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An Agricultural Law Research Article

Farmers Who Sell Mortgaged Farm Products and Don't Tell; Buyers Who Buy Farm Products and Don't Pay—An Electrifying Solution

by

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Originally published in DRAKE LAW REVIEW
34 DRAKE L. REV. 429 (1984)

FARMERS WHO SELL MORTGAGED FARM PRODUCTS AND DON'T TELL; BUYERS WHO BUY FARM PRODUCTS AND DON'T PAY—AN ELECTRIFYING SOLUTION

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I. The Problem

Special treatment of farmers under the law has been based upon the image of the innocent American gothic figure. The special treatment received by farmers is exemplified by the way "farmers" are defined in various state statutes. In at least nine states, the farmer is defined as a "simple tiller" of the soil.[1] From the definitions adopted in some thirty-four states, it

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1. Courts in Arkansas (Cook Grains, Inc. v. Fallis, 239 Ark. 962, 395 S.W.2d 555 (1965)), Iowa (Sand Seed Serv., Inc. v. Poeches, 249 N.W.2d 663 (Iowa 1977)), New Mexico (Fear Ranches, Inc. v. Berry, 470 F.2d 905 (10th Cir. 1972)), Utah (Lish v. Compton, 547 P.2d 223 (Utah 1976)), South Dakota (Terminal Grain Crop. v. Freeman, 270 N.W.2d 806 (S.D. 1978)), and Montana (Pierson v. Arnst, 33 U.C.C. Rep. Serv. 457 (D. Mont. 1982)) have held that a farmer is not a merchant under U.C.C. § 2-104 for the purpose of applying U.C.C. § 2-201, an exception to the statute of frauds in the case of oral contracts as between merchants. Unless otherwise indicated, all references and notations in this article to the text and comments of the Uniform Commercial Code, are hereinafter referred to as the Code or the U.C.C., and are to the 1978 Official Text with comments.

An example of the judicial reasoning for holding that a farmer is not a merchant under the U.C.C. can be found in *Terminal Grain Corp. v. Freeman*, 270 N.W.2d 806, 811 (S.D. 1978). The court noted that the Official Comment to U.C.C. § 2-104 indicated that the definition of the term "merchant" had its origins in the "law merchant" concept of a professional in business. The farmer is not a "professional equal in the marketplace with grain buying and selling companies." *Id.* at 812.

Courts have not consistently resolved the issue of whether or not a farmer is a merchant. In one of the earlier decisions, the court simply stated that "[t]here is nothing whatever in the statute indicating that the word 'merchant' should apply to a farmer when he is acting in the capacity of a farmer, and he comes within that category when he is merely trying to sell the commodities he has raised." Cook Grains, Inc. v. Fallis, 239 Ark. 962, 968, 295 S.W.2d 555, 557 (1965). One commentator has responded to this argument by stating that:

> It is true that there is nothing in the Code which specifically declares that a farmer is or should be regarded as a merchant when selling his crop, but that observation covers only half the picture. It is equally true that nothing in the Code prohibits applying the merchant status, and other courts decline to withhold it from a farmer merely because he has grown or raised what he has sold. To do otherwise would be to employ logic which if applied to the case of a manufacturer would lead to the absurd conclusion that in the sale of goods it manufactures it is not a merchant—a result clearly not embraced by any court.

Bender's Uniform Code Service, *Sales*, § 1.02, at 1-18 (1983) (footnote omitted).

Three states have developed conflicting interpretations over the "simple tiller" notion. In Alabama, the court in *Loeb & Co., Inc. v. Schreiner*, 294 Ala. 722, 725, 321 So. 2d 199, 202 (1975) held that a farmer was not a merchant in Alabama under the first two tests of U.C.C. § 2-104. *Loeb* did not expressly exclude farmers from the third category of the merchant. In a later case, the Alabama Court of Civil Appeals held that a farmer who employed an agent could be classified as a "merchant". Bradford v. Northwest Alabama Livestock Ass'n, 379 So. 2d 609, 611 (Ala. Civ. App. 1980). It is the agent who by his occupation holds himself out as having knowledge or skill concerning goods involved in the sale. *Id.* The agent's knowledge and skill transforms the farmer into a merchant. *Id.*

The Supreme Court of Wisconsin and the United States District Court in Wisconsin differ in their interpretation of the issue. In *Gerner v. Vasby*, 75 Wis. 2d 660, ____, 250 N.W.2d 319, 325 (1977), the court held that Gerner "was not a merchant in respect to the sale of grain" because "[h]e was not in the business of selling grain but, rather, conducted a cattle-feeding

is unclear whether the farmer has even joined the Twentieth Century.[2] Only seven states have defined the farmer as a "professional" and a "merchant."[3] The special treatment and exceptions provided farmers is anomalous in the face of modern farming practices. With the advent of telecommunications, microcomputers, $100,000 tractors, and agribusinessmen as familiar aspects of modern farming, it is time to bring the farmer's commercial practices into the current century and pave the way for the future.

This article will discuss some of the problems that arise as a result of the special treatment that is given to farm product transactions. These problems exist because of a reluctance to define farmers as merchants in spite of their similarity. Even if society is not willing to define farmers as merchants *per se*, farmers should be defined as merchants when, for exam-

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operation and that he grew grain primarily for that purpose and sold grain only when it was surplus to his cattle feeding needs." *Id.* In *Continental Grain Co. v. Brown*, 19 U.C.C. REP. SERV. 52, 58-59 (W.D. Wis. 1976) the federal District Court noted:

> [T]here seems to be wide acceptance of the view that, in dealing in sales of his own products, a farmer may be a 'merchant' as the term is used in the Uniform Commercial Code. . . . In fact, it appears likely that the term 'merchant' was intended to apply to all but the consumer purchaser or the most casual and inexperienced seller. It is reasonable to charge persons with the knowledge and skill of merchants if the persons create the impression of familiarity with particular products or practices.

Id. (footnotes omitted).

The federal district court upheld its 1976 ruling in 1978 by distinguishing *Continental* and *Gerner*. The court held that *Gerner* was decided on the basis of a casual grain sale by the defendant. *Continental* involved a sale of grain grown for contract. Continental Grain Co. v. Brown, 23 U.C.C. REP. SERV. at 874-75.

In Kansas, using the language of *Decatur Coop. Ass'n v. Urban*, 219 Kan. 171, 547 P.2d 323 (1976), the court of appeals held in *Musil v. Hendrich*, 627 P.2d 367, 373 (Kan. App. 1981) that a hog farmer of 30 years was a "dealer," and by his occupation held himself out to have the knowledge or skill of a "hog merchant." The court in *Decatur Coop. Ass'n v. Urban*, 219 Kan. 171, 547 P.2d 323 (1976) had held that farmers were not merchants if they were dealing in their own right.

2. In *Kimball County Grain Coop. v. Yung*, 200 Neb. 233, 263 N.W.2d 818 (1978), the Nebraska court did not decide whether a farmer is a merchant under the U.C.C. The concurring opinions, however, split on the issue of whether a farmer was a "simple tiller" or a "merchant". *Id.* at ____, 263 N.W.2d at 821 (Brodkey, J., concurring). Other states (except those listed in *supra* note 1 and *infra* note 3) have not addressed the issue in recorded opinions.

3. Article 2 of the U.C.C. makes a distinction between the rights and duties applicable to merchants and those applicable to non-merchants. The principle underlying this distinction is that a different set of rules would apply to buyers and sellers who are "professionals in business" rather than "casual" buyers and sellers. *See* U.C.C. § 2-104 comments 1 and 2 (1978). Several courts have concluded that the farmer is a merchant. Campbell v. Yokel, 20 Ill. App. 3d 702, 313 N.E.2d 628 (1974); Sebasty v. Perschke, ____ Ind. App. ____, 404 N.E.2d 1200 (1980); Barron v. Edwards, 45 Mich. App. 210, 206 N.W.2d 508 (1973); Rush Johnson Farms, Inc. v. Missouri Farmers Ass'n, 555 S.W.2d 61 (Mo. App. 1977); Ohio Grain Co. v. Swisshelm, 400 Ohio App. 2d 203, 318 N.E.2d 428 (1973); Nelson v. Union Equity Coop. Exch., 548 S.W.2d 352 (Tex. 1977). Many of the cases holding farmers to be merchants have involved the sale of grain based on farmers failing to deliver on oral grain contracts during the volatile grain markets of the 1970's.

ple, their commercial sales are greater than a certain number of dollars. Several courts have focused inquiries into the merchant status of farmers on the basis of factors such as: (1) the size of the transaction in both quantity and dollar amount;[4] (2) the frequency and length of time a farmer has engaged in selling the particular goods involved;[5] (3) whether the goods sold are the farmer's principal crop;[6] and (4) the farmer's familiarity with the market in which the goods were sold.[7] These or other standards could easily be adopted to provide a method for determining whether or not a particular farmer is a merchant.

Farmers must possess much of the same professionalism as other merchants if they are to remain profitable commercial farmers. To continue to define farmers as simple tillers of the soil, ignores modern farming practice. Today the farmer is likely to be a well trained and seasoned businessman. Those farmers who are not well trained in the commercial aspects of agriculture can be educated as to their responsibility as merchants under the Uniform Commercial Code through farm groups, extension services, and farm publications. The farmer should be defined as a merchant by uniform legislation.[8]

The conflict over the farmer-merchant rule sets the stage of this article. First, this conflict shows the need for reunification of the Uniform Commercial Code (U.C.C.) by removing conflicting interpretations of the same problem. Second, this conflict focuses our attention on the fact that the farmer is no longer a "simple tiller" who deals in a simple market place. New direction must be adopted that will bring the farmer into the modern business world, yet protect the buyer of farm products from farmers who do not tell the buyer about the mortgages on those products[9]; while protecting the farmer who sells his products to buyers who do not pay.[10]

The problems that this article will discuss arise in a typical farm trans-

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4. Campbell v. Yokel, 20 Ill. App. 3d 702, 313 N.E.2d 628 (1974); Continental Grain Co. v. Brown, 19 U.C.C. REP SERV. 52 (W.D. Wis. 1976).

5. Musil v. Hendrich, 627 P.2d 367 (Kan. Ct. App. 1981); Barron v. Edwards, 45 Mich. App. 210, 206 N.W.2d 508 (1973).

6. Nelson v. Union Equity Coop. Exch., 548 S.W.2d 352 (Tex. 1977).

7. Musil v. Hendrich, 627 P.2d 367 (Kan. Ct. App. 1981).

8. *Cudahy Foods Co. v. Holloway*, 55 N.C. App. 626, 627, 286 S.E.2d 606, 607 (1982) is an application of this principle. A real estate agent was held not to be a merchant when she purchased cheese. *Id.*

9. Article 9 of the U.C.C. provides the method by which farm products can be used as collateral in modern transactions. The term "mortgaged farm products" has its origin in the concept of chattel mortgages and means farm products secured by a U.C.C. Article 9 lien. *See* U.C.C. §§ 9-109(3), 9-203(1)(b), 9-204(2)(a), 9-204(4)(a), 9-307, 9-312(2), 9-401, 9-402 (1978).

10. Farm product sellers often receive checks that are subsequently dishonored. Low margins in the beef industry resulted in a series of beef industry bankruptcies in the mid 1970's. H. Rep. No. 94-1043, 94th Cong., 2d Sess. (1976); *More Can be Done to Protect Depositors at Federally-Examined Grain Warehouses*, Report by General Accounting Office, CED-81-112, June 19, 1981 [hereinafter cited as *GAO Report*].

action in which the farmer delivers farm products to a buyer.[11] Often, these farm products are secured under the U.C.C. Article 9 by a third-party lender. Many times, however, the farmer does not notify the buyer that the farm products have been pledged to the third-party, the purchaser does not search the appropriate records for evidence of the secured transaction, or the record search is inadequate to show the secured interest. Such a secured interest follows the farm product sold by the farmer to the purchaser. If the farmer subsequently becomes insolvent or fails to pay the debt to the secured third-party, such party may bring an action in conversion against any subsequent holder of the farm product.[12] If such an action is successful, the purchaser will find that he has bought the farm product twice; once from the farmer and once from the lender. In the same or a similar transaction, the buyer may provide the farmer with a check which is later returned marked "insufficient funds," or the purchaser (usually a grain elevator) has gone bankrupt before the check is cashed. In these cases, the farmer becomes an unsecured party in any subsequent bankruptcy proceeding.

The problem that arises with buyers who do not pay is that nonpayment may force the innocent farmer out of business.[13] An estimated $21,000,000 was lost nationwide from grain elevator bankruptcies between 1974 and 1979.[14] Ninety percent of this loss was absorbed by farmers; the remaining ten percent was absorbed by bankers and other grain companies.[15] Thus, elevator bankruptcies have been responsible for a direct loss from the farmer's pocket.

