

The National Agricultural
Law Center



University of Arkansas
System Division of Agriculture

NatAgLaw@uark.edu | (479) 575-7646

An Agricultural Law Research Article

**Proposals for Improvement in Agricultural
Marketing Transactions or Will Farmers
Join the Electronic Age**

by

L. Leon Geyer

Originally published in SOUTH DAKOTA LAW REVIEW
29 S. D. L. REV. 361 (1984)

www.NationalAgLawCenter.org

PROPOSALS FOR IMPROVEMENT IN AGRICULTURAL MARKETING TRANSACTIONS OR WILL FARMERS JOIN THE ELECTRONIC AGE

L. LEON GEYER*

Agriculture has long been provided special treatment in various aspects of our laws. We have the image of the innocent American Gothic in our minds. But over time, the simple tiller of the soil has become an agribusinessman. The farmer and farm products buyers have found a twin problem in the sale and exchange of farm products. The twin problem may be stated as farmers who sell mortgaged farm products and do not tell and buyers who buy and do not pay. A myriad of possible solutions have been proposed to resolve the problem by governmental action at either the state or federal level and in either the executive or legislative areas. Actions, to date, by various states have resulted in a splintering of the Uniform Commercial Code (U.C.C.). This paper will explore the problem of sellers who do not tell, and buyers who do not pay, and will propose the use of electronics for the improvement in the transaction efficiency of agricultural marketing transactions.

TRANSACTION RISK

The ideal market transaction takes place when the seller delivers clear title to the goods to be sold to a buyer who at the same instant in time delivers payments of value for the goods to the seller. The ideal market transaction involves zero risk to both buyer and seller. No seller would sell to an insolvent buyer without cash payment, and no prudent buyer would purchase mortgaged goods from seller without a release of the mortgage or lien by lender.¹ The uncertainty of clear title on the part of the farm product buyer and the uncertainty of full payment² on the part of the farmer seller is an example of transaction risk. Transaction risk can be defined as the risk of not receiving the goods or the money for which one traded. Price risk is the

* Assistant Professor of Agricultural Law in the Department of Agricultural Economics, Virginia Polytechnic Institute and State University.

1. Real property is sold subject to mortgages that have not been released. Personal property liens may or may not be valid against the buyer of goods in the ordinary course of business. U.C.C. § 9-307 reads as follows: "A buyer in ordinary course of business 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." Unless otherwise indicated, all references and citations in this article to the text and comments of the Uniform Commercial Code, hereinafter referred to simply as the Code or the U.C.C., are to the 1978 Official Text with Comments. *See infra* text accompanying notes 8-15.

2. Full payment is the prompt and complete payment without recourse for goods delivered to another. *See generally* FEDERAL MARKETING PROGRAMS IN AGRICULTURE 242, 263-64 (Ambruster ed. 1983). For legislative enactment of this principle, *see* 7 U.S.C. § 228b and 7 U.S.C. § 499b(4) (1982).

risk associated with changes in product price at the time of sale. Price risk is the risk farmers most often associate with the sale of farm products.

Transaction risk was depicted humorously in a cartoon in which the prosecutor stated, "This man wrote a bum check for a new wagon." The accused answered, "it was a fair deal." The judge asked, "How do you figure that?" The accused replied, "The wagon fell apart before the check cleared."³ Unfortunately, this is too often the dilemma facing the farm product buyer and the farm product seller. The modern farmer delivers "farm products"⁴ to a buyer. The "farm products" secured under U.C.C. article 9 by a third party are converted by the buyer. The buyer provides the seller with a check which is returned marked "insufficient funds" and is subsequently not paid due to buyer's insolvency.

THE CURRENT LEGAL DILEMMA

A. *Farm Product Buyer's Dilemma*

The farm product buyer purchases secured farm products subject to a security interest. U.C.C. section 9-307(1) provides that:

A buyer in ordinary course of business (subsection (9) of Section 1-102), 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.⁵

In the most trivial application, U.C.C. section 3-307 provides that a consumer who buys tomatoes (a good) from a farmer-producer's roadside stand buys the tomatoes subject to an existing U.C.C. article 9 crop lien on the farmer's tomatoes. If the same or similar tomatoes are purchased from Ma and Pa Grocery store, the tomatoes would be taken free of a U.C.C. article 9 (assuming there is one) inventory security interest. Tomatoes, in an unmanufactured state, bought from the farmer who raised them, are bought from the farmer-debtor who granted a security interest in the crop to a secured party. If the tomatoes were processed into tomato preserves by the farmer's wife and sold in jars at the stand, they at the stand would take free of the security interest.⁶ As one commentator has observed:

The difficulties (under U.C.C. section 9-307) are aggravated were the security interest is in an annual crop such as wheat, which the debtor sells to a grain elevator in violation of a security agreement, and the elevator in turn sells to the manufacturer of breakfast cereal, which subsequently sells to distributors, and ultimately retailers sell the ce-

3. *The Wizzard of Id* by Parker and Hart is reported in the Washington Post, April 13, 1983 at D.C. 12.

4. "Farm products" is defined at U.C.C. § 9-109(3) (1978).

5. California's U.C.C. § 9-307(1) deletes the phrase "other than a person buying farm products from a person engaged in farming operations." Cal. Com. Code § 9-3701(1) (West 1964 & Supp. 1983). All states except Louisiana have adopted the official provision as written.

6. R. HENSON, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE 143 (1973).

real to consumers. Under the Code, the farmer's secured party could follow the wheat into the hands of the consumer, (although surely not profitably beyond that point), since even buyers in ordinary course take free only of security interests created by their sellers, not of security interests further back in the chain. The breakfast cereal is a product of the original wheat, and the original security interest presumably can be traced.⁷

What the Code provides is relatively clear. A security interest continues in farm products pledged as collateral "not withstanding sale, exchange or other disposition thereof, unless the disposition was authorized by the secured party in the security agreement or otherwise. . . ."⁸

Farm products, as long as they remain unmanufactured by a farmer, which are pledged as collateral subject to a secured party's security interest in the farmers crops,⁹ livestock,¹⁰ unmanufactured farm products¹¹ and supplies used or produced in farming operations,¹² do not cease to be "collateral" when purchased by buyer from a "person engaged in farming operations."¹³

The usual result of this section is that the lender (secured party) sues the buyer of the farm products for conversion of the secured party's collateral.¹⁴ The buyer is "surprised" when he is requested to pay for the merchandise twice. The U.C.C. allows the security interest to follow the collateral through a succession of purchasers even if the "goods" are no longer "farm products" but become "inventory."¹⁵

When the original farmer-borrower is without funds, the lender brings his action for conversion against the farm product purchaser. Paying twice for the same good has "led to a negative reaction by farm product purchasers and efforts to change the impact of U.C.C. section 9-307(1). The alterna-

7. *Id.* at 143-44. See also U.C.C. § 9-306(2) (1978). If the right steps were taken to claim "products" in the financing statement, this might be an instance where U.C.C. § 9-315 could be utilized. Apparently no cases have yet applied this section.

