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University of Arkansas
System Division of Agriculture
NatAgLaw@uark.edu | (479) 575-7646

An Agricultural Law Research Article

The Federalization of the Farm Products Exception Rule of U.C.C. 9-307(1): Anomaly or Opening Salvo?

by

Sarah Pitts Eldridge

Originally published in DRAKE LAW REVIEW
36 DRAKE L. REV. 115 (1986)

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NOTES

THE FEDERALIZATION OF THE FARM PRODUCTS EXCEPTION RULE OF U.C.C. 9-307(1): ANOMALY OR OPENING SALVO?

I. INTRODUCTION

When the United States Congress enacted section 1324 of the 1985 Farm Bill,[1] it obtruded upon a legislative area previously reserved solely to the states — the Uniform Commercial Code (U.C.C).[2] Prior to enactment of section 1324, forty-nine states had statutes incorporating U.C.C. section 9-307(1),[3] which provides that any buyer in the ordinary course of business[4] other than a buyer purchasing farm products[5] directly from the producing farmer takes clear title, regardless of any perfected security interest.[6] The stated purpose of section 1324 is to relieve the burden on interstate commerce by protecting buyers of farm products from the risk of double payments — once, at time of purchase, and again when the seller fails to repay the lender — when the buyer "lacks any practical method for discovering the existence of the security interest."[7] The gist of the federal provision is that a buyer of farm products takes clear title unless the buyer has received

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1. Food Security Act of 1985, Pub. L. No. 99-198, 99 Stat. 1354 (1985).
2. All references herein to the U.C.C. are to the 1978 Official Text and Comments.
3. Louisiana is the only state not to enact the U.C.C.
4. The U.C.C. defines "buyer in the ordinary course of business" as:

> a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker.

U.C.C. § 1-201(9).

5. The U.C.C. defines "farm products" as

> crops or livestock or supplies used or produced in farming operations or if they are products of crops or livestock in their unmanufactured states (such as ginned cotton, wool-clip, maple syrup, milk and eggs), and if they are in the possession of a debtor engaged in raising, fattening, grazing or other farming operations. If goods are farm products they are neither equipment nor inventory.

U.C.C. § 9-109(2).

6. U.C.C. § 9-307(1).
7. Food Security Act of 1985, Pub. L. No. 99-198, § 1324 99 Stat. 1354 (1985).

prior notification from the lender or seller of the security interest[8] or unless the state has instituted a central filing system approved by the Secretary of Agriculture.[9]

Prior to enactment of section 1324, many states had passed modifications to the farm products exception provision of U.C.C. 9-307(1).[10] The resulting multitude of variations to U.C.C. 9-307(1) severely undercut the primary purpose of the U.C.C. — uniformity.[11] Although a purpose of section 1324 is the creation of uniformity regarding title provisions for farm product purchases, the section is so poorly conceived as to virtually guarantee a continuing lack of uniformity.[12] In addition to this fundamental problem, section 1324 presents other thorny issues which the courts likely will be called upon to resolve. It is the purpose of this note to examine the origin, creation, and final form of the federal clear title provisions of section 1324.

II. Genesis of U.C.C. 9-307(1)

An understanding of section 1324 begins with a brief look at its roots in the U.C.C., specifically section 9-307(1). The U.C.C. was drafted by the American Law Institute and the National Conference of Commissioners on Uniform State Laws for a dual purpose: to simplify, clarify, and modernize law governing commercial transactions and to create uniformity in commercial law among the various states.[13] The general U.C.C. rule is that a perfected security interest in collateral continues upon disposition of the collateral, unless the secured party has authorized the disposition.[14] Section 9-307 is the exception to this rule; it is designed to benefit inventory buyers and sellers.[15] Although farm products are akin to inventory, section 9-307(1) treats them differently. The Official Comments to the U.C.C. are silent regarding this farm products exception, but several theories have developed as to its genesis. One theory postulates that the U.C.C. drafters viewed farmers as being more like consumers than merchants and that the effect is a "paternalism that looks at the farmer as a sturdy yeoman . . . rather than a sophisticated borrower."[16] Another theory is that agricultural lending is unique and that the farm products exception, with its allocation of risk to the buyer, was necessary to ensure availability of agricultural loan money.[17]

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8. *Id.* at § 1324(e)(1).

9. *Id.* at § 1324(e)(2).

10. *See generally* Van Hooser, *Farm Products: Recent Legislative Changes to Section 9-307*, 29 S.D.L. Rev. 346 (1984) [hereinafter Van Hooser].

11. *See* U.C.C. § 1-102.

12. *See infra* notes 24-37 and accompanying text.

13. U.C.C. § 1-102.

14. U.C.C. § 9-306.

15. U.C.C. § 9-307 comments 1-4.

16. Clark, *The Agricultural Transaction: Equipment and Crop Financing*, 1 Agri. L.J. 172 (1979).

17. Miller, *Farm Collateral Under the U.C.C.*, 2 Agri. L.J. 253, 254 (1980) [hereinafter

The final theory is that farm products purchasers do not require special protection because access to filed financing statements is readily available; the conscientious buyer need only check for perfected security interests in the products being sold.[18]

Whatever the reason for the farm products exception, the effect has been to put the burden of risk of loss squarely on the buyer. Such an effect may not have been cause for concern when section 9-307(1) was drafted, however, since that time, agricultural financing has become business on a scale much larger than ever contemplated by the drafters of the U.C.C.[19] This burden of risk is exacerbated by the nature of the collateral; farm products — grain, livestock, fruit, etc. — cannot readily be physically restricted, secured, or identified.[20] Clearly, the secured party is at a disadvantage in monitoring his collateral. The farm products exception of section 9-307 (1) may merely represent acknowledgment of the realities of the situation confronting agricultural lenders.

