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Iowa's Ever-Changing Farm Products Exception-Where Will It End?

by

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IOWA'S EVER-CHANGING FARM PRODUCTS EXCEPTION—WHERE WILL IT END?

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I. INTRODUCTION

In recent years dissatisfaction with the Uniform Commercial Code's "farm products exception"¹ has led to significant statutory changes. These changes began at the state level. Variations in the responses made by the states led to nonuniformity. In 1985, in an attempt to reduce the number of state variations and to change what was perceived as an unfair burden on buyers of farm products, Congress enacted legislation.² Section 1324 of the Food Security Act of 1985 offers states the option of adopting a system of actual notice or of certified central filing to notify buyers of farm products of the existence of perfected security interests.³ A recent *Drake Law Review* note provides an excellent discussion of the details of the federal law.⁴

The present note focuses on the developments which have taken place in Iowa's volatile farm products exception since 1985.⁵ The farm products exception in Iowa was subjected to major revisions in the 1985, 1986, and 1987 General Assemblies.⁶ Many of the changes have been inconsistent with

1. U.C.C. § 9-307 (1987).

2. Food Security Act of 1985, Pub. L. No. 99-108, 99 Stat. 1354 (codified at 7 U.S.C. § 1631 (1987)).

3. *Id.*

4. Note, *The Federalization of the Farm Products Exception Rule of U.C.C. 9-307(1): Anomaly or Opening Salvo?*, 36 *DRAKE L. REV.* 115 (1987).

5. IOWA CODE § 554.9307 (1987).

6. See *infra* notes 59-148 and accompanying text.

the 1985 federal legislation. These differences between state and federal law have raised federal pre-emption questions and have been the subject of litigation. While the most recent changes in Iowa's farm products exception have settled many of the pre-emption questions, confusing language remains. Two recent and conflicting court decisions have also created confusion as to one class of buyer. Finally, the legislature may again rewrite the statute by changing from actual notice to certified central filing.

II. THE TRADITIONAL FARM PRODUCTS EXCEPTION

As a starting point, this note is relevant to a set of facts involving the sale of farm products by a farmer to a buyer of farm products. A secured party will have a perfected security interest⁷ in the farm products which are sold. A typical example is presented by the sale of a corn crop by a farmer to an elevator. Before the sale the farmer will have used the crop as collateral on a loan which is still outstanding, and the lender bank will have a perfected security interest in the growing crop.⁸ The issue is whether the security interest in the farm products survives sale or disposition, thus allowing the secured party—the bank—to bring an action for conversion against the buyer.⁹

An enforceable security interest requires a valid security agreement.¹⁰ When the security interest pertains to farm products, the security agreement must describe the collateral, value must have been given, and the debtor must have rights in the collateral.¹¹ When these requirements have been met, the agreement becomes enforceable against the debtor and the collateral can be attached.¹² Unless the agreement is perfected, however, it is not enforceable against others claiming an interest in the collateral.¹³

The secured party perfects a security interest by filing a financing statement.¹⁴ The Uniform Commercial Code offers the states three alternatives

7. For an explanation of a perfected security interest, see *infra* notes 7-27 and accompanying text.

8. See, e.g., *Farmers State Bank v. Edison Non-Stock Coop. Ass'n*, 190 Neb. 789, 212 N.W.2d 625 (1973) (recently overruled in part on the issue of prior course of dealing by *Farmers State Bank v. Farmland Foods, Inc.*, 225 Neb. 1, ___, 402 N.W.2d 277, 282 (1987)). Another example is the sale of a farmer's cattle by an auctioneer or commission agent. See, e.g., *Bank of Landisburg v. Burruss*, 362 Pa. Super 317, 524 A.2d 896 (1987). The auctioneer is a buyer even though he is selling the farm product for the farmer. *Id.*

9. See *id.*; *Farmers State Bank v. Edison Non-Stock Coop. Ass'n*, 190 Neb. 789, 212 N.W.2d 625 (1973).

10. U.C.C. § 9-203(1) (1987); IOWA CODE § 554.9203(1) (1987).

11. U.C.C. §§ 9-203(1), 9-203(1)(a)-(c) (1987); IOWA CODE §§ 554.9203(1), 554.9203(1)(a)-(c) (1987). When the interest is in growing crops, the agreement must describe the real estate. U.C.C. § 9-203(1)(a) (1987); IOWA CODE § 554.9203(1)(a) (1987).

12. U.C.C. § 9-203(2) (1987); IOWA CODE § 554.9203(2) (1987).

13. U.C.C. § 9-301(1)(c) (1987); IOWA CODE § 554.9301(1)(c) (1987).

14. U.C.C. § 9-302 (1987); IOWA CODE § 554.9302 (1987).

as to the proper place of filing.¹⁵ Alternative one, referred to as central filing, requires that the financing statement be filed with the state secretary of state's office.¹⁶ Central filing is the alternative used in Iowa,¹⁷ but it is the minority approach.¹⁸ The second and third alternatives, which lead to the same result with respect to farm products, require that the financing statement be filed "in the county of the debtor's residence . . . or if the debtor is not a resident of [the] state then . . . in the county where the goods are kept, and in addition, when the collateral is crops growing or to be grown . . . in the county where the land is located."¹⁹ Once the security interest is valid and perfected, it is enforceable against purchasers of the collateral and against other creditors, as well as against the debtor.²⁰

The general rule, then, is that a perfected security interest survives sale of the collateral unless the sale was authorized by the secured party.²¹ A major exception to the rule pertains to a "buyer in the ordinary course of business."²² The buyer in the ordinary course of business²³ exception allows a good faith buyer to purchase products free of any security interest.²⁴ The farm products exception, referred to as an exception to the exception,²⁵ excludes buyers of farm products from the ordinary course of business exception.²⁶ As a result, a lender with a perfected security interest in farm products traditionally retains an interest after the products are sold, but a lender with an interest in other products sold in the ordinary course of business will lose the interest.²⁷

15. U.C.C. § 9-401(1) (1987).

16. U.C.C. § 9-401(1) (first alternative) (1987).

17. IOWA CODE § 554.9401(1)(c) (1987).

18. Twelve states had adopted central filing by 1985. Van Hooser, *Farm Products: Recent Legislative Changes to Section 9-307*, 29 S.D.L. REV. 346, 358 n.75 (1984).