8. U.C.C. § 9-306(2) (1978).

9. *United States v. McClesey Mills, Inc.*, 409 F.2d 1216 (5th Cir. 1969). The government's security interest in soybeans under a FmHA loan transaction continued despite the sale of soybeans to defendant, operator of a grain elevator. Defendant did not take free of the security interest under § 9-307(1), since he bought farm products from a person engaged in farming operations. Defendant had constructive notice of the government's security interest. Lack of actual knowledge was no defense to a claim of conversion. *United States v. Hughes*, 340 F. Supp. 539 (N.D. Miss. 1972). See also *Production Credit Ass'n v. Columbus Mills*, 22 U.C.C. Rep. Serv. (Callaghan) 228 (Wis. Cir. Ct. Dane Co. 1977).

10. *Garden City Prod. Credit Ass'n v. Lannan*, 186 Neb. 668, 186 N.W.2d 99 (1971), *Clovis Nat'l Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726 (1967); and *Utah Farm Prod. Credit Ass'n v. Dinner*, 302 F. Supp. 897 (D. Colo. 1969).

11. Under U.C.C. § 9-109(3) (1978), ginned cotton, wool clips, maple syrup, milk and eggs are still unmanufactured. Comment 4 to section 9-109 elaborates that processes closely connected with farming are not manufacturing.

12. U.C.C. § 9-109(3) (1978).

13. *Cox v. Bancoklahoma Agri-Services Corp.*, 641 S.W.2d 400, 401 (Tex. Ct. App. 1982); *Weisbart & Co. v. First Nat'l Bank of Balhart*, 568 F.2d 391, n.3 (5th Cir. 1973).

14. In *United States v. Topeka Livestock Auction, Inc.*, 392 F. Supp. 944 (N.D. Ind. 1975), an auctioneer was held liable in conversion to the secured party for selling livestock subject to a perfected security interest.

15. *Baker Production Credit Ass'n v. Long Creek Meat Co.*, 266 Or. 643, 513 P.2d 1129 (1973).

tive to the application of U.C.C. section 9-307(1) as now written can be categorized as 1) rejection, 2) courts' exceptions to strict application and 3) legislative modification. A fourth alternative, use of technology, will be explained later in this paper as a solution to the impact of U.C.C. section 9-307(1) on farm product buyers.

1. Rejection

Perhaps the simplest solution to the impact of U.C.C. section 9-307(1) on farm product buyers is the rejection of its application to farm products. California has rejected outright the application of U.C.C. section 9-307(1).¹⁶ By statute, the secured party's security interest does not follow the "farm products" when the farmer sells them to a buyer. In other words, the California Code provides the same protection to a buyer of farm products in ordinary course of business as it does buyer's of non-farm goods. Obviously, this provision does not satisfy the desires of lenders.

2. Courts' Exception to the Strict Application of U.C.C. section 9-307(1).

While section 9-307(1) protects the security interest of the farmer's lender in farm products, the courts have often strictly interpreted the provisions and applications of the security agreement in order to reduce the purchaser's liability for conversion of lenders secured interest. U.C.C. section 9-306(2) states with respect to secured party's rights on disposition of collateral: "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."¹⁷

Under section 9-306(2), where a sale of collateral has been authorized unconditionally either in the instrument or otherwise, the security interest in farm products does not survive the sale. The secured party's express consent and authority to sell contrary to the terms of the security agreement has been held to cut off the security agreement.¹⁸ Terms and conditions of the security agreement can be expressly waived.¹⁹

Controversy surrounds implied waiver of security interest, implied waiver of the requirement of prior written permission to sell and implied

16. California's U.C.C. § 9-307(1) deletes the phrase "other than a person buying farm products from a person engaged in farming operations." CAL. COM. CODE § 9-307(1) (West 1964 & Supp. 1983).

17. U.C.C. § 9-306(2) (1978).

18. *Anon, Inc. v. Farmers Production Credit*, 446 N.E.2d 656, 35 U.C.C. Rep. Serv. (Callaghan) 1383 (Ind. App. 1983); *Baker Production Credit Ass'n v. Long Creek Meat Co.*, 266 Or. 645, 513 P.2d 1129 (1973); and *Farmers State Bank v. Edison Non-Stock Coop. Ass'n*, 190 Neb. 789, 212 N.W.2d 625 (1973).

19. See U.C.C. § 1-103 (1978). Waiver can be characterized as a voluntary abandonment or remainder, by a capable person of a right known to him to exist with the intent that such a right shall be surrendered and such person deprived of its benefit.

waiver inferred from a course of dealing or usage of trade. U.C.C. section 1-205(4) provides that

[t]he express terms of an agreement, and an applicable course of dealing or usage of trade shall be construed wherever reasonable is 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.

In addition, U.C.C. section 2-209(4) provides that “[a]lthough an attempt at modification or rescission does not satisfy the requirements of subsection (2) or (3) [a writing must be modified in writing], it can operate as a waiver.”

Based on U.C.C. sections 2-209(4) and 1-205(4), some courts have held that certain conduct, courses of dealing, or usages of trade and the like may create a waiver of the conditions in a security agreement or a waiver of the security agreement itself.²⁰ Other courts have held that U.C.C. section 1-205(4) prohibits implied authority where the security agreement requires written authority.²¹ The disparity among jurisdictions on the subject comes in spite of the stated objective of the U.C.C. “to make uniform law among the various jurisdictions.”²²

There is no reason why the interpretation of essentially similar cases is not the same under the Code. If a better method of filing and retrieving crop liens under U.C.C. article 9 is adopted, the split in current cases would be unnecessary.

