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## **An Agricultural Law Research Article**

### **Farm Products Lending and Oklahoma's New Article IX –A Practical Analysis**

by

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# FARM PRODUCTS LENDING AND OKLAHOMA'S NEW ARTICLE IX — A PRACTICAL ANALYSIS

TIPTON F. McCUBBINS\*

## INTRODUCTION

Until recently, the Uniform Commercial Code (UCC)<sup>1</sup> provided lenders in farm products<sup>2</sup> a special protected status not afforded other secured lenders in inventory. Persons who purchased inventory<sup>3</sup> in the ordinary course of business<sup>4</sup> took free of any security interest in the inventory.<sup>5</sup> This was true even if the purchaser was aware of the security interest.<sup>6</sup> However, under the U.C.C., farm products were not classified as inventory.<sup>7</sup> Any purchaser of a farm product was subject to all perfected security interests in the inventory. This was true even though the purchaser had no actual knowledge of the security interest and even if he had no feasible way of discovering the existence of the security interest.<sup>8</sup>

Therefore, if the farmer defaulted on the initial loan, the secured party simply looked to the purchaser of the farm product for repayment. This had the practical effect of frequently requiring the purchaser to pay twice for the products.<sup>9</sup> That is, the purchaser paid the farmer who produced the goods and paid a second time to the secured party who loaned money to the farmer.

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1. OKLA. STAT. tit. 12A, § 9-307(1) (1981).

2. OKLA. STAT. tit. 12A, § 9-109(3) (1981).

3. OKLA. STAT. tit. 12A, § 9-109(4) (1981).

4. OKLA. STAT. tit. 12A, § 1-201(9) (1981).

5. OKLA. STAT. tit. 12A, § 9-307 (1981).

6. *Id.*

7. OKLA. STAT. tit. 12A, § 9-109(3) (1981).

8. OKLA. STAT. tit. 12A, § 9-307 (1981). *See also* 7 U.S.C. § 1631(a)(1) (Supp. IV 1986). *See Richards, Federal Preemption of the U.C.C. Farm Products Exception: Buyers Must Still Beware*, 15 STETSON L. REV. 371 (1986).

9. 7 U.S.C. § 1631(a)(2) (Supp. IV 1986).

In December 1985, the United States Congress enacted the Food Securities Act of 1985.<sup>10</sup> In May 1987, the Oklahoma legislature passed Oklahoma Statute title 12A, section 9-307<sup>11</sup> in an effort to comply with the requirements of the Act. The United States Secretary of Agriculture certified the Oklahoma legislation as meeting federal requirements in January 1988.<sup>12</sup> At the time this article was written, implementation of the Oklahoma legislation was pending.<sup>13</sup>

There are two primary functions of the federal legislation (section 1631). The first is to remove the specially protected status enjoyed by lenders in farm products.<sup>14</sup> The second is to reassign part of the risk of loss resulting from a farmer's default from the purchaser to the secured party.<sup>15</sup> This should create a commercial climate for farm products somewhat like that which exists with respect to other types of inventory.<sup>16</sup>

10. Section 1324 of the Food Securities Act is codified at 7 U.S.C. § 1631.

11. OKLA. STAT. tit. 12A, § 9-307 (Supp. 1987). *See also* OKLA. STAT. tit. 12A, §§ 9-401(2), 9-403(5) (Supp. 1987); OKLA. STAT. tit. 28, § 111(4)-(9) (Supp. 1987); OKLA. STAT. tit. 51, § 155(28) (Supp. 1987).

12. The Daily Oklahoman, Jan. 7, 1988, at 18 col. 1. Approval of a state's legislation is required before a state's system can become effective. 7 U.S.C. § 1631(c)(2) (Supp. IV 1986).

13. *See* OKLA. STAT. tit. 12A, § 9-307.6(1) (1987).

14. 7 U.S.C. § 1631(a), (b) (Supp. IV 1986). "Farm products" are defined by 7 U.S.C. § 1631(c)(5) (Supp. IV 1986) and OKLA. STAT. tit. 12A, § 9-307.2(1)(e) (Supp. 1987) as:

[A]n 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, and eggs), that is in the possession of a person engaged in farming operations.

Court decisions under U.C.C. § 9-307(1) (1978) regarding the definition of "farm products" will continue to apply to the extent that they do not conflict with the above definition. 9 C.F.R. § 205.211 (1988). Compare OKLA. STAT. tit. 12A, § 9-109(3) (1981). Section 9-109(3) sets out the definition of "farm products" prior to the enactment of section 1631. Section 9-109(3) still applies to sections other than section 9-307.

15. 7 U.S.C. § 1631(d), (g)(1) (Supp. IV 1986). *See also* 131 CONG. REC. S 16296-16300 (daily ed. Nov. 22, 1985) [hereinafter CONG. REC. S 16296] and 131 CONG. REC. H 12499, 12523-176 (daily ed. Dec. 18, 1985).

16. 7 U.S.C. § 1631(a), (b) (Supp. IV 1986).

To obtain the above stated goals, section 1631 preempts<sup>17</sup> all previously existing law regarding the effect of perfected security interests<sup>18</sup> upon buyers<sup>19</sup> of farm products.<sup>20</sup> Section 1631 also affects the rights of commission merchants<sup>21</sup> and selling agents<sup>22</sup> who, in the ordinary course of their business, sell farm products for people engaged in farming operations.<sup>23</sup> Federal and Oklahoma laws treat buyers, commission merchants, and selling agents similarly.<sup>24</sup> Therefore, this arti-

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17. 7 U.S.C. § 1631(d), (g) (Supp. IV 1986). See also CONG. REC. S 16296, *supra* note 14, at S 16298; and *House Committee Report* on Pub. L. No. 99-198, No. 99-271, Part 1, Sept. 13, 1985, at 118.

18. 7 U.S.C. § 1631(c)(7) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.2(1)(h) (Supp. 1987) define a security interest as "an interest in farm products that secures payment or performance of an obligation." Cf. OKLA. STAT. tit. 12A, § 1-201(37) (1981). See also 9 C.F.R. § 205.212 (1988).

19. 7 U.S.C. § 1631(c)(1) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.2(1)(a) (Supp. 1987) defines a "buyer in the ordinary course of business" as one "who, in the ordinary course of business, buys farm products from a person engaged in farming operations who is in the business of selling farm products." Cf. OKLA. STAT. tit. 12A, § 1-201(9) (1981). See also 9 C.F.R. § 205.212 (1988). The above definition poses an extremely interesting question. Subsections 1631(c) and 9-307.2 define most of the important terms used in the acts. However, the phrase "buyer in the ordinary course of business" is not used at any place in either act other than the cited definition subsections. At all other places, the unqualified term "buyer" is used. The unqualified term "buyer" is not defined at any point in either act. Are we to assume that the term "buyer" refers to "buyer in the ordinary course of business" in the definition section? If so, the legislation would not apply to the casual buyer. Nothing in either act or in the regulations proposes this limitation. But if this limitation is not intended, why is only a "buyer in the ordinary course of business" defined? On the other hand, the unqualified terms "commission merchant" and "selling agent" are limited by their definition as applying only to those who deal in the ordinary course of business.

20. 7 U.S.C. § 1631(d) (Supp. IV 1986).

21. 7 U.S.C. § 1631(c)(3) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.2(1)(c) (Supp. 1987). Both these provisions define a "commission merchant" as one who is "in the business of receiving any farm products for sale, on commission, or for or on behalf of another person."

22. 7 U.S.C. § 1631(c)(8) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.2(1)(i) (Supp. 1987) define a "selling agent" as one who is in the business of negotiating the sale and purchase of any farm product on behalf of a person engaged in farming operations.

23. Neither 7 U.S.C. § 1631 (Supp. IV 1986) nor OKLA. STAT. tit. 12A, § 9-307 (Supp. 1987) define "farming operations." Therefore, prior court decisions under section 9-307 of the U.C.C. should continue to be applicable. 9 C.F.R. § 205.211(a) (1988).