The U.C.C. protects lenders by providing for general notice of a security interest in collateral by the filing of financing statements.[21] Financing statements state the names and addresses of the debtor and secured party, are signed by the debtor, and briefly describe the collateral.[22] U.C.C. section 9-401 offers adopting states three alternatives for filing financing statements: central filing with the state's Secretary of State; local/county filing at the farmer's county of residence.[23] The fact that three options are presented regarding farm collateral filings has resulted in lack of uniformity among the states as to the place of filing financing statements regarding farm products.[24] Purchasers have been required to know the laws of each state in order to seek out any filed security interests in farm products. An inadequate search might result in the buyer paying double for farm products — first to the farmer/seller and later to the secured party.[25] One commentator has observed that the farm products exception may have created lender laziness:[26] because the burden of risk has fallen so squarely on buyers, lenders may not have been diligent in their credit investigations.[27] Accordingly, a reevaluation of the allocation of the risks of loss in farm products transactions was appropriate.

Miller].

18. *Id.*

19. Uchtmann, Bauer, & Dudek, *The UCC Farm Products Exception — A Time to Change*, 69 MINN. L. REV. 1325 (1985) [hereinafter Uchtmann].

20. Miller, *supra* note 17, at 254.

21. *See* U.C.C. § 9-401.

22. *Id.*

23. *Id.*

24. *See* Section III *infra*.

25. U.C.C. § 9-307(1).

26. Uctmann, *supra* note 18, at 1320-21.

27. *Id.*

The practical effect of the farm products exception was that if a farmer sold farm products and then defaulted on a loan which was secured by the same farm products, the lender could seek payment from the buyer if unable to collect from the farmer.[28] The lenders' cause of action against the purchaser was for conversion of the lenders' collateral.[29] Purchasers of farm products have been volubly unhappy with this exposure to liability for double payment.[30] They have been especially critical of the unwieldy procedures for searching for financing statements.[31] In order to search for filings, the purchaser must know the county where the financing statements are filed; if found, the buyer does not know if the information on file is current.[32] The information available is purposely cursory and may well not contain necessary information regarding conditional waivers on sales of collateral.[33] In addition, the seasonal nature of farming, with its volume buying compressed within a brief period, creates an enormous time crunch for buyers. The difficulties inherent in the situation have been vividly characterized by one commentator's imagined scenario of grain sellers lined up at grain elevators while the purchaser sends representatives to comb the county or state files in search of filed financing statements.[34] Because of the severe practical difficulties inherent in the current procedure, farm products purchasers have effectively become sureties on their sellers' loans.[35] Livestock buyers, which must make payment to their sellers within twenty-four hours of purchase[36] have joined with commodity buyers to pressure for new procedures and reallocation of risk.[37] Within the last four years many of the states have responded to this pressure and enacted modifications to the farm products exception.

III. State Responses to Demands for Revision of 9-307(1)

Response to the demands for revision to the farm products exception has taken four forms: (1) central filing; (2) requiring buyers to obtain the names of secured creditors from sellers; (3) requiring lenders to give notice of their security interests to buyers; and (4) repeal of the farm products exception.[38] A survey of the states and the revisions made prior to enact-

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28. *Id.*

29. *Id.* at 1219-20.

30. *See* Van Hooser, *supra* note 10, at 349. *See also* Uchtmann, *supra* note 18, at n.28.

31. *See generally* Geyer, *Proposals for Improvements in Agricultural Marketing Transactions*, 29 S.D.L. Rev. 361 (1984).

32. Uchtmann, *supra* note 18, at 1327-28.

33. *Id.*

34. *Id.*

35. *Id.*

36. The Packers and Stockyards Act provides for payment to livestock sellers by close of business the next day. 7 U.S.C. § 228b (1985).

37. *See* Van Hooser, *supra* note 10, at 349.

38. *See generally* Van Hooser, *supra* note 10.

ment of section 1324 reveals a confusing array of attempts to ameliorate an already confused situation.

A. *Central Filing*

Iowa,[39] Nebraska,[40] Montana,[41] and Kansas[42] each adopted their own version of a central filing system. The common intent of these statutes was to continue to protect lenders by retaining the farm products exception, but also provide buyers with a more responsive and timely search mechanism. The Iowa statute provided that security interests in farm products could be filed with the office of the Secretary of State.[43] By agreement with an outside party, the central filing data was put into a computerized file, which was readily available by telephone or computer hook-up.[44]

Nebraska changed its laws so that even though secured parties were still required to file in the county of farmer's residence, the county clerk was required to transmit the filing information to the Secretary of State, who enters the data into a central computer system.[45] The information was accessible by any means, including computer dial-up.[46]

Kansas law required the farm lender to send the financing statement to the Kansas Secretary of State.[47] The Montana version of central filing required creditors to file their security interests directly with the Department of Livestock, which transmitted the information to the central livestock markets.[48] A purchaser of livestock could take free of any security interest not filed with the Department of Livestock, and hence, the central market.[49]

Each of these state responses reduced the search burden of the buyer. Although the purpose of each of the statutes was the same, the means varied widely; uniformity was not achieved.