3. Recent Legislative Modification

Just as the courts have worked to disunite the Code, so too have the state legislatures.²³ A variety of legislative changes have been offered to modify section 9-307(1) of the sale of mortgaged farm products. Some of the changes reflect the singular interest of pressure groups.

Several of the state legislatures have removed the farm product excep-

20. *Clovis Nat'l Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726 (1967); *In re Cadwell Nat'l Meat Co.*, 10 U.C.C. Rep. Serv. (Callaghan) 710 (E.D. Cal. 1970); *United States v. Central Livestock Ass'n, Inc.*, 349 F. Supp. 1033 (D. N.D. 1972); *Farmers State Bank v. Edison Non-Stock Coop. Ass'n* 190 Neb. 789, 212 N.W.2d 625 (1973); *Libson Bank & Trust Co. v. Murray*, 206 N.W.2d 96 (Iowa 1973); *Planters Production Credit Ass'n v. Bowles*, 256 Ark. 1063, 511 S.W.2d 645. (1974); *Central Washington Production Credit Ass'n v. Baker*, 11 Wash. App. 17, 521 P.2d 226 (1974); *Hedrick Sav. Bank v. Myers*, 229 N.W.2d 252 (Iowa 1975).

21. *Garden City Production Credit Ass'n v. Lannan*, 186 Neb. 668, 186 N.W.2d 99 (1971); *Vermilion Co. Production Credit Ass'n v. Izzard*, 111 Ill. App. 2d 190, 249 N.E.2d 352 (1969); *Colorado Bank and Trust Co. v. Western Slope Investments, Inc.*, 539 P.2d 501 (Colo. App. 1975); *United States v. E.W. Savage & Son, Inc.*, 343 F. Supp. 129 (D. S.D. 1972), *aff'd*, 475 F.2d 305 (8th Cir. 1973); *Burlington Nat'l Bank v. Strauss*, 50 Wis. 2d 270, 184 N.W.2d 122 (1971); *North Central Kansas Prod. Credit Ass'n v. Washington Sales Co.*, 223 Kan. 689, 577 P.2d 35, (1978); *Farmers State Bank v. Edison Non-Stock Coop. Ass'n*, 190 Neb. 789, 212 N.W.2d 625 (1973); *Wabasso State Bank v. Caldwell Packing Co.*, 308 Minn. 349, 251 N.W.2d 321 (1976); *Fisher v. First Nat'l Bank of Memphis*, 584 S.W.2d 515 (Tex. Civ. App. 1979); *First Tennessee Production Credit Ass'n v. Gold Kist, Inc., v. Carson* 653 S.W.2d 418 (Tenn. App. 1983). New Mexico has done so by statute, N.M. STAT. ANN. § 55-1-205(3), (4) (1978).

22. U.C.C. § 1-102(1)(c) (1978).

23. For an additional discussion of legislative changes in the states, see VanHooser, *Problems Arising From Sale of Mortgaged Farm Products*, 29 S.D.L. REV. — (1984).

tion from section 9-307(1) unless the buyer of farm products has received a prescribed written notice of a lien on the product. For example, Indiana changed the application of U.C.C. section 9-307(1) by removing the lenders protection (the farm product exemption) unless the lender files written notice with the potential purchaser.²⁴ The debtor/farmer is required to give the secured party a list of potential buyers upon request. Failure to list ultimate buyers is a Class C misdemeanor. The penalty is a maximum of sixty days in jail and/or a \$500 fine. Debtor must sign and date the notice which includes names and addresses of debtor and secured party, description of the collateral, date and location of the filing of the security interest and signature of the secured party with date. The notice must be labelled with recording data. A buyer with this notice of a lien must pay with a check issued to

24. The phrase "other than a person buying farm products from a person engaged in farming operations were" was deleted from U.C.C. § 9-307(1) and the following provisions added, effective June 1, 1983:

The following apply whenever a person is buying farm products from a person engaged in farming operations who has created a security interest on the farm products."

(a) A person buying farm products from a person engaged in farming operations is not protected by this subsection if he has received prior written notice of the security interest. "Written notice" means notice on a form prescribed by the secretary of state and containing the following:

- (i) The full name and address of the debtor.
- (ii) The full name and address of the secured party.
- (iii) A description of the collateral.
- (iv) The date and location of the filing of the security interest.
- (v) The date and signature of the secured party.
- (vi) The date and signature of the debtor.

A notice expires eighteen (18) months after the date the secured party signs the notice or at the time the debt that appears on the notice is satisfied, whichever occurs first. Notice must be received before a buyer of farm products has made full payment to the person engaged in farming operations for the farm products if the notice is to be considered "prior written notice."

(b) A secured party must within fifteen (15) days of the satisfaction of the debt inform a buyer in writing whenever a debt has been satisfied and written notice, as required by subdivision (a), had been previously sent to that buyer.

(c) A debtor engaged in farming operations who has created a security interest in farm products must provide the secured party with a written list of potential buyers of the farm products at the time the debt is incurred if such a list is requested by the secured party. The debtor may not sell farm products to a buyer who does not appear on the list (if the list is requested by the secured party) unless the secured party has given prior written permission to the debtor to sell to someone who does not appear on the list, or the debtor satisfies the debt for that secured party on the farm products he sells within fifteen (15) days of the date of sale. A debtor who knowingly or intentionally sells to a buyer who does not appear on the list (if the list is requested by the secured party) and who does not meet one (1) of the above exceptions, commits a Class C misdemeanor. A secured party commits a Class C infraction if he knowingly or intentionally gives false or misleading information on the notice required by subdivision (a) or he fails within fifteen (15) days of satisfaction of the debt to notify purchasers to whom notice had been previously sent (under subdivision (a)) of the satisfaction of the debt.