Likewise, the buyer of mortgaged farm products can be seriously financially injured. The Midwest Livestock Producers Association has twenty-seven claims pending against it alleging the conversion of lender's collateral

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11. U.C.C. § 9-109(3) (1978).

12. Conversion is generally defined as tortious interference with the possessory rights of another to personal property. 18 AM. JUR. 2d *Conversion* §§ 1, 25 (1965).

13. An elevator bankruptcy, causing a $27,000 loss to a farmer, put him out of business. Des Moines Register, Aug. 17, 1980, at 2B, col. 5. Perhaps only a few farmers are in a position to withstand large economic losses for non-payment on the sale of farm products. In Virginia, two elevator bankruptcies were settled in 1982 with producers receiving approximately seven and one-half cents on the dollar in one bankruptcy and approximately 29 cents on the dollar on the other. Virginia Farm Bureau News, Jan. 1982, at 1, col. 5. One of these settlements involved 27 producers amounting to $274,055.20 in losses, or an average of over $10,000 per loss. *Id.* BUREAU OF GRAIN MKT. SERVS. VIRGINIA DEP'T OF AGRICULTURE AND CONSUMER SERVS. ANN. REP. July 1, 1981-June 30, 1982, at 3-4. One farmer lost $30,000 in a single transaction. *Id.*

14. "Between January 1975 and May 1981, a total of 177 grain elevators reported insolvency . . . [and] two percent of the approximately 10,000 grain warehouses nationwide [went] bankrupt between 1974" and 1982. Geyer, *Prompt and Full Payment for Agricultural Commodity Producer*, 4 AGRICULTURAL LAW JOURNAL 247, 262 (1982) (footnotes omitted) [hereinafter cited as Geyer]. For a discussion on the impacts of the problem in the livestock industry prior to the change in the Packers and Stockyards Law, see S. REP. No. 94-932, 94th Cong., 2d Sess. 4 (1976) (where it was reported that "[b]etween 1958 and early 1975, 167 packers failed, leaving livestock producers unpaid for over $43 million worth of livestock").

15. Calculated from information found in *GAO Report*, *supra* note 10.

worth a total of $200,000.[16] This represents nearly one year's net earnings for that association.[17] The Farmer's Home Administration's figures show that in the 1978 fiscal year, 105 livestock claims, having a value of $508,130, were referred to the United States Department of Agriculture's (USDA) Office of General Counsel.[18] In the 1982 fiscal year, the comparative numbers were 292 and $4,004,680.[19] Also, in the 1982 fiscal year, the Farmer's Home Administration referred to the Office of General Counsel 199 claims involving grain with a total dollar amount of $4,215,940.[20] Private sector claims have also increased.[21]

Both the buyer and the seller often enter into a market transaction with unclean hands.[22] A farmer may sell mortgaged farm products, while the buyer pays with a check that is backed by insufficient funds. No farmer would knowingly sell his products to an insolvent firm.[23] Similarly, no purchaser of farm products would knowingly buy mortgaged farm products from a farmer without a release of the mortgage or lien by the lender.[24] Interestingly, however, buyers admit to these purchases of farm products without checking the public record for recorded liens.[25]

How, then, can the law be changed to provide protection for both the buyer and the seller?[26] How can the transaction risk to both the buyer and the seller be reduced or eliminated in the exchange of farm products?[27] How

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16. 62 FARM BUREAU NEWS 201 (Nov. 21, 1983).

17. *Id.*

18. *Review of Problems Related to Purchase of Mortgaged Agricultural Commodities: Hearings*, 98th Cong., 1st Sess. 257 (1983) (statement of Dennis D. Casey, Associate Manager, Livestock Marketing Ass'n) [hereinafter cited as *Mortgaged Commodities Hearings*].

19. *Id.*

20. *Id.*

21. *Id.* In calendar year 1981, LMIA, Inc. (insurance company) was made aware of 58 claims totaling $1,038,104.00. *Id.* In 1982, the Agency was informed by the insurance customers of 99 claims having a value of $1,440,621.00. *Id.* From January 1 through November 9, 1983, the numbers were 95 and $1,466,601.00 *Id.* Of the total 252 claims totaling $3,945,326.00 during this period, the Farmers' Home Administration was implicated in 180 claims (71 ½%) having a value of $2,287,603.00 equalling 55 ½% of the total. *Id.*

22. Geyer, *What Happens in an Elevator Bankruptcy to the Farmer and Other Creditors*, U.S.D.A., EXTENSION SERVICE PROC.: PRODUCERS GRAIN MARKETING CONF., Oct. 1982, p. 137. [hereinafter cited as Geyer, *Elevator Bankruptcy*].

23. Geyer, *Elevator Bankruptcy*, *supra* note 22, at 137.

24. Geyer, *The Farmer Under the Uniform Commercial Code — The Need for Knowledge, Agricultural Law: Virginia Law and Emerging Issues*, DEP'T OF AGRIC. ECON., VA. TECH., MB-321, 48 (1984) [hereinafter cited as *Agricultural Law — Virginia*].

25. *Mortgaged Commodities Hearings*, *supra* note 18, at 234-236 (testimony of James Strasma, Interstate Producers Livestock Association, Peoria, Ill.).

26. Geyer, *Elevator Bankruptcy*, *supra* note 22, at 137. Transaction risk can be defined as the risk of not receiving the goods or the money for which you traded. *See Agricultural Law — Virginia*, *supra* note 24. Price risk is the risk associated with changes in product price during the production and sales period. *Id.* Price risk appears to be the risk farmers most often associate with the sale of farm products.

27. *See Agricultural Law — Virginia*, *supra* note 24.

can "credit" be removed from these so-called cash transactions? This article will address these issues and will offer a solution to the problems faced by the participants of agricultural transactions. This article proposes the use of electronic communication and data storage by computer to eliminate the problems that are prevalent in agricultural transactions and to enhance the efficiency of the agricultural product market.[28]

II. Protecting Buyers From Purchasing Mortgaged Farm Products

The thrust of Article 9 of the U.C.C. as well as the U.C.C. in general is to ensure that business transactions function as planned.[29] The goal is to minimize the possibility of disputes between parties to commercial contracts.[30] Parties to commercial transactions must be able to determine their rights and obligations with a reasonable degree of certainty[31] and a degree of fairness.[32] "[C]ommerce knows nothing of State boundaries"[33] and increasingly, the sales of agricultural products are being conducted by larger farmers at greater distances from the county of production.

The commercial case law of the nineteenth century and the uniform commercial statutes that followed have failed to achieve the necessary certainty and uniformity.[34] The early uniform statutes were not comprehensive enough for some commercial enterprises. They were not construed systematically and often they conflicted with each other. Consequently, they failed to satisfy the needs of an increasingly mercantile society.[35] The U.C.C. was intended to remedy these failures.[36]

Article 9 of the Code was designed "to provide a simple and unified structure within which the immense variety of present-day secured financing transactions can go forward with less cost and with greater certainty."[37] Pre-Code secured financing had been plagued by conflicting and arbitrary requirements of the numerous financing devices involved, such as the chattel

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28. Geyer, *Elevator Bankruptcy*, *supra* note 22.

29. Hawkland, *Uniform Commercial "Code" Methodology*, 1962 U. Ill. L.F. 291, 294 [Hereinafter cited as Hawkland].

30. R. Speidel, R. Summers, & J. White, Teaching Materials on Commercial and Consumer Law, 264 (2d ed. 1974).

31. Lockyer v. Offley, 99 Eng. Rep. 1079, 1983-84 (1786).

32. *Id.*

33. M. Chalmers, *Address on the Codification of Mercantile Law*, 19 Law Q. Rev. 10, 18 1903).

34. The commercial case law system was developed in the wake of the industrial revolution and the early uniform statutes were enacted to remedy the failure of the case law. *See* Gilmore, *Legal Realism: Its Cause and Cure*, 70 Yale L. J. 1037, 1940-43 (1961).

35. Hawkland, *supra* note 29, at 297-99.

36. *See* Kripke, *The Principles Underlying the Drafting of the Uniform Commercial Code*, 1962 U. Ill. L.F. 321, 330-31.

37. U.C.C. § 9-101 comment (1978).

mortgage, the conditional sale, and the trust receipt.[38] Professor Gilmore has observed that "[a] tradition going back for hundreds of years stigmatized any security agreement, outside the real property field, in which the debtor was allowed to remain in possession of the collateral as a fraudulent conveyance or the next thing to it."[39] Article 9 has attempted to bring consistency to the field of personal property security or fixtures security agreements by recognizing the similarity of all transactions and recognizing distinctions only when they are of "functional utility."[40] But has this consistency been achieved with respect to agricultural transactions?

Dole[41] describes the basic Article 9 definition as follows:

> Section 1-201(37) provides [that] an Article 9 security interest is an interest in a debtor's personal property or fixtures that secures payment or performance of an obligation and is created by either contract or the Code. Article 9 security interests ordinarily are created by contract.
>
> An agreement that creates or provides for a security interest is a security agreement. A creditor in whose favor a security interest exists is a secured party. A person obligated to pay or otherwise to perform a secured obligation is a debtor. Personal property or a fixture that is subject to a security interest is collateral. Collateral can include: proceeds-personal property or a fixture that is obtained through disposition or collection of any collateral (for example, the purchase price of livestock collateral); and accessions-personal property or a fixture that is attached to other personal property or fixtures without loss of its physical identity (for example, a new motor installed in an automobile).[42]

Article 9 was created to provide security in personal property for lenders similar to the security provided to lenders in real property. As we will see, however, the general rule of Article 9 does not apply in the case of a transaction involving farm products.

A. Farm Product Exception Under U.C.C. Section 9-307(1)

The typical situation under which a farm product financing agreement arises is as follows: the farmer wishes to borrow $10,000 to plant his corn crop from a local bank; the bank is willing to loan the money if it can find acceptable collateral; the farmer is willing to pledge the crop he will plant as security for payment; in the resulting secured transaction, the bank is the

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38. *Id.*

39. 1 G. GILMORE, SECURITY INTEREST IN PERSONAL PROPERTY, § 15.1 at 462 (1965) (footnote omitted) [hereinafter cited as GILMORE].

40. U.C.C. § 9-101 comment (1978). As discussed later, when the appropriate political pressures are applied, alternatives are created. *See infra* notes 91-94 and 125-31 and accompanying text.

41. Dole, *The Article 9 Security Interest*, 2 A TRANSACTIONAL GUIDE TO THE UNIFORM COMMERCIAL CODE 894-95 (R. Alderman 2d ed. 1983) [hereinafter cited as Dole].

42. *Id.*

secured party; the farmer is the debtor; the crops, the collateral; and the $10,000, the secured obligation; the farmer then grows a crop of 4,000 bushels; the farmer harvests the crop and sells the crop for $3.00 per bushel to an elevator operator; the elevator operator then commingles the corn with other corn purchased or stored in his inventory;[43] to purchase the corn, the elevator operator had borrowed $12,000 from another bank; the elevator operator secured his inventory under U.C.C. Article 9;[44] a grain merchant purchases the inventory of corn from the elevator operator and sells it to a producer; the producer then smashes, grinds, pops, and boxes the corn into a final product; the final product is sold at a retail market to the president of the bank.

Section 9-307(1) provides:

> A buyer in ordinary course of business (subsection (9) of Section 1-102) other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence.[45]

The implication of this provision is that the bank could, in fact, retrieve the final product from its president's breakfast table[46] through a suit for conversion. It is equally clear that the other bank's security interest in the elevator's inventory is defeated in the purchase of the grain by the grain merchant.[47] Professor Henson has observed that under section 9-307(1):

> [t]he difficulties are aggravated where the security interest is in an annual crop such as wheat which the debtor sells to a grain elevator in violation of a security agreement, and the elevator in turn sells to the manufacturer of breakfast cereal which subsequently sells to distributors, and ultimately retailers sell the cereal to consumers. Under the Code, the farmer's secured party could follow the wheat into the hands of the consumer (although surely not profitably beyond that point), since even buyers in ordinary course take free only of security interests created by

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43. Corn and similar agricultural products are defined as "farm products" under U.C.C. § 9-109(3) (1978) when in the hands of the farmer.

> '[F]arm products' . . . are crops, . . . livestock, supplies used or produced in farming operations, or . . . 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.

Id. The same physical commodity is defined as inventory when it is in the hands of a non-farmer such as an elevator-merchant. U.C.C. § 9-109(4) (1978).

44. U.C.C. § 9-109(4) (1978). This hypothetical assumes that all security interests were properly filed.

45. U.C.C. § 9-307(1) (1978).

46. R. HENSON, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE 143 (1979) [hereinafter cited as HENSON]. As Henson reports, there has been no reported case where a farmer's financer tried to reclaim steaks from a dinner table.