B. *Requiring Buyers to Obtain the Name of Secured Creditors From Seller*

Four states modified their farm products filing laws so that a buyer would take free of any security interest in the collateral if the buyer obtained the name of the secured party from the seller and made payment

39. Iowa Code §§ 554.9407(2)-(4) (1985).
40. Neb. Rev. Stat. U.C.C. §§ 9-413 to -415 (Cum. Supp. 1984).
41. Mont. Code Ann. § 81-8-301 (1986).
42. Kan. Stat. Ann. §§ 84-9-401 to -410 (Supp. 1984).
43. Iowa Code §§ 554.9407(2)-(4) (1985).
44. *Id.*
45. Neb. Rev. Stat. U.C.C. §§ 9-413 to -415 (Cum. Supp. 1984).
46. Neb. Rev. Stat. U.C.C. § 9-413(5) (Cum. Supp. 1984).
47. Kan. Stat. Ann. §§ 84-9-401 to -410 (Supp. 1984).
48. Mont. Code Ann. § 81-8-301 (1986).
49. *Id.*

with a check payable jointly to the farmer and his lender.[50] Instead of acting as surety for the seller, the buyer relied on the representations of the farmer/seller.

North Dakota's law established five prerequisites to a buyer taking free of a security interest: (1) buyer must try to get the name of all secured parties from the farmer/seller; (2) if the seller provides no names, the buyer must search the county records for five years preceding sale for a financing statement; (3) purchaser must issue a check payable jointly to the seller and all secured parties; (4) purchaser may not have actual knowledge of a secured party whose name is not included on the check; (5) buyer must maintain records to support his actions.[51] In addition, North Dakota required the lender to direct its borrower to inform all buyers of its security interests.[52]

Although their laws were not as detailed as those of North Dakota, similar laws were enacted in Oklahoma,[53] Nebraska,[54] and South Dakota.[55] None of these states required the buyer to check for county filings if the seller did not list a secured party. Oklahoma[56] and South Dakota[57] made a seller subject to criminal penalties for failure to disclose a security interest. Nonetheless, a seller's misrepresentation regarding security interests did not shield the purchaser; the buyer still took subject to the security interest.[58]

C. *Requiring Lenders to Give Notice to Buyers of Security Interest*

Those state statutes that placed the burden of lenders to notify purchasers of the security interest in the farm products generally required the farmer to provide his lenders with a list of his potential buyers.[59] Upon receipt of the farmer's list, it was up to the lender to notify the listed buyers of the security interest; failure to so notify allowed buyers to take free of the security interest.[60] There are six states that developed variations of this type of statute.[61] Illinois law provided that lenders might require farmers to pro-

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50. The four states are North Dakota, Oklahoma, Nebraska, and South Dakota.
51. N.D. CENT. CODE § 41-09-28 (1983).
52. *Id.* at § 41-09-28(4) (1983).
53. OKLA. STAT. ANN. tit. 12A § 9-307 (West Supp. 1987).
54. NEB. REV. STAT. U.C.C. § 9-307(4) (CUM. SUPP. 1984).
55. S.D. CODIFIED LAWS ANN. § 57A-9-503.1 -.2 (Supp. 1984).
56. OKLA. STAT. ANN. tit. 12A § 9-307(3)(a) (West Supp. 1984-85). "The certificate shall include a warning that any false statement as to the imprisonment in the state penitentiary for a period not to exceed three (3) years or in the county jail for a period not to exceed one (1) year, or by a fine not to exceed Five Hundred Dollars ($500.00)." *Id.*
57. S.D. CODIFIED LAWS ANN. § 57A-9-503.2 (Supp. 1984). A seller who does not reveal secured parties commits a Class 1 misdemeanor. *Id.* Intent to defraud is an element of the crime. *Id.* Failure to provide notice is prima facie evidence of intent to defraud. *Id.*
58. OKLA. STAT. ANN., tit. 12A, § 9-307(3)(a) (West Supp. 1984-85) and S.D. CODIFIED LAWS ANN.] 57A]-9-503-.2 (Supp. 1984).
59. Uchtmann, *supra* note 18, at 1340-41.
60. *Id.*
61. *Id.* The six states referenced are Illinois, Ohio, Indiana, Tennessee, Kentucky, and

vide a list of potential buyers; if a farmer sold to a buyer not on the list, it was a Class A misdemeanor.[62] The list of buyers could be amended, provided the addition was made at least seven days prior to sale.[63] Ohio[64] and Indiana[65] statutes were fundamentally similar to Illinois; however, the Ohio statute required that purchasers' checks be made payable to both the farmer and the secured parties.[66] Tennessee[67] and Kentucky[68] also had variations of the lender notification statutes.

The general thrust of the lender notification modification to U.C.C. 9-307(1) was a more equitable sharing of the risks of loss; buyers needed to search only their own records to ascertain if a farmer/seller's products were subject to a security interest and to determine who held that interest. Lenders had responsibility for obtaining purchaser lists from their debtors and were forced to incur the costs of notifying those buyers. Because of the ease of implementation and relative informality of the system, lender notification met with growing acceptance as a modification to U.C.C. 9-307(1).[69]

D. *Repeal of the Farm Products Exception*

California was the only state to do away completely with the farm products exception.[70] Accordingly, farm products buyers took free of any security interest granted by their sellers. Tennessee repealed the farm products exception for all farm products except tobacco, grain or soybeans, and livestock.[71]

E. *Federal Precursors to Section 1324*

Representative Tom Harkin (D. Iowa), now a United States Senator, submitted a bill in the 98th Congress altering the farm products exception.[72] The 1983 bill provided for federal preemption of the states' U.C.C. 9-307 (1) section and completely repealed the farm products exception.[73] The language of the bill was that a buyer of farm products took free of any security interest created by his seller, even though perfected and even though the