19. U.C.C. § 9-401(1) (second and third alternatives) (1987).

20. U.C.C. § 9-201 (1987); IOWA CODE § 554.9201 (1987).

21. The language states: "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" U.C.C. § 9-306(2) (1987).

22. The exception states: "A buyer in the 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." U.C.C. § 9-307(1) (1987). Iowa's version of the exception was identical until 1985. IOWA CODE § 554.9307(1) (1983).

23. U.C.C. § 1-201(a) (1987) defines a 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"

24. U.C.C. § 9-307(1) (1987).

25. Bauer, Dudek & Uctman, *The UCC Farm Products Exception—A Time to Change*, 69 MINN. L. REV. 1315, 1317 (1985) [hereinafter Bauer].

26. U.C.C. § 9-307(1) (1987).

27. U.C.C. § 9-306(2) (1987).

III. DISSATISFACTION WITH THE EXCEPTION

Two areas of dissatisfaction with the farm products exception are illustrated by two typical examples. The first appears in *Farmers State Bank v. Edison Non-Stock Cooperative Association*.²⁸ In *Edison* the bank had a perfected security interest in a farmer's corn crop.²⁹ The security agreement allowed the farmer to sell farm products, subject to a security interest in the proceeds, as long as the farmer did not default on the loan.³⁰ The farmer defaulted the day the loan was signed when he violated specific default provisions; therefore he had no authorization to sell.³¹ A few months after the agreement was signed, however, the farmer sold his corn to an elevator.³²

Farmers State Bank brought an action against the elevator for conversion of the crop subject to its perfected security interest.³³ In holding that the elevator was liable to the bank for conversion, the court recognized the fact that the elevator was unaware of the provisions of the security agreement, unaware that the farmer had defaulted, and unaware that a security agreement even existed.³⁴ The court reasoned, however, that the bank had complied with the Uniform Commercial Code in perfecting its security interest.³⁵ In very clear language the court held that lack of knowledge on the part of a buyer of farm products is not a defense to a claim of conversion where a perfected security interest exists: "The defendant elevator in purchasing farm products from a person engaged in farming operations [is] bound by the provisions of the code and must take the risk of a failure to check lien records."³⁶

28. *Farmers State Bank v. Edison Non-Stock Coop. Ass'n*, 190 Neb. 789, 212 N.W.2d 625 (1973) (see *supra* note 8).

29. *Id.* at 627.

30. *Id.* at 626-27.

31. *Id.* at 628. Under the agreement the debtor warranted, in part: that he owned the collateral "free from any adverse lien, security interest or encumbrance . . ."; "[t]hat no financing statement covering the [c]ollateral or any proceeds thereof is on file in any public office . . ."; and that he would not "permit or allow any adverse lien, security interest or encumbrance whatsoever upon the [c]ollateral . . ." *Id.* at 627.

On the day that the agreement with Farmers State Bank was entered into, the farmer also entered into a security agreement with another bank and used the same crop as collateral. *Id.* Entering into a second agreement using the same collateral caused default because the first had a provision stating that:

DEBTOR SHALL BE IN DEFAULT . . . upon the happening of any of the following . . . conditions: . . . (2) any warranty, representation or statement made or furnished to [s]ecured [p]arty by or on behalf of [d]ebtor proves to have been false in any material respect when made or furnished; . . . (4) loss, theft, damage, sale or encumbrance to or of any of the [c]ollateral . . ."

Id.

32. *Id.*

33. *Id.* at 626.

34. *Id.* at 629.

35. *Id.*

36. *Id.*

The decision in *Edison*³⁷ came about because the Uniform Commercial Code allowed a perfected security interest in collateral to continue³⁸ without any additional burden on the secured party to notify the buyer.³⁹ Since there was no burden on the secured party to notify, the burden fell on the buyer to check records.⁴⁰ As a practical matter, however, when local filing was the alternative adopted by a state, a buyer of farm products found it difficult to check county records.⁴¹ If the buyer did not discover the perfected security interest, he was forced to pay twice: once to purchase the product from the farmer and once to satisfy its liability to the bank for conversion.⁴²

The second source of dissatisfaction with the farm products exception was the situation which resulted from the sale of farm products by auctioneers and commission agents. In *Bank of Landisburg v. Burruss*,⁴³ the bank loaned money to a farmer named Burruss while a second farmer guaranteed the loan. In return, the second farmer was allowed to perfect a security interest in Burruss' cattle.⁴⁴ Burruss hired an auctioneer who took control of the cattle, sold them, and received a commission.⁴⁵ Burruss disappeared with the proceeds and did not repay the loan.⁴⁶

The difference between the commission seller or auctioneer and other buyers of farm products is that the commission seller never actually owns the livestock. Instead, the livestock are sold to a buyer on behalf of the seller and the commission agent receives a commission.⁴⁷

The court ruled that an auction company would be liable for conversion of the collateral when it auctioned livestock and when notice of the security interest had been filed, even though the auction company had no knowledge of the perfected security interest and did not purchase the cattle.⁴⁸ The court reasoned that one purpose of article 9 of the Uniform Commercial

37. *Farmers State Bank v. Edison Non-Stock Coop. Ass'n*, 190 Neb. 789, 212 N.W.2d 625 (1973).

38. U.C.C. § 9-306(2) (1987).

39. *Farmers State Bank v. Edison Non-Stock Coop. Ass'n*, 190 Neb. at ____, 212 N.W.2d at 629.

40. *Id.*

41. *See infra* note 56.