(d) A purchaser of farm products buying from a person engaged in farming operations must issue a check for payment jointly to the debtor and those secured parties from whom he has received prior written notice of a security interest as provided for a subdivision (a). A purchaser of farm products (on which there is a perfected security interest) buying from a person engaged in farming operations who withholds all or part of the proceeds of the sale from the seller, in order to satisfy a prior debt ('prior debt' does not include the costs of marketing the farm product or the cost of transporting the farm product to the market) owned by the seller to the buyer, commits a Class C infraction. IND. CODE ANN. § 26-1-9-307(1) (Burns Supp. 1983).

debtor and secured parties. A debtor may not sell farm products to a buyer who does not appear on the list given to the secured party unless the secured party has given written permission to the debtor, or the debtor satisfies the debt for the secured party on the farm products he sells within fifteen days of the date of sale. A debtor who does not follow these rules commits a misdemeanor.²⁵

Kentucky and Ohio have adopted provisions similar to the Indiana law.²⁶ In Ohio, the lien creditor may request a list of potential buyers from the debtor.²⁷ The creditor can then notify the potential buyers of the farmer's lien. If grain is delivered to the buyer, the buyer is informed in the letter of the proper payment procedures.²⁸ The Ohio statute requires additional duties of the farmer. The farmer is required to inform the handlers of existing liens on commodities at the time the commodity is delivered.²⁹ The farmer is permitted to deliver a commodity to a buyer whose name is not on the original list furnished to the creditor. However, the farmer in this case must provide the creditor with the name of the buyer fifteen days prior to selling the commodity, *i.e.*, before the title is passed for value. This provision's impact on various pricing alternatives, such as deferred pricing and delayed pricing, is unknown. As of January 1, 1984, a handler who knows only of the existence of a lien, but does not know the specific terms of the contract buys the commodity free of the lien. The creditor can hold only the farmer responsible for paying the loan unless the buyer received notice, and yet, did not follow payment procedures set forth in creditor's letter of notification.

Indiana, Ohio and Kentucky statutes attempt to shift the burden of reviewing article 9 filings from the buyer to the creditor.³⁰ In a real estate transaction, this would be like requiring the mortgagee to notify all prospective real estate buyers of his interest in the property. Buyers not notified would purchase the property free of secured lenders interest. The Ohio statute attempts to place responsibility to inform the buyer of the lien on the farmer-seller. Placing responsibility on the farmer-seller to notify buyers of liens on his product may have some merit. However, it is unlikely to deter the farm-product sellers who would cheat.

The Indiana, Ohio and Kentucky laws³¹ are designed to encourage notification of the buyer of farm products by lender. The approach is highly questionable. With the increasing movement of farm products across county and state lines and marketing decisions being made over a long period of time, the prudent debtor would have to provide the lender with a large

25. *Id.*

26. KY. REV. STAT. § 355.9-307 (1983) and OHIO REV. CODE ANN. § 1302.26 (Page 1983).

27. OHIO REV. CODE ANN. § 1309.26 (Page 1983).

28. *Id.*

29. *Id.*

30. *Id.*

31. IND. CODE ANN. § 26-1-9-307(1) (Burns Supp. 1983), OHIO REV. CODE ANN. § 1309.26 (Page 1983) and KY. REV. STAT. § 355.9-307 (1983).

number of potential buyers even though he might sell to only a few. Farmers do not always know to whom they will sell so far in advance. The eighteen month expiration of liens on farm products is questionable for storable agricultural products.³² Further, a farmer could have mixed crop years and mixed lenders represented in the same loan of grain. The statutes provide that a debtor may sell to a party who has been notified if debtor remits payments to lender within fifteen days.³³ That, of course, is the fifteen days in which the debtor becomes insolvent. The enforceability of the misdemeanor provisions is questionable.

Nebraska, Georgia, Montana, Kentucky and perhaps other states provide that auctioneers or commission agents shall generally not be liable to the secured party for the sale of mortgaged farm products.³⁴ In addition, Kentucky provides that the buyer of the livestock also takes free of the security interest unless written notice by certified mail is provided to the publicly licensed stockyard.³⁵ Montana has a similar notice requirement for stockyards.³⁶ The notice is centrally filed and dispensed by the state government to livestock markets.

Additional activity in this area can be expected in other states.³⁷ Recent legislative activities indicate a trend towards special interest protection for auctioneers, commission markets and livestock buyers, and a requirement that creditors provide notice to potential buyers or selling agents. In some states, only the auctioneer or commission agent is protected, while in others, the final product purchaser is also protected. An anomaly of such special protection provisions under U.C.C. section 9-307 results in liability for conversion for the buyer of the farm product at the farmer's place of business and a buyer at the auction house taking free of the creditor's secured interest. Just as the courts have splintered the application of U.C.C. section 9-307(1), the legislatures have also disunified the Uniform Commercial Code.

B. *The Farm Product Sellers Dilemma*

The farmer is often confronted by an onerous situation when goods are sold to a seller but prompt and full payment for farm products is not received. The buyer provides the seller with a check which is returned marked "insufficient funds" or buyer has gone bankrupt. The problem, accentuated in hard economic times, can put the innocent party out of business.³⁸ An estimated twenty-one million dollars was lost nationwide from grain eleva-

32. IND. CODE ANN. § 26-1-9-307(1) (Burns Supp. 1983), OHIO REV. CODE ANN. § 1309.26 (Page 1982) and KY. REV. STAT. § 355.9-307 (1983).

33. IND. CODE ANN. § 26-1-9-307(1) (Burns Supp. 1983), OHIO REV. CODE ANN. § 1309.26 (Page 1983) and KY. REV. STAT. § 355.9-307 (1983).

34. IND. CODE ANN. § 26-1-9-307(1) (Burns Supp. 1983), OHIO REV. CODE ANN. § 1309.26 (Page 1983) and KY. REV. STAT. § 355.9-307 (1983).

35. NEB. REV. STAT. § 69-109.01 (1981), GA. CODE 109A-9-307(3) (1982), MONT. CODE ANN. § 81-8-301(1) (1983) and KY. REV. STAT. § 355.9-307(4) (1983).

36. KY. REV. STAT. § 355.9-307(4) (1983).

37. MONT. CODE ANN. § 81-301 (1981).

38. See generally Van Hooser, *supra* note 23.

tor bankruptcies between 1974 and 1979.³⁹ Ninety percent of this loss was absorbed by farmers. The remaining ten percent was spread between bankers and other grain companies. Thus, the elevator bankruptcy has been a direct dip into the farmers' pocket. If and when tobacco and peanuts are traded in a free market like the grains, we can expect similar problems. The question posed is how can risk for the farm product seller be reduced in the simple cash transaction of selling farm products.