24. 7 U.S.C. § 1631(d), (e), (g) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.4 (Supp. 1987); 9 C.F.R. § 205.210(c) (1988).

cle will include all three within the term "buyer" in order to facilitate discussion.<sup>25</sup>

Section 1631 of the Federal Code became effective December 23, 1986,<sup>26</sup> and immediately affected Oklahoma law by displacing Oklahoma Statute title 12A, section 9-307 (Supp. 1983) as it existed at that time.<sup>27</sup> The scope of section 1631 is, however, limited. First, section 1631 deals only with relationships between secured lenders and subsequent buyers, commission merchants, and selling agents. It does not deal with priorities among competing secured parties. Therefore, secured lenders must still comply with the filing requirements of section 9-307<sup>28</sup> in order to perfect their secured interest against subsequent lenders in the same collateral.

Second, section 1631 deals only with buyers who buy from debtors engaged in farming operations.<sup>29</sup> Therefore, if a debtor-farmer sells wheat to Buyer A, Buyer A may be protected by section 1631. But if Buyer A, a party not engaged in farming operations, resells that wheat to Buyer B, Buyer B did not buy a farm product from a party engaged in farm operations. Thus, he will not have the protection of section 1631. A lender whose security interest is not effective against Buyer A may still have a perfectly valid security interest against Buyer B. As a result, Buyer B may be required to forfeit the collateral or repay the loan if the farmer who originally borrowed the money and sold the wheat defaults.

Finally, section 1631 applies only to "farm products."<sup>30</sup> If the court determines that the collateral is not a farm product, section 1631 will have no effect on a secured creditor's remedy against the purchaser of the collateral.<sup>31</sup>

25. See 9 C.F.R. §§ 205.1(f), 205.104 (1988) for a similar treatment of the terms.

26. 7 U.S.C. § 1631(j) (Supp. IV 1986).

27. OKLA. STAT. tit. 12, § 9-307 (Supp. 1983). See *supra* note 16.

28. OKLA. STAT. tit. 12A, § 9-307.6(6) (Supp. 1987) actually requires that all secured creditors, including those perfecting under OKLA. STAT. tit. 12A, § 9-307 (Supp. 1987), must file a 9-401 finance statement.

29. The term "farming operations" has not been defined in the new legislation. Therefore, prior court decisions under Article IX which define "farming operations" should be applicable. 9 C.F.R. § 205.211(a) (1988).

30. 7 U.S.C. § 1631(d), (e), (g) (Supp. IV 1986); OKLA. STAT. tit. 12A, §§ 9-307.4, 9-307.6 (Supp. 1987).

31. See *supra* note 14, regarding the definition of "farm product."

The first part of this article describes the two notification systems allowed under the federal law and discusses how Oklahoma law departs from the federal mandate. The second major part discusses the risks and duties of the secured creditor, the buyer, and the debtor under the new legislation.

### THE SYSTEM

When analyzing the system by which a secured party may perfect a security interest, perhaps the most important point to remember is that the federal legislation contains not one, but two, separate<sup>32</sup> and distinct systems.<sup>33</sup> The system that applies to any given transaction is that adopted by the state in which the farm product, i.e. collateral, was produced.<sup>34</sup> If no state action has been taken to select either of the two federally mandated systems, the prenotification system is in effect.<sup>35</sup> A state may, of course, specifically select the prenotification system. On the other hand, if a state has elected not to remain under the prenotification system, a central filing system may be in effect.<sup>36</sup> However, even if a central filing system has been adopted by a state, the filing system will not be effective unless it fully complies with the federal legislation.<sup>37</sup>

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32. 7 U.S.C. § 1631(e), (g)(2) (Supp. IV 1986).

33. It is important to note that the two systems were intended to be mutually exclusive. The legislative history of the act clearly indicates that the states are intended to choose between two clear cut alternatives. CONG. REC. S 16296, *supra* note 15, at S 16300. See generally 9 C.F.R. § 205.208(f) (1988); Fry, *Buying Farm Products: The 1985 Farm Bill Changes the Rules of the Game*, 91 COM. L.J. 433 at 444-48 (1986) [hereinafter Fry]; Note, *Federal Legislation Provides Protection for Buyers of Farm Products: Food Security Act Supersedes the Farm Products Exception of U.C.C. Section 9-307(1)*, 47 U. PITT. L. REV. 749, at 751 (1986) [hereinafter Note, *Farm Products*].

34. 7 U.S.C. § 1631(e)(2), (3), (g)(2)(C), (D) (Supp. IV 1986); 9 C.F.R. § 205.210(a), (b) (1988). The state of production may or may not be the state of the loan. One problem which arises with this requirement is that no definition of the word "produced" is provided by either the statutes or the regulations. Is "produced" the original point of production of the farm product or some point of production in the hands of the borrower? For example: An eastern Oklahoma egg producer pledges his entire laying stock which was originally hatched in Arkansas. Is the state in which the "collateral (hens) is produced" Oklahoma or Arkansas? Unfortunately, no guidelines for answering this question currently exist. See also 9 C.F.R. §§ 205.103(a)(3), 205.105(a) (1988).

35. 7 U.S.C. § 1631(e), (g)(2) (Supp. IV 1986).

36. 7 U.S.C. § 1631(e) (Supp. 1985).

37. 7 U.S.C. § 1631(c)(2), (i) (Supp. 1985). 9 C.F.R. § 205.214 (1987).

If a state has a non-complying central filing system, the secured party must fulfill the requirements of the prenotification system to protect his security interest.<sup>38</sup>

Lenders, buyers, and farmers must be aware of the requirements of both systems regardless of which applies in their particular state. First, they must know how to proceed with respect to farm products produced in another state. Second they must be able to assess their risks in the event the filing system under which they are operating is held invalid. As will subsequently be shown, the latter is a very real risk.

### *The Prenotification System*

The first of the two systems permitted under federal legislation is the prenotification system.<sup>39</sup> Under the prenotification system, a lender in farm products may protect his security interest against the buyer of the collateral. To do this, he must send actual<sup>40</sup> written notification<sup>41</sup> of the security interest to the buyer of the collateral. The notice must be received<sup>42</sup> by the buyer within one year prior to his purchase.<sup>43</sup> In order for the secured party to know which potential buyers to notify of his interest, the secured party may require the debtor to provide a list of all potential buyers who may purchase the collateral.<sup>44</sup>

38. 7 U.S.C. § 1631(e)(2), (3), (g)(2)(C), (D) (Supp. IV 1986); 9 C.F.R. § 205.214 (1988).

39. 7 U.S.C. § 1631(e)(1), (g)(2)(A) (Supp. IV 1986). OKLA. STAT. tit. 12A, § 9-307.7 (Supp. 1987) provides for similar action by a lender to protect his interest in farm products produced in Oklahoma. See the section entitled "Oklahoma Variations" for potential problems associated with this provision.

40. 7 U.S.C. § 1631(c)(6) (Supp. IV 1988); OKLA. STAT. tit. 12A, § 9-307.2(f) (Supp. 1987).

41. 7 U.S.C. § 1631(e)(1), (g)(2)(A) (Supp. IV 1986). Cf. OKLA. STAT. tit. 12A, § 9-307.7 (Supp. 1987).

42. If the buyer resides in Oklahoma, receipt of the written notice is presumed if the notice is sent by certified mail. If the buyer resides outside of Oklahoma, the laws of the buyer's state of residence must be consulted to determine what constitutes receipt. 7 U.S.C. § 1631(f), (g)(3) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.7(3) (Supp. 1987).

43. 7 U.S.C. § 1631(e)(1), (g)(2)(A) (Supp. IV 1986). OKLA. STAT. tit. 12A, § 9-307.7(1) (Supp. 1987).

44. 7 U.S.C. § 1631(h) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.7(4) (Supp. 1987).

The notice must contain the name and address of the secured party,<sup>45</sup> and the name, address, and social security number of the debtor.<sup>46</sup> In addition, the notice must contain a specific description of the farm product subject to the security interest.<sup>47</sup> This description must include the quantity of the product subject to the security interest,<sup>48</sup> the crop year in which the product was produced,<sup>49</sup> and the place where it was produced.<sup>50</sup> Finally, the prenotification statement must con-

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45. 7 U.S.C. § 1631(e)(1)(A)(ii)(I), (g)(2)(A)(ii)(I) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.7(1)(b)(i) (Supp. 1987).