42. *Id.* Even though the buyer has a remedy against the seller, the seller may be judgment proof or, as in *Bank of Landisburg v. Burruss*, 362 Pa. Super. 317, ____, 524 A.2d 896, 898 (1987), the seller may disappear.

43. *Bank of Landisburg v. Burruss*, 362 Pa. Super. 317, ____, 524 A.2d 896, 897-98 (1987).

44. *Id.* at 898.

45. *Id.*

46. *Id.*

47. *Id.*

48. *Id.* at 901. *See also* *Sanborn County Bank, Inc. v. Magness Livestock Exchange, Inc.*, 410 N.W.2d 565 (S.D. 1987); *First Nat'l Bank & Trust Co. v. Atchison County Auction Co.*, 699 P.2d 1032 (Kan. Ct. App. 1985).

Code was to protect the secured party.⁴⁹ Protecting the secured party promotes lending to farmers.⁵⁰ Imposing liability on auctioneers, the court concluded, encourages those dealing with livestock to check records for perfected security interests.⁵¹

Criticism of results such as those reached in *Edison*⁵² and *Burruss*⁵³ began with the fact that the farm products buyer was liable for converting the bank's collateral even though it had no knowledge of the existence of a security agreement.⁵⁴ Buyers argued that they became the surety for the farmer's debts.⁵⁵ While this is an overstatement, buyers did become exposed to liability when, as a practical matter, they had difficulty checking county records because they dealt in large volume transactions on a daily basis and because they lacked the time or personnel to make such inquiries.⁵⁶ In an effort to "lessen the impact of the farm products exception" and to increase protection for farm products buyers, states began to make modifications.⁵⁷ By 1985 more than one-third had made statutory changes in the farm products exception.⁵⁸

IV. MODIFICATION OF THE EXCEPTION

Iowa adopted the Uniform Commercial Code, and with it the farm products exception, in 1967.⁵⁹ At the same time Iowa adopted central filing.⁶⁰ Until recently the Uniform Commercial Code as applied in Iowa provided that once the lender had perfected a security interest in a farm product, the burden fell on the buyer to check for a financing statement at the secretary of state's office.⁶¹ It should be noted that Iowa recognized excep-

49. *Bank of Landisburg v. Burruss*, 362 Pa. Super. at ____, 524 A.2d at 900.

50. *Id.*

51. *Id.*

52. *Farmers State Bank v. Edison Non-Stock Coop. Ass'n*, 190 Neb. 789, 212 N.W.2d 625 (1973).

53. *Bank of Landisburg v. Burruss*, 362 Pa. Super. 317, 524 A.2d 896 (1987).

54. 7 U.S.C. §1631(a)(1) (1987).

55. *United States v. Progressive Farmers Mktg. Agency*, 788 F.2d 1327, 1330 (8th Cir. 1986); *Utah Farm Prod. Credit Ass'n v. Hansen*, 738 P.2d 642, 645 (Utah Ct. App. 1987).

56. *See, e.g., Utah Farm Prod. Credit Ass'n v. Hansen*, 738 P.2d at 645. *See also Van Hooser, supra* note 18.

57. *Utah Farm Prod. Credit Ass'n v. Hansen*, 738 P.2d at 644-45. *See also United States v. Progressive Farmers Mktg. Agency*, 788 F.2d at 1330.

58. *United States v. Progressive Farmers Mktg. Agency*, 788 F.2d at 1330. These changes were of five types: exemption of commission sellers from the farm products exception, central filing, requiring buyers to obtain the identity of secured creditors from sellers, requiring lenders to give notice of a security interest to potential buyers, and repeal of the farm products exception. *Bauer, supra* note 25, at 1330-44. *See also Van Hooser, supra* note 18.

59. IOWA CODE ANN. § 554.9307(1) (West 1967).

60. IOWA CODE ANN. § 554.9401 (West 1967).

61. IOWA CODE §§ 554.9306(2), 554.9307(1), 554.9401(1) (1983).

tions for waiver and prior course of dealing.⁶²

A. 1985—House File 554

At the same time that other states were enacting changes, Iowa made a series of major modifications in the farm products exception, beginning with the passage of House File 554 in 1985.⁶³ The intent of H.F. 554 was to shift the burden of checking records from the buyer of farm products to the secured party. The shift was accomplished by requiring the secured party to notify potential buyers that a perfected interest existed.⁶⁴

The 1985 changes removed the traditional farm products exception language from section 554.9307(1) of the Iowa Code.⁶⁵ The new language stated that a buyer of farm products in the ordinary course of business took the products free of a security interest unless written notice of the interest was received prior to the sale.⁶⁶ House File 554 also required that a debtor provide a written list of potential buyers to the secured party upon request.⁶⁷ The addition of these actual notice requirements did not change the requirement that a financing statement be filed with the secretary of state to perfect a security interest.

There were three exceptions to the general rule that the buyer took free of a perfected security interest unless the secured party gave proper notice. First, when notice to the potential buyer was proper,⁶⁸ the buyer could still take free of a perfected security interest by issuing a check jointly payable

62. The exception arises from language in U.C.C. § 9-306(2) (1987), and in IOWA CODE § 554.9306(2) (1987), which states that a perfected interest continues on disposition unless the secured party authorizes the contrary "in the security agreement or otherwise."

The word "otherwise" prompted courts to hold that a secured party's prior course of dealing can impliedly waive the security interest. *Lisbon Bank & Trust Co. v. Murray*, 206 N.W.2d 96, 98-100 (Iowa 1973). In *Murray*, for example, a prior course of dealing was established because the debtor had been allowed to sell some of the collateral, hogs, on previous occasions. *Id.* at 98.

63. 1985 Iowa Acts 188 [hereinafter H.F. 554].

64. 1 IOWA AGRIC. L. REP. 2, 6 (Sept. 1985). The *Iowa Agricultural Law Reporter* is published by Drake University Law School.