Generally, under the bankruptcy law, a farmer who has sold produce to a buyer and has not received full payment is treated as an unsecured creditor. The producer must share with other unsecured creditors the assets remaining after claims of the secured creditors are settled. Although the sale of farmers' produce to a buyer is thought to be a cash transaction, in reality, it is often unwarranted extension of credit on the part of the farmer-seller.

1. Livestock Sellers

Livestock producers are accorded protection for the sale of livestock products under the Packers and Stockyards Act.⁴⁰ Timely payment by a packer, market agency or dealer for livestock purchased is required by law. Timely payment may be made by:

1. Actual delivery of a valid check;
2. Funds wire-transferred to seller; or
3. Valid check placed in mail where it is scheduled to be collected before the next business day following the purchase and transfer of possession of the livestock in question.⁴¹

If seller authorizes the mailing of a check instead of payment at point of transfer, the time extension does not constitute an extension of credit.⁴² Unless seller expressly agrees in writing, payment must be by check or wire. A payment by a draft which is not a check constitutes an extension of credit and removes the seller's eligibility for the benefits of the trust provisions discussed below.⁴³

The wire transfer provision, when used, assures the immediate availa-

39. An elevator bankruptcy, causing a \$27,000 loss to a farmer, put him out of business. Des Moines Register, August 17, 1980, at 2B, col. 5. Perhaps only a few farmers are in a position to withstand large economic losses for non-payment of the sale of farm products. For a discussion on the impacts of the problem in the livestock industry prior to the change in the Packers and Stockyards Law, see S. REP. NO. 94-932, 94th Cong., 2d Sess. 4 (1976) where it was reported that between 1958 and 1975, 167 packers failed leaving livestock producers unpaid for over \$43 million worth of livestock.

40. Between January 1975 and May 1981, a total of 177 grain elevators reported insolvency. Two percent of the approximately 10,000 grain warehouses have gone bankrupt between 1974 and 1982. Geyer, *Prompt and Full Payment for Agricultural Commodity Producer*, 4 AGRIC. L. J. 262 (1982). In Virginia, two elevator bankruptcies were settled in 1982 with producers receiving approximately seven and one-half cents of the dollar in one bankruptcy and approximately twenty-nine cents on the dollar on the other. One of these settlements involved 27 producers amounting to \$274,055.30 in losses or an average of \$10,000 per loss. ANNUAL REPORT, BUREAU OF GRAIN MTKG. SERV., DIV. OF MKT. VIRGINIA DEPT. AGRIC. CON. SERV. (1981-82).

41. 9 C.F.R. § 201.43(b)(2) (1983).

42. *Id.* § 203.16(b).

43. *Id.* § 201.200(b).

bility of funds to the seller. These prompt pay provisions of the Packers and Stockyards Act strengthen the power of the seller to withstand pressures by the packer for the extension of credit or delay in payment. However, the prompt payment provisions do not guarantee that a check will not be dishonored when deposited or cashed by seller. The adoption of the statutory trust provides surety for the seller of livestock when the check is dishonored. To protect the "innocent" seller of livestock, Congress created the "Packer Trust" in 1976.⁴⁴ Packers with average annual livestock purchases of over \$500,000 are required to hold all livestock, meats and receivables or proceeds from the livestock in trust until all the sellers of livestock have received full payment for their livestock. Sellers who expressly extend credit to the packers are not eligible for the benefits of the trust.⁴⁵ The seller must present checks for payment within thirty days (prompt endorsement provision?) to retain the benefits of the trust.⁴⁶ If the seller's attempt to cash the check fails due to nonsufficient funds, the seller must notify the Packers and Stockyard Administration within fifteen days.⁴⁷

The 1976 amendments to the Packers and Stockyards Act provide a "statutory trust" which is not an asset of the bankrupt's estate.⁴⁸ The provision does not create a lien. Instead, the trust for livestock sellers is a floating pool of commingled inventories, receivables and proceeds from cash sales. The assets are separated from those derived from credit sales by an audit. The unpaid sellers are satisfied out of a pro rata share of the "trust" created for payment of their livestock. Sellers of livestock now receive their money, the money they expected to receive when they sold their livestock, before secured creditors receive their money.⁴⁹ This provision is the teeth of the Packers and Stockyard Act which provides assurance that farmers will receive payment for livestock sold.

2. Non-Livestock Sellers

The Perishable Agricultural Act requires merchants, dealers and brokers to make full payment promptly to producers of perishable agricultural commodities.⁵⁰ Payment must be made within ten days unless express agreement to the contrary is negotiated by the parties.⁵¹ The broker, merchant or dealer licensed to purchase may be suspended for failure to

44. Act of Sept. 13, 1976, Pub. L. No. 94-410 § 8, 90 Stat. 1251, (codified at 7 U.S.C. § 196(b)-(c) (1982)).

45. Middlemen, such as market agencies, dealers and order buyers through subrogation, are entitled to the benefits of the trust provisions as well as farmer-sellers.

46. 7 U.S.C. § 196(b) (1982). See also *In re Frost Morn Meats, Inc.*, No. BK 77-31707, slip op. at 1-8 (Bankr. M.D. Tenn. Oct. 16, 1978), *appeal docketed*, No. 78-3541 (M.D. Tenn. Nov. 24, 1978).

47. 7 U.S.C. § 196(b) (1982).

48. *Id.*

49. In the minds of farmers, this provision rectified the results of being treated like unsecured creditors in bankruptcy proceedings. See H. REP. NO. 94-1043, 94th Cong., 2d Sess. (1976).

50. 7 U.S.C. § 499b(4) (1982).