47. *Id. See also* U.C.C. § 9-307(1) and 9-109(3) (1978).

> their sellers, not of security interests further back in the chain. The breakfast cereal is a product of the original wheat and the original security interest presumably can be traced.[48]

What the Code provides is relatively clear. A security interest continues in farm products pledged as collateral "not withstanding sale, exchange, or other disposition thereof by the debtor unless [the disposition] was authorized by the secured party in the security agreement or otherwise."[49] Farm products (as long as they remain unmanufactured by the farmer) pledged as collateral to a secured third party, do not cease to be "collateral" when purchased by a buyer from a "person engaged in farming operations."[50] This is true for farm products, whether they are crops,[51] livestock,[52] other unmanufactured farm products,[53] or supplies used or produced in farming operations.[54]

U.C.C. section 9-307(1) applies when the lender (secured party) sues the buyer of the farm products for conversion of the secured party's collateral[55] after the farm product seller fails to satisfy the lender with the proceeds of the sale. The buyer is unpleasantly surprised when he is requested to pay for the merchandise twice. The U.C.C. allows the security interest to follow the collateral through a succession of purchasers even if the "goods" are no longer "farm products," but have become "inventory" in the hands of a

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48. HENSON, *supra* note 46 at 143-44. *See also* U.C.C. § 9-306(2) (1978). If the right steps were taken to claim "products" in the financing statement, this might be an instance where U.C.C. § 9-315 could be utilized. Apparently, no cases have yet applied this section.

49. U.C.C. § 9-306(2) (1978).

50. Weisbart & Co. v. First Nat'l Bank, 568 F.2d 391 (5th Cir. 1978); First State Bank v. Producers Livestock Mktg. Ass'n, 200 Neb. 12, 261 N.W.2d 854, 858 (1978); Cox v. Bancoklahoma Agri-Services Corp., 641 S.W.2d 400, 401 (Tex. Ct. App. 1982).

51. United States v. McCleskey Mills, Inc., 409 F.2d 1216 (5th Cir. 1969). In United States v. Hughes, 340 F. Supp. 539 (N.D. Miss. 1972), the government's security interest in soybeans under a Farmer's Home Administration loan transaction continued despite the sale of soybeans to the defendant, an operator of a grain elevator. *Id.* at 543. The defendant did not take free of the security interest under section 9-307(1) since he bought farm products from a person engaged in farming operations. *Id.* The defendant had constructive notice of the government's security interest. *Id.* Lack of actual knowledge was no defense to a claim of conversion. *Id.* at 544. *See also* Production Credit Ass'n v. Columbus Mills, 22 U.C.C. REP. SERV. 228 7th Cir. 1977).

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

53. U.C.C. § 9-109(3) (1978) includes "ginned cotton, wool clips, maple syrup, milk and eggs" as examples of unmanufactured products. Comment 4 to section 9-109 indicates that processes "closely connected to farming" are not manufacturing.

54. *Id.*

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

nonfarmer.[56] For example, a recent case involved a dispute between a secured creditor, a bankrupt food processor, and a secured creditor of a group of farmers from whom the food processor bought vegetables.[57] "[T]hree farmers had obtained financing from [a local bank] and had granted the bank a security interest in their crops and the 'proceeds' thereof."[58] The food processor filed an action in bankruptcy after receiving, processing, and reselling the farmers' vegetables but before it had finished paying all purchase price installments to the farmers.[59] Not receiving payment for their vegetables, the farmers were unable to pay the bank.[60] The bank brought an "adversary proceeding in bankruptcy court against all of the food processor's secured creditors to establish the priority of the bank's security interest in the farmers' vegetables and in the cash proceeds thereof."[61] The court agreed that the bank's security interest transferred with the vegetables and that the packer and others in the marketing chain took the farm products subject to the bank's interest.[62] The case was remanded to determine and apportion the interest of the parties under several other provisions of the Code.[63]

B. Rationale of U.C.C. Section 9-307(1)—Farm Product Exception.

The special treatment accorded farm product lenders under U.C.C. section 9-307(1) is historical in origin. Generally courts and legislatures had resisted allowing the use of inventory as collateral.[64] One of the reasons given by the courts is that one who buys goods held out for sale should not have to worry about security interests created by the seller.[65] Although farm products are not treated as inventory in the hands of a farmer, the same commodity is inventory in the hands of the nonfarmer.[66] Pre-code common law firmly established a method of distinguishing agricultural collateral on

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56. Baker Prod. Credit Ass'n v. Long Creek Meat Co., 266 Or. 643, 513 P.2d 1129 (1973).
57. Peoples State Bank v. San Juan Packers, Inc., 696 F.2d 707 (9th Cir. 1983).
58. *Id.* at 708.
59. *Id.*
60. *Id.*
61. *Id.*
62. *Id.* at 710.
63. *Id.* at 711. The judgement required apportionment of proceeds under several different time periods prior to and during bankruptcy and to secured and unsecured parties. The proceedings were remanded:

> (1) to determine what proportion of each mass of the various vegetables was sold by the food processor prior to its bankruptcy;
> (2) to apportion the available proceeds, if any, from such sales between the bank and the can manufacturer in accordance with sections 9-315(2) and 9-306(4); and
> (3) to apportion the proceeds of sales made under the bankruptcy court's supervision between the bank and the can manufacturer in accordance with section 9-315(2).

64. GILMORE, *supra* note 39, § 2.2.
65. GILMORE, *supra* note 39, § 2.3.
66. GILMORE, *supra* note 39, § 2.3; U.C.C. § 9-109(3)-(4) (1978).

the basis of the holder's status rather than the physical characteristics of the product.[67] Professor Rohner[68] explains that the rationale for the rule is grounded in the small town era of the late 1800's and the early decades of this century when the "privately-owned, farm-community bank was thought to be indispensable to the area's economic progress and well-being." The rule was thought necessary to prevent bank failure and the loss of customer deposits and predated federal deposit insurance programs.[69]

The logic of the farm product exception rule is also alleged to be found in the historical difference between farm products and non-farm commercial inventory.[70] Nonfarm commercial inventory is sold continually to unidentified customers. Proceeds are often used to replace inventory in a continuous cycle which always gives the lender a security interest in the debtor's collateral.[71] Farm products, on the other hand, are sold to a few identifiable buyers.[72] Due to the biological nature of agricultural product production, once the steer or grain is marketed the loan is often paid off.[73] Proceeds are not reinvested in a replacement crop-inventory. Thus, if the producer fails to apply the sales proceeds from his crop to his production loan, the lender will find himself under-secured or unsecured. Not only is the collateral lost, but the primary and often exclusive source for repayment of the loan is lost.[74] Additionally, there may or may not be identifiable proceeds to satisfy the lender.

Although farm product sales are in many ways similar to "in bulk" sales, they are not subject to the creditor protections afforded inventory lenders under Article 6 of the Code.[75] "Bulk sales" under U.C.C. Article 6 are not in the ordinary course of business.[76] The essence of Article 6 is a

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67. GILMORE, *supra* note 39, § 26.10, at 708. This is consistent with U.C.C. §§ 9-109(1) and (2) in which a radio is classified as a "consumer good" or "inventory" depending on the status of the possessor. U.C.C. § 9-109 comment 2 (1978). *See also* U.C.C. § 9-109 comment 2 (1972).

68. *Mortgaged Commodities Hearings*, *supra* note 18, at 96 (statement of Ralph J. Rohner, Professor of Law, Catholic University of America, on Behalf of the American Meat Institute).

69. *Id.*

70. *Id.* at 142 (Preliminary Report on the Task Force on Farm Product Liens to Farm Credit Council, Sept. 6, 1983).

71. *Id.*

72. *Id.* at 143.

73. *Id.*

74. *Id.*

75. U.C.C. §§ 6-101, 6-111 (1978). Article six addresses two types of transfers as follows:

> (a) The merchant owing debts, who sells out is stock in trade to a friend for less than it is worth, pays his creditors less than he owes them, and hopes to come back into the business through the back door some time in the future.
>
> (b) The merchant, owing debts, who sells out his stock in trade to anyone for any price, pockets the proceeds, and disappears leaving his creditors unpaid.

U.C.C. § 6-101 comment 2 (1978).

76. U.C.C. § 6-102 (1978).

requirement that prior to a bulk sale, the transferee notify the transferor's creditors of the intended sale.[77] The creditors, armed with this information, can take steps to prevent the sale or to protect themselves in whatever way they find appropriate. The principle embodied in Article 6 is similar to the general principle of lender notification that is embodied in secured transactions and it should be applied to farm product transactions. It can be argued that the sale of farm products is like a "bulk" transfer, except that it is in the ordinary course of business and that it is not a sale of inventory. Despite the similarity between a bulk sale and a farm product transaction, the two are treated quite differently, particularly in terms of the protection provided to the holder of the secured interest.

The principle that the debtor should not be allowed to fraudulently conceal or dispose of his property to the detriment of his creditors has long been imbedded in Anglo-American law. As far back as the Statute of Elizabeth in 1570,[78] conveyances made with intent to delay, hinder, or defraud creditors have been declared void. Similarly, landlord liens in some states provide protection for a creditor-lender.[79] By statute or case law, today's purchasers of crops, produced on rented land, take such crops subject to a landlord's lien.[80] Article 9, like landlord-tenant law or real estate mortgage law, was designed to protect creditors from unlawful disposal of their collateral.[81]

In addition to protecting private lenders, section 9-307(1) protects government financed or government supported farm credit programs. As a major financer of agriculture, the U.S. government has become a major beneficiary of the farm products exception.[82] One writer has argued that "it taxes credulity to justify a preferential rule for large government lending programs on the ground that those programs are essentially small country banks."[83] The writer, however, fails to explain why, by law, the United States taxpayer should receive any less preference than the county banks.

The U.C.C. section 9-307(1) farm product exception was an early at-

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77. U.C.C. §§ 6-101 to 6-111 (1978).

78. 13 ELIZ. ch. 5 (1570).

79. *See* KAN. STAT. ANN. § 58-2526 (1983) (notice required). For examples of cases construing state statutes, see Cleveland v. McNabb, 312 F. Supp. 155 (W.D. Tenn. 1970), Holmes v. Riceland Foods, Inc., 261 Ark. 27, 546 S.W.2nd 414 (1977), and Prior v. Rathjen, 199 N.W.2d 327 (Iowa 1972).

80. *See supra* note 79.

81. *Mortgaged Commodities Hearings*, *supra* note 18, at 140 (Preliminary Report on the Task Force on Farm Product Liens to Farm Credit Council, Sept. 6, 1983).

82. During the first ten months of 1983, 71 ½ % of total claims and 55 ½ % of the value of the claims filed by insured farm product buyers with one insurance agency were related to Farmer's Home Administration claims. *Mortgaged Commodity Hearings*, *supra* note 18, at 257 (statement of Dennis D. Casey, Associate Manager, Livestock Marketing Ass'n).

83. *Mortgaged Commodities Hearings*, *supra* note 18, at 96 (statement of Ralph J. Rohner, Professor of Law, Catholic University of America, on Behalf of the American Meat Institute).

tempt to weigh and apportion transaction risk among farm product sellers, lenders, and buyers.[84] The issue is whether or not technology should be used to better resolve the competing interest of these three parties.

The structure of American agriculture and agricultural markets is changing rapidly. In addition to greater production per farmer, farm products are increasingly marketed over greater distances, at terminal markets far from the county of origin. Many farm products are marketed via computerized marketing systems.[85] Buyers now serve many more sellers, resulting in decreased personal knowledge of the sellers' financial position. It is equally difficult for lenders to identify potential buyers in order to control and track their security.[86] The same is true for farm product sellers who take the risk of selling to insolvent buyers. Production is increasingly carried on under operating leases and between two or three interrelated business entities. Additionally, low farm income combined with more leveraged businesses have increased farmers' debt servicing problems.

The time frame within which the market operates is short. Within the time the grain or livestock is delivered and payment is issued or required to be issued, it is often operationally difficult, under the laws of some states, to search for the lien across county and state lines.[87] Lien information is sometimes incomplete. It may also be difficult to match specifically named sellers to a given lot of fungible farm products.[88] Additionally, farm product markets and auctions often operate during nonworking hours of local county courthouses. Clearly, the changing nature of American agricultural markets requires reevaluation of the operation, if not the very viability, of the farm products exception.

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84. *Mortgaged Commodities Hearings*, *supra* note 18, at 132, 141-49 (statement of Delmar V. Banner, President, Farm Credit Council).

85. Rodgers and Purcell, *Electronic Marketing: Wave of the Future*, 344 VIRGINIA AGRIC. ECONOMIST, July-Aug. 1982.

86. *Mortgaged Commodities Hearings*, *supra* note 18, at 132 (appendix to statement of Delmar V. Banner, President, The Farm Credit Council).

87. *Id.* at 131-33.