65. H.F. 554 removed the following language: "other than a person buying farm products from a person engaged in farming operations." 1985 Iowa Acts 188 § 1.

66. IOWA CODE § 554.9307(1), as amended by H.F. 554, stated in part: "Except as provided in subsection four, a buyer in ordinary course of business . . . takes free of a security interest created by that person's seller . . ." 1985 Iowa Acts 188 § 1.

H.F. 554 added subsection 4 to IOWA CODE § 554.9307, which stated in part: "A buyer in ordinary course of business buying farm products from a person engaged in farming operations takes free of a security interest created by that person's seller even though the security interest is perfected, unless the buyer receives prior written notice of the security interest . . ." *Id.* at § 2.

67. 1985 Iowa Acts 188 § 2.

68. Specific requirements for proper notice were set out. 1985 Iowa Acts 188 § 1 (codified as IOWA CODE § 554.9307(4) (1987)).

to the debtor and the secured party.⁶⁹ Second, if the buyer purchased the debtor's farm products outside the debtor's "trade area," and third, if the "buyer's principal place of business was located outside of the [debtor's] trade area," then the buyer did not take free of a perfected security interest.⁷⁰ The trade area consisted of the county in which the debtor resided and the counties adjacent to its borders.⁷¹

The 1985 law did not ordinarily allow the debtor to sell to a buyer who was not on the list provided to the lender. Nor did it allow sale to a buyer who was outside the debtor's trade area. The debtor could, however, sell to a buyer who was not on the list and could sell outside the trade area if prior written consent was given by the secured party, or if the proceeds of the sale were applied to the loan within fifteen days.⁷² A knowing or intentional sale to an unauthorized buyer was a serious misdemeanor.⁷³

Finally, selling agents and others who sold livestock on commission were treated as other buyers of farm products: they were statutorily subject to the same liability for conversion of collateral covered by a perfected security interest.⁷⁴

B. 1985—*The Food Security Act of 1985*

Shortly after Iowa added its actual notice requirements with the enactment of H.F. 554, the federal government became involved in the farm products exception when it enacted the Food Security Act of 1985.⁷⁵ The Act marked the first time that Congress involved itself in amending provisions of the Uniform Commercial Code.⁷⁶ The Food Security Act allows states to adopt one of two options for notification of farm products buyers.⁷⁷

First, states may establish a central filing system which must be certified by the office of the United States Secretary of Agriculture.⁷⁸ Certified central filing allows the lender to maintain a perfected security interest in farm products which are sold if the lender files a financing statement with the state secretary of state's office and the buyer fails to register.⁷⁹ The lender also maintains the secured interest against a buyer who receives notice from the secretary, but who fails to obtain a release or waiver from the

69. 1985 Iowa Acts 188 § 2 (codified as IOWA CODE § 554.9307(4) (1987)).

70. 1985 Iowa Acts 188 § 2.

71. *Id.*

72. *Id.* The fifteen days ran from the latter of the date of sale or the delivery of the products. *Id.*

73. *Id.*

74. *Id.* at § 1. However, see *infra* text accompanying notes 151-72.

75. 7 U.S.C. § 1631 (1987).

76. Note, *Federalization of the Farm Products Exception Rule of U.C.C. 9-307(1): Anomaly or Opening Salvo?*, 36 DRAKE L. REV. 115, 115 (1987).

77. 7 U.S.C. § 1631 (1987).

78. 7 U.S.C. § 1631(c)(2) (1987).

79. 7 U.S.C. § 1631(e)(2) (1987).

secured party.⁸⁰

Certified central filing requires that the secretary of state compile a master list of financial statements organized according to the type of farm product.⁸¹ The list must be organized alphabetically according to the debtor's name, numerically according to the debtor's social security number, geographically according to the debtor's county, and chronologically according to the crop year of the debt.⁸² The secretary of state must periodically furnish lists to the registered buyer.⁸³

The Food Security Act went into effect one year after its passage. Those states which had not adopted the central filing option by the effective date, December 24, 1986, were considered to have adopted the second option, actual notice.⁸⁴ The actual notice option is similar in principle to H.F. 554 in the sense that the buyer of farm products takes free of a security interest unless written notice is received prior to the sale.⁸⁵

C. 1986—Senate File 2050

In 1986 Iowa chose to adopt the federal actual notice option, and as a result the legislature again made major changes in the farm products exception. It passed Senate File 2050 in an attempt to make state and federal law consistent.⁸⁶ Senate File 2050 amends the 1985 version of subsection one of Iowa Code 554.9307 in that it adopts the Food Security Act of 1985.⁸⁷

Section 2 of S.F. 2050 eliminated subsection 4 of Iowa Code 554.9307, which had been added in 1985.⁸⁸ Striking the 1985 version of subsection 4 eliminated a number of provisions which were in conflict with the Food Security Act.⁸⁹ First, subsection 4 embodied the exceptions which prevented buyers from taking farm products free of a security interest when the prod-

80. 7 U.S.C. § 1631(e)(3) (1987).

81. 7 U.S.C. § 1631(c)(2)(C)(i) (1987).

82. 7 U.S.C. § 1631(c)(2)(C)(ii) (1987).

83. 7 U.S.C. § 1631(c)(2)(E) (1987). The buyer registers according to the type of product involved. 7 U.S.C. § 1631(c)(2)(D)(iii) (1987). The secretary of state provides lists of the types of products in which the buyer has an interest. 7 U.S.C. § 1631(c)(2)(E) (1987). In addition, the secretary of state is required to provide both written and oral confirmations to nonregistered buyers upon request. 7 U.S.C. § 1631(c)(2)(F) (1987).

84. 7 U.S.C. § 1631(j) (1987).

85. Compare 7 U.S.C. §§ 1631(d), (e)(1), (h) (1987) with 1985 Iowa Acts 188 §§ 1, 2 (codified as Iowa Code §§ 554.9307(1), (4) (1987)).