51. 7 C.F.R. § 46.2(aa)(9) (1983).

pay.⁵² As the late payment trends in the perishable agricultural product markets have been increasing from 30% to 50% paid after thirty days,⁵³ it has been proposed that a statutory trust similar to the Packers and Stockyard Act be created under the Perishable Agricultural Commodity Act.⁵⁴

Farmer producers of storable agricultural commodities generally have the option of selling or storing the produced commodity. When a farmer does sell the commodity, he has no special statutory protection for the non-payment for his product by the buyer. A farmer-seller who is not paid for goods⁵⁵ in a cash transaction,⁵⁶ due to buyer's insolvency or failure to pay must pursue his rights under state creditor rights law or the bankruptcy law⁵⁷ as appropriate. Neither remedy results in satisfaction for most cash sellers. With the return of a check by an insolvent buyer or the inability to pay on a delayed pricing contract or deferred payment contract by an insolvent buyer, the farmer-producer has often unwillingly or unknowingly extend credit to the farm product buyer. Although legislative remedies have been proposed to resolve the differential treatment of livestock and other farm producers, farmers still receive different treatment according to the type of commodity produced.⁵⁸

PROVIDING PROTECTION FOR BOTH BUYER AND SELLER OF FARM PRODUCTS IN CASH TRANSACTIONS

The basic premise of this argument is that to date, both the buyer and the seller sometimes enter the market place with "dirty hands." No farmer would knowingly sell to an insolvent firm. Under present law in most states, no purchaser would buy farm products from and deliver a sole party check to a farmer-seller if the buyer knew the farm products were pledged as collateral under U.C.C. article 9. The question is, how can the law be changed to provide protection for both the farm product buyer and the farm product seller? The remainder of this section will discuss two proposals for providing protection for the buyer and the seller of farm products in the cash transaction.⁵⁹ In other words, how can "cash" be returned to a cash transaction

52. *Marvin Tragash Co. v. United States Dep't of Agric.*, 524 F.2d 1255 (5th Cir. 1975); *In re Kafcsak*, 39 Agric. Dec, United States Dept. of Agric. 683, 685-86 (1980), *appeal docketed*, No. 80-3406 (6th Cir. June 26, 1980).

53. 62 FARM BUREAU NEWS 157 (1983).

54. H.R. 3867, 98th Cong., 1st Sess. (1983) and 62 FARM BUREAU NEWS 157 (1983).

55. This includes payment by check which is subsequently dishonored.

56. Deferred payment and delayed pricing contracts are treated the same if the buyer becomes insolvent.

57. For an extended discussion of these issues, see Geyer, *supra* note 40; Bird & Looney, *Protecting the Farmer in Grain Marketing Transaction*, 31 DRAKE L. REV. 519 (1981-82); Hamilton & Looney, *Federal and State Regulation of Grain Warehouses and Grain Warehouse Bankruptcy*, 27 S.D.L. REV. 334 (1982); Note, *Dealing With Grain Dealers: The Use of State Legislation to Avert Grain Elevator Failures*, 68 IOWA L. REV. 304 (1983); Note, *Grain Elevator Bankruptcies: How can the Grain Producer be Better Protected?*, 31 U. KAN. L. REV. 157 (1982); and Note, *A Survey of Current Issues of Legislation Concerning Grain Elevator Insolvencies*, J. CORP. L. 111 (1982).

58. Geyer, *supra* note 40 at 266-77.

59. A seller who sells on a delayed pricing contract or deferred payment contract is extending credit to the buyer. As such, protection accorded to cash buyers should not be extended to them as alternative protection when a purchase money security interest is available to them.

and "audit" removed?

A. *Acceptable Alternatives to U.C.C. section 9-307(1)*

Two acceptable alternatives to U.C.C. section 9-307(1) to assure knowledge of a farm products lien are arguably 1) the California option of the deletion of protection under U.C.C. section 9-307(1) to the farm products lender⁶⁰ and 2) the improvement in the ability of buyer to search the official records to determine if a farm product lien has been created on the farm products. The deletion of "other than a person buying farm products from a person engaged in farming operation" from U.C.C. section 9-307(1) is a policy judgment. The logic in favor of this alternative is that it treats farm product lenders the same as lenders to other businesses. Farmers are treated as businessmen and not simply tillers of soil.

The second alternative that is equally feasible and defensible is the central filing of farm product liens with instantaneous (computer) retrieval of such information. The logic of requiring a lien search for farm products prior to purchase is similar to the logic of searching titles in the case of real estate purchases. The Code changes now being made are modifying section 9-307(1) on a product by product basis, are being made without logical consistency. The type of collateral, livestock, grain or other farm products should not be the determining factor for an exemption under section 9-307(1).

In theory, by filing secured transactions under the requirements of U.C.C. section 9-401, the secured party has provided all "would be" purchasers of farm products with constructive notice of the secured parties interest in the collateral. The issue that confronts us today is the practicality and results of the filing requirements of Code section 9-401 in the modern marketing of agricultural "products." In an electronic age, the current filing provisions can be modernized to accommodate the needs of both the secured party and the purchaser of "pledged" farm products.

The official version of article 9 of the Uniform Commercial Code suggests three alternative ways for filing liens on farm products: 1) central filing,⁶¹ 2) local filing⁶² and 3) local and central filing.⁶³ With centralized computer filing, the benefits of local and central filing are automatically achieved because the "local" computer can access the central file. Centralized computer filing allows for a more thorough search of the file⁶⁴ and resolves the question of where to file.⁶⁵

60. See *supra* text accompanying note 5.

61. U.C.C. § 9-401 (1st alternative) (1978).

62. U.C.C. § 9-401 (2nd alternative) (1978).

63. U.C.C. § 9-401 (3rd alternative) (1978).

64. Many lien searches are done on the name only as given. For instance, Hooker, T.J. would only be searched by the local filing agent as Hooker, T.J. Central filing with computer search would provide search on Hooker, T. Thus, Hooker T.J.; Hooker Thomas J.; Hooker, Thomas Jay; Hook T. Jay and all variations would show up under the search.

65. Under current law in many states a tractor and scraper require local filing if used on the

Comment three to section 9-401 reads: In states where it is felt wise to preserve local filing for transactions of essentially local interest, either the second or third alternative" for section 9-401 should be adopted. With farmers selling farm products both locally and at regional and terminal markets, is secured agricultural financing "essentially" a local interest? With lending institutions also working on a state or area-wide basis, is the filing of agricultural (farm equipment, farm products, growing crops) financing essentially local? I think not. But if it is now, it is likely to be less so in the future. With computer assisted search of the central file by direct linkage between a purchaser's microcomputer and central data base or a purchaser phone call to the central location, the buyer will be able to instantaneously search the record for liens on seller's farm products.