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Delaware. *Id.*

62. ILL. ANN. STAT. ch. 26, §§ 9-205.1, 9-306.01, 9-306.02, 9-307, 9-307.1, 9-307.2 (Smith-Hurd Supp. 1984-85).

63. *Id.*

64. OHIO REV. CODE ANN. § 1309.26 (Page Supp. 1984).

65. IND. CODE ANN. § 26-1-9-307 (Burns Supp. 1984).

66. OHIO REV. CODE ANN. § 1309.26 (Page Supp. 1984).

67. TENN. CODE ANN. § 47-9-307 (Supp. 1984).

68. KY. REV. STAT. ANN. § 355.9-307 (Bobbs Merrill Supp. 1984).

69. Uchtmann, *supra* note 18, at 1340-43.

70. CAL. COM. CODE § 9307 (West Supp. 1985).

71. TENN. CODE ANN. § 4-9-307 (Supp. 1984).

72.. H.R. 3296, 98th Cong., 1st Sess., 129 CONG. REC. 3961 (1983).

73. *Id.*

buyer knew of the existence of the security interest.[74] No action was taken on this bill.

IV. Congressional Enactment of Section 1324

Shortly after the 99th Congress convened, clear title bills were presented in both the Senate and the House of Representatives.[75]In the House, Rep. Charles Stenholm (D. Tex.) and Rep. Steve Gunderson (R. Wisc.) submitted House of Representives File 1591, which provided that buyers of farm products took clear title unless they had received prior written notice of a security interest from the lender together with instructions for payment of the sale proceeds.[76] The bill also created civil penalties for borrowers/sellers who failed to apply sale proceeds to their loans.[77] The bill was referred to the House Subcommittee on Conservation, Credit and Rural Development, which held hearings on the measure on March 26, 1985.[78] Testimony before the subcommittee focused on the existing allocation of the risk of loss to the buyers of farm products and the practical difficulties buyers faced in their search for liens.[79] No testimony was presented, however, that provided data regarding the total amounts that buyers of farm products had had to pay in "double payments."[80] Nonetheless, the subcommittee determined that federal action was required and reported the clear title provision to the Agriculture Committee on July 10, 1985.[81]

Rep. Stenholm was successful in his effort to amend the measure to allow lenders to require in security agreements that borrowers provide lists of potential buyers for prenotification purposes.[82] The amendment afforded some flexibility in its provision that if sellers sold to a buyer not on the list previously provided to the secured party, then sellers must notify the lender of the buyer's identity within seven days prior to sale, or account to the lender for the sale proceeds within ten days after sale; violation of this section was punishable by a fine not to exceed $5,000.[83] The Agriculture Com-

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74. *Id.*

75. H.R. 1591, 99th Cong., 1st Sess., 131 Cong. Rec. 1276 (1985) was submitted on March 19, 1985 as an amendment to the Agriculture and Food Act of 1981. S. 744, 99th Congress, 1st Sess., 131 Cong. Rec. 3425 (1985) was submitted on March 26, 1985, also as an amendment to the Agriculture and Food Act of 1981.

76. H.R. 1591, 99th Cong., 1st Sess., 131 Cong. Rec. 1276 (1985).

77. *Id.*

78. H.R. Rep. No. 99-271, 420, 99th Cong., 1st Sess. (1985). Parties speaking in favor of the bill were American Farm Bureau Federation, National Cattlemen's Ass'n, American Meat Institute, and Livestock Marketing Ass'n. The American Bankers' Ass'n. and Farm Credit Administration spoke against the measure.

79. *Id.*

80. *Id.*

81. *Id.* at 428.

82. *Id.*

83. *Id.*

mittee adopted Stenholm's amendment by a voice vote.[84] Rep. Glickman's amendment to allow states three years to adopt laws to over-ride the clear title provisions of the bill was defeated in a voice vote.[85]

The clear title provisions were reported out by the House Agriculture Committee as section 1324 of the House of Representatives File 2100 on September 13, 1985.[86] In addition to the provisions discussed *supra*, the reported measure stated that the exposure of buyers of farm products to double payment constituted a burden on and obstruction to interstate commerce and that the purpose of the section was to remove such burden and obstruction.[87] In addition, the section provided that commission merchants[88] and selling agents[89] were afforded the same clear title opportunities as buyers in the ordinary course of business, and that the section would become effective thirty days after enactment.[90] The full House of Representatives passed House of Representatives File 2100, including section 1324, on October 8, 1985.

In the Senate, Senator Thad Cochran submitted Senate File 744, which mirrored the 1983 Harkin bill in that it completely repealed the farm products exception of U.C.C. 9-307(1).[91] The bill was sent to the Senate Committee on Agriculture, Nutrition, and Forestry, which met in markup on the bill on August 1, 1985.[92] During Committee discussion, Senator Howell Heflin (D. Ala.) questioned the necessity of federal involvement in the area.[93] In response, Senators Cochran, Melcher, and Harkin cited the lack of uniformity among the states regarding title upon sale of farm products, the practical problems presented by existing search mechanisms, and the equities regarding the burden of risk of loss falling solely on the buyer.[94] Senator Cochran proposed that Senate File 744 be added to the Committee farm bill as an amendment.[95] The Cochran amendment passed by a voice vote.[96]

At the request of the Majority Leader, the Cochran amendment was

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84. *Id.*

85. *Id.*

86. *Id.* at 821.

87. *Id.* at 295.