46. 7 U.S.C. § 1631(e)(1)(A)(ii)(II), III(g)(2)(A)(ii)(I), (III) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.7(1)(b)(ii), (iii) (Supp. 1987).

47. Based upon the amount of detail (note the requirements set out in the text) required by the statute, 7 U.S.C. § 1631(e)(1)(A)(ii)(IV), (g)(2)(A)(ii)(IV) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.7(1)(b)(iv) (Supp. 1987), it is clear that a very specific description of the property is envisioned by the drafters of the statute. This is quite unlike the general description of collateral required in finance statements covering non-farm goods under OKLA. STAT. tit. 12A, § 9-402 (1981). The Code of Federal Regulations states that the description is to be sufficiently precise to allow the buyer to identify which products are or are not subject to a security interest merely by examining the description without looking to outside information. 9 C.F.R. § 205.208 (1988). Actually, 9 C.F.R. § 205.208 (1988) applies directly only to information filed in central filing systems. However, the statutory language of the description requirement is the same for both prenotification and central filing systems and therefore 9 C.F.R. § 205.208 (1988) should apply by analogy to prenotification statements. Cf. 7 U.S.C. § 1631(c)(4)(D) (Supp. IV 1986). 9 C.F.R. § 205.206 (1988) contains a detailed list of farm product descriptions which have been approved for central filing systems. Presumably, the same classifications would be appropriate for prenotification statements.

48. 7 U.S.C. § 1631(e)(1)(A)(ii)(IV), (g)(2)(A)(ii)(IV) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.7(1)(b)(iv) (Supp. 1987). A statement of amount is required only if the secured party is claiming less than all of the debtor's particular farm product. However, if the secured party does not properly limit the amount of the farm product in which he claims an interest, his attempted notification will be invalid due to vagueness. Therefore, the secured party would not be protected with respect to any of the collateral. 9 C.F.R. § 205.207 (1988).

49. 7 U.S.C. § 1631(e)(1)(A)(ii)(IV), (g)(2)(A)(ii)(IV) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.7(1)(b)(iv) (Supp. 1987). For purposes of effective finance statements in states having adopted a central filing system, 9 C.F.R. § 205.107(a) (1988) defines the crop year as: "(1) For a crop grown in soil, the calendar year in which it is harvested or to be harvested; (2) For animals, the calendar year in which they are born or acquired; (3) For poultry or eggs, the calendar year in which they are sold or to be sold." Presumably, the courts will adopt a similar definition for prenotification statements.

50. 7 U.S.C. § 1631(e)(1)(A)(ii)(IV), (g)(2)(A)(ii)(IV) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.7(1)(b)(iv) (Supp. 1987). If the secured party is claiming an interest in all of the debtor's product produced in a given county, only the county of production need be identified. However, if the security interest covers only part of a

tain any payment obligations imposed by the lender upon the buyer.<sup>51</sup> The prenotification will be valid until one of the following occurs: the expiration of one year,<sup>52</sup> the expiration of the period set out in the statement, the payment of the underlying obligation, or the subsequent notification to the buyer by the secured party.<sup>53</sup>

In the event that the debtor and secured party materially alter<sup>54</sup> their agreement, a written amendment must be mailed to the potential buyer within three months.<sup>55</sup> It is further required that the amendment be "similarly signed."<sup>56</sup> Interestingly, there is no requirement that the initial prenotification statement be signed. Therefore, there is no antecedent to which "similarly signed" can refer. However, in states having

debtor's product in any given county, the notification must contain sufficient additional information to allow the buyer to determine which portion of the product is subject to the security interest. Failure to properly limit the amount of farm product claimed by properly stating the place of production would theoretically defeat the attempted prenotification due to vagueness. 9 C.F.R. §§ 205.103(a)(3), 205.207 (1988). The cited statutes actually refer only to "a reasonable description of the property." Whether this is the property where the collateral is located or the property where the farm product is produced is not absolutely clear. *See infra* note 79 for more on this subject.

51. 7 U.S.C. § 1631(e)(1)(A)(v), (g)(2)(A)(v) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.7(1)(e) (Supp. 1987). A common example of a payment obligation is a joint payee check issued by the buyer to both the debtor (farmer) and the secured party. Note, *Farm Products*, *supra* note 33, at 751.

52. 7 U.S.C. § 1631(e)(1)(A), (g)(2)(A) (Supp. 1985); OKLA. STAT. tit. 12A, § 9-307.7(1) (Supp. 1987).

53. 7 U.S.C. § 1631(e)(1)(A)(iv), (g)(2)(A)(iv) (Supp. 1985). *Cf.* OKLA. STAT. tit. 12A, § 9-307.7(1)(d) (Supp. 1987).

54. With respect to central filing systems, a "material change" is any change which would render previously supplied information no longer informative as to what is subject to the security interest in question. 9 C.F.R. § 205.209(a) (1988). By analogy this definition should also apply to prenotification statements.

55. 7 U.S.C. § 1631(e)(1)(A)(iii), (g)(2)(A)(iii) (Supp. IV 1986); 9 C.F.R. § 205.209(c) (1988). *Cf.* OKLA. STAT. tit. 12A, § 9-307.7(1)(c) which has a ten day requirement. To rationalize the validity of this time requirement is difficult. It seems that receipt of the amendment within a reasonable time prior to purchase would be a more valid requirement for prenotification systems. However, note the identical requirement for effective finance statements set out at 7 U.S.C. § 1631(c)(4)(E) (Supp. IV 1986). That the requirements for prenotification statements were intended to mirror those for effective finance statements is obvious. This certainly strengthens the argument for applying 9 C.F.R. §§ 205.1-205.214 (1988) to prenotification statements by analogy.

56. 7 U.S.C. § 1631(e)(1)(A)(iii), (g)(2)(A)(iii) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.7(1)(c) (Supp. 1987).

a central filing system, both the debtor and secured creditor must sign effective financing statements<sup>57</sup> and amendments to effective financing statements.<sup>58</sup> The "similarly signed" language logically refers to the signatures of those parties. Therefore, the prudent creditor should make certain that both the initial prenotification statement and all amendments are signed by the lender and the debtor.

### *The Central Filing System*

Section 1631 provides that a state may elect not to rely on the prenotification system and may adopt a central filing system.<sup>59</sup> From the legislative history of the act, it is clear that Congress intended that one system or the other be selected by a state.<sup>60</sup> With respect to any given farm product, the state, not the secured party, must select which means shall be used to perfect the lender's security interest.<sup>61</sup>

If a state opts for a central filing system, it will be maintained by the state's secretary of state.<sup>62</sup> The central filing system basically consists of two parts.<sup>63</sup> The first part is a true central filing system.<sup>64</sup> The second part is a central notification system.<sup>65</sup> With respect to the central filing portion of the

57. 7 U.S.C. § 1631(c)(4)(B), (C) (Supp. IV 1986); 9 C.F.R. § 205.209(c) (1988); OKLA. STAT. tit. 12A, § 9-307.2(1)(d)(ii), (iii) (Supp. 1987).

58. 7 U.S.C. § 1631(c)(4)(E) (Supp. IV 1986); 9 C.F.R. § 205.209(c) (1988); OKLA. STAT. tit. 12A, § 9-307.2(1)(d)(v) (Supp. 1987).

59. 7 U.S.C. § 1631(c)(2), (e)(2), (3), (g)(2)(C), (D) (Supp. IV 1986).

60. 131 CONG. REC. S 16296, *supra* note 15, at S 16300. *See generally* 9 C.F.R. § 205.208(f) (1988); Fry, *supra* note 33, at 444. Note, *Farm Products*, *supra* note 33 at 751.

61. It is possible for a state to set up only a partial central filing system. For example, central filing may be required for wheat, milo, and cattle, but not sugar beets, walnuts, or oranges. In such a situation, a lender taking a secured interest in the debtor's wheat is required to file centrally to protect his interest. But to protect his interest in the same debtor's walnuts, the same lender is required to notify potential buyers in advance. 9 C.F.R. § 205.206(c) (1988).

62. 7 U.S.C. § 1631(c)(2)(A) (Supp. 1985); 9 C.F.R. § 205.1(e) (1988); OKLA. STAT. tit. 12A, § 9-307.6(1) (Supp. 1987).