State-wide filing is still a relatively novel and unfamiliar device. As the business and banking communities become familiar with its operation, they may well come to appreciate its merits. This seems to have happened in the limited areas in which state-wide filing has been in force for any period of time.⁶⁶

In the absence of centralized computers, but with the establishment of comprehensive state-wide files in any state, private agencies have developed through which file checks can be made as promptly as if the files were located in the county courthouse. A Monday morning phone call to a central agency in the state capital may be as cheap for a file search (if not cheaper) by a farm product purchaser than a forty mile trip to the county seat (or several county seats) to search for the lien record of farmer-sellers.

Because centralized computer filing of article 9 liens can provide an instantaneous check of the file for farm product liens, it is ideally suited to provide instantaneous information to the farm product buyer. The buyer can check the file conveniently and, as a result, U.C.C. section 9-307(1) functions as intended, to prevent the conversion of farm products.

B. *Prompt Payment Provisions for Farm Goods in Cash Markets*

The farm buyer can be protected from the purchase of mortgaged farm products as outlined in a previous section. But how can the farmer be protected in a cash transaction from the insolvent or near insolvent farm product buyer?⁶⁷

The substitution of paper in the room of gold and silver money, replaces a very expensive instrument of commerce with one much less costly, and sometimes equally convenient. . . . There are several different sorts of paper money; but the circulating notes of banks and bankers are the species which is best known, and which seems best

farm, central filing if used in the construction business and both if the owner is both a farmer and construction contractor.

66. The search can be conducted by the debtor name, address variations and type of farm product.

67. See *supra* text accompanying notes 39-57 for a discussion of the problem.

adapted for this purpose.⁶⁸

If Adam Smith were alive today, I am sure he would write the following, "The substitution of Electronic Funds Transfer (EFT)⁶⁹ in the room of checks, paper, gold and silver money replaces very expensive instruments of commerce with one much less costly and more convenient to use."

Electronic funds transfer can address the prompt payment needs of the farm product producer. Electronic Funds Transfer is not new. Ever since the telegraph and telephone came into public use, commercial participants in the nation's fund payment system have been able to use electronic communications to transfer funds. The Federal Reserve system has actively used electronic funds transfer since 1918 for the movement of funds among reserve accounts of each member bank.⁷⁰ The newness of EFT is the economical use of the service in day-to-day business and consumer transactions. The physical cost of EFT compared with checks is competitive if not more inexpensive.⁷¹

EFT removes "credit" from the check transactions and returns cash to the "cash" transaction. The only other way to have a cash transaction is to have an actual transfer of gold, silver, coins or Federal Reserve Notes at the time of the cash transaction.

The loss of, or reduction in, float is often used as an argument against electronic funds transfer. Float is a term used to refer to those funds that have been credited to one account before they have been debited from another account and, therefore, are temporarily credited in two accounts. As the banking industry has developed more rapid means for clearing checks, float has decreased.⁷²

Need and value of float can be looked at from the viewpoint of both consumers and business. Consumer surveys suggest that the majority of consumers at some time issue checks knowing that they do not have sufficient funds in their account at that moment.⁷³ If the check is written without

68. A SMITH, AN INQUIRY INTO THE NATURE OF CAUSES OF THE WEALTH OF NATIONS, 276-277 (1937).

69. Electronic Funds Transfer (EFT) is a broad term susceptible to a variety of definitions. The Federal Electronic Funds Transfer Act defines EFT as "any transfer of funds, other than a transaction originated by check, draft, or similar paper instrument, which is initiated through an electronic terminal, telephonic instrument, or computer or magnetic tape so as to order, instruct, or authorize a financial institution to debit or credit an account. . . ." 15 U.S.C. § 1693a(6) (1982). There are other systems not covered by the Uniform Commercial Code or the federal act which are also given the blanket title EFT. For a general description of electronic payment systems, see N. PENNEY AND D. BAKER, THE LAW OF ELECTRONIC FUNDS TRANSFER SYSTEMS (1980 & Supp. 1982) and R. ZIMMER AND T. EINHOM, THE LAW OF ELECTRONIC FUNDS TRANSFER (1978).

70. Schroeder, *Developments in Consumer Electronic Fund Transfer*, RICHMOND FED. RESERVE BULL. 395 (June 1983).

71. The Bank Administration Institute estimated \$.07 as the cost to the bank of an EFT deposit, \$.24 for an over-the-counter teller deposit and \$.59 for a bank-by-mail deposit. Trotter, *Cost and Benefits of Direct Deposit*, MAG. BANK ADMIN., 41-43 (July 1981). See also Schroeder, *supra* note 73 at 395-403.

72. A North Carolina bank flies a jet to New York daily to reduce float and makes a profit at doing so. Bankers often get together daily in a local area and transfer checks.

73. James T. LePage and Assoc., *Kansas Banking: Public Attitude Study on Kansas' Usage and Attitudes Toward Kansas Banking*, prepared for the Kansas Bankers Association (October 1976).

sufficient funds in the account, and even if the funds are subsequently deposited prior to the check clearing, the writer is check-kiting.⁷⁴

Float is, in fact, an extension of credit. Float is a credit extension activity which results from the use of checks instead of handling the transaction by cash. Float is not a legal right, but rather a characteristic of the present banking system.⁷⁵ As a company takes float in, it also give it out. Therefore, float may well balance out for most companies. It comes at a cost to the unwary recipient of a check which is returned with "non-sufficient funds" stamped on the back and ensuing bankruptcy on the part of the check issuer.

Strong consideration should be given to amending the U.C.C. to allow cash sellers of farm products the right to request electronic funds transfer for the payment in lieu of checks. U.C.C. section 2-507⁷⁶ could easily be amended with the following addition: (3) Sellers may demand electronic fund transfer payment upon delivery of goods in a cash market or (3) Sellers of farm products may demand electronic funds transfer payment upon delivery of farm products when the sales transaction is for cash. The rationale for this is several fold. First, it would provide equal treatment to all agricultural product producers. Secondly, it would provide parity of bargaining power for farm product sellers.⁷⁷ The individual request (demand) for EFT is not likely to result in satisfaction for the individual farm seller. We must have the authority of law to achieve this goal. Thirdly, it would allow the farmer to receive immediate payment for sale of goods and thereby reduce or eliminate the need for some of the other more expensive remedies proposed to protect the innocent seller of farm products from an insolvent or a soon to be insolvent buyer.