86. 1986 Iowa Acts 1126.

87. The pertinent part of the statute was amended as follows: "Except as provided in the Food Security Act of 1985 . . . a buyer in the ordinary course of business . . . takes free of a security interest created by that person's seller." 1986 Iowa Acts 1126 § 1.

It was probably not necessary for the statute to formally adopt the Act because, on the effective date, prenotification is imposed on states which do not adopt certified central filing. 7 U.S.C. § 1631(j) (1987).

88. 1986 Iowa Acts 1126 § 2.

89. 7 U.S.C. § 1631 (1987).

ucts were purchased outside the debtor's trade area, or when the buyer's principal place of business was outside the debtor's trade area.⁹⁰ The Food Security Act has no such exceptions.⁹¹

Second, subsection 4 contained specific requirements with which the secured party had to comply to make his notice to the buyer effective.⁹² The Food Security Act has provisions which are similar, but with enough differences to create potential problems.⁹³ The major difference in the notice requirement was in the description of the collateral. Subsection 4 required only a reasonable description of the farm product.⁹⁴ The Food Security Act required inclusion of the amount of the farm product involved, the crop year, the county, and a reasonable description of the property.⁹⁵

Third, subsection 4 of the Code provided for expiration of notice either after eighteen months or when the debt was satisfied.⁹⁶ Under the Food Security Act, the notice expires after one year or when a notice of expiration signed by the secured party is transmitted to the buyer.⁹⁷

Fourth, subsection 4 of the Code required that, upon the request of the secured party, the debtor furnish the secured party with a list of potential buyers.⁹⁸ The debtor could not sell to a buyer who was not on the list unless the secured party was given prior written notice, or the debtor applied the proceeds to the debt within fifteen days.⁹⁹ Intentional violation by the debtor constituted a serious misdemeanor.¹⁰⁰ The Food Security Act allows a secured party to require the debtor to furnish a list of potential buyers, but only if there is a parallel provision in the security agreement.¹⁰¹ The debtor may not sell to buyers who are not on the list unless the debtor accounts to the secured party for the proceeds within ten days.¹⁰² Violation of the section subjects the debtor to a fine of the greater of \$5,000 or fifteen percent of the benefit received.¹⁰³

Fifth, subsection 4 allowed a properly notified buyer to extinguish the

90. 1985 Iowa Acts 188 § 2.

91. 7 U.S.C. § 1631 (1987).

92. 1985 Iowa Acts 188 § 2.

93. Compare 7 U.S.C. § 1631(e)(1)(A)(ii) (1987) with 1985 Iowa Acts 188 § 2.

94. 1985 Iowa Acts 188 § 2.

95. 7 U.S.C. § 1631(e)(1)(A)(ii)(IV) (1987).

96. 1985 Iowa Acts 188 § 2.

97. 7 U.S.C. § 1631(e)(1)(A)(iv) (1987).

98. 1985 Iowa Acts 188 § 2.

99. *Id.*

100. *Id.*

101. 7 U.S.C. § 1631(h)(1) (1987).

102. *Id.* at § 1631(h)(2). Iowa law required that the debtor "apply" the proceeds, *supra* note 98, while federal law requires that the debtor "account for" the proceeds, 7 U.S.C. § 1631(h)(2) (1987). Could a debtor account for the proceeds under federal law without applying them under state law?

103. 7 U.S.C. § 1631(h)(3) (1987). The Act provides no information regarding the penalty, such as who brings the action and what happens to the money which is collected.

secured party's interest in the collateral by issuing a check jointly payable to the debtor and the secured party.¹⁰⁴ The Food Security Act is much less specific.¹⁰⁵ It requires that the notice to the buyer include obligations imposed by the secured party on the buyer as a condition of release or waiver.¹⁰⁶

While S.F. 2050 eliminated a great deal of the language which originally created conflicts, it added several new subsections which were inconsistent with the Food Security Act. First, while it eliminated one subsection concerning the issuance of jointly payable checks, it created another.¹⁰⁷ The new subsection, which was even more restrictive than the old, allowed the secured party to request a jointly payable check, but only if the security agreement contained provisions stating that a joint check might be requested or required, and only if such provisions were separately signed and dated.¹⁰⁸ As was discussed earlier, the Food Security Act contains a general provision which requires the inclusion of payment obligations imposed on the buyer in the notice to the buyer.¹⁰⁹

Second, S.F. 2050 subjected the debtor to a penalty for selling to a buyer who was not on the list of potential buyers.¹¹⁰ The penalty was similar to the one provided by the Food Security Act, but with some additions.¹¹¹ Senate File 2050 placed money received from fines in the general fund.¹¹² It also allowed the secured party to obtain the debtor's fine to the extent he had been damaged.¹¹³ Finally, it subjected the debtor to a potential prosecution for theft.¹¹⁴

Third, S.F. 2050 created penalties which are not present in the Food Security Act. The secured party was subjected to a \$200 fine for each buyer who was notified, but who was not on the debtor's list.¹¹⁵ The penalty was imposed to cure a problem caused by confusion in H.F. 554.¹¹⁶ Because H.F. 554 went into effect halfway through the 1985 growing season for Iowa crops,¹¹⁷ secured parties did not have an opportunity to request lists of po-

104. 1985 Iowa Acts 188 § 2 (codified as IOWA CODE § 554.9307(4) (1987)).

105. 7 U.S.C. § 1631 (1987).

106. 7 U.S.C. § 1631(e)(1)(A)(v) (1987).

107. 1986 Iowa Acts 1126 § 2 (codified as IOWA CODE § 554.9307(4) (1987)).

108. *Id.* The signature operated to warn or inform the debtor. Practically, however, the debtor is in no position to turn down the loan even if he dislikes the idea of a jointly payable check.

109. 7 U.S.C. § 1631(e)(1)(A)(v) (1987).

110. 1986 Iowa Acts 1126 § 3 (codified as IOWA CODE § 554.9307(5) (1987)).