88. *Id.* at § 1324 (c)(3). "[C]ommission merchant means any person engaged in the business of receiving any farm product for sale, on commission, or for on behalf of another person." *Id.*

89. Food Security Act of 1985, Pub. L. No. 99-198, § 1324 (c)(8), 99 Stat. 1354 (1985), states that a "selling agent means any person, other than a commission merchant, who is engaged in the business of negotiating the sale and purchase of any farm product on behalf of a person engaged in farming operations." *Id.*

90. H.R. Rep. No. 99-271 at 295-96.

91. S. 744, 99th Cong., 1st Sess., 131 CONG. REC. 3425 (1985).

92. S. Rep. No. 99-147, 99th Cong., 1st Sess. (1985).

93. *Id.*

94. *Id.*

95. *Id.*

96. *Id.*

removed from the farm bill on October 4, 1985, in order to allow consideration of the matter by the Senate Committee on Banking, Housing, and Urban Affairs.[97] The Senate Banking Committee held hearings on October 9, 1985, to consider the effect Senate File 744 would have on agricultural credit and lenders.[98] The Committee received the testimony of nineteen witnesses; all of whom had strong opinions,[99] but none of whom provided data as to the amount of money lost by farm products buyers in double payments.[100] Chairman Jake Garn chastised the competing interests for their "unwillingness to talk about this issue and try and compromise it," and referenced the "very desperate campaign" of some farm groups to prevent the Senate Banking Committee from holding hearings.[101] The major revision to come out of the Senate Agriculture Committee was Senator Mark Andrews' (R. N.D.) proposal that states be permitted to select either lender notification of buyers, or, alternatively, implementation of a state central filing system, which would serve as constructive notice to buyers.[102] Sen. Cochran modified Senate File 744 to include Sen. Andrews' central filing alternative and to revise the effective date of the bill from thirty days after enactment to twelve months after enactment.[103]

The Senate passed Senate File 744 on November 23, 1985, and the bill was sent to conference on December 14. The Conference Report noted several differences between the House and Senate clear title provisions.[104] The Conference stated that the House bill provided that the buyer takes clear title unless the buyer has received written notice of a security interest and payment obligations within the past year, and the buyer fails to perform the payment obligation.[105] The Senate amendment added an exception to the clear title provision by exempting buyers of products produced in states

97. *Id.*

98. S. Rep. No. 99-147, 99th Cong., 1st Sess. (1985). *Hearing before the Committee on Banking, Housing, and Urban Affairs* on October 9, 1985.

99. *Id.* Statement of Martin D. Jackson, Banking Commissioner for the State of Arkansas: "International robber grain barons and mammoth poultry and meat processors aren't concerned and are not attempting to eliminate the normal risk of their business transactions . . . . Rather, they are attempting in the midst of chaos that exists, because of the farm credit crisis, to shift the risk that is normal to their business . . . to the capital accounts of community banks." *Id.* at 157. Statement of Jim De Gaetano, President of Pennsylvania Livestock Auction Ass'n, Inc., that the livestock workers in Pennsylvania "are in very dire need of . . . legislative support or we are all going to go out of business. Our sales gross between $150,000 and $300,000 . . . all of which we can be sued for at any time. We alone paid $8,000 in the last year to banks and FHA for cattle that we had sold." *Id.* at 97.

100. *See generally* S. Rep. No. 99-147, 99th Cong., 1st Sess. (1985), *Hearing Before the Committee on Banking, Housing, and Urban Affairs.*

101. *Id.* at 132.

102. *Id.* at 12-16.

103. *See generally id.*

104. *See generally* H.R. Rep. No. 99-447, 99th Cong., 1st Sess. (1985) at 485-87.

105. *Id.* at 485.

with central filing of farm products financing statements.[106] The House bill provided that security agreements may require sellers to furnish lenders with lists of potential buyers and off-list sales by sellers may result in fines to sellers of up to $5,000.[107] The Senate version differed in that it also applied to commission merchants and selling agents and the fine provision was the greater of $5,000 or fifteen percent of the value of the products sold.[108] Whereas the House provided that the clear title provisions become effective thirty days after enactment, the Senate amendment set twelve months as the grace period.[109] The Senate amendment had a more inclusive definitions section than the House bill. And, finally, the House bill contained Congressional findings of fact and statement of purpose, while the Senate amendment contained no similar section.[110] The Conference Committee submitted its own text, which was passed by both houses of Congress on December 18, 1985.[111] The measure was signed by President Reagan on December 23, 1985.

V. The Clear Title Provisions of Section 1324: What it Does and Does Not Say

Section 1324 of the Food Security Act of 1985[112] begins with a statement of Congressional findings that the legislation is needed because state laws subject purchasers of farm products to double payment and that exposure to double payment "inhibits free competition in the market for farm products . . . [and] constitutes a burden on and an obstruction to interstate commerce in farm products."[113] The avowed purpose of the section was to remove the "burden on and obstruction to interstate commerce in farm products."[114] Thus, authorization for the legislation derived from the commerce clause of the United States Constitution.[115]

The heart of the new "clear title" legislation is the statement that except for prenotification of buyers or central filing, a buyer who in the ordinary course of business buys a farm product from a seller engaged in farming operations shall take free of a security interest created by the seller, even though the security interest is perfected; and the buyer knows of the existence of such interest.[116] The plain language of the section effectively

106. *Id.* at 485-86.
107. *Id.* at 486.
108. *Id.*
109. *Id.*
110. *Id.* at 487.
111. 131 Cong. Rec. S51788, S17893, H12516 (daily ed. Dec. 18, 1985)
112. Pub. L. No. 99-198 § 1324(a).
113. *Id.*
114. *Id.* at § 1324(b).
115. U.S. Const. art. I, § 8, cl. 3.
116. Food Security Act of 1985, Pub. L No. 99-198 § 1324(d), 99 Stat. 1354 (1985).

serves to reallocate the existing U.C.C. 9-307(1) burden of risk of loss from the buyer of farm products to the farm products lender. A total about-face in the law is avoided only by the provisions that lenders remain protected if they provide prior notification of the security interest to a buyer or if the state where the transaction occurs has a central filing system.[117]

Subsections (e) and (g) are parallel; subsection (e) pertains to "buyers of farm products," while subsection (g) pertains to commission merchants[118] or selling agents.[119] These sections are very detailed.[120] The gist of both is

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117. The prenotification and central filing requirements are found in subsections (e) and (g). Food Securities Act of 1985, Pub. L. No. 99-198 S. 1324(e) and (g).