88. *Id.* at 147. For example:

(a) It is frequently difficult to determine ownership of farm products because multiple individuals and/or entities may be involved in ownership of the commodities. This poses problems for lenders in tracing their collateral as well as for buyers in determining to whom payment should be made.

(b) Often times, filing office records may not reflect the true status of liens because some lienholders, anticipating future financing, may not release liens after satisfaction of the debt. Checks made jointly payable to lienholders in such cases may create ill will among buyers, sellers, and lenders.

(c) Grains and oil seeds and, to a less extent, livestock are largely homogeneous products that cannot be identified in a similar fashion as equipment with an identification number or real estate with a legal description.

Id. at 148.

C. Rejection or Revision of U.C.C. Section 9-307(1)

The application of U.C.C. section 9-307(1) with respect to farm products has resulted in farm product buyers "purchasing" farm commodities twice.[89] The farm product exception to U.C.C. section 9-307(1) has been eliminated in California[90] and has been the subject of legislative hearings in Congress.[91] In the absence of outright rejection of the farm product exceptions of U.C.C. section 9-307(1), some state courts and legislatures have been revising state law to modify the impact of section 9-307(1). The following sections discuss alternative ways to deal with the problem of sellers who do not tell.

1. Rejection of Farm Product Exception

California has rejected outright the application of U.C.C. section 9-307(1).[92] By statute, the secured party's security interest does not follow the farm products when the farmer sells them to a buyer in California.[93] In other words, the California Code provides the same protection to a buyer of farm products in the ordinary course of business as it does buyers of non-farm goods.[94] Although similar legislation has been introduced in other states, it has not been adopted, to date, any place outside of California.

Recently federal legislation to remove the application of section 9-307(1) to farm products has also been proposed as an alternative to state-by-state amendment of U.C.C. section 9-307(1).[95] H.R. 3296 states:

> A buyer in the ordinary course of business who buys farm products from a person engaged in farming operations shall own such goods free of any security interest in such goods created by his seller even though the security interest is perfected in accordance with applicable state law and even though the buyer knows of its existence.[96]

The basis of the legitimacy of this bill is the commerce clause of the Constitution.[97] The bill declares that the "exposure of purchasers of farm products to double payment inhibits free competition in the market for farm prod-

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89. *See supra* text accompanying notes 12-23.

90. CAL. COM. CODE § 9-307(1) (West 1983). California has, however, omitted "other than a person buying farm products from a person engaged in farming operations" from the corresponding U.C.C. § 9-307(1) (1978).

91. *Mortgaged Commodities Hearings*, *supra* note 18. The United States Senate Agriculture, Nutrition and Forestry Committee held hearings on S. 2190 during the end of the 98th Congress 2d Sess. 63 FARM BUREAU NEWS at 1, col. 1 (Oct. 1, 1984).

92. CAL. COM. CODE § 9-307(1) (West 1983).

93. *Id.*

94. *Id.*

95. S. 2190, H.R. 3296, H.R. 3297, 98th Cong., 1st Sess. (1983).

96. H.R. 3296, 98th Cong., 1st Sess. § 4 (1983). *See also* H.R. ____ 99th Cong., 1st Sess. (1985).

97. U.S. CONST. art. I, § 8, cl. 3.

ucts."[98] Such "double exposure constitutes a burden on and an obstruction to commerce in farm products."[99] The bill would remove such a burden.[100] The livestock, grain, and cotton purchasing industries are generally in support of such legislation.[101] Understandably, the farm product purchasing industry does not want to be the cosigner of farm loans.

Another more limited federal approach is taken in House of Representatives bill 3297.[102] This bill would reject the application of U.C.C. section 9-307(1) only with respect to the livestock industry.[103] Both House of Representatives bills 3296 and 3297 would allow the purchaser of farm products to take free and clear of perfected security interest even if the buyer knows of the secured party's interest. While it may be wise to create uniform federal legislation in this area, as House of Representatives bill 3296 would do, it would not be prudent to further fragment the problem with special interest legislation such as House of Representatives bill 3297. Public policy should not treat equals (farm product purchasers and producers of milk, chickens, livestock, cotton, and grain) unequally by subjecting them to different laws and exceptions.

Uniform removal of the farm product exception from section 9-307(1) at the state level or by federal legislation is attractive as a "quick fix" to the problem. It would provide the same treatment to farm products (farmer's inventory) as to other business inventory and it could easily be implemented. Such a view implies that financing farm products has lost its uniqueness. The effect, however, will be that farm lenders will be weakened in their ability to police their collateral. The credit was extended in the first place on the strength of a self-liquidating lien. Professor Meyer argues that the removal of the application of the farm product exception to U.C.C. sec-

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98. H.R. 3296, 98th Cong., 1st Sess. § 2(a)(3). The provision states that the current operation of U.C.C. § 9-307(1) discourages purchasers "from dealing with sellers who have defaulted or may default on loans." This section implies that buyers should not be concerned with sellers who may "steal" lenders' collateral. The burden of enforcement of liens is a legitimate legislative policy issue. *See generally Mortgaged Commodity Hearings*, *supra* note 18, at 137-50, 188-203.

99. H.R. 3296, 98th Cong., 1st Sess., § 2(a)(4) (1983).

100. *Id.* § 2(b).

101. *Mortgaged Commodity Hearings*, *supra* note 18 at 2, 12, 47, 65 (testimony of representatives of the American Meat Institute, National Meat Association, American Cotton Shippers Association, National Grain and Feed Association, and Livestock Marketing Association.)

102. H.R. 3297, 98th Cong., 1st Sess. (1983). This bill states that section 409 of the Packers and Stockyards Act, 1971 (7 U.C.C. § 228b), is amended by adding the following new subsection:

> (d) Notwithstanding any other Federal or State law, any buyer of livestock in the ordinary course of business, including a livestock marketing agency, shall take the livestock free of any security interest created by any person or agency even though the security interest is perfected and even though the buyer knows of its existence.

Id.

103. H.R. 3297, 98th Cong., 1st Sess. (1983).

tion 9-307(1) would have the following negative impacts:

> (1) Farm lenders will lose a substantial protection. This includes any leverage to obtain a joint payee check.
> (2) It seems this loss would require lenders to be much more conservative in their lending approach, charge higher interest rates, require more collateral, require cosigners or guarantors, and not be willing to take chances on young or less established farmers.
> (3) This could put much more pressure on the federal government to get more involved in the lending business. . . .
> (4) When farmers go bankrupt, lenders will have problems claiming money in general checking accounts containing deposit proceeds from the sale of collateral.[104]

The farm credit industry also argues that the cost of agricultural credit would be increased and/or the availability of such credit would diminish.[105]

In arguing that the impact of the removal of the farm product exemption would be minimal on agricultural credit, Professor Rohner states that:

> (1) Presumably some lenders, though legally entitled to pursue the purchaser, do not do so for reasons of expediency.
> (2) [P]reemption of the farm products rule would not mean that purchasers could never be accountable. The buyer would still have to qualify as a "purchaser in the ordinary course of business."
> (3) A reallocation of risk from buyers to lenders is also justifiable if the net amount of losses would be reduced, or if those losses could be absorbed more efficiently by lenders than purchasers.
> (4) [L]enders are inherently better positioned to absorb and distribute the resulting losses.[106]

Rohner cites no authority for the first argument.[107] In fact, other authority indicates that actions for conversion generally are undertaken even when the farmer product seller is insolvent.[108] The second argument is contradicted by the proposed legislation.[109] The third argument incorrectly assumes that the lenders could inexpensively and routinely police their collateral. Although the efficiency argument is unsubstantiated, it is acceptable

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104. *Mortgaged Commodity Hearings*, *supra* note 18, at 192 (statement of Professor Keith Meyer, University of Kansas).

105. *Mortgaged Commodity Hearings*, *supra* note 18 (appendix to Statement of Delmar K. Banner, President, The Farm Credit Council). A study of the impact of California's exemption could and should be undertaken to verify or discredit this theory; it was offered without collaboration.

106. *Mortgaged Commodity Hearings*, *supra* note 18, at 89-114 (statement of Ralph H. Rohner, Professor of Law, Catholic University of America on Behalf of the American Meat Institute).

107. *Mortgaged Commodity Hearings*, *supra* note 18, at 89-114.

108. *Mortgage Commodity Hearings*, *supra* note 18, at 192-94 (statement of Professor Keith Meyer, University of Kansas).

109. H.R. 3296, 98th Cong., 1st Sess. § 2 (1983); H.R. 3297, 98th Cong., 1st Sess. (1983).

public policy to reallocate the risk from farm product buyers to farm product lenders.[110] Moreover, similar allocation of risk is made with respect to "bulk transfers" and real estate liens; therefore, it is not a required policy to reallocate risk in the area of farm product liens. The fourth argument is perhaps the most persuasive for shifting the transaction risk solely to the lenders. This, however, presupposes that there are no acceptable legislative alternatives to resolve the current problem and that the removal of the farm products exemption is sound public policy.[111] Although the modernization of the treatment of agricultural transactions should not be delayed, the rationale behind the farm product exemption is still valid.

2. *Revision by State Legislation of the Farm Product Exemption*

Proposals to modify the application of U.C.C. section 9-307(1) by legislative alteration have been adopted in several states in recent years and have been rejected in at least eight other states.[112] Whether adopted or rejected, the proposed legislation has not been uniform. The legislative changes can be characterized[113] as requiring (1) the secured party to give notice to the buyer; (2) the buyer to obtain a statement from seller of existing liens; (3) criminal penalties for sellers who do not tell; (4) shorter statutes of limitation; (5) exemptions for selected buyers; or (6) central filing of security interests.

In Delaware, for example, the secured party must give actual notice to the buyer of any grain crop in order to preserve a security interest.[114] In Illinois,[115] Indiana,[116] Kentucky,[117] Ohio,[118] and Tennessee,[119] the secured party may require the debtor to furnish a list of potential buyers of the debtor's farm product. The secured party must then give actual notice to the buyer of a farm product in order to preserve its security interest. Louisiana provides that a lienor also must give notice to the commission agents.[120]

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110. GILMORE, *supra* note 39, § 26.10.

111. For a discussion of alternatives, see *supra* text accompanying note 105.

112. *Mortgaged Commodity Hearings*, *supra* note 18, at 259-66 (statement of Ernest H. Van Hooser on behalf of Livestock Marketing Association). States which have rejected such changes are: Alabama, Arkansas, Georgia, Michigan, Missouri, North Carolina, South Carolina, and Texas. *Id.*

113. *Mortgaged Commodity Hearings*, *supra* note 18, at 158-76 (statement of Delmar Banner, President, Farm Credit Council for a compilation of state statutes). Several state statutes are discussed in greater detail later in this section.

114. DEL. CODE ANN. tit. 6, § 9-307(2)(A) (1980).

115. ILL. REV. STAT. ch. 26, § 9-209.1 (1983).

116. IND. CODE § 26-1-9-307 (1983).

117. KY. REV. STAT. § 355.9-307 (1982).

118. OHIO REV. CODE ANN. § 1309.26(c) (Page 1979).

119. TENN. CODE ANN. § 47-9-307 (1983).

120. *Mortgaged Commodity Hearings*, *supra* note 18, at 59 (statement of Delmar Banner, President, Farm Credit Council). Louisiana has not adopted the U.C.C.

In Nebraska,[121] North Dakota,[122] Oklahoma,[123] and South Dakota,[124] the buyer must obtain a statement from the seller identifying existing lien holders, if any. If Illinois,[125] Indiana,[126] North Dakota,[127] Ohio,[128] Oklahoma,[129] and South Dakota,[130] state law provides criminal penalties[131] for a seller's misrepresentation as to existing liens and or for failure to remit collateral proceeds.[132] In South Dakota, the secured party must also file a criminal complaint against a debtor to proceed against the farm product buyer. South Dakota has also shortened the statute of limitations for conversion suits. Special exemptions for the buyers of farm products, primarily selling agents, have been adopted in Louisiana,[133] Georgia,[134] Kentucky,[135] Montana,[136] and Nebraska.[137] Although central filing has always been an option, several states have only recently adopted it. Those states include Connecticut,[138] Delaware,[139] Georgia,[140] Hawaii,[141] Iowa,[142] Kansas,[143] Maine,[144] Nevada,[145] Oregon,[146] Utah,[147] Virginia,[148] and Washington.[149]

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121. NEB. REV. STAT. § 90-9-307(4) (1983) (sunset provision phases out statute by sept. 1, 1987).