This author does not believe that the cash sale of farm products was ever meant to be a credit transaction. The issue is how to allocate or reduce

74. If funds are earning interest in a negotiable order of withdrawal account, the check issuer is truly receiving a benefit for his ability to earn money on his account before debiting. The check issuer is benefiting from the float. A second related phenomenon involves no interest earnings checking customers use their ability to "capitalize" on the way the system works. Checking customers draw checks for some bill payments knowing that, although there may not be sufficient funds at the time of issuance or mailing of the checks to pay bills, funds will be in the account when those checks are presented for payment. The checking customer makes an "in person" deposit of a paycheck or other credit item in time to be reflected in the consumer's account prior to the check clearing. Of course, this is illegal "kiting" unless the consumer has an overdraft line, but the realities are that many customers operate their checking accounts in just this way. EFT involves a "giving up" of whatever benefit exists in according the consumer the benefit of timely payment on the basis of postmark date. N. PENNEY AND D. BAKER, *supra* note 69, at ¶14.010.

75. *Electronic Funds Transfer Systems: Hearings Before the Subcomm. on Financial Institutions of the Senate Committee on Banking, Housing and Urban Affairs*, 95th Cong., 1st Sess. 380 (1977). This author searched the economic and financial literature for an economic study of cost/benefits and need for float. A definitive study was not found.

76. U.C.C. § 2-507 now reads:

(1) Tender of delivery is a condition to the buyer's duty to accept the goods and, unless otherwise agreed, to his duty to pay for them. Tender entitles the seller to acceptance of the goods and to payment according to the contract. (2) Where payment is due and demanded on the delivery to the buyer of goods or documents of title, his right as against the seller to retain or dispose of them is conditional upon his making the payment due.

77. See Geyer *supra* note 42, at 247-55 for a discussion of legislation to provide farmers with increased authority to demand prompt and full payment for livestock. The principle has been established. The issue is whether to carry the protection to other farm products.

transaction risk in the marketing of farm products. Allowing the farmer to request cash, or its equivalent via EFT, is not inconsistent with the position of other market place participants. Merchants generally are in a position to enforce their credit policies. The extension of credit through credit cards, credit policies or cash only sales are enforceable by merchant sellers. Farmers should be provided the same protection. When was the last time a merchant sold a \$10,000 item for payment by check and transferred title prior to the check clearing? Most states provide mechanic and materialmen liens to protect suppliers of services.

A farm product buyer unable to pay cash under EFT for the farm products could arrange a line of credit with his bank. The bank could create a security interest in the purchased farm product. If credit to farm product buyers is to be extended, it should be extended directly. It should not be extended unknowingly by an innocent farmer-seller. A farmer-seller under a delayed pricing contract or a deferred payment contract should be made aware that he is extending credit. Protection for such transactions should be accorded through regular security agreements. These contracts are not cash transactions.

Perhaps a form providing the following information should be adopted to show evidence of a clear title on the part of the farmer and to show transfer of funds on the part of the merchant buyer in a "farm product cash" transaction.

FARMER/MERCHANT TITLE TRANSFER TRANSACTION

Date _____ Product _____ Quality _____
 Number of units _____ (bu/hd/#) Per Unit _____ Price _____
 Shipping Information _____
 Seller _____ Buyer _____

Type of Transaction:

- _____ 1. Storage—Warehouse Receipt # _____ Issued by Farm Product Warehouseman
- _____ 2. Cash Sale _____ Electronic Funds Transfer # _____
 _____ Check Issued—Seller Please Promptly Cash As You Are An Unsecured Seller.
- _____ 3. Delayed or Deferred Pricing Contract—Seller has Knowingly Extended Credit to Merchant/Buyer.

I understand that I am extending credit to seller and I should consider taking a purchase money security interest in the transaction.

 Seller's Signature

I, _____, seller, certify under penalty of law that I have title to this product, and I am the legal owner of the farm product, and;

A. _____ I have no liens against this farm product or;

- B. _____ I have a lien against this farm product with the following institutions:
- a. Name _____ Address _____
Institution _____
- b. Name _____ Address _____
Institution _____
- c. Name _____ Address _____
Institution _____

The following receipt indicates:

_____ Date \$_____ transferred from Farm Product Buyer's account at Ipay National Bank of Bleaksburg, Virginia to Farmer Sellers Account at Iam Paid Bank of Reedford, Virginia.

CONCLUSION

As we look to the future, we have a choice. We can continue to muddle through with alternative proposals and litigation in the various states. Or we can work to establish uniform legislation that will resolve the twin problem: buyers who do not pay and sellers that do not tell.

Resistance to change can be expected from many quarters. Industry has always had its Luddites. And of course some Luddites refused to adopt and use the telephone, hedge grain operations, secure commodity market news and other technological advances. Some of the Luddites might just be out of business today. But change will come as farmers and other businesses expect convenience and timeliness in the delivery of goods and services.

The use of electronic funds transfer between farmer and business will speed up the transaction time. It will provide an advantage in the receipt of immediately available funds. The bank will serve as a conduit of funds rather than as a reservoir of funds as it has in the past.

Producers of livestock and perishable agricultural commodities have a more comprehensive system and better protection for prompt and full payment for farm production than do sellers of storable agricultural commodities. The market psyche that accompanies an assurance of payment for goods sold is impossible to quantify. What is it worth to a producer to know that the integrity of the market is available to him when he is selling his product in an era of volatile markets? As the fluctuations in agricultural markets continues, the problem for producers of storable goods is likely to intensify.

The electronic exchange during a cash market transaction would consist of 1) electronic access to centrally filed security interest so that the buyer instantaneously knows that he is receiving clear title and 2) electronic funds transfer so that the buyer knows that he is receiving prompt and full payment. Technology can be used to reduce and perhaps eliminate transaction risk on the part of product seller and product buyer.