118. *See supra* note 89.

119. *See supra* note 88.

120. Subsection (e) and (g) of section 1324 provide respectively:

(e) A buyer of farm products takes subject to a security interest created by the seller if—

(1)(A) within 1 year before the sale of the farm products, the buyer has received from the secured party or the seller written notice of the security interest organized according to farm products that—

(i) is an original or reproduced copy thereof;

(ii) contains,

(I) the name and address of the secured party;

(II) the name and address of the person indebted to the secured party;

(III) the social security number of the debtor or, in the case of a debtor doing business other than as an individual, the Internal Revenue Service taxpayer identification number of such debtor;

(IV) a description of the farm products subject to the security interest created by the debtor, including the amount of such products, where applicable, crop year, county or parish, and a reasonable description of the property, etc; and

(iii) must be amended in writing, within three months, similarly signed and transmitted, to reflect material changes;

(iv) will lapse on either the expiration period of the statement or the transmission of a notice signed by the secured party as conditions for waiver or release of the security interest; and

(B) the commission merchant or selling agent has failed to perform the payment obligations;

(C) in the case of a farm product produced in a State that has established a central filing system—

(i) the commission merchant or selling agent has failed to register with the Secretary of such State prior to the purchase of farm products; and

(ii) the secured party has filed an effective financing statement or notice that covers the farm products being sold; or

(D) in the case of farm products produced in a State that has established a central filing system, the commission merchant or selling agent— (i) receives from the Secretary of State of such State written notice as provided in subsection (c)(2)(E) or (c)(2)(F) that specifies both the seller and the farm products being sold by such seller as being subject to an effective financing statement or notice;

(g)(1) Except as provided in paragraph (2) and notwithstanding any other provision of Federal, State, or local law, a commission merchant or selling agent who sells, in the ordinary course of business, a farm product for others, shall not be subject to a security interest created by the seller in such farm product even though the security

that a buyer (including commission merchants and selling agents) takes subject to a lender's security interest if the buyer has received actual prenotification from the lender or if the buyer has constructive notice via the state's central filing system and if the buyer fails to comply with the lender's conditions for waiver of sale as set out in the prenotification or central filing.[121]

A. *The Prenotification Alternative*

Sections 1324(e)(1) and (g)(2)(A) provide that the purchaser of farm products takes clear title if within one year prior to sale the buyer has received written original or reproduced notice of the security interest from

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interest is perfected and even though the commission merchant or selling agent knows of the existence of such interest.

(2) A commission merchant or selling agent who sells a farm product for others shall be subject to a security interest created by the seller in such farm product if—

(A) within 1 year before the sale of such farm product the commission merchant or selling agent has received from the secured party or the seller written notice of the security interest; organized according to farm products, that—

(i) is an original or reproduced copy thereof;

(ii) contains,

(I) the name and address of the secured party;

(II) the name and address of the person indebted to the secured party;

(III) the social security number . . . or taxpayer identification number of such debtor;

(IV) a description of the farm products . . . including the amount of such products . . . crop year, county or parish, and a reasonable description of the property, etc.; and

(iii) must be amended in writing, within 3 months . . . to reflect material changes;

(iv) will lapse at either the expiration period of the statement or the transmission of a notice signed by the secured party that the statement has lapsed, whichever occurs first; and

(v) any payment obligations . . . as conditions for waiver or release of the security interest; and

(B) the commission merchant or selling agent has failed to perform the payment obligations;

(C) in the case of a farm product produced in a State that has established a central filing system—

(i) the commission merchant or selling agent has failed to register with the Secretary of State of such State prior to purchase of farm products; and

(ii) the secured party has filed an effective financing statement . . . or

(D) in the case of a farm product produced in a State that has established a central filing system, the commission merchant or selling agent—

(i) receives from the Secretary of State of such State written notice . . . that specifies both the seller and the farm products being sold . . . as being subject to an effective financing statement or notice; and

(ii) does not secure a waiver or release of the security interest . . . by performing any payment obligation or otherwise.

Id.

121. *Id.*

either the secured party/lender or the seller/farmer.[122] Such notice must be organized according to farm product and contain relatively detailed information.[123] Additionally, the section requires that notice of material changes in the information be provided to the buyer in writing within three months of the change.[124] Notice lapses upon the earlier of notification signed by the secured party or expiration of the statement period.[125]

The buyer who receives notification conforming with the requirements set forth above and acts in compliance with any payment obligations delineated in the notice, takes clear title to the farm products.[126] Determination of what constitutes "receipt" of notice is established by the law of the state in which the buyer resides.[127]

B. *Central Filing Alternative*

Section 1324 permits two means for lenders to defeat the clear title provisions in states which have central filing of farm products liens.[128] In the first, the buyers do not take clear title if they fail to register with the secretary of state prior to purchase and the secured party has filed an "effective financing statement."[129] Alternatively, the buyers take subject to the lender's security interest if they receive written notice from the secretary of state with all the information contained in an "effective financing statement" and fail to obtain a waiver or release from the secured party either by conforming with the payment obligations stipulated or otherwise.[130]

An "effective financing statement" as used in section 1324 is not the same as the usual U.C.C. financing statement.[131] A section 1324 "effective financing statement" is signed by both the borrower and the lender and is filed by the lender with the secretary of state.[132] An "effective financing statement" contains a great deal more information than a standard U.C.C. financing statement.[133] To wit, an "effective financing statement" must contain the name and address of the secured party and the debtor; the debtor's social security or tax identification number; a description of the farm product collateral, including the amount of the product, if applicable, and a

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122. *See supra* note 120.

