify all potential buyers in the state and any in adjoining states that have adopted the lender notice alternative. This does not seem to be prohibited by section

\textsuperscript{102} See Food Security Act, supra note 82, § 1324(h).
\textsuperscript{103} Id.
\textsuperscript{104} Most Federal regulatory schemes differentiate between criminal penalties and civil penalties by delineating criminal penalties as fines, E.g., 42 U.S.C. § 7413(c) (1982) (fines) and § 7413(b) (civil penalty).
1324. There is no language restricting notice to buyers supplied by the debtor. Subsection (e) simply refers to a buyer; there is no limitation in subsection (h) that authorizes the secured party to require the list. Thus, it seems that the lender can blanket buyers with the appropriate written notice.

Lenders must then determine who is a "buyer." While "buyer in ordinary course" is defined, "buyer" is not. However, it seems clear that Congress intended the buyer to be one buying farm products. Thus, buyers will include not only ordinary commercial buyers who buy from a debtor selling farm products,\(^{105}\) but also buyers such as feedlots and farmers who buy from other farmers or ranchers.

Congress required lenders to send an original or copy of the notice. This raises the question of whether a lender can send a large computer printout of all borrowers and attach the necessary notice with the appropriate information. If a multiple borrower list is possible, it is unclear how the debtors' names (individual and business) are to appear. While Congress was specific as to what the Secretary of State must supply to buyers under the "central filing system" alternative, no reference is made to any specific order, such as alphabetical, by name, by social security number, by county, or by crop year. Also, it is unclear whether a separate notice is required for each farm product even if the same borrower is involved.\(^{106}\) It seems buyers would want an organized list instead of a large number of single notices. In any event, buyers will be receiving notices from many different lenders because many different lenders are taking security interests in farm products. Undoubtedly, this will create much more paperwork for buyers. Interesting questions concerning whether the seller received the notice will inevitably arise. The new law implies that the burden is on the seller to establish orderly record-keeping of the notices. Yet, what constitutes receipt is left to state law.\(^{107}\)

The statute does define what constitutes a written notice. It must either be an original or a reproduced copy and must contain: (1) the names and addresses of the secured party and the debtor; (2) the social security number or, in certain specified situation, the debtor's IRS taxpayer identification number; (3) a description of the secured farm products "including the amount of such products where applicable, crop year, county or parish, and a reasonable description of the property"; and (4) "any payment obligations imposed on the buyer by

\(^{105}\) See supra text accompanying notes 12-14.

\(^{106}\) Food Security Act, supra note 82, § 1324(e)(1)(A) states, "A buyer of farm products takes subject to a security interest created by the seller if within 1 year before the sale of the farm products, the buyer has received written notice of the security interest organized according to farm products . . . ." (other alternative provisions omitted).

\(^{107}\) Id. § 1324(f), (g)(3).
the secured party as conditions for waiver or release of the security interest."

Because the description requirement of the notice is not self-defining, a number of potential issues are raised. For example, can the notice simply say "all farm products now being produced or hereafter to be produced" by the debtor? Or must the notice specifically identify the type of farm product? Congress seems to have required a specific list when it required "a description of the farm products." Thus, a description of "all farm products of whatever kind" may well be inadequate. Congress was clearly trying to assure that sellers can easily tell what is subject to a security interest. This is yet another area in which litigation is likely. When must the amount of the products be included and what does "amount" mean? Does it mean number of animals, acres of land planted, or number of bushels, to name a few possibilities? Are the "county" description and "reasonable description of the property" requirements satisfied by describing where the farm products are growing or located, or where the debtor resides? In many instances the debtor's residence will not be located in the county where the animals or crops are growing or located. The reasonable description of the property requirement appears to require a nonlegal real estate description. This surely will produce litigation.

If an erroneous legal description is in the notice, the description would appear to be defective because the land involved could never be identified. One has to assume "reasonable description" meant that the land could be identified. This requirement applies to livestock as well as crops. This is not the case under the U.C.C. There is no specific minor error rule such as in the U.C.C.