63. 7 U.S.C. § 1631(c)(2) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.6(4)(b), (c) (Supp. 1987).

64. 7 U.S.C. § 1631(c)(2)(A), (B), (C) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.6(4)(a)(b) (Supp. 1987).

65. 7 U.S.C. § 1631(c)(2)(D), (E), (F) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.6(4)(c)(d) (Supp. 1987).

system, the secretary of state must organize the system by individual types of farm products.<sup>66</sup> Within each farm product classification, the system must further be broken down four ways: 1) by alphabetical order of the debtor's name,<sup>67</sup> 2) by numerical order of the debtor's social security or taxpayer's identification number,<sup>68</sup> 3) by the county in which the farm product was produced,<sup>69</sup> and 4) by the crop year in which the farm product was produced.<sup>70</sup>

The secured party has the responsibility of filing an effective financing statement (EFS) with the secretary of state.<sup>71</sup> The EFS must contain the information necessary to put any potential buyer of the collateral on notice of the secured party's interest. More specifically, the EFS must be in writing;<sup>72</sup> must contain the social security or tax identification number of the debtor,<sup>73</sup> the name and address of both the debtor<sup>74</sup> and the secured creditor;<sup>75</sup> and must be signed by

66. 7 U.S.C. § 1631(c)(2)(C)(i) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.6(4)(b) (Supp. 1987). The various permissible types of farm product classifications are set out at 9 C.F.R. § 205.206 (1988). Miscellaneous categories are not permitted. 9 C.F.R. § 205.106 (1988).

67. 7 U.S.C. § 1631(c)(2)(C)(ii)(I) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.6(4)(b)(ii)(A) (Supp. 1987).

68. 7 U.S.C. § 1631(c)(2)(C)(ii)(II) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.6(4)(b)(ii)(B) (Supp. 1987).

69. 7 U.S.C. § 1631(c)(2)(C)(ii)(III) (Supp. IV 1986); 9 C.F.R. §§ 205.103(3), 205.105(a), 205.207(c) (1988); OKLA. STAT. tit. 12A, § 9-307.6(4)(b)(ii)(C) (Supp. 1987). See also the discussion at *infra* note 79.

70. 7 U.S.C. § 1631(c)(2)(C)(ii)(IV) (Supp. IV 1986). 9 C.F.R. § 205.107 (1988). A definition of crop year is set out, *supra* note 49.

71. 7 U.S.C. § 1631(c)(2)(A), (4)(B) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.2(1)(d)(ii) (Supp. 1987). In Oklahoma, a standard form developed by the State Auditor and Inspector will be available to assist in this task. OKLA. STAT. tit. 12A, § 9-307.3 (Supp. 1987).

72. The EFS must be a "paper document" since it must be signed. 9 C.F.R. § 205.202(b) (1988).

73. 7 U.S.C. § 1631(c)(4)(D)(iii) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.2(1)(d)(iv)(C) (Supp. 1978). The "debtor" is the person who owns the farm product subject to the security interest whether or not that person owes a debt to the secured party. 9 C.F.R. § 205.213(b) (1988).

74. 7 U.S.C. § 1631(c)(4)(D)(ii) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.2(1)(d)(iv)(B) (Supp. 1987).

75. 7 U.S.C. § 1631(c)(4)(D)(i) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.2(1)(iv)(A) (Supp. 1987).

both parties.<sup>76</sup> In addition, the EFS must contain a description of the collateral including the amount of the farm product pledged as security,<sup>77</sup> the crop year of the collateral,<sup>78</sup> and the county in which the collateral is produced.<sup>79</sup> In Oklahoma, a single EFS may include information relating to several products or counties.<sup>80</sup>

As stated above, the second part of the central filing system is really a central notification system. The secretary of state is required to maintain a list of all buyers of farm products registered with it.<sup>81</sup> At regular intervals (in Oklahoma at the end of each month)<sup>82</sup> the secretary of state must send a master list of all filed effective financing statements to these registered buyers.<sup>83</sup> The list of registered buyers is obtained when individual buyers file a standard form with the secretary

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76. 7 U.S.C. § 1631(c)(4)(B), (C) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.2(1)(ii), (iii) (Supp. 1987).

77. 7 U.S.C. § 1631(c)(4)(D)(iv) (Supp. IV 1986); 9 C.F.R. § 205.207 (1988); OKLA. STAT. tit. 12A, 9-307.2(1)(d)(iv)(D) (Supp. 1987). Note the discussion included in *supra* note 48.

78. 9 C.F.R. § 205.103(1) (1988); OKLA. STAT. tit. 12A, § 9-307.2(1)(d)(iv)(D) (Supp. 1988). See *supra* note 49 (definition of "crop year").

79. 7 U.S.C. § 1631(c)(4)(D)(iv) (Supp. IV 1986); 9 C.F.R. §§ 205.103(a)(3), 205.207 (1988); OKLA. STAT. tit. 12A, § 9-307.2(1)(d)(iv)(D) (Supp. 1987). The cited statutory subsections refer to the "county or parish in which the property is located" (emphasis added). The cited regulations just as clearly require the place where the property is "produced," not the place where the property is located. The position set out in the regulation is supported by 7 U.S.C. § 1631(e)(2), (3), (g)(2)(C), (D) (Supp. IV 1986) which require secured creditors to perfect under the laws of the state in which the farm products were "produced." This position is also supported by the fact that the central filing system for the state in which the collateral is produced will only provide filing classification for counties within that state. Therefore, if the collateral was produced in Oklahoma but is located in Kansas, it would be impossible for the Oklahoma Secretary of State to properly file the EFS by county if the county listed were the county of location, i.e., a county in Kansas. Are the regulations correct? Or did Congress intend this inconsistency? Only the courts can answer this question. See also 9 C.F.R. §§ 205.105(a), 205.210(b) (1988) for consistency within the regulations. See also *supra* note 34 (discussion regarding the definition of "produced"). For a discussion of when more detail than the county of production is necessary for a valid description of location, see *supra* note 50.

80. 9 C.F.R. § 205.103(C) (1988); OKLA. STAT. tit. 12A, § 9-307.2(1)(d) following "part" (ix) (Supp. 1987).

81. 7 U.S.C. § 1631(c)(2)(D) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.6(4)(c) (Supp. 1987).

82. OKLA. STAT. tit. 12A, § 9-307.6(4)(d) (Supp. 1987).

83. 7 U.S.C. § 1631(c)(2)(E) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.6(4)(d) (Supp. 1987).

of state.<sup>84</sup> The form includes the buyer's name and address, the farm products in which the buyer is interested, the counties of production in which the buyer is interested, and such other information as the state wishes to require.<sup>85</sup>

Upon receipt of the master list of filed effective financing statements the buyer becomes subject to security interests in the farm products for which he has registered.<sup>86</sup> A buyer is not subject to a security interest until he receives actual notice of the security interest through the secretary of state. Therefore, a gap always exists between the time that the secured party files the security interest and the time it in fact becomes effective. Under the federally mandated rules for central filing systems, this gap cannot be prevented.<sup>87</sup>

A buyer cannot escape liability by failing to register with the secretary of state or by registering for only some products or in some counties. In the first case, the buyer is liable for all those secured interests of which he would have obtained notice had he in fact registered.<sup>88</sup> In the second, the buyer is treated as unregistered for all products and counties for which he is not specifically registered.<sup>89</sup> That is, the buyer takes subject to properly filed effective financing statements even though he has no notice of them.

For the casual buyer<sup>90</sup> of farm products or for the buyer who only deals occasionally in certain products or products

84. 7 U.S.C. § 1631(c)(2)(D) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.6(4)(c) (Supp. 1987).

85. 7 U.S.C. § 1631(c)(2)(D) (Supp. IV 1986); 9 C.F.R. §§ 205.104, 205.208 (1988). Again, although the regulations are clear in emphasizing the county in which the product "is produced" as the important criterion, the statutes are less than definite. See *supra* note 79.

86. 7 U.S.C. § 1631(e)(3), (g)(2)(D) (Supp. IV 1986); 9 C.F.R. § 205.208(c) (1988); OKLA. STAT. tit. 12A, § 9-307.6(4)(d)(iii) (Supp. 1987).

87. 9 C.F.R. § 205.208(f) (1988).