123. Food Security Act of 1985, Pub. L. No. 99-198 § 1324(c) (4)(F), 99 Stat. 1354 (1985).

124. *Id.* at § 1324(c)(4).

125. *Id.* at § 1324(c)(4)(F). The effective statement period is five years from date of filing; refilings or continuation statements must be filed within 6 months before expiration. *Id.*

126. *Id.* at § 1324(c)(4).

127. *Id.* at § 1324(f).

128. Food Security Act of 1985, Pub. L. No. 99-198 § 1324(e)(2)-(3) and (g)(2)(D), 99 Stat. 1354(1985).

129. *Id.* at § 1324(e)(2) and (g)(2)(C).

130. *Id.* at §1324(e)(3) and (g)(2)(D).

131. *Id.* at § 1324(c)(4).

132. *Id.*

133. *Id.*

description of the land where the product is produced, including county or parish; amended filings in writing must be made within three months of material changes.[134] Like a regular U.C.C. financing statement, an "effective financing statement" is in effect for five years from the date of filing; may be continued for an additional five year period by refiling or filing a continuation statement within six months preceding the expiration; and lapses upon expiration of the five year period or the filing of a notice signed by the secured party.[135]

To facilitate the implementation of the section 1324 scheme, subsection (h) provides that a security agreement may require the debtor to furnish the lender with a list of buyers, commission merchants, and selling agents with whom he deals.[136] Further, if the security agreement requires provision of such a list and the debtor/farmer sells to a party not on the list, he is subject to a fine of the greater of $5,000 or fifteen percent of the value of the sale proceeds from farm products subject to the security agreement.[137] The potential harshness of this provision is mitigated somewhat by the provision that the borrower/seller debtor may notify the secured party in writing of a buyer within seven days preceding sale or the borrower may account for the proceeds within ten days after sale.[138]

Section 1324 clear title provisions are to become effective twelve months after date of enactment — December 23, 1986.[139] While at first blush this appears to be a liberal time frame, the realities become obvious when one recalls that any central filing system developed by a state to comply with this legislation must accord with regulations promulgated by the Secretary of Agriculture.[140] Factoring in a necessary time period for interpreting the Secretary's new regulations and the fact that many state legislatures either were winding down or would not be in session during the nine months remaining before the section becomes effective, results in an appreciation of the difficulties thrust upon the states in implementing section 1324. These significant administrative difficulties confronting the states are exacerbated by the serious questions regarding interpretation of the new law.

VI. Questions of Interpretation of Section 1324

Section 1324 indicates congressional intent to do away with the prevailing U.C.C. 9-307(1) provision protecting farm product lenders.[141] The sweeping change from burdening the buyer with the primary risk of loss to bur-

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134. *Id.*
135. *Id.*
136. *Id.* at § 1324(h)(1).
137. *Id.* at § 1324(h)(3).
138. *Id.* at § 1324(h)(2).
139. *Id.* at § 1324(j).
140. *Id.* at § 1324(c)(2).
141. *Id.* at § 1324(d).

dening the lender with the risk was mitigated by the two narrow provisions regarding prenotification and central filing.[142]

A litigable question exists as to whether a state is preempted from allowing buyers to take clear title to farm products, without exception.[143] Specifically, does a state statute that repeals the farm products exception, such as the California statute, violate section 1324 either on the basis that Congress preempted such enactments or on the basis of conflict with federal law? Regarding the latter, the Supremacy Clause of the United States Constitution[144] will control if there is a direct conflict between the state and federal laws. Clearly the laws are different, but are they in direct conflict?

Possible litigation likely will focus on the preemption issue.[145] Generally, Congressional intent governs regarding preemption.[146] Where Congress does not express its intent to preempt state law, the courts generally uphold the state law unless it directly conflicts with or frustrates the federal scheme, or the court discerns "from the totality of the circumstances that Congress sought to occupy the field to the exclusion of the states."[147]

Section 1324 does not contain a clear statement regarding Congressional intent pertaining to preemption of state laws. The closest indication is the phrase— "notwithstanding any other provisions of Federal, State, or local law."[148] Because the statute is ambiguous, the legislative history must be scrutinized for Congressional intent on the matter of preemption of state law.

As noted earlier, the Senate File 744 provided that buyers of farm products took clear title except when the buyer was prenotified.[149] The Senate bill was amended to permit states with central filing to retain their system.[150] Thus, the two exceptions to buyers taking clear title came about. The House of Representatives bill was essentially the same as the original Senate bill; farm products purchasers took clear title unless they did not comply with prenotification conditions established by secured parties.[151] The joint conference reported out the Senate version of the bill, with its two exceptions — prenotification and central filing — to clear title.[152]

The very limited floor debate on the clear title provision failed to ad-

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142. *See id.* at §§ 1324(e)-(g).

143. *See generally* Cohen, *Clear Title to Purchasers of Secured Farm Products*, CONG. RESEARCH SER.: AM. LAW DIV. (Jan. 28, 1986) [hereinafter Cohen].