Other uncertainties exist under the Food Security Act regarding when the notice ceases to be effective. Section 1324(e)(1)(A)(iii) provides that the notice "must be amended in writing, within 3 months, similarly signed and transmitted, to reflect material changes." It is unclear when the three month time period begins to run. Apparently, it is triggered when a material change occurs. Yet, material change is not defined. Does it mean a change in the name or address of the debtor, or in the number of animals, or when the farmer starts raising wheat instead of milo? Also, the "similarly signed" language only produces the question, "Signed similarly to what?"

108. Id. § 1324(e)(1)(A)(i), (ii), (v).
110. The real estate description requirement for a security interest in growing crops has been much litigated. See, e.g., United States v. Oakley, 483 F. Supp. 762 (E.D. Ark. 1980); First Nat'l Bank v. Francis, 342 N.W.2d 468 (Iowa 1984).
111. U.C.C. §§ 9-203(1), 9-402(1) (1978) description of real estate required only for crops or timber).
112. See Id. § 9-402(8). But see infra note 119 and accompanying text.
Another confusing area concerns the provision in subsection 1324(e)(1)(A)(iv), which states that the notice “will lapse on either the expiration period of the statement or the transmission of a notice signed by the secured party that the statement has lapsed, whichever occurs first.” The only reference in section 1324 to a time period dealing with the lender-seller notice alternative is in subsection (e)(1)(A), which states that a buyer takes subject to a security interest if “within 1 year before the sale” the buyer receives proper notice. While the date of the statement is relevant, the sale date is the benchmark date. Consider this situation: Farmer gives a perfected security interest in his 1987 crop and Lender gives the appropriate written notice in April 1987 to Elevator, directing Elevator to issue a joint payee check. Farmer harvests the 1987 crop in October and stores at Elevator. Farmer sells the crop in June 1988 to Elevator. Elevator issues a single payee check and Farmer does not pay Lender and defaults. Does Elevator take subject to Lender’s interest and have to pay twice? The answer appears to be no. Since notice was not received within one year of the sale, Lender will either have to issue a new notice after one year, force Farmer to repay the loan, or require Buyer to sell the grain within one year, which raises control problems. Because Congress limited the effectiveness of notice to one year, this must be considered the expiration of the statement.

Clearly, the notice alternative creates a number of problems. Conceivably, some of the uncertainties can be clarified by the regulations that the Secretary of the United States Department of Agriculture must issue by the middle of March 1986.

(2) Notice Provided to Buyers by Secretary of State

The second option available to states is the adoption of the so-called “central filing system.” While this term is similar to central filing perfection requirements for security interests in farm products under some states’ versions of the U.C.C., Congress never intended this system to be a perfection system under the U.C.C. Rather, it relates only to the perfected, secured creditor’s priority battle against buyers and commission merchants.

The term “central filing system” is defined in section 1324(c)(2) 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 the United States Department of Agriculture.” Another new term is “effective financing statement.”


114. See Food Security Act, supra note 82, § 1324(i) (requiring the regulations within 90 days of the enactment of the Act).
It means a statement that is an original or reproduced copy that contains the addresses of the secured party and the debtor and is signed by both, the debtor’s social security number or IRS taxpayer identification number, and a description of the secured farm products.\textsuperscript{115} The description requirement is the same as that required in the lender notice alternative. Recall that the lender notice is good only if received by the buyer within one year before sale.\textsuperscript{116} The “effective financing statement” is valid for five years and can be continued within six months of expiration.\textsuperscript{117} While this is similar to U.C.C. section 9-403(3), Congress did not state who must sign the continuation statement or what it must include. U.C.C. section 9-403 permits filing by the secured party and requires only his signature. With regard to signatures, the federal requirement of dual signatures in the “effective financing statement” is at odds with the 1972 version of the U.C.C., adopted in at least forty-two states, which requires only the secured party’s signature on the security agreement and the financing statement.