88. 7 U.S.C. § 1631(e)(2), (g)(2)(C) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.4 (Supp. 1987).

89. 9 C.F.R. §§ 205.104(a)(3), (b), 205.208(e) (1988); OKLA. STAT. tit. 12A, § 9-307.6(4)(d)(ii) (Supp. 1987).

90. In fact a genuine question exists as to whether the casual buyer is subject to the provisions of section 1631. The definition's section of 1631 does not give a definition for the unqualified term "buyer." It only defines "buyer in the ordinary course of business." Throughout the remainder of section 1631 the term "buyer in the ordinary course of business" is never used. Only the unqualified term "buyer." The regulations do not shed any light on this inconsistency. With the exception of 9 C.F.R. § 205.212

produced in certain areas, the cost and inconvenience of maintaining a business system for all products and counties cannot be justified. Therefore, the central filing system provides that these individuals may receive notice of security interests affecting isolated transactions on an individual basis.<sup>91</sup> To receive notice the buyer need merely query, either orally or in writing, the secretary of state regarding a particular transaction.<sup>92</sup> The secretary of state then has a maximum of twenty-four hours to supply an oral confirmation as to whether an EFS exists which affects the transaction.<sup>93</sup> The oral confirmation must then be followed by a written confirmation.<sup>94</sup> In Oklahoma, the secretary of state has until the end of the business day following the date of the oral confirmation to provide the written confirmation.<sup>95</sup> If prior to purchase, the buyer properly registers with or inquires of the secretary of state and receives no notice of a filed security interest, the buyer may buy in complete confidence. Even if an EFS has been properly filed, the buyer takes free of the secured party's interest.<sup>96</sup>

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(1988) the regulations universally use the unqualified term "buyer." Section 205.212 merely cautions that the definition of "buyer in the ordinary course of business" as set out in 7 U.S.C. § 1631(c)(1) differs from the definition set out in the U.C.C. at OKLA. STAT. tit. 12A, § 1-201. On the other hand, the Oklahoma statute frequently uses the phrase "a buyer of farm products, commission merchant, or selling agent who purchases or sells farm products in the ordinary course of business . . . ." OKLA. STAT. tit. 12A, §§ 9-307.4, 9-307.5 (Supp. 1987).

Compare the different treatment of the unqualified terms "commission merchant" and "selling agent" whose definitions include the qualification that they be dealing as a part of their business. 7 U.S.C. § 1631(c)(3), (8) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.2(1)(c) (Supp. 1987).

91. 7 U.S.C. § 1631(c)(2)(F) (Supp. IV 1986). OKLA. STAT. tit. 12A, § 9-307.6(4)(f) (Supp. 1987).

92. To make inquiry, the buyer must provide the Secretary of State the name and social security number of the seller, the type of farm product, the county, and the crop year of interest. OKLA. STAT. tit. 12A, § 9-307.6(4)(f)(ii).

93. 7 U.S.C. § 1631(c)(2)(F) (Supp. IV 1986). OKLA. STAT. tit. 12A, § 9-307.6(4)(f) (Supp. 1987).

94. *Id.*

95. OKLA. STAT. tit. 12A, § 9-307.6(4)(f) (Supp. 1987).

96. 7 U.S.C. § 1631(e)(3)(A), (g)(2)(D)(i) (Supp. IV 1986). 9 C.F.R. § 205.208(c), (g) (1988).

*Oklahoma Variations*

It is apparent from the Oklahoma statute<sup>97</sup> that the Oklahoma legislature intended to follow the federal guidelines as laid down in section 1631. In general, the legislature succeeded in that aim. Nonetheless, there are several significant differences.

Undoubtedly, the greatest departure from the federal guidelines is the treatment of prenotification statements. Oklahoma has not observed the dichotomy between the prenotification and central filing systems set out above but has attempted instead to combine the two. Under the Oklahoma system, a prenotification statement may be mailed to prospective buyers only if the secured party has first filed an EFS with the secretary of state.<sup>98</sup> The prenotification statement is then effective only until the secretary of state's next distribution to registered buyers of the master list of effective finance statements.<sup>99</sup> The prenotification statement is, therefore, effective only until the last business day of the month in which the debtor signed the EFS.<sup>100</sup>

It is quite obvious that the purpose of prenotification in Oklahoma is limited to protecting the secured party between the time the loan is made and the next distribution of the master list. This provides protection for precisely that period unprotected by the federal statute. The Oklahoma provision provides an obvious advantage to both the lender and debtors. It aids the lender because there is no gap between the making of the loan and the distribution of the next master list. The borrower is benefited because credit will be evenly available throughout the period between distributions of the master list. Without access to this additional protection provided by the Oklahoma statute, lenders may tend to make loans only

97. OKLA. STAT. tit. 12A, § 9-307.1 *et seq.* (Supp. 1987).

98. OKLA. STAT. tit. 12A, § 9-307.7(2)(b) (Supp. 1987).

99. OKLA. STAT. tit. 12A, § 9-307.7(1)(d), (2)(a) (Supp. 1987).

100. OKLA. STAT. tit. 12A, §§ 9-307.6(4)(d), 9-307.7(1)(d), (2)(a) (Supp. 1987). Section 9-307.7(2)(a) states that the prenotification is effective only until "distribution" of the next ensuing master list. According to Section 9-307.6(4)(d) this is to be on the last business day of the month. However, receipt of the master list is not presumed to have occurred until three days after distribution. Therefore it can be persuasively argued that the prenotification statement should remain effective until three days after the distribution.

shortly before scheduled distributions of the master list. This precaution will shorten the lender's exposure to an unprotected status. Unfortunately, the ability to make such innovative improvements has been strictly curtailed by the federal preemption in this area.<sup>101</sup> Therefore, it should be presumed that the Oklahoma legislation providing for prenotification statements will be stricken by the courts.

It is argued that, since Oklahoma has provided for both a prenotification and a central filing system, the two systems should be allowed to stand independently. This could be easily accomplished by striking two provisions. The first is the provision which requires filing an EFS before furnishing a prenotification statement.<sup>102</sup> The second is the provision which terminates the prenotification statement upon distribution of the master list.<sup>103</sup> These two deletions make prenotification provisions essentially the same under both the Oklahoma and federal laws.<sup>104</sup> However, it is difficult to find support for this argument.

One additional note of caution should be observed. When the courts strike all or parts of Oklahoma's legislation regarding prenotification, it is at least possible that all of the statute could be invalidated. Should this happen, Oklahoma would effectively be a state without a central filing system.<sup>105</sup> Oklahoma creditors would then be forced to rely strictly on the prenotification system as outlined in a preceding section of this article.<sup>106</sup>

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101. 7 U.S.C. § 1631(d), (g) (Supp. IV 1986). See also CONG. REC., *supra* note 15, at S 16298. House Committee Report on Pub. L. (No. 99-271) No. 99-198, Part 1, Sept. 13, 1985, at 110. One of the major points that Senator Kassenbaum raised in arguing against passage of section 1631 was that it stymied the state's ability to innovate new and better solutions to the problem.

102. OKLA. STAT. tit. 12A, § 9-307.7(2)(b) (Supp. 1987).

103. OKLA. STAT. tit. 12A, § 9-307.7(1)(d), (2)(a) (Supp. 1987).

104. See generally 7 U.S.C. § 1631(e)(1), (g)(2)(A) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.7 (Supp. 1987). One substantial difference does exist. The Oklahoma law requires that amendments of prenotification statements be made within 10 days after a material change. OKLA. STAT. tit. 12A, § 9-307.7(1)(c) (Supp. 1987). The federal law allows 3 months. 7 U.S.C. § 1631(e)(1)(iii), (g)(2)(A)(iii) (Supp. IV 1986).

105. 9 C.F.R. § 205.214 (1988).

106. *Id.* Of course, if the Oklahoma central filing system is found to be improper for any other reason, the result will be the same.

A second major area of potential conflict between the Oklahoma and federal laws is raised by section 9-307.6(7) of the Oklahoma Statutes. This section states that any financing statement filed under section 9-401 between the effective date of the federal legislation, December 23, 1986, and the effective date of the Oklahoma legislation (not yet available) is ineffective against buyers of farm products unless a prenotification statement has been mailed to the buyer. This statement is undoubtedly true. However, its implication is not.