144. *Id.* U.S. CONST., art. VI, cl. 2.

145. *See generally* Cohen, *supra* note 143.

146. *See generally* Allis-Chalmers Corp. v. Lueck, 105 S. Ct. 1904, 1910 (1985).

147. *Id.* (citing Maloxe v. White Motor Corp., 435 U.S. 497, 504 (1985)).

148. Food Security Act of 1985, Pub. L. No. 99-198 § 1324 (d), 99 Stat. 1354 (1985).

149. S. 744, 99th Cong., 1st Sess., 131 CONG. REC. 3525 (1985).

150. *Id.*

151. H.R. 2100, 99th Cong., 1st Sess., 131 CONG. REC. 2144 (1985).

152. H.R. Rep. No. 99-467, 99th Cong., 1st Sess. (1985).

dress the preemption question.[153] The intent to preempt state laws may be inferred from Sen. Cochran's comments on the floor:

> [T]he clear title provision . . . puts an end to continuing disagreements and concerns that have been expressed . . . . The fact is that section 9 of the Uniform Code had become ununiform. Some 21 states opted to change the provisions, and no one can know what they are from one state to another . . . . We were trying to protect the interests of buyers, lenders, and farmers . . . .[154]

It is not unreasonable to infer from Senator Cochran's expressed strong concern for uniformity an intent to preempt not only the old U.C.C. 9-307(1) provisions, but also those state laws that wholly repealed the farm products exception.[155] The logic behind such an inference is that if the dominant Congressional concern was uniformity, all state laws at variance with the prevailing Congressional standard would need to be repealed. Of course, Congress guaranteed lack of uniformity by permitting the states to select either prenotification or central filing as exceptions to buyers taking clear title to farm products.[156]

The only patently germane statement in the record on the matter of Congressional preemption of state laws is found in the House Agriculture Committee report:

> A single federal rule is needed to restore consistency to this area of the law and remove that burden [upon interstate commerce]. . . .
>
> The bill is intended to preempt state law (specifically the so-called "farm products exception" of Uniform Commercial Code section 9-307) to the extent necessary to achieve the goals of this legislation. Thus, this Act would preempt state laws that set as conditions for buyer protection of the type provided by the bill requirements that the buyer check public records, obtain no-lien certificates from the farm product sellers, or otherwise seek out the lender and account to that lender for sale proceeds. By contrast, the bill would not preempt basic state-law rules on the creation, perfection, or priority of security interests.[157]

The fact that the requirements set out in section 1324 are in such detail may indicate a federal scheme so pervasive as to leave no room for the States to supplement it. Additionally, if Congress had intended to allow the States to supplement the law, it should have so stated. The enactment is silent on this point.

A strong argument for Congressional intent not to preempt can be made by recalling the stated purpose of the section: to remove the burdens on and obstructions to interstate commerce occasioned by the exposure of farm

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153. *See* 131 CONG. REC. S17888, S17893, and H12516 (daily ed. December 18, 1985).
154. 131 CONG. REC. S17893 (daily ed. Dec. 18, 1985) (statement of Sen. Cochran).
155. California statute repealed farm products exception. *See infra* text at Section III.
156. Subsections (e) and (g) of Section 1324. *See supra* note 120.
157. H.R. Rep. No. 99-271 at 109-110, 99th Cong., 1st Sess. (1985).

products buyers to the risk of double payment for farm products.[158] Clearly, this Congressional goal would be more nearly met by state legislation such as that of California, which repealed completely the farm products exception. This argument against preemption is supported by the wording of section 1324(d) to the effect that except as provided in (e), a buyer of farm products takes free of a security interest created by the seller. Effectively, this approach renders the goal of uniformity subordinate to the goal of unburdening interstate commerce by relieving farm products buyers of the risk of double payment.

The fact that arguments can readily be made both in favor of and against Congressional intent regarding preemption highlights the ambiguity of section 1324. The Supreme Court has held that when there is ambiguity regarding Congressional intent to preempt state laws, the Court must assume that preemption is not intended in the absence of clear and manifest Congressional intent.[159] Under this interpretation, then, the California statute that repealed the farm products exception would be sustained.

VII. Conclusion

Congress used the powers granted it under the interstate commerce clause of the United States Constitution to enact section 1324 of the 1985 Farm Bill. The expressed goal of the act was to remove the burden on interstate commerce imposed by farm products buyers' exposure to the risk of double payments for farm products, as provided in U.C.C. 9-307(1). Relief from this burden was to be accomplished by providing that buyers of farm products take clear title unless the lender protects its interests by means of providing the buyer with prenotification of a security interest in the farm products or the same information is provided to buyers via central filing with the state's secretary of state. In implementing the exceptions to clear title, states may select either prenotification or central filing.

The rather inartfully drafted section 1324 reveals the lack of a hammering out of a compromise by the various interests. As a result, although a purpose of the section is to create uniformity in the treatment of title to farm products in sale transactions, the section inherently obviates that purpose with its choice of exceptions. The measure is more successful in attaining its purpose of "unburdening interstate commerce" in that the risk of loss has been removed from buyers solely and placed upon agricultural lenders. Review of the record regarding section 1324 indicates that it represents an isolated Congressional foray into the traditional state realm of regulation of

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158. Food Security Act of 1985, Pub. L. No. 99-198 § 1324(b), 99 Stat. 1354(1985).

159. Jones v. Rath Packing Co., 430 U.S. 519, 525 (1977).

commercial relationships and, thus, is an anomaly. Now that section 1324 is law, however, Congress may use it as precedent for further broadsides on the U.C.C.

Sarah Pitts Eldridge