122. N.E. CENT. CODE § 41-09-28 (1983).

123. OKLA. STAT. ANN. tit. 12A, § 9-307(3)(a) (West 1983). This provision is limited to farm products other than livestock. *Id.*

124. S. D. CODIFIED LAWS ANN. § 57A-9-307 (1983). This provision provides that the seller must notify the buyer of preexisting liens. *Id.*

125. ILL. REV. STAT. ch. 26 § 9-306.01, .02.

126. IND. CODE § 26-1-9-307 (1983).

127. N.D. CENT. CODE § 41-09-28(4) (1983).

128. OHIO REV. CODE § 1309.26 (Page 1979).

129. OKLA. STAT. ANN. tit. 12A, § 9-307 (West 1983).

130. S.D. CODIFIED LAWS ANN. § 57A-9-307 (1982).

131. For example, section 23A-2-1 of the South Dakota Codified Laws provides such criminal penalties.

132. S.D. CODIFIED LAWS ANN. § 57A-9-503.1 (1982).

133. *Mortgaged Commodity Hearings*, *supra* note 18, at 59 (statement of Delmar Banner, President, Farm Credit Council). Although Louisiana has not yet adopted the U.C.C., Louisiana has provided special exemptions for commission agents unless they have received written notice of a security interest.

134. GA. CODE ANN. § 109A-9-307(3) (1982). Exemptions apply to auctioneers and commission agents. *Id.*

135. KY. REV. STAT. ANN. § 355-9-307 (Baldwin 1981). Exemptions apply to auctioneers and commission agents. *Id.*

136. MONT. CODE ANN. § 81-8-301 (1982). Exemptions apply to auctioneers, commission agents, and stockyards only if notice has been given to a state agency. *Id.*

137. NEB. REV. STAT. § 69-109.01 (1983). Exemptions apply to auctioneers, commission agents, and stockyards only if notice has been given to a state agency. *Id.*

138. CONN. GEN. STAT. ANN. § 42a-9-401 (West 1983).

139. DEL. CODE ANN. tit. 6, § 9-401 (1982).

140. GA. CODE ANN. § 11-9-401 (1982).

141. HAWAII REV. STAT. § 490.9-401 (1982).

142. IOWA CODE ANN. § 554.9-401 (West 1983).

143. KAN. STAT. ANN. § 84-9-401 (1982). In Kansas, central filing is to be phased in over a five year period. *Id.*

Individual state efforts to modify section 9-307(1) by trial-and-error have come at the expense of the unity of the Uniform Commercial Code. An example of state trial-and-error is Indiana's 1982 change in the U.C.C.[150] In 1982, Indiana law was amended to require all farm product liens to be centrally filed, starting in 1984.[151] Central filing in Indiana was then repealed in 1983.[152] As outlined below, most of the current modifications of U.C.C. section 9-307(1) are unacceptable or insufficient.

a. Secured Party Provides Notice

Indiana law is an example of changing the application of U.C.C. section 9-307(1) by removing the lender's protection (the farm product exemption) unless the lender files written notice with the potential purchaser.[153] The debtor farmer is required to give the secured party a list of potential buyers upon request.[154] The debtor must sign and date the notice which includes names and addresses of the debtor and the secured party, a description of the collateral, date and location of the filing of the security interest, and the dated signature of the secured party.[155] The notice must also be labeled with recording data.[156] The notice given under this provision expires eighteen months after it is secured or when the debt is satisfied, whichever comes first.[157] A buyer with this notice of a lien must pay with a check issued to both the debtor and the secured party.[158] Additionally, the debtor may not sell farm products to a buyer who does not appear on the list given to the secured party unless the secured party has given written permission to the debtor, or the debtor satisfies the debt to the secured party within fifteen days of the date of sale.[159]

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144. ME. REV. STAT. ANN. tit. 11, § 9-401 (1983). Maine still requires local filing with respect to farm crops. *Id.*

145. NEV. REV. STAT. § 104.9401 (1980).

146. OR. REV. STAT. § 97.4010 (1981). Security interests in livestock products are valid against livestock buyers only if they are also filed with the State Department of Agriculture. *Id.*

147. UTAH CODE ANN. § 70A-9-401 (1983).

148. VA. CODE § 8.9-401 (1983). Central filing is required only with respect to grain. *Id.*

149. WASH. REV. CODE ANN. § 62A.9-401 (1983).

150. *See* IND. CODE § 26-1-9-307(1), 26-1-9-401 (1983) (legislative history accompanying these code sections provides for a discussion of previous law).

151. *Id.*

152. *Id.*

153. IND. CODE § 26-1-9-307(1) (1983).

154. *Id.*

155. *Id.*

156. *Id.*

157. *Id.*

158. *Id.*

159. *Id.*

Kentucky,[160] Delaware,[161] Illinois,[162] Tennessee,[163] and Ohio[164] have adopted provisions similar to the Indiana law. In Ohio, however, the lien creditor may request a list of potential buyers from the debtor.[165] The creditor can then notify the potential buyer of the farmer's lien. If grain is delivered to the buyer, the buyer is informed of the proper payment procedures.[166] The Ohio statute provides for additional duties of the farmer. The farmer is required to inform the buyer of existing liens on commodities at the time the commodity is delivered.[167] The farmer is permitted to deliver a commodity to a buyer whose name is not on the original list furnished to the creditor.[168] The farmer in this case, however, must provide the creditor with the name of the buyer within fifteen days prior to selling the commodity—before title has passed.[169] This provision's impact on various pricing alternatives, such as deferred pricing and delayed pricing contracts, is unknown. As of January 1, 1984, if the buyer only knows of the existence of a lien and does not know specific terms of the lien, he buys the commodity free of the lien. This means the creditor can hold only the farmer responsible for paying the loan unless the buyer received notice, even though the buyer did not follow payment procedures set forth in the letter of notification.

Notice statutes adopted in Kentucky, Ohio, Indiana, Illinois, Tennessee, and Delaware attempt to shift the burden of reviewing for Article 9 filings by requiring article 9 creditors to notify all potential buyers of the lien.[170] In a real estate transaction, this would be like requiring the mortgagee to notify all prospective real estate buyers of his interest in the property. Buyers not notified would purchase the property free of the mortgagee's interest. Requiring the farmer-seller to notify buyers of liens on his product has merit. It is unlikely, however, to deter the unethical farm-product sellers. Similarly, that requirement alone is not likely to resolve the problem of mortgaged farm products. Consequently, the modification of U.C.C. section 9-307(1) by notice statutes not only shatters the uniformity of the Uniform Commercial Code, but the modification also creates burdensome and highly questionable procedures.[171]

In theory, notice statutes establish a method of notification that pro-

160. KY. REV. STAT. ANN. § 9-307 (Baldwin 1981).
161. DEL. CODE ANN. tit. 6, § 9-307(2) (1982).
162. ILL. REV. STAT. ch. 26, § 9-20.1 (1983).
163. TENN. CODE ANN. § 47-9-307 (1983).
164. OHIO REV. CODE ANN. § 1309.26 (Page 1979).
165. *Id.*
166. *Id.*
167. *Id.*
168. *Id.*
169. *Id.*
170. *See supra* notes 160-64.
171. *See supra* note 152 for an example of a cumbersome statute.

vides the lender with a tool by which he can police collateral and the application of collateral proceeds. Under the above mentioned alternative, the lender and buyer share responsibility for policing collateral. The burden of inadequate information shifts to the lender who is thought to have superior information as to the seller's business and financial condition. Just as buyers can never be certain where grain or livestock originated, neither can lenders be certain as to whom the grain or livestock will be sold. The lender cannot always be certain of when and where he must give notice. The modification of U.C.C. section 9-307(1) by notice statutes, therefore, may not be a sound public policy alternative. With the increasing movement of farm products across county and state lines, and with marketing decisions being made over longer periods of time, the prudent debtor would have to provide the lender with a large number of potential buyers even though he might ultimately sell to only one or a few.

Likewise, the eighteen-month expiration date of the security interest under section 9-307(1), as provided by some statutes, is questionable when applied to storable agricultural products, dairy cattle, and livestock used in a breeding herd.[172] Further, a farmer could have mixed crop years and mixed lenders represented in the same load of grain. He may have grain that was stored under a government loan for as many as three years. Such provisions reduce, if not eliminate, the usefulness of five-year moving farm products inventory loans.[173]

This statutory modification also provides that a debtor may sell to a party who has not been notified if the debtor remits payment to the lender within fifteen days. That, of course, can always be the fifteen days in which the debtor becomes insolvent. How does this legislation protect against the dishonest debtor? Will prosecutors really enforce the misdemeanor provision? Central filing with computer retrieval may provide a more workable and comprehensive alternative to a modification of section 9-307(1) that requires notice to potential buyers.[174]

b. Buyers Obtains Lien Statement from Seller

North Dakota, South Dakota, Nebraska, and Oklahoma require the buyer to obtain from the seller a certificate of ownership in which the seller certifies the condition of the title and specifically identifies any security interests outstanding against the farm product.[175] If there is a lien, the buyer

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172. *Id.*

173. *See, e.g.*, First Nat'l Bank & Trust Co. v. Iowa Beef Processors, Inc., 626 F.2d 764, 767 (10th Cir. 1980).

174. *See supra* notes 160-70 and accompanying text. If the reader is not convinced, read the text of the Indiana statute cited at *supra* note 153.

175. *See supra* notes 121-24. In North Dakota, those procedures include an obligation to search for liens in the county where the seller resides when the certificate reveals no liens. Oklahoma law provides for a "title" certificate which includes owner and merchant names along

is obliged to make payment jointly to the seller and the lienholder.[176] The buyer will take the commodity subject to any outstanding lien unless he can produce the seller's certificate and demonstrate that the appropriate procedures were followed.[177] The certificate of title approach is attractive because it imposes a burden on producers. The certification process, at the moment of sale, draws to the seller's attention the importance of satisfying the lien, but provides buyers no ironclad protection against sellers who would give a false certificate and then divert the proceeds. It is consistent, however, with the historical desire to have evidence of title and to deter fraud.

The lien statement or title alternative imposes an administrative obligation on buyers to obtain certificates in connection with every transaction or assume the financial risk of paying twice for purchased farm commodities. Considering that farm product transactions often involve large sums of money, it seems prudent to require certification of clear title at the time of purchase. The transaction time should be less than the time to transfer title to a car or real property. Few would buy a $5,000 car or $10,000 of real estate without title information. There is no reason why $5,000 or $10,000 worth of farm products should be treated differently. Despite the attractiveness of this modification, computer retrieval of the actual title condition (discussed in section IV) is clearly superior to mere certification or warranty of title.

c. *Criminal Penalties*

The laws enacted in Illinois, Indiana, North Dakota, Ohio, Oklahoma, and South Dakota introduce the concept of imposing criminal sanctions on farmer-sellers who provide fraudulent information or otherwise defraud the lender.[178] The provisions are intended to encourage notification to the buyer of liens on farm products.[179] The notified buyer would then issue a joint check to the lender and farmer.[180] These provisions recognize the need to

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with a list of the lender(s). The "title" must be signed by the seller and witnessed by the buyer and or a notary public. The certificate is to include the following statement:

> Warning: Any untrue statement as to the identification of such lenders is a felony under Oklahoma law and is punishable by imprisonment in the penitentiary for a period not exceeding three (3) years or in the county jail not exceeding one (1) year, or by a fine not to exceed five hundred dollars ($500.00).

OKLA. STAT. ANN. tit. 12A, § 9-307(3) (West 1983). Nebraska's law has a sunset provision and provides for a study commission to resolve the problem. Many farm product purchase contracts already require information as to whether the farm products to be sold are pledged as collateral. Good draftsmanship of commodity and vertical contracts in agriculture requires such a provision.

176. *See supra* notes 121-24.

177. *Id.*

178. *See supra* notes 125-30.