111. 7 U.S.C. § 1631(h) (1987).

112. 1986 Iowa Acts 1126 § 3 (codified as IOWA CODE § 554.9307(5)(a) (1987)).

113. *Id.*

114. 1986 Iowa Acts 1126 § 3 (codified as IOWA CODE § 554.9307(6)(b) (1987)).

115. *Id.*

116. 1985 Iowa Acts 188.

117. Hamilton, *The Farm Products Rule and Financing Agricultural Production*, Drake Agricultural Law Center, p. 3, FI-003-1986. The newsletter is published by the Agricultural

tential buyers from their debtors.¹¹⁸ To be safe, secured parties attempted to notify all possible buyers.¹¹⁹ The large volume of notices buried buyers of farm products under "dozens of lists containing the names of hundreds of buyers . . ." ¹²⁰ To prevent future problems, subsection 6(b) penalized the secured party for sending notices to buyers who were not on the debtor's list.¹²¹

Senate File 2050 penalized the secured party for failing to provide potential buyers with notice that the security interest had terminated.¹²² The buyer was subjected to a \$200 penalty for disseminating or publicly displaying information contained in the notice.¹²³ Senate File 2050 also created liability for damages resulting from violation of the penalty provision by either the secured party or the buyer.¹²⁴

Finally, S.F. 2050 did not change the treatment of livestock commission sellers which had been added to the Code in 1985.¹²⁵ The 1985 change statutorily defined such sellers as buyers in the ordinary course of business and, therefore, subject to the same liability as buyers of farm products. The Food Security Act contains a special section covering those who sell on commission.¹²⁶ While section (g) of the Act specifically addresses commission sellers, its approach is similar to that which the Code adopts toward other buyers of farm products.¹²⁷ While the state and federal provisions were not identical, their rules were virtually the same. Thus, under both the Food Security Act and S.F. 2050, the general rule was that commission sellers took free of a perfected security interest unless proper notice was given.¹²⁸

D. 1987—Senate File 13

Senate File 2050 made an attempt at consistency, but it put the Iowa farm products exception in serious conflict with federal law, and the differing versions made a challenge to the Iowa statute inevitable. In November of 1986 the Iowa Bankers Association filed a petition against the state of Iowa to prevent enforcement of the 1986 changes.¹²⁹ The petition alleged that

Law Center, Drake University Law School.

118. *Id.*

119. *Id.*

120. *Id.*

121. 1986 Iowa Acts 1126 § 3 (codified as IOWA CODE § 554.9307(6)(b) (1987)). The language of the Code permitted a strange result: a correct guess as to presence on the list was not penalized while an incorrect guess was penalized. *Id.*

122. 1986 Iowa Acts 1126 § 3 (codified as IOWA CODE § 554.9307(6)(a) (1987)).

123. 1986 Iowa Acts 1126 § 3 (codified as IOWA CODE § 554.9307(7) (1987)).

124. 1986 Iowa Acts 1126 § 3 (codified as IOWA CODE § 554.9307(8) (1987)).

125. 1986 Iowa Acts 1126 § 1.

126. 7 U.S.C. § 1631(g) (1987).

127. Compare 7 U.S.C. § 1631(g) (1987) with 1986 Iowa Acts 1126 § 1.

128. *Id.*

129. Iowa Bankers Ass'n v. State, Equity No. CEO2615221, Iowa District Court for Polk

"Congress intended to occupy the field of law dealing with the sale of farm products subject to a perfected security interest."¹³⁰ The petition cited the stated purpose of the Food Security Act: to remove the burden on interstate commerce caused by state legislation concerning the farm products exception.¹³¹ As a result, the petition alleged, the Supremacy Clause dictated that federal law pre-empted state legislation which stood in conflict.¹³² The petition pointed out that Iowa's law contained a specific joint check provision while the federal law did not.¹³³ In addition, it explained that the penalty imposed on the secured party for sending a notice to a buyer who was not on the debtor's list frustrated the goals of the federal law.¹³⁴ The petition concluded that the Supremacy Clause mandated federal pre-emption of the 1986 Iowa statute because the statute was a barrier to the accomplishment of the goals of the Food Security Act.¹³⁵

The petition alleged only two areas of conflict between state and federal law, but each of the differences discussed in the previous section raised questions of federal pre-emption. The petition, and the other differences mentioned above but not discussed in the petition, resulted in yet another round of legislative changes in 1987.¹³⁶ Senate File 13 amended the farm products exception to eliminate the major pre-emption questions.¹³⁷

First, S.F. 13 removed the language which simply adopted the Food Security Act.¹³⁸ It also excised inconsistent language.¹³⁹ In its place, much of the exact language of the Food Security Act is incorporated into Iowa's farm products exception.¹⁴⁰ The Code now contains the language of the Food Security Act which states that a buyer of farm products takes subject to a perfected security interest if proper notice is received within one year prior to the sale.¹⁴¹ The requirements for proper notice and those for making amendments are virtually identical to their federal counterparts.¹⁴² Simi-

County (1986).

130. *Id.* (see paragraph 16).

131. *Id.*

132. *Id.* (see paragraph 26).

133. *Id.* (see paragraphs 23-24).

134. *Id.* (see paragraphs 26-27).

135. *Id.*

136. 1987 Iowa Acts 38.

137. *Id.*

138. *Id.* at § 1.

139. *Id.*

140. Compare 7 U.S.C. § 1631 (1987) with 1987 Iowa Acts 38.

141. 1987 Iowa Acts 38 § 2 (codified as IOWA CODE § 554.9307(4)(a) (1987)).