The implication is that if an effective prenotification statement was mailed to the buyer after December 23, 1986, but before the Oklahoma central filing system becomes effective, the prenotification statement remains effective. That is, the prenotification statement remains effective even after the Oklahoma central filing system goes into effect. The support for this position is found in the provision that once a prenotification statement is mailed it remains effective for one year.<sup>107</sup> However, section 1631<sup>108</sup> clearly states that once a state has adopted a central filing system the only way in which a secured party can perfect his interest is by filing. This appears to be the stronger argument. Under this view, prior perfection under the prenotification system becomes ineffective upon the effective date of the central filing system. Therefore, the only way a previously perfected secured creditor can continue his protection is to file an EFS in the state's central filing system.

Another question raised by section 9-307.6 is whether a secured interest properly perfected either under Oklahoma or some other state's law<sup>109</sup> prior to December 23, 1986, remains effective after December 23, 1986, the effective date of the federal legislation, or the effective date of the Oklahoma central filing system. Neither the federal nor Oklahoma legislation provides a direct answer to these questions. However the

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107. 7 U.S.C. § 1631(e)(1)(A), (g)(2)(A) (Supp. IV 1986).

108. 7 U.S.C. § 1631(e)(2), (3), (g)(2)(c), (D) (Supp. IV 1986).

109. As noted earlier, a security interest is now protected according to the laws of the state where the farm product is produced. See *supra* note 34 and accompanying text. This was not necessarily true under prior legislation of the various states. Therefore, security interests, which, since December 23, 1986, must be perfected under Oklahoma law, might have previously been properly perfected under the laws of some other states.

federal legislation did not become effective until a year after it was passed.<sup>110</sup> This fact supports the argument that previously perfected secured lenders are expected to come into compliance with the new law to continue their protected status. Therefore, the cautious approach is that previously secured lenders who have not complied with the new requirements should consider themselves no longer protected.

A third area of variation between the federal and Oklahoma laws "deals with" or "concerns" the requirements of notices mailed to buyers. The federal legislation contains two notice provisions. The first requires that the laws of the state where the buyer resides governs receipt of notice.<sup>111</sup> Therefore, the sections of the Oklahoma law which state that a prenotification statement is presumed to be received if sent by certified mail<sup>112</sup> and that a master list is presumed to be received three days after first class mailing<sup>113</sup> are not necessarily relevant to an Oklahoma secured creditor or the Oklahoma secretary of state. The buyer who receives the prenotification statement or master list must be a resident of Oklahoma for the Oklahoma provisions to apply. If the buyer is not an Oklahoma resident, creditors and the secretary of state must comply with the specific law of the state of the buyer's residence to give effective notice.

The federal legislation also provides that the buyer receive actual knowledge.<sup>114</sup> Therefore any presumption of receipt raised by the Oklahoma statute<sup>115</sup> is rebuttable by the buyer. If the presumption were not rebuttable, the presumption would, in effect, create a condition of constructive knowledge which is not allowed.<sup>116</sup>

The final major departure of the Oklahoma law from the federal mandate is title 12A, section 9-307.8 of the Oklahoma Statutes (Supp. 1987). Subsection 8 is a revision of section 9-307 (Supp. 1983). The 1983 version of section 9-307 required

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110. 7 U.S.C. § 1631(j) (Supp. IV 1986).

111. 7 U.S.C. § 1631(f) (Supp. IV 1986).

112. OKLA. STAT. tit. 12A, § 9-307.7(3) (Supp. 1987).

113. OKLA. STAT. tit. 12A, §§ 9-307.2(2), 9-307.6(4)(d) (Supp. 1987).

114. 7 U.S.C. § 1631(c)(b) (Supp. IV 1986).

115. Presumptions of receipt are set out at OKLA. STAT. tit. 12A, §§ 9-307.2(2), 9-307.6(4)(d), 9-307.7(3).

116. 7 U.S.C. § 1631(c)(b) (Supp. IV 1986).

the buyer of farm products to obtain a certificate of clear title<sup>117</sup> from the seller. If the buyer failed to obtain this certificate, he purchased the farm product subject to any existing security interest. Prior to passage of section 1631, Congress considered and specifically rejected inclusion of this type of provision in the new legislation<sup>118</sup> because it would create cumbersome paperwork for the buyer.<sup>119</sup> Therefore, without revision, section 9-307 would undoubtedly have been stricken as a preempted area.

However, the 1987 version of section 9-307 removes all of the onus from the buyer and places it squarely on the seller-debtor requiring the seller-debtor, of his own initiative, to provide the buyer with a certificate of clear title. Failure to do so is punishable by both fine and imprisonment.<sup>120</sup> However, whether the seller provides or fails to provide the required certificate has absolutely no effect upon the buyer.<sup>121</sup> In either event, the buyer's liability to the secured party is determined solely by notification provided either by a prenotification statement or the central filing system.<sup>122</sup> Even though the buyer has actual knowledge of an existing security interest through some other means, such as a certificate of clear (encumbered) title, the buyer takes free of the security interest.<sup>123</sup> Therefore, Oklahoma's subsection 8 appears to lie outside the scope of federal section 1631.<sup>124</sup> Lying outside the scope of section 1631, it is not preempted, and therefore, places a valid burden upon the seller-debtor. This is true in spite of the fact that subsection 8<sup>125</sup> provides absolutely no effective protection to any valid interest of the buyer, seller, or secured party.<sup>126</sup>

117. A certificate of encumbered title may be substituted if in fact a security interest in the collateral existed.

118. H.R. REP. NO. 271, 99th Cong., 1st Sess. 430 (1985).

119. *Id.*

120. OKLA. STAT. tit. 12A, § 9-307.8(2) (Supp. 1987).

121. OKLA. STAT. tit. 12A, § 9-307.8 (Supp. 1987).

122. 7 U.S.C. § 1631(d), (g)(1) (Supp. IV 1986). OKLA. STAT. tit. 12A, § 9-307.4 (Supp. 1987).

123. 7 U.S.C. § 1631(d), (g)(1) (Supp. IV 1986).

124. *See generally* 7 U.S.C. § 1631 (Supp. IV 1986).

125. OKLA. STAT. tit. 12A, § 9-307.8 (Supp. 1987).

126. To what extent subsection 8 will provide an effective deterrent to destitute farmers trying to sell encumbered property is a subject for conjecture.

## THE PARTIES

*The Secured Party*

The major duty of the secured party is to comply with the requirements of the appropriate system set out above. In Oklahoma, this apparently means that he must file an EFS with the secretary of state plus a U.C.C. section 9-401 financing statement in the appropriate office.<sup>127</sup> When filing the EFS the secured party should use the form developed by the state auditor and inspector to assure that the proper information is included in the EFS.<sup>128</sup> A caveat is that the secured party must be sure that he does not use a description of the collateral which is overly broad. As noted above and in footnote 48 a description which is too broad is as ineffective in giving the buyer notice of the extent of the lien claimed as is a failure to provide a description. Therefore, an overly broad description would cause the secured party to be unprotected.<sup>129</sup>

A second danger of which the secured party must be aware is that simply filing a properly prepared EFS, together with the required filing fees,<sup>130</sup> in the secretary of state's office does not automatically provide protection. The risk of any errors in the system has been shifted from the buyer to the secured party.<sup>131</sup> Therefore, if notice of the secured interest is

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127. 7 U.S.C. § 1631(e)(2), (3), (g)(2)(C), (D) (Supp. 1985); OKLA. STAT. tit. 12A, §§ 9-307.4(a), 9-307.6(4)(b). This is assuming that the Oklahoma central filing system has gone into effect. This had not yet happened at the time this article was written. Also, as noted in the above section, it is possible that the courts will find Oklahoma's central filing system invalid. In this case, the only way a secured party could protect his security interest is to continue to mail prenotification statements to potential buyers. Until there is greater security with regard to the validity of the Oklahoma system, a creditor lending large sums of money may wish to continue the practice of mailing prenotification statements as an additional measure of security.