179. *Id.*

180. *Id.*

place the responsibility on the seller to provide information to both the buyer and the lender because without such information neither party can adequately protect their interest in the commodity. South Dakota provides a twist by requiring the secured lender to initiate a criminal action against the farm product seller before a civil suit can be filed against the buyer.[181]

d. Shorter Statutes of Limitations

A shorter statute of limitation requires lenders to promptly pursue their claims against buyers.[182] By reducing the period of time available to lenders to make their claim, the buyers' exposure to contingent liabilities is likewise reduced. Arguably, the number of claims would also be reduced. From the lenders' standpoint, this rule is unfavorable because in many instances considerable time may have elapsed before the diversion is discovered and traced to the buyer. Yet, the major financial risk of diverted proceeds would still rest with the buyer. The reduction of time from five years to only three, for example, may be a sensible policy alternative. It requires lenders to more closely police their loans and it provides a shorter period of exposure for the buyer.

e. Special Exemptions

Nebraska,[183] Georgia,[184] Montana,[185] Louisiana,[186] and Kentucky,[187] provide that auctioneers or commission agents shall generally not be liable to the secured party if they purchase mortgaged farm products. In addition, Kentucky[188] provides that buyers of livestock also take free of any security interest unless written notice by certified mail is provided to the licensed stockyard. Montana[189] has a similar notice requirement for stockyards. The notice is centrally filed and dispensed by the state government to central livestock markets.[190] Such modifications of U.C.C. section 9-307(1) by state legislatures indicate a trend towards special interest protection for auctioneers, commission markets, and livestock buyers. The anomaly of such special interest provisions under U.C.C. section 9-307 is that while the buyer of the farm product at the farmer's place of business is liable for conversion, a buyer at an auction house takes free of the creditor's secured interest. If a

181. S.D. CODIFIED LAWS ANN. § 57A-9-306 (1983).
182. *See supra* note 132.
183. NEB. REV. STAT. § 69-109.01 (1983).
184. GA. CODE ANN. § 11-9-307 (1982).
185. MONT. CODE ANN. § 81-8-301 (1982).
186. *Mortgaged Commodity Hearings*, *supra* note 18, at 59 (statement of Delmar Banner, President, Farm Credit Council). Louisiana has not adopted the U.C.C.
187. KY. REV. STAT. § 355.9-307 (1982).
188. *Id.*
189. MONT. CODE ANN. § 81-301 (1982).
190. *Id.*

creditor's interest in mortgaged farm products is to be severed, like a creditor's interest in inventory[191] in a sale in the ordinary course of business, then the creditor's interest should be severed in all such transactions, not just a select few.

f. Central Filing and Agricultural Products

In theory, by filing under Article 9, the secured party has provided all "would be" purchasers of farm products with constructive notice of the secured party's interest in the collateral.[192] The issue that arises, however, is whether or not the filing requirements of section 9-401[193] are practical in light of the modern marketing techniques of agricultural or farm products. In this electronic age, the current filing provisions should be modernized to accommodate the needs of both the secured party and the purchaser of pledged farm products. Central filing could reduce the potential for conversion suits against purchasers of farm products in the ordinary course of business. What is the current law for filing a security interest in farm products and how should it be updated?

Perfection[194] under the Uniform Commercial Code can be obtained by either possession[195] or filing.[196] Obviously, in modern commercial agriculture, taking possession of growing crops, raised livestock, stored grain, or flowing milk is not a realistic alternative to perfecting the secured party's interest in farm products. Historically:

> [F]iling was looked at as merely an alternative, a less desirable alternative, to possession taken by the secured party . . . . A tradition going back for hundreds of years stigmatized any security arrangement, outside the real property field, in which the debtor was allowed to remain in possession of the collateral as a fraudulent conveyance or the next thing to it.[197]

The judicial philosophy espoused above was in contrast with the early legislative requirement of filing mortgages for secured transactions of real estate.[198]

The logic and need for filing security interest in non-real estate property led to the establishment of formal filing requirements. With the change in attitudes toward filing systems, a proliferation of systems as well as security devices were created.[199] During the formulation of the U.C.C. Article 9,

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191. U.C.C. § 9-307(1) (1978).
192. U.C.C. § 9-401 (1978).
193. *Id.*
194. U.C.C. § 9-303 (1978).
195. U.C.C. § 9-305 (1978).
196. U.C.C. § 9-302 (1978).
197. GILMORE, *supra* note 39 at 462.
198. *Id.*
199. *Id.* at 463.

some commentators suggested that modern techniques for the collection and communication of credit information had made filing systems unnecessary and obsolete.[200] Some argued that financial statements scrutinized by lenders and specialized credit information agencies would be adequate.[201] The proponents of "no filing" have argued that appropriate safeguards could be introduced to protect people misled by false or incomplete statements.[202] The argument for this system founders, of course, on what the appropriate safeguards should be.[203]

Access to public files is a key to the validity of keeping the lenders protected against the conversion of lender's collateral by a purchaser of farm products. Presently, public files are not consulted when they should be. Professor Meyer has queried, "[h]ow many agribusinesses have tried to comply with Article 9 and search . . . the records."[204] In the area of farm products and farm equipment, the filing system may be incomplete because perfection can be secured only by possession,[205] notation on title,[206] place of residence,[207] location of growing crop,[208] place of business,[209] and type of collat-

200. *Id.*

201. *Id.*

202. *Id.*

203. *Id.*

204. *Mortgaged Commodity Hearings*, *supra* note 18, at 191 (statement of Professor Keith Meyer, University of Kansas).

205. U.C.C. § 9-305 (1978).

206. Trucks and cars that are used in the farm business. U.C.C. § 9-302 (1978).

207. U.C.C. § 9-401(1) (1978) (Alternatives 1, 2, 3). The three alternative provisions established by the drafters are as follows:

I. Alternative 1—The proper place to file in order to perfect a security interest is as follows:

(a) When the collateral is timber to be cut or is minerals or the like (including oil and gas) or accounts subject to subsection (5) of Section 9-103, or when the financing statement is filed as a fixture filing (Section 9-313) and the collateral is goods which are or are to become fixtures, then the office where a mortgage on the real estate would be filed or recorded;

(b) in all other cases, in the office of the (Secretary of State).

II. Alternative 2—The proper place to file in order to perfect a security interest is as follows:

(a) When the collateral is equipment used in farming operations, or farm products, or accounts or general intangibles arising from or relating to the sale of farm products by a farmer, or consumer goods, then in the office of the . . . in the county of the debtor's residence or if the debtor is not a resident of this state then in the office of the . . . in the county where the goods are kept, and in addition when the collateral is crops growing or to be grown in the office of the . . . in the county where the land is located.

(b) When the collateral is timber to be cut or is minerals or the like (including oil and gas) or accounts subject to subsection (5) of Section 9-103, or when the financing statement is filed as a fixture filing Section 9-313 and the collateral is goods which are or are to become

eral.[210] The "one big filing system" philosophy became the official code position.[211] The code, however, promoted disunity from the beginning in the area of filing and filing continues to vary between the states.[212] In an effort to accommodate differing views concerning central versus local filing, the drafters provided three alternative filing provisions.[213] States acting on their own have added further disunity to these provisions.[214]

In general, real estate related collateral, other than growing crops, is

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fixtures then in the office where a mortgage on the real estate would be filed or recorded;

(c) in all other cases, in the office of the (Secretary of State).

III. Alternative 3—The proper place to file in order to perfect a security interest is as follows:

(a) When the collateral is equipment used in farming operations, or farm products, or accounts, or general intangibles arising from or relating to the sale of farm products by a farmer, or consumer then in the office of the . . . in the county of the debtor's residence or if the debtor is not a resident of this state then in the office of the . . . county where the goods are kept, and in addition when the collateral is crops growing or to be grown in the office of the . . . in the county where the land is located;

(b) When the collateral is timber to be cut or is minerals or the like (including oil and gas) or accounts subject to (5) of Section 9-301, or when the financing statement is filed as a fixture filing (Section 9-313) and the collateral is goods which are or are to become fixtures, then in the office where a mortgage on the real estate would be filed or recorded;

(c) In all other cases, in the office of the (Secretary of State) and in addition, if the debtor has a place of business in only one county of this state, also in the office of . . . of such county, or if the debtor has no place of business in this state, but resides in the state, also in the office of . . . of the county in which he resides.

The alternative provision of 9-401(1) which have been adopted by the individual states as of June, 1983 follow. 1986 Code and Modification of the three alternative provisions are noted in parenthesis after the appropriate state.

Id.

Alternative 1 has been adopted in Delaware, the District of Columbia, Connecticut, Georgia, Iowa, Maine, Oregon, Utah (modified), and Washington. Alternative 2 has been adopted in Alabama, Alaska, Arizona, California, Colorado, Florida, Idaho, Illinois, Kansas, Michigan, Minnesota, New Hampshire, New Jersey, Oklahoma, Rhode Island, South Dakota, Tennessee, Texas, and Wisconsin. Alternative 3 has been adopted in Arkansas, Maryland (modified), Massachusetts, Mississippi, Missouri, New York, Nevada, North Carolina, Ohio, Pennsylvania, Virginia (modified), and West Virginia. Guam, Kentucky (2nd and 3rd), and Louisiana (has not adopted Article 9) have mixed versions for the place of filing.

208. U.C.C. § 9-401(1) (1978).

209. *Id.*

210. *Id.*

211. GILMORE *supra* note 39, at 465.

212. *See supra* note 207.

213. D. BAKER, A LAWYER'S BASIC GUIDE TO SECURED TRANSACTIONS, at 118 (1983).

214. *See supra* note 207.

filed in the local office where a mortgage on the pertinent real estate is recorded or filed.[215] With respect to all other cases (consumer goods, equipment, farm products, inventory, documents, chattel paper, accounts, and other general intangibles), the three filing alternatives are very different.[216]

Under the first alternative,[217] adopted by twelve states,[218] in all cases other than fixtures, timber to be cut, and minerals at the wellhead or minehead, filing is at a central location.[219] Thus, farm equipment and farm products, including crops, are filed centrally.

The second alternative,[220] adopted in twenty-three states,[221] adds local filing for growing crops, farm equipment, farm products, and consumer goods.[222] The proper county (or town) depends on the debtor's residency, where goods are kept for nonresidents, where crops are growing or are to be grown (debtors place of business), and the type of business organization.[223] Thus, the same tractor with a scraper blade may be filed centrally, locally, or both, depending on whether it is used as a farm tractor to scrape feed lots (local), by a construction firm (central), or by a farmer who also works construction on the side (both).[224] To summarize the distinction between the first alternative and the second alternative it should be noted that the second alternative requires local filing for farm collateral (equipment and farm products), consumer goods, and realty-connected collateral. The first alternative only requires local filing for realty-connected collateral.

Approximately thirteen states have enacted the third alternative with variations.[225] The third alternative of section 9-401(1)[226] repeats the language of the second alternative except that local filing is required for all items that must be centrally filed. The local filing must be in the debtor's county where he has a business or in his county of residence. Again, the proper place to file depends on the identity of the collateral involved. In this case, however, filing of the tractor as farm equipment is local, while the filing of the same item of equipment used in a business is centrally and locally

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215. U.C.C. § 9-401 (1) (1978) (first, second, and third alternative). The 1972 revision added timber to be cut and minerals.

216. U.C.C. § 9-401(1) (1978) (alternatives 1, 2, and 3).

217. U.C.C. § 9-401 (1978) (first alternative).

218. *See supra* note 207.

219. U.C.C. § 9-401(1) (1978) (first alternative).

220. U.C.C. § 9-401(1) (1978) (second alternative).

221. *See supra* note 207.

222. U.C.C. § 9-401(1) (1978) (second alternative).

223. *Id.*

224. *Id.* For example, a landscaper who only landscapes as a subcontractor for builders has liens filed centrally. A landscaper who, in addition to landscaping, uses the tractor in his nursery that he operates to provide plant mineral for his landscaping business has liens filed both centrally and locally.

225. *See supra* note 207.

226. U.C.C. § 9-401(1) (1978) (third alternative).

in the debtor's place of doing business.[227]

Because many farmers grow crops in more than one county, their place of business may be in doubt. In this case, the proper place to file for farm products, farm equipment, and growing crops may be confusing. This should be resolved by filing in every possible county, and also centrally when appropriate.[228] The possibility of improper or inadequate filing by the lender and insufficient checking by the farm product purchaser is increased under local filing systems. Comment three to the code states that "[i]n state where it is felt wise to preserve local filing for transactions of essentially local interest, either the second or third alternative for 9-401 should be adopted."[229]

With farmers selling farm products both locally and at regional and terminal markets, secured agricultural financing is no longer essentially a local interest. With lending institutions also working on a state or area-wide basis, the filing of agricultural collateral (farm equipment, farm products, and growing crops) may not be essentially local. Even if it is presently local, it is not likely to remain purely local in the future. Dole stated that "[t]ransferring all agricultural filings to the state level will remove this practical compulsion to file everywhere. . . . It will remove the severe penalty for loss of perfection and priority that can be imposed for a failure to file everywhere."[230] Computer assisted search of one central file by direct linkage between purchase and the central data base, will enable the buyer to instantaneously examine the record for liens on farm products.[231]

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227. *Id.*

228. Dole, *supra* note 41, at 1003. Of course, the cost of filing is passed to the debtor, so why should the lender care?