142. Compare 7 U.S.C. § 1631(e)(1)(A)(i)-(v) (1987) with 1987 Iowa Acts 38 § 2 (codified as IOWA CODE § 554.9307(4)(b), (d) (1987)). Some differences remain. For example, the state version allows both the debtor and the secured party to notify a buyer of a perfected security interest. 1987 Iowa Acts 38 § 2 (codified as IOWA CODE § 554.9307(4)(b), (d) (1987)). The federal version is silent as to whether the debtor may properly notify the buyer. 7 U.S.C. § 1631(e)(1)(A)(i)-(v) (1987).

larly, S.F. 13 makes Iowa's procedure for obtaining the list of potential buyers, and its time limitations on notice, consistent with the Food Security Act.¹⁴³

Second, S.F. 13 removes conflicting provisions added in 1986. The provision requiring the debtor's consent to the issuance of jointly payable checks was eliminated.¹⁴⁴ Also removed were penalties and liabilities imposed on the secured party and the potential buyer.¹⁴⁵

The penalty imposed on the debtor is retained in S.F. 13 because the Food Security Act has such a provision.¹⁴⁶ Senate File 13 does, however, make the state and federal versions consistent by eliminating the secured party's option to make a claim for the penalty as compensation for damages, and by eliminating potential exposure to a theft prosecution.¹⁴⁷ In addition, S.F. 13 amends the subsection by using identical language concerning the requirement that, in order to sell to a buyer who is not on the potential buyers list, the debtor must either notify the secured party in writing at least seven days before the sale, or account to the secured party for the proceeds within ten days after the sale.¹⁴⁸

V. THE PRESENT

Iowa has had an actual notice requirement in its farm products exception only since 1985.¹⁴⁹ The relatively recent addition of this system means that many cases now before the courts arose from commission sales which took place before the enactment of actual notice. Recent and conflicting decisions concerning these cases have been handed down by the Eighth Circuit Court of Appeals¹⁵⁰ and the Iowa Supreme Court.¹⁵¹

United States v. Progressive Farmers Marketing Agency was decided by the Eighth Circuit in 1986.¹⁵² In *Progressive* the debtor, without notice to the secured party, sold hogs through a marketing agent while the hogs were subject to the plaintiff's perfected security interest.¹⁵³ The plaintiff, a bank, brought an action for conversion against the marketing agency which sold the hogs.¹⁵⁴ The sale of the hogs occurred before either the state or the fed-

143. Compare 7 U.S.C. § 1631(e)(1)(A), (h)(1) (1987) with 1987 Iowa Acts 38 § 2 (codified as IOWA CODE § 554.9307(4)(a), (c) (1987)).

144. 1987 Iowa Acts 38 § 2.

145. *Id.* at §§ 4, 5.

146. *Id.* at § 3.

147. *Id.*

148. Compare 7 U.S.C. § 1631(h) (1987) with 1987 Iowa Acts 38 § 3 (codified as IOWA CODE § 554.9307(5) (1987)).

149. 1985 Iowa Acts 188.

150. *United States v. Progressive Farmers Mktg. Agency*, 788 F.2d 1327 (8th Cir. 1986).

151. *First Nat'l Bank v. Lamoni Livestock Sales Co.*, 417 N.W.2d 443 (Iowa 1987).

152. *United States v. Progressive Farmers Mktg. Agency*, 788 F.2d 1327 (8th Cir. 1986).

153. *Id.* at 1328.

154. *Id.*

eral actual notice provisions were enacted.¹⁵⁵ The Eighth Circuit decided the case after the passage of both laws, but it initially applied pre-actual-notice law because of the date of the sale.¹⁵⁶

The court held that the marketing agency, as a commission seller, was a buyer in the ordinary course of business and so was not subject to the perfected security interest.¹⁵⁷ In reaching the decision, the court stated that the rule prior to actual notice was such that the marketing agency would have been liable for conversion as if the sale had been made directly to a buyer.¹⁵⁸ The court then reasoned that, while the new Iowa law did not specifically apply, its enactment was a public policy statement that commission sellers were not to be included among buyers of farm products.¹⁵⁹ The most controversial holding of the court was its finding that the intent of the Uniform Commercial Code was that farm products which come into the hands of commission sellers should be treated as inventory.¹⁶⁰ If farm products are treated as inventory, they are held in the ordinary course of business and are no longer subject to the farm products exception.¹⁶¹

Shortly after the Eighth Circuit decision, the Iowa Supreme Court decided *First National Bank v. Lamoni Livestock Sales Co.*,¹⁶² a case in which the facts resembled those which appeared in *Progressive*. *Lamoni* held that the perfected security interest continued and that commission sellers could be held liable for conversion.¹⁶³ In reaching its decision the court refused to adopt *Progressive*.¹⁶⁴ First, the court reasoned that the subsequent legislative changes were not dispositive; it chose to apply only the law which was in effect at the time of the transactions.¹⁶⁵ Second, the court disagreed with the interpretation of the Uniform Commercial Code presented in *Progressive*.¹⁶⁶ The court in *Lamoni* reasoned that classification as inventory takes place only when the financing statement is initially created.¹⁶⁷ Once collateral is classified as a farm product, it does not change to inventory when it is sold.¹⁶⁸ As a result, the security interest survives the sale of the collateral to a commission seller.¹⁶⁹ Third, the decision in *Progressive* makes the survival

155. *Id.* at 1330.

156. *Id.*

157. *Id.*

158. *Id.* at 1329.

159. *Id.* at 1330.

160. *Id.* at 1329.

161. *Id.*

162. *First Nat'l Bank v. Lamoni Livestock Sales Co.*, 417 N.W.2d 443 (Iowa 1987).

163. *Id.* at 448.

164. *Id.* at 446.

165. *Id.*

166. *Id.*

167. *Id.*

168. *Id.*

169. *Id.*

of the security interest dependent on the method of sale.¹⁷⁰ The court in *Lamoni* did not believe that the legislature intended that a debtor should be able to extinguish a security interest simply by choosing to sell through a commission seller.¹⁷¹

Lamoni reaches the proper conclusion because it relies on laws which were in effect at the time.¹⁷² More importantly, it does not result in a rule which allows a debtor to choose whether the secured party's interest will be extinguished. At present, however, the disagreement between the cases makes it speculative to predict future holdings.