128. OKLA. STAT. tit. 12A, § 9-307.3 (Supp. 1987). According to 9 C.F.R. § 205.213(c) (1988) the secured party may file documentation which was obtained prior to the implementation of the central filing system so long as it contains the required information. On the other hand the cited Oklahoma legislation seems to require use of the standard form prepared by the State Auditor and Inspector.

129. 9 C.F.R. § 205.207(d) (e) (f) (1988).

130. An EFS is not considered filed unless accompanied by the appropriate filing fee. OKLA. STAT. tit. 12A, §§ 9-307.2(1)(d)(viii), 9-307.6(8) (Supp. 1987). For a list of current filing fees see OKLA. STAT. tit. 28, § 111 (Supp. 1987).

131. 9 C.F.R. § 205.208(g) (1988); OKLA. STAT. tit. 12A, § 9-307.5 (Supp. 1987).

not properly included on the master list mailed to the buyer, the secured party will be unprotected even if the secured party has done everything in compliance with the system. Furthermore, the secured party can do nothing to protect himself prior to the next regularly scheduled distribution of the master list.<sup>132</sup> The same result would occur if the secretary of state failed to inform an unregistered buyer seeking oral confirmation<sup>133</sup> that a security interest existed.<sup>134</sup> That is, the unregistered buyer would take free of the properly perfected secured party's interest.

A final caution is that the secured party must be sure to file the EFS in the state where the farm product was produced.<sup>135</sup> Filing in any other place is totally without effect even if the filing places the buyer on notice. Therefore multiple filings are pointless.<sup>136</sup> The requirement that the filing must be made in the state of production is further complicated by the fact that there is no clear definition of the phrase, "where produced."<sup>137</sup>

Assuming that the EFS has been properly filed it will remain effective for up to five years.<sup>138</sup> In addition, it may be renewed indefinitely for additional five year periods.<sup>139</sup> These extensions must be signed by both the lender and the borrower.<sup>140</sup> In the event that there is a change of circumstances which would render the original EFS no longer informative, an amendment to the EFS must be filed. It must be filed by the secured party within three months of the change.<sup>141</sup> Amendments must be signed by both the lender and bor-

132. 7 U.S.C. § 1631(d), (g)(1) (Supp. IV 1986).

133. 7 U.S.C. § 1631(c)(2)(F) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.6(f) (Supp. 1987).

134. 9 C.F.R. § 205.208(g) (1988); OKLA. STAT. tit. 12A, § 9-307.5 (Supp. 1987).

135. 7 U.S.C. § 1631(e)(2), (3), (g)(2)(C), (D) (Supp. IV 1986).

136. 9 C.F.R. § 205.210(a) (b) (1988).

137. See *supra* note 34 for a comment on the term "produced".

138. 7 U.S.C. § 1631(c)(4)(F) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.2(1)(d)(vi) (Supp. 1987).

139. *Id.*

140. 7 U.S.C. § 1631(c)(4) (Supp. IV 1986); 9 C.F.R. § 205.209(d) (1988); OKLA. STAT. tit. 12A, § 9-307.2(1)(d)(vi) (Supp. 1987). Standard forms should be used for filing continuations. OKLA. STAT. tit. 12A, § 9-307.3 (Supp. 1987).

141. 7 U.S.C. § 1631(c)(4)(E) (Supp. IV 1986); 9 C.F.R. § 205.209 (1988); OKLA. STAT. tit. 12A, § 9-307.2(1)(d)(v) (Supp. 1987).

rower.<sup>142</sup> Once the obligation for which the EFS was filed has been satisfied, and there is no obligation to make future advances, the secured party must file a release of the EFS within ten days.<sup>143</sup>

### *The Buyer, Selling Agent, or Commission Merchant*

The buyer<sup>144</sup> is the truly favored party under the new law. His obligations are few. His benefits are tremendous. But still there are significant potential problems. The registered buyer's primary obligation is to register with the secretary of state.<sup>145</sup> Registration is facilitated by the use of a standardized form<sup>146</sup> and remains effective for a period of one year after it is accepted by the secretary of state.<sup>147</sup> While registered, the buyer will receive a copy of the state master list of filed effective financing statements once a month from the secretary of state. Each buyer's mailing will include only the portion of the state master list containing information regarding the farm products in which the buyer has expressed an interest.<sup>148</sup> The buyer need only check his copy of the master list to determine whether he is purchasing goods subject to a security interest.<sup>149</sup> If the buyer's copy does not indicate a security interest in the goods, he will take them free of any such interest even if an EFS has been properly filed with the secretary of state claiming a security interest in the goods.<sup>150</sup>

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142. 7 U.S.C. § 1631(c)(4) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.2(1)(d)(v) (Supp. 1987). Standard forms should be used for filing amendments. OKLA. STAT. tit. 12A, § 9-307.3 (Supp. 1987).

143. OKLA. STAT. tit. 12A, § 9-307.6(9) (Supp. 1987). Standard forms should be used for filing releases. OKLA. STAT. tit. 12A, § 9-307.3 (Supp. 1987).

144. As used here the term "buyer" includes not only "buyers," but also "commission merchants" and "selling agents" as defined in 7 U.S.C. 1631(c)(1) (Supp. 1985); OKLA. STAT. tit. 12A, § 9-307.2(1)(a) (Supp. 1987). See also *supra* note 19.

145. 7 U.S.C. § 1631(e)(2), (3), (g)(2)(C), (D) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.4 (Supp. 1987).

146. OKLA. STAT. tit. 12A, § 9-307.3 (Supp. 1987).

147. OKLA. STAT. tit. 12A, § 9-307.6(4)(g) (Supp. 1987).

148. 7 U.S.C. § 1631(c)(2)(E) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.6(4)(c), (d) (Supp. 1987).

149. 7 U.S.C. § 1631(e)(3), (g)(2)(D) (Supp. IV 1986); 9 C.F.R. § 205.208 (1988); OKLA. STAT. tit. 12A, § 9-307.4 (Supp. 1987).

150. 9 C.F.R. § 205.208(g) (1988); OKLA. STAT. tit. 12A, § 9-307.5 (Supp. 1987).

The buyer's paperwork in maintaining an up-to-date list of claimed security interests has been minimized by allowing a master list to be supplemented only twice before a new master list is distributed.<sup>151</sup> Therefore, the buyer need only consult the latest master list which he has received, plus up to a maximum of two subsequent supplements. All other master lists or supplements may be discarded.

Two cautionary notes are necessary at this point. Oklahoma has muddied the picture by allowing the secured party to mail statements of liens claimed, i.e. prenotification statements, between regular distributions of the master list and supplements.<sup>152</sup> It is unlikely that this provision will be upheld by the courts. But if it is, the buyer would have to maintain and consult an additional file containing these prenotification statements. However, the mailing of the next subsequent master list, or supplement thereto, makes these notices invalid.<sup>153</sup> Therefore, all notices in this file could be discarded once a month.

The second caveat is that, if for any reason the courts find the central filing system to be invalid, the state will then be treated as if it has no central filing system.<sup>154</sup> In that event, the only way a secured party could protect his secured interest is by mailing a prenotification statement to all potential buyers.<sup>155</sup> These notices are effective for one year.<sup>156</sup> An obvious problem arises if a buyer relies upon the master list distribution through the state's central filing system, does not keep a complete file of all prenotification statements, and then suddenly finds the state's central filing system ruled invalid by the courts. All of the discarded prenotification statements, not the master lists, become the operant factor in determining the buyer's liability. The buyer is therefore left with no desirable way to determine if he is purchasing goods subject to a security interest.<sup>157</sup>

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151. 9 C.F.R. § 205.105(c) (1988).

152. OKLA. STAT. tit. 12A, § 9-307.7 (Supp. 1987).

153. OKLA. STAT. tit. 12A, § 9-307.7(1)(d) (Supp. 1987).

154. 9 C.F.R. § 205.214 (1988).

155. 7 U.S.C. § 1631(e)(1), (g)(2)(A) (Supp. IV 1986).

156. *Id.*

157. Actually the current master list, as supplemented, plus subsequent prenotification statements should contain all the information, needed by the buyer. This is

A different, but related problem, involves farm products produced in a state with a non-central filing system. For example, if an Oklahoma buyer buys products produced in Kansas, the products will not appear on the master list distributed by the Oklahoma secretary of state. This will be true even if the buyer, debtor, and secured party all reside in Oklahoma.<sup>158</sup> Instead, the secured party will protect his interest according to the prenotification laws of Kansas.<sup>159</sup> Therefore, an Oklahoma buyer who purchases farm products produced in two or more states will have to maintain and consult separate information systems for each state from which product purchases are produced.