229. U.C.C. § 9-401 comment 3 (1978).

230. Dole, *supra* note 41, at 1003.

231. The search can be conducted by using the debtor's name, variations of name and address, and the type of farm product. Most local clerks file by the name given. Thus, Hooker, Thomas J. of RR #1, Farmville is the only listing. When Hooker, T. J. sells his farm products, the clerk might overlook Hooker, Thomas, J. in searching the record. The computer, searching on Hooker, T., would provide a listing of Hooker, T.J.; Thomas Jay; Tom; Tom Jay; Thomas Jay; T. Jay; etc. at RR #1, Farmville. With computer assisted search of the central file by direct linkage between the purchaser's microcomputer and central data base or the purchaser's phone call to the central location, the buyer will be able to instantaneously search the record for liens on the seller's farm products. State-wide filing is still a relatively novel and unfamiliar device. As the business and banking communities become familiar with its operation, they may well come to appreciate its merits. This seems to have happened in the limited areas in which state-wide filing has been in force for any period of time. In the absence of centralized computers, private agencies have developed through which state-wide file checks can be made as promptly as if the files were located in the county courthouse. A phone call for a file search to a central agency in the state capital may be as cheap (if not cheaper) than a forty mile trip to the county seat (or several county seats) to search the local lien records of farmer-sellers. Because centralized computer filing of Article 9 liens can provide an instantaneous check of the file for farm product liens, it is ideally suited to provide instantaneous information to the farm product buyer. The buyer can check the file conveniently, and thus, U.C.C. § 9-307(1) will function as intended, giving notice to prevent the conversion of farm products.

Farm product buyers need not search every transaction. Buyers could establish a credit policy for each of its regular sellers. Such a policy could include a periodic update of those farm product sellers who have liens. Then when a regular seller offered secured farm products, the buyer could, pursuant to its credit policy, issue a check payable to both the seller and lender. The buyer would only need a full credit check on an unknown farm product seller.

So long as alternative methods and places of perfection are required, search of lien files will remain inconclusive. With the advent of regionally-produced farm products, multiple local filing and perfection systems should be replaced with a uniform system. An easier search for a perfected security interest in farm products would be beneficial to a farm products buyer. The conversion suit under U.C.C. section 9-307(1) would almost disappear because a file could be easily searched.

The adoption of central filing, however, would not be without opposition. As Professor Gilmore observed:

> Our discussion has assumed that the decision between exclusive and double filing will be made on what may be called its commercial merits. This assumption is to a degree unrealistic; experience to date suggests that the issue is quite likely to become entangled in local politics. The town and county clerks are naturally disinclined to lose the business on which their jobs depend. Their association will typically insist on legislative hearings on the maintenance of an exclusively local filing system or, as a reluctant compromise, on the addition of local to state filing. Anyone who scoffs at the political influence of the county clerks on state legislatures will in due course become a sadder but wiser man.[232]

The geographical size of the state might tend to encourage or discourage central filing. A single set of files in Texas or Alaska is quite a different matter than in a small New England state. The technology of electronic data retrieval, however, does provide an answer to the problem of central filing which was unimaginable when the filing provisions were originally discussed. California, one of the largest states, requires exclusive state-wide filing for everything except certain types of agricultural collateral.[233] Therefore, it is clear that uniform statewide filing is not inconceivable.

The central filing solution basically leaves intact the unique treatment of farm products sold in the ordinary course of business. It maintains the established balance of responsibility between lenders and buyers of farm products. This solution recognizes that buyers' operating problems are largely problems of notice and attempts to deal with the notice problem by establishing within each state a single office where all farm product liens must be filed. This solution also recognizes the need for timely and accurate

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232. GILMORE, *supra* note 39, at 524.

233. CAL. COM. CODE § 9-401(1) (West 1983).

information on farm product liens.

Critics of central filing argue that it is only a partial solution and is not easily implemented. For example:

> Problems of identifying the true owners of farm products remain. Timing problems. Buyers (especially livestock buyers) would still have difficulties unless the central filing location in each state (presumably the Secretary of State's office) had its records computerized with 24-hour telephone access.
>
> Even if computerized, computers search for exact information. Even minor errors in spelling or descriptions could frustrate accurate reporting of existing liens.
>
> Most states do not now have central filing for farm products collateral, and the costs associated with establishing and maintaining a computerized central filing system are considerable.
>
> Central filing leaves with the buyer the burden of checking the records or buying at his peril.[234]

These problems can be diminished, if not eliminated, over time. This is particularly true if central filing is combined with alternatives such as: requiring the seller to certify that he is the title holder (if seller is unknown to buyer, that buyer can check driver's license); providing criminal penalties for the seller's misrepresentation as to lien status; posting signs in the buyer's place of business; conducting educational meetings for farmers; requiring a signature on a card at the time of a loan by a debtor in which he acknowledges the possibility of criminal sanctions for selling farm products contrary to terms of the security agreement; secure and publicize several convictions under criminal statutes; and shorten the statute of limitation. Many of the critics' complaints relative to central filing may be resolved by computer system design and proper implementation of central filing.[235] Central filing works for both equipment liens and farm equipment liens which are already centrally filed in some states. Additionally, central filing of farm product liens has been successfully adopted in several states.

With central filing readily available, is there still a reason to treat farmers as a "special class" of debtors under the U.C.C.? In this commercial era of American agriculture, why are farmers treated with such paternalism? Or is it really the farm lenders who are treated with paternalism? Under the current Code, the subsequent purchaser is without any built-in safeguards to protect further buyers. Some farm product buyers think that it is essential to take farm products free of a security interest, just as buyers of nonfarm products take. On the other hand, many financers of farmers feel that it is just as essential that their security interest be protected. The latter has

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234. *Mortgaged Commodity Hearings*, *supra* note 48, at 151 (statement of Delmar Banner, President, Farm Credit Industry).

235. *See supra* note 231.

been the traditional position of the United States government.[236] That position is not surprising in light of the fact that the United States is an extremely important financer of agricultural products. Therefore, all taxpayers have an interest. Protecting commercial sources of agricultural credit is a persuasive argument for the retention of some type of farm product exception.

Returning to the example of the farmer and the elevator operator,[237] the present application of section 9-307(1) may even pit different officers of the same bank against each other. For example, in states with branch banking, it is conceivable that a farm loan officer would sue the elevator operator for conversion of lender's interest in the farmer's farm product. A commercial loan officer of the same bank might have the security interest in the elevator operator's inventory. Both are secured in the same collateral when the farm product becomes the elevator's inventory. The farm loan officer's success in conversion might weaken the financial viability of the elevator and the commercial loan officer's loan to the elevator. As exemplified in the *San Juan* case,[238] when there is not enough to go around, the bank officers merely fight among themselves. This problem would be reduced, if not eliminated, with the use of computer assisted electronic search of centrally filed security interests. Computer retrieval of lien information could easily provide actual notice for the would-be purchaser of secured farm products under Article 9.

3. *Revision of Farm Products Exception by the Courts*

The courts have modified the application of section 9-307(1). Although section 9-307(1) protects the security interest of the farmer's lender in the farm products, the courts have often strictly interpreted the provisions and applications of the security agreement in order to reduce a purchaser's liability for conversion of the lender's secured interest.[239] U.C.C. section 9-306(2) states, with respect to a secured party's rights on disposition of collateral, "[e]xcept where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable pro-

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236. *See* United States v. McCleskey Mills, Inc., 409 F.2d 1216 (5th Cir. 1969); United States v. Big Z Warehouse, 311 F. Supp. 283 (S.D. Ga. 1970). *See generally* Dolan, *Section 9-307(1): The U.C.C.'s Obstacle to Agricultural Commerce in the Open Market*, 72 NW. U.L. REV. 706 (1978). At one stage in the redraft of Article 9, the words "other than a person engaged in farming operations" were deleted. HENSON, *supra* note 46, at 144-45. This language, however, was eventually restored. *Id.* This author is unaware of a definitive study supporting the inclusion or exclusion of the prior phase. *See Mortgaged Commodity Hearings*, *supra* note 18, at 127-76 (statement of Delmar Banner, President, Farm Credit Council).

237. *See supra* notes 43-66 and accompanying text.

238. Peoples State Bank v. San Juan Packers, Inc., 696 F.2d 707 (9th Cir. 1983).

239. U.C.C. § 9-105(1)(b) (1978).

ceeds including collections received by the debtor."[240]

The question of what constitutes "authorization by the secured party in the security agreement or otherwise" has been the subject of much litigation.[241] Many security agreements for farm products require that the lender's consent be given orally or in writing for the sale of a farm product by the farmer-debtor.[242] In practice, however, many sales take place without the lender's implied or expressed permission. The reality of farm product financing is that the secured party wants the collateral to be sold continually in order for the secured party to receive prompt payment on the line of credit it has extended. In this application, the extension of farm credit appears to be similar to inventory financing. The secured party is also reluctant to give blanket consent to all sales because it would lose its right to go against the purchaser under U.C.C. section 9-307(1) should the debtor default. Consequently, secured parties have protected themselves by resorting to the judicially recognized conditional sales authorization doctrine, whereby the lender consents to the sale if payment is made jointly to the seller and the lender.[243] Authorization to sell may also be contingent on the condition that the buyer's drafts draw on the defendant bank were honored and paid,[244] or consent to sell is extended so long as no prior default has occurred.[245]

Under section 9-306(2), where a sale of collateral has been authorized unconditionally, either in the instrument or otherwise, the security interest in farm products (and other goods as well) does not survive the sale.[246] The secured party's expressed consent and authority to sell, even when contrary to the terms of the security agreement, cuts off the security interest.[247] Terms and conditions of the security agreement may be expressly waived.[248] Waiver has been characterized as a "voluntary abandonment or remainder,

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240. U.C.C. § 9-306(2) (1978).

241. *See infra* notes 244-300 and accompanying text.

242. Lenders often place words such as "debtor may not sell, lease or otherwise dispose of any collateral unless specifically authorized in a separate writing [agreed upon] by [the] lender except as provided in this agreement." The security agreement may also state that the debtor may sell milk to a particular buyer, sell cattle as long as a joint check is drafted in favor of the lender and the debtor, or similar restrictions.

243. North Central Kan. Prod. Credit Ass'n v. Washington Sales Co., 223 Kan. 689, 694, 577 P.2d 35, 38 (1978).

244. Baker Prod. Credit Ass'n v. Long Creek Meat Co., 266 Or. 643, 648, 513 P.2d 1129, 1134 (1973).

245. Farmers State Bank v. Edison Non-Stock Coop. Ass'n, 190 Neb. 789, 793, 212 N.W.2d 625, 628 (1973).

246. U.C.C. § 9-306(2) (1978). *See* Baker Prod. Credit Ass'n v. Long Creek Meat Co., 266 Or. 645, 513 P.2d 1129 (1973) and Farmers State Bank v. Edison Non-Stock Coop. Ass'n., 190 Neb. 789, 212 N.W.2d 625 (1973).

247. U.C.C. § 9-306(2) (1978). *See also* North Central Kansas Prod. Credit Ass'n v. Washington Sales Co., 223 Kan. 689, 577 P.2d 35 (1978).

248. *See also* U.C.C. § 1-103 (1978).

by a capable person of a right known to him to exist with the intent that such a right shall be surrendered and such person deprived of its benefit."[249] An express waiver need not be communicated to the buyer.[250]

Controversy surrounds an implied waiver of security interest, an implied waiver of the requirement of prior written permission to sell, and an implied waiver inferred from a course of dealing or usage of trade.[251] U.C.C. section 1-205(4) provides that:

> the express terms of an agreement and an applicable course of dealing or usage of trade shall be construed wherever reasonable as consistent with each other, but when such construction is unreasonable, express terms control both course of dealing and usage of trade and course of dealing controls usage of trade.[252]

U.C.C. section 2-209(4) provides that although an attempt at modification or rescission of a security agreement does not fulfill the requirement that a written document must be modified in writing under subsection (2) or (30) of U.C.C. section 2-209, such an attempt can operate as a waiver.[253]

Based on U.C.C. sections 2-209(4) and 1-205(4), some cases[254] have held that certain conduct, course of dealings, or usage of trade may create a waiver of the conditions in a security agreement or may create a waiver of the entire security agreement itself. In cases involving similar fact patterns, however, other courts have refused to find such a waiver.[255] The division[256]

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249. Anon, Inc. v. Farmers Prod. Credit Ass'n, ___ Ind. App. ___, ___, 446 N.E.2d 656, 659. (1983) (citing North Central Kansas Prod. Credit Ass'n v. Washington Sales Co., 223 Kan. 689, 577 P.2d 35 (1978)).

250. *Id.* at ___, 446 N.E.2d at 660.

251. *See infra* notes 254-58 and accompanying text.

252. U.C.C. § 1-205(4) (1978).

253. U.C.C. § 2-209(4) (1978).

254. The following cases have found an implied waiver of the security agreement: United States v. Central Livestock Ass'n Inc., 349 F. Supp. 1033 (D.N.D. 1972); In re Caldwell, Martin Meat Co., 10 U.C.C. REP. SERV. 710 (E.D. Cal. 1970); Planters Prod. Credit Ass'n v. Bowles, 256 Ark. 1063, 511 S.W.2d 645 (1974); Hedrick Sav. Bank v. Myers, 229 N.W.2d 252 (Iowa 1975); Lisbon Bank & Trust Co. v. Murray, 206 N.W.2d 96 (Iowa 1973); Clovis Nat'l Bank v. Thomas, 77 N.M. 554, 425 P.2d 726 (1967) (In 1968 New Mexico by statute set aside the Clovis rule. *See* N.M. STAT. ANN. § 55-2-401(1)); and Central Washington Prod. Credit Ass'n v. Baker, 11 Wash. App. 17, 521 P.2d 226 (1974) (evidence of implied waiver rendered summary judgment improper).