The “effective financing statement” must be amended within three months of any material changes.\textsuperscript{118} Again, Congress never stated who must sign the amendment. Congress did adopt a minor error rule patterned after U.C.C. section 9-402(8).\textsuperscript{119} No provision exists, however, for filing an “effective financing statement” in another state if the debtor moves the farm products or it becomes apparent the debtor will sell the farm products in another state. If the new state had the “central filing system,” an “effective financing statement” apparently could not be filed unless the debtor signs it. Under U.C.C. section 9-402(2) a debtor need not amend the financing statement when farm products subject to a perfected security interest are moved to another state. The rationale, either ignored or rejected by Congress, is that time may be of the essence and a farmer trying to avoid a joint payee check will probably be uncooperative.

Upon the filing of an effective financing statement the Secretary of State must do a number of things. A master list must be maintained. It must be organized according to each different farm product, and each farm product is to be organized alphabetically by the last name of the individual debtors or by the first word of the name of nonindividual debtors, numerically by social security number or taxpayer identification number, geographically (county or parish), and by crop year.\textsuperscript{120}

\textsuperscript{115} Id. § 1324(c)(4).
\textsuperscript{116} See supra text accompanying note 113.
\textsuperscript{117} Food Security Act, supra note 82, § 1324(c)(4)(F).
\textsuperscript{118} Id. § 1324(c)(4)(E).
\textsuperscript{119} Id. § 1324(c)(4)(I).
\textsuperscript{120} Id. § 1324(c)(2)(C) (emphasis added).
The Secretary of State is also required to maintain a list of all buyers of farm products and commission merchants who register with the office by filing an appropriate form which must include: (1) the name and address of the buyer, commission merchant, or selling agent; (2) the interest it has in receiving notice of filed effective financing statements; and (3) the farm products in which it has an interest. Written notice of those farm products which are noted on the form filed by the buyer or commission merchant or selling agent. Interestingly, Congress left the definition of “regularly” to each state’s discretion, apparently not placing a premium on the value of uniformity. Finally, the Secretary of State is required to supply to those buyers, commission merchants, and selling agents who have not registered “oral confirmation within 24 hours of any effective financing statement on request followed by written confirmation to any buyer.” This provision is vague. No mention is made of the buyer who registers. Does this mean that the buyer who has registered cannot obtain the information within 24 hours, but must wait until the regular report comes from the Secretary of State? Or does it mean that a registered buyer would be entitled to the information immediately upon request? Arguably, allowing states to define “regularly” would permit states to create an access system, including telephone or computer access. Yet, requiring the Secretary of State to supply to those on the buyer’s list “a copy in written or printed form” of the relevant information on the master list raises a serious question concerning dissemination by electronic means. Moreover, Congress left it to the states to determine what constitutes receipt. Conceivably, a buyer could obtain the name of a lender over the phone, but not a written confirmation. Some states do have phone access for filed U.C.C. financing statements.

Neither the information that must be included in an effective financing statement nor the information required to be given to buyers by the Secretary refer to any payment obligations imposed on the buyer. This is in contrast with the lender notice alternative which provides that the written notice must include any description of the “payment obligations imposed on the buyer by the secured party as conditions for waiver or release of the security interest.” Thus, the buyer will apparently be required to contact the lender.

121. Id. § 1324(c)(2)(D).
122. Id. § 1324(c)(2)(E) (emphasis added).
123. Id. § 1324(c)(2)(F).
124. Id. § 1324(c)(2)(E).
125. Id.
126. Id. § 1324(f), (g)(3).
Section 1324(e)(2) provides that a buyer will take subject to a perfected security interest in a state establishing a "central filing system" if the buyer does not register (and never requests notice from the Secretary before the purchase) and the secured party has filed an "effective financing statement" covering the farm products sold.\textsuperscript{127} Furthermore, subsection (e)(3) provides that a buyer who has registered and received a regular report concerning an effective filed financing statement will take subject to a security interest if it "does not secure a waiver or release of the security interest specified in such effective financing statement or notice from the secured party by performing any payment obligation or otherwise."\textsuperscript{128} This is also the case for the buyer who does not register but requests and receives notice from the Secretary of State.\textsuperscript{129} Remember the information supplied to the buyer is not required under the "central notice system" to include the lender payment instructions.