A registered buyer may encounter another problem. Unlike prenotification statements, the EFS, and therefore the master list, does not contain the payment obligations which the buyer must meet to purchase free of the security interest.<sup>160</sup> As a result, if the buyer is purchasing at a time when he cannot contact the secured party, e.g. on a weekend, he may know that a security interest exists, but he does not know what he must do to purchase free of the security interest.<sup>161</sup> This problem is particularly acute for buyers with twenty-four hour payment deadlines under the Packers and Stockyard Act<sup>162</sup> and others with similar short payment deadlines. Under current law, there seems to be no practical solution to this problem. The buyer must either take his risk with the security interest or decline the purchase. Amendment of the current law to provide that any payment obligation must be included in the EFS would be a logical step.<sup>163</sup>

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assuming that secured parties have filed an EFS instead of, or in addition to, mailing prenotification statements. However the liability for an incomplete or incorrect list of secured creditors now shifts from the secured party to the buyer.

158. 9 C.F.R. § 205.210(b) (1988).

159. 7 U.S.C. § 1631(e), (g)(2) (Supp. 1985).

160. Compare 7 U.S.C. § 1631(e)(1)(A)(v), (g)(2)(A)(v) (Supp. IV 1986) and OKLA. STAT. tit. 12A, § 39-307.7(1)(e) (Supp. 1987) with 7 U.S.C. § 1631(c)(4) (Supp. IV 1986) and OKLA. STAT. tit. 12A, § 9-307.2(1)(d) (Supp. 1987).

161. A common example of a payment obligation required to purchase free of the security interest is a joint-payee check.

162. 7 U.S.C. § 228(b) (Supp. 1982).

163. The state would be free to institute such a requirement. 9 C.F.R. § 205.103(c) (1987).

For the unregistered buyer,<sup>164</sup> and there is no requirement that buyers must register,<sup>165</sup> the situation is different. His primary obligation is to inquire of the secretary of state regarding any filed security interest.<sup>166</sup> The secretary of state has twenty-four hours to orally respond to this inquiry.<sup>167</sup> Obviously, for the buyer with a short payment deadline, this could create a nearly insurmountable problem. Payment could be due before or immediately upon discovery of the existence of a security interest. An additional problem is created if the purchase is made on a holiday or weekend. The payment deadline might pass before the secretary of state's office reopened and was available for inquiry. Finally, even if the response is timely, the secretary of state cannot disclose any payment obligations required by the lender. As stated above, such payment obligations are not included in the EFS and are, therefore, not available to the secretary of state. However, if the buyer makes inquiry and is informed that no security interest exists, he takes the goods free from encumbrances even if the secretary of state has mistakenly informed the buyer that no secured interest exists when in fact a secured party has properly perfected his lien.<sup>168</sup>

A final option for the buyer is to register with the secretary of state for only those farm products or counties of production in which he has a primary interest.<sup>169</sup> A buyer who chooses this route will be treated as a fully registered buyer only for those products or counties in which he has expressed an interest, i.e. registered.<sup>170</sup> His risks and obligations will be the same as those expressed for registered and unregistered buyers depending upon which class of products or counties he happens to be dealing in at the time. Of course, his major con-

164. That is, unregistered in the state where the farm product was produced. This may or may not be the state where the actual purchase takes place. 7 U.S.C. § 1631(e)(2)(D) (Supp. IV 1986); 9 C.F.R. § 205.210(b) (1988).

165. 7 U.S.C. § 1631(c)(2)(F) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9.307.6(f) (Supp. 1987).

166. 9 C.F.R. § 205.208 (1988).

167. 7 U.S.C. § 1631(c)(2)(F) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9.307.6(f) (Supp. 1987).

168. 9 C.F.R. § 205.208(g) (1988); OKLA. STAT. tit. 12A, § 9.307.5 (Supp. 1987).

169. 9 C.F.R. § 205.208(e) (1988).

170. *Id.*

cern in this situation is to make absolutely certain that he knows where the goods he is purchasing were produced. Without this knowledge, he will not know whether to rely upon the portion of the master list he received from the secretary of state or whether he must make an inquiry as an unregistered buyer.

### *The Debtor*

Under the new legislation, the term "debtor" does not necessarily mean "the person who borrowed the money." Rather, the debtor is the person who allows his property to be subjected to the security interest of the creditor. The debtor may be either the actual borrower or an accommodating party who is lending his credit to benefit the borrower.<sup>171</sup>

The debtor has two major responsibilities. Under the Oklahoma law,<sup>172</sup> a debtor selling farm products other than livestock must, of his own initiative, execute a "certificate of no lien claimed." The statutes provide a standard certificate form which states in part that no party claims a security interest in the products.<sup>173</sup> If a security interest is claimed, the certificate sets out the details of the lien.<sup>174</sup> Under the current legislative scheme, the certificate serves no practical purpose and may be stricken by the courts as invalid.<sup>175</sup> However, the debtor cannot afford to ignore the requirement. Failure to issue the certificate carries a penalty of up to three years in the state penitentiary.<sup>176</sup>

The second responsibility affects debtors who encumber farm products produced in states relying on a prenotification system. Here, the debtor has an obligation to provide the secured party with a list of all persons to whom the collateral may be sold.<sup>177</sup> If the debtor subsequently sells the property to a party not on the original list, he must either: (1) Notify

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171. 9 C.F.R. § 205.213(b) (1988).

172. OKLA. STAT. tit. 12A, § 9-307.8 (Supp. 1987).

173. *Id.*

174. *Id.*

175. For a discussion of this point see text accompanying notes 118-126.

176. OKLA. STAT. tit. 12A, § 9-307.8 (Supp. 1987).

177. 7 U.S.C. § 1631(h) (Supp. IV 1986); OKLA. STAT. tit. 12A, § 9-307.7(4) (Supp. 1987).

the secured party of the identity of the buyer at least seven days prior to sale; or (2) account to the secured party for the proceeds of the sale within ten days after the sale. Failure to do one of the above subjects the debtor to a fine of five thousand dollars or fifteen percent of the value of the collateral, whichever is greater.<sup>178</sup>

To what extent the latter provision includes farm products produced in Oklahoma remains to be seen. As discussed in the prior section entitled "Oklahoma Variations," Oklahoma has retained elements of a prenotification system in spite of the fact that a central filing system has been adopted.<sup>179</sup> To the extent that the courts allow the Oklahoma prenotification system to co-exist with the central filing system, the above responsibilities will continue to apply. Of course these responsibilities will also continue to apply with respect to any transaction involving a farm product produced in a state which has not adopted a central filing system. As always, it is irrelevant where the loan or purchase occur.<sup>180</sup>

#### CONCLUSION

It is clear that the rules for perfecting security interests in farm products have been vastly altered. The overall impact of the changes is to shift the brunt of the risks in dealing with encumbered property from the buyer to the secured party. The apparent ease with which a buyer can now determine a secured party's interest in goods should eventually facilitate the free flow of farm products in commerce. However, the new legislation creates a number of potential problems which must be solved before this goal is achieved.

First, both the buyer and lender must properly ascertain the state where the farm products were produced. The difficulty of this task is increased by the fact that no definition for the place of production is currently available. Without making this determination, it is impossible for the parties to know under which set of laws they must proceed.

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178. *Id.*

179. OKLA. STAT. tit. 12A, § 9-307.7 (Supp. 1987).

180. 9 C.F.R. § 205.210(b) (1988).

Once the point of production has been identified the parties must then scrutinize the applicable law to determine how to proceed. Unfortunately, there are a number of uncertainties regarding what is actually required of the parties. These problems are particularly acute in a state such as Oklahoma which has not strictly adhered to the federal guidelines.

Until the courts have had an opportunity to examine these problem areas, the parties must be particularly aware of the factors set out in this article. It is only in this way that they can properly evaluate: 1) the risks which they face, and 2) alternative avenues to reduce or eliminate unacceptably high levels of risk.