255. The following cases have held that U.C.C. § 1-205(4) prohibits implied authority to sell where the security agreement requires written authority: United States v. E.W. Savage & Son, Inc., 343 F. Supp. 123 (D.S.D. 1972), *aff'd*, 475 F.2d 305 (8th Cir. 1973); Colorado Bank & Trust Co. v. Western Slope Inv. Inc., 36 Colo. App. 149, 539 P.2d 501 (1975); Vermilion County Prod. Credit Ass'n v. Izzard, 111 Ill. App. 2d 190, 249 N.E.2d 352 (1969); North Central Kansas Prod. Credit Ass'n v. Washington Sales Co., Inc. 223 Kan. 689, 577 P.2d 35 (1978); Wabasso State Bank v. Caldwell Packing Co., 308 Minn. 349, 251 N.W.2d 321 (1976); Farmers State Bank v. Edison Non-Stock Coop. Ass'n, 190 Neb. 789, 212 N.W.2d 625 (1973); Garden City Prod. Credit Ass'n v. Lannon, 186 Neb. 668, 186 N.W.2d 99 (1971); Baker Prod. Credit Ass'n v. Long Creek Meat Co., 266 Or. 643, 513 P.2d 1129 (1973) (conditional consent insufficient to

existing among jurisdictions on this issue is illustrated by two recent cases: *Anon, Inc. v. Farmers Production Credit Association*[257] and *First Tennessee Production Credit Association v. Gold Kist, Inc.*[258]

Defendant-appellant, Anon, Inc.,[259] appealed from an adverse judgment for conversion of hogs in a suit brought by plaintiff-appellee, Farmers Production Credit Association of Scottsburg (FPCA), a creditor owning a security interest in hogs purchased by Anon, Inc.[260] Anon claimed that FPCA lost its security interest in the hogs by giving the debtor, Flynn, authority to sell them in his own name. Applying prior case authority, the court held that "[w]hen FPCA consented to the sales on the condition that Flynn (debtor-seller) remit, *it knowingly* and intentionally renounced a prior right, that is, the right to require prior written consent for each sale."[261] "Anon's failure to examine the record [was] irrelevant because actual authority"[262] to sell free of the secured lender existed. FPCA gave Flynn free reign to sell and according to the court FPCA could have prevented Flynn from selling.[263]

In *Anon*, the cases supporting the waiver theory were discussed in detail.[264] Some of the cases hold that by common practice in the trade and by custom and usage, the secured party has acquiesced in and consents to the sale, and has thereby waived its security interest.[265] In these cases, the courts have reasoned that the secured party is in a much better position to protect itself than the buyer because he knows of the debtor and the origin of the product.[266] The buyer, sometimes at remote distances, does not have this knowledge.[267] Therefore, the loss is cast soley upon the secured party. "It is generally held that where conditions to a sale are imposed by the secured party, a sale by the debtor in violation of the conditions is unauthorized, and the security interest continues."[268] Where a security agreement

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constitute waiver of security interest); Fisher v. First Nat'l Bank, 584 S.W.2d 515 (Tex. Civ. App. 1979); Burlington Nat'l. Bank, v. Strauss, 50 Wis. 2d 270; 184 N.W.2d 122 (1971). By statute, New Mexico has legislated the same result. *See* N.M. STAT. ANN. § 50A-1-205(3,4) (1983).

256. This division arises despite the stated purpose of the U.C.C. which is "to make uniform law among the various jurisdictions," U.C.C. § 1-102 (1978).

257 Anon, Inc. v. Farmers Prod. Credit Ass'n, ___ Ind. App. at ___, 446 N.E.2d at 662.

258. First Tenn. Prod. Credit Ass'n v. Gold Kist, Inc., 653 S.W.2d 418, 421-22 (Tenn. Ct. App. 1983).

259. Anon, Inc. v. Farmers Prod. Credit Ass'n, ___ Ind. App. at ___, 446 N.E.2d at 657.

260. *Id.*

261. *Id.* at ___, 446 N.E.2d at 662 (emphasis added).

262. *Id.*

263. *Id.* The court, however, did not explain how the lender could have prevented the debtor from selling absent the lender taking possession of the collateral. *Id.*

264. *Id.* at ___, 446 N.E.2d at 659-60.

265. *Id.* at ___, 446 N.E.2d at 660.

266. *Id.*

267. *Id.* This rationale ignores constructive notice provided by filing of financing statement under U.C.C. Article 9.

268. *Id.* at 661.

contains no reference to sales, the court can look beyond the written agreement because "under section 9-306(2) authorization can be given in the security agreement or otherwise."[269] In support of its holding, the court in *Anon* reasoned that if the secured party never asserts any right to require written consent and admits that the debtor had standing authority to sell the farm product "upon the condition that he promptly remit the proceeds to the secured party for application on the debt," the secured party has effectively consented to the sale.[270] This "consent is effective to release the lien on the collateral sold even though the secured party never receives the proceeds" pursuant to the original conditional authorization.[271] In such instances, the failure of the buyer to check the records is irrelevant because the secured party gave the debtor actual authority to sell, and it was, therefore, not necessary that such authority be communicated to purchaser. If the buyer had checked with the secured party, the latter would presumably have told the buyer that the debtor had the authority to sell in his own name.[272] Therefore, consent given to the debtor by the secured party to sell in the debtor's own name provided that the debtor remits the proceeds, is not a true conditional sales authorization.[273] In essence, such a condition would make the buyer an insurer of acts beyond his control and is unfair to a good faith purchaser. "[T]he policy of the Uniform Commercial Code to promote ready exchange in the marketplace . . . outweighs the secured party's interest in the collateral under these circumstances."[274]

In *Anon*,[275] the court acknowledged that between October 1979 and October 1980, debtor-Flynn sold shipments of secured hogs to Anon on ten occasions without disclosing the security interest.[276] Because Anon did not investigate the record of security interest, "[t]he checks were issued to Benny Flynn alone as payee and contained a stamped certification which the payee endorsed by which the *payee guaranteed* that *he was the unconditional owner of the hogs* and *there were no liens*."[277] The court held that the secured party had expressly given standing authority to the debtor to sell in his own name upon the condition that debtor remit the proceeds to the secured party.[278]

In a similar fact pattern, "plaintiff-appellee, First Tennessee Produc-

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269. *Id.*
270. *Id.*
271. *Id.*
272. First Nat'l Bank & Trust Co. v. Iowa Beef Processors, Inc., 626 F.2d 764, 768 (10th Cir. 1980).
273. *Id.* at 769.
274. *Id.*
275. Anon, Inc. v. Farmers Prod. Credit Ass'n, ___ Ind. App. at ___, 446 N.E.2d at 657.
276. *Id.*
277. *Id.* (emphasis added).
278. *Id.* at ___, 446 N.E.2d at 662.

tion Credit Association (PCA),[279] filed [a] complaint against defendant-appellant, Gold Kist, Inc. (Gold Kist), alleging that Gold Kist converted a crop of soybeans on which PCA held a valid and perfected security interest by purchasing and commingling the [debtor-Carson's] crop with [Gold Kist's] soybeans."[280] Gold Kist argued that the secured party, PCA, waived the provisions of the security agreement with debtor-Carson which prohibited the sale of crops without PCA's written consent.[281] Gold Kist further asserted that PCA, by its course of dealing, authorized the sale of the collateral and that under Tennessee law, the security interest in the collateral or any identifiable proceeds had terminated.[282]

In the four years that debtor-Carson had been financing his crops through PCA, PCA had never enforced the provisions requiring the debtor to obtain the written consent of PCA.[283] Apparently, PCA had not required other debtors to obtain written consent either.[284] The court stated: "[T]he primary questions are whether the alleged course of dealing . . . can constitute a waiver of the specific requirement of a written authorization and whether such conduct by PCA constituted an authorization for the sale within the meaning of Tennessee law."[285] If so, there would be no conversion by Gold Kist.

> The same factual circumstances control a determination of both waiver and authorization. The practical effect in this case of a finding either way appears to be identical. To prove a waiver of the contract provision, the proof must show that PCA voluntarily and intentionally relinquished its right to demand compliance with the written consent provision.[286]

Fisher v. First National Bank,[287] *Garden City Production Credit Association v. Lannan*,[288] and *Wabasso State Bank v. Caldwell Packing Co.*[289] state that the fundamental objective of Article 9 of the U.C.C. is to provide a legal framework within which secured transactions can be effected cheaply, openly, and safely, and to furnish acceptable and suitable stan-

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279. First Tenn. Prod. Credit Ass'n v. Gold Kist, Inc. 653 S.W.2d at 419.
280. *Id.*
281. *Id.* at 420. The security contained the following language:
That the Debtor will care for and maintain the crops and property described herein in a good and husbandlike manner and will not further encumber, conceal, remove, sell or otherwise dispose of the same without the written consent of the Lender and, upon demand, will provide additional collateral acceptable to the Lender.
Id.
282. *Id.*
283. *Id.* at 419-20.
284. *Id.*
285. *Id.* at 421.
286. *Id.*
287. 584 S.W.2d 515, 519 (Tex. Civ. App. 1979).
288. 186 Neb. 668, ___, 186 N.W.2d 99, 102 (1971).
289. 308 Minn. 349, ___, 251 N.W.2d 321, 325 (1976).

dards which promote fluidity in farm credit. At the same time, Article 9 facilitates the sale of the collateral by furnishing a definable and ascertainable standard upon which the purchaser can rely.[290] These cases suggest that when an agreement is clear on its face, a court should hesitate to infer a waiver by conduct of the parties and should do so only to prevent fraud.[291] The buyer, having constructive notice of the security agreement, can inform himself of its existence by requesting a copy of the consent, and can then take steps to protect himself by putting both names on the draft. These cases demonstrate that the mere fact that the secured party learns of the debtor's sales when the proceeds are remitted provides no basis for a waiver because the secured party is confronted by an accomplished fact.[292]

In *Gold Kist*, it is clear that the Tennessee court recognized that other jurisdictions have "split on the question of whether a secured party authorizes the debtor to sell the collateral by not objecting to a course of dealing in which the debtor has previously sold collateral without consent."[293] The Tennessee court held that "it would not be reasonable to find that [a lender] had "authorized" [the debtor to sell] in the past when each time [the lender] was simply presented with a *fait accompli*."[294] In accord, the Supreme Court of Minnesota has stated:

> The fallacy in this argument is that it ignores the realities of the situation. The bank was not made aware of the sales of collateral before they occurred. Farmers would simply notify the bank of the sales when they came in with the proceeds to pay off the loan. At this point, not only was the bank not harmed by the sale but it was presented with an accomplished fact.[295]

Relying in part on this rationale, the Tennessee court held that the lender "could not have done anything more to protect its security interest, and its acceptance of the proceeds of the previous sales made without written consent cannot realistically be termed a course of dealing as we normally think of the term."[296]

In concurrence with U.C.C. section 1-205(4),[297] the Tennessee court held that the express terms of an agreement will control when their construction is inconsistent with the course of dealing by the parties.[298] This holding is consistent with those in other cases including *North Central Kansas Pro-*

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290. *Id.* at ____, 251 N.W.2d at 325.

291. *See* Wabasso State Bank v. Caldwell Packing Co., 308 Minn. 349, 251 N.W.2d 321 (1976); Garden City Prod. Credit Ass'n v. Lannan, 186 Neb. 668, 186 N.W.2d 99 (1971); Fisher v. First Nat'l Bank, 584 S.W.2d 515 (Texas Civ. App. 1979).

292. First Tenn. Prod. Credit Ass'n v. Gold Kist, Inc., 653 S.W.2d at 421.

293. *Id.*

294. *Id.*

295. Wabasso State Bank v. Caldwell Packing Co., 308 Minn. 349, 215 N.W.2d 321 (1976).

296. First Tenn. Prod. Credit Ass'n v. Gold Kist, Inc., 653 S.W.2d at 421.

297. TENN. CODE ANN. § 47-1-205(4) (1979).

298. First Tenn. Prod. Credit Ass'n v. Gold Kist, Inc., 653 S.W.2d at 421.

duction Credit Association[299] and *Lannan*.[300] Under the rationale of *Gold Kist*, the purchaser of farm products carries the heavy burden of overcoming the secured party's valid and perfected security interest.[301]

If society is going to continue to enforce conversion under the provisions of U.C.C. section 9-307(1), can we use technology and more carefully worded financing agreements to resolve the conflict between *Anon, Inc.* and *