The statutory language clearly does not effectively deal with a number of questions. Conceivably, the regulations which the Secretary of the United States Department of Agriculture must promulgate in March 1986 could settle many issues.

c. Why choose the "central filing system"?

Lenders may desire the central filing alternative because, at least under this system, lenders will face less exposure to loss than they will under the lender notice system where their knowledge of buyers is dependent upon the farmer supplying the information. Furthermore, buyers will prefer the central filing alternative since a list from the Secretary of State is preferable to being deluged with numerous lists of farmers from a variety of lenders, each seeking to provide legal notice to every conceivable buyer of their debtors' products. The central filing system also provides the best protection to lenders concerned about farmers selling farm products in other states. Once the lender files the "effective financing statement" in the new state, it shifts the burden of protection to the buyer.

The central filing system does, however, raise some problems. The system will be costly and complex. Also, because it uses U.C.C. terms of art, any congressionally intended deviation will cause confusion. Moreover, the system will require multiple filing systems in every state, regardless of whether the state has local or central filing for the perfection of security interests in farm products. When central filing is used,

\textsuperscript{127} Id. § 1324(e)(1)(A)(v).
\textsuperscript{128} Id. § 1324(e)(2)(A). The bracketed language does not appear in the statute but must have been considered implicit when the priority rules of § 1324(e)(3)(A) & (B) were considered.
\textsuperscript{129} Id. § 1324(e)(3)(A), (B).
the Secretary of State must maintain three sets of files: (1) U.C.C.-1’s; (2) master lists that must be divided into sublists dealing with individual farm products, debtor’s names, social security or tax identification numbers, geographical locations, and crop year; and 3) a buyer and commission merchant list. The Secretary must also erect a system for supplying the required information. In a state requiring local filing for farm products, the Secretary must maintain two filing systems.

d. Impact

The federal change will affect all states, regardless of whether the state has changed its U.C.C. farm products rule. States having the uniform rule may well have an easier time dealing with the preemption than those states that have changed the rule. Those states using an amended farm products rule must not only defer to federal political judgment, but be forced to dismantle an existing complicated notice system or assure that the system can adapt to the federal system. In any event, the change will surely open old political wounds as the states scramble to make changes by December 1986.

California, which abolished its farm product rule in 1976, will be especially disconcerted. The lender notice alternative legitimizes asking borrowers for lists of sellers and sending the notice to all buyers. This may disrupt life for both buyers and lenders. Many California lenders, under current law, have been quite successful in requiring the borrower to secure a committed buyer of its products before making a loan. Moreover, lenders obtain from the farmer a written assignment of the crop proceeds, which authorizes the buyer to make direct payments to the lender. Normally, the lender forwards the crop assignment to the buyer who acknowledges it and agrees to send the crop proceeds directly to the lender in an amount stipulated in the assignment. Whether buyers will be as cooperative in view of the federal change remains unclear.

Non-U.C.C. state laws dealing with sales of farm products will also be changed. For example, in many states, buyers of crops produced on rented land have been subject to unpaid landlords who have a landlord’s lien under state law. Landlord liens are excluded from U.C.C. coverage under section 9-104(b). Some states, either by statute,130 or by case law,131 have also subjected the buyer to a landlord’s claim. Congress reversed this rule as well when it provided in section 1324(d): “Except as provided in subsection (e) and notwithstanding any other provision of Federal, State, or local law . . . .”132 If this

132. Food Security Act, supra note 82, § 1324(d).
VI. Conclusion

This author opposes federal legislation concerning the sale of farm products. Since Congress felt compelled to act, it should have required all states to adopt the "central filing system." This method would at least create a uniform site to file and seek information in every state. Still, this system needs some substantial refining. Hopefully, the regulations issued by the Secretary of Agriculture will provide some clarity to the present vagaries.