VI. THE FUTURE

A. *Inconsistent Language*

While S.F. 13 does not make Iowa's farm products exception identical to federal provisions with respect to actual notice, it does harmonize much of the language. One indication of the harmony is the fact that, after the passage of S.F. 13, the Iowa Bankers Association dismissed its pre-emption suit against the state of Iowa.¹⁷³ On the other hand, it is curious that the Iowa legislature has not simply incorporated all of the actual notice language of the 1985 Food Security Act into the state's farm products exception. Had this been done in 1986, there would have been no need to rewrite the statute in 1987.¹⁷⁴

The current language, while probably not sufficiently inconsistent to raise pre-emption issues, causes confusion. For example, the Iowa Code¹⁷⁵ deals specifically only with livestock commission sellers, while the Act is addressed to all commission sellers.¹⁷⁶ The existence of the Iowa Code version may force the courts to define livestock, which may in turn force them to decide how other commission sellers will be treated.¹⁷⁷

There is no reason for Iowa to retain language which is different from the Food Security Act. The language serves no significant purpose, while the inconsistencies could be eliminated simply by striking past changes. The federal government clearly intended to pre-empt the notification provisions of the farm products exception, because the purpose of the Food Security Act is to remove the burden which state laws impose on this area of inter-

170. *Id.* at 447.

171. *Id.*

172. *See id.*

173. *Iowa Bankers Ass'n v. State*, Equity No. CEO2615221, Iowa District Court for Polk County (1986). *See Dismissal Without Prejudice*. The pertinent part of the dismissal states: "the Legislature has passed and the Governor has signed Senate File 13 (1987) which effectively moots those issues in the present lawsuit . . ." *Id.*

174. *See supra* text accompanying notes 129-48.

175. IOWA CODE § 554.9307 (1987).

176. *Compare* 7 U.S.C. § 1631(g) (1987) *with* IOWA CODE § 554.9307 (1987).

177. IOWA CODE § 554.9307(1) (1987).

state commerce.¹⁷⁸

B. *Certified Central Filing*

The Uniform Commercial Code creates a complex balance between the interests of the secured party and the interests of others involved in commercial transactions.¹⁷⁹ The Food Security Act shifts the balance in favor of the buyer of farm products. The actual notice option is more favorable to the buyer than certified central filing.

Certified central filing provides a more evenly balanced approach because it places a burden on both parties. The secured party protects its perfected interest by filing a financial statement with the secretary of state.¹⁸⁰ The buyer has the burden of searching government records, but the records are all filed at one location.¹⁸¹ The statements are easy to examine because they are organized according to product, debtor, county, and crop year.¹⁸² If the buyer registers with the secretary of state, a master list will be sent to him periodically.¹⁸³ Even if the buyer does not register, the records can be checked simply by calling the secretary of state.¹⁸⁴ Currently, fourteen states have a system of central filing which has been certified by the Secretary of Agriculture.¹⁸⁵

Actual notice tips the balance too far in favor of the farm products buyer because the secured party risks losing the collateral even when he complies with all of the law's provisions. A buyer of farm products takes subject to a perfected security interest if he is notified of the interest prior to purchase.¹⁸⁶ The problem is that if a debtor sells to a farm products buyer who is not on the list of potential buyers, the buyer will not have been notified and the security interest will be extinguished. Penalties imposed on the debtor may discourage the debtor from making such a sale, but there is still a possibility that the collateral may be lost.¹⁸⁷ This risk may, in turn, make farm loans more risky.

178. 7 U.S.C. § 1631(a), (b) (1987).

179. *Bank of Landisburg v. Burruss*, 362 Pa. Super. 317, ____, 524 A.2d 896, 900 (1987).

180. 7 U.S.C. § 1631(e)(2), (3) (1987).

181. 7 U.S.C. § 1631(c)(2)(A) (1987).

182. 7 U.S.C. § 1631(c)(2)(C) (1987).

183. 7 U.S.C. § 1631(c)(2)(E) (1987).

184. 7 U.S.C. § 1631(c)(2)(F) (1987).

185. The states are: Alabama, 52 Fed. Reg. 41,312 (1987); Arkansas, 51 Fed. Reg. 46,887 (1987); Idaho, 51 Fed. Reg. 36,257 (1986); Louisiana, 51 Fed. Reg. 47,036 (1987); Maine, 51 Fed. Reg. 43,941 (1987); Mississippi, 51 Fed. Reg. 33,647 (1986); Montana, 51 Fed. Reg. 32,673 (1986); Nebraska, 51 Fed. Reg. 45,493 (1986); New Hampshire, 51 Fed. Reg. 37,192 (1987); North Dakota, 51 Fed. Reg. 45,493 (1986); Oregon, 51 Fed. Reg. 43,647-48 (1986); South Dakota, 52 Fed. Reg. 37,192 (1987); Utah, 51 Fed. Reg. 37,769 (1986); Vermont, 52 Fed. Reg. 37,035 (1987).

186. See 7 U.S.C. § 1631(e)(1)(A) (1987); IOWA CODE § 554.9307(4) (1987).

187. See 7 U.S.C. § 1631(h)(3) (1987); IOWA CODE § 554.9307(5) (1987).

The possibility of higher risk seems to frustrate the goal of the farm products exception. The exception is intended to protect lenders to the extent required to encourage them to extend loans which are secured by farm products.¹⁸⁸ The risk that they may lose their secured interests in farm products may make lenders less willing to loan money when farm products are the collateral. The risk may also increase the debtor's cost of borrowing. To avoid these undesirable results, the Iowa General Assembly should change from actual notice to certified central filing.

Kirk J. Fjelstul

188. Bauer, *supra* note 25, at 1322-23. See also Phillips, *Agricultural Financing Under the UCC*, 12 ARIZ. L. REV. 391, 413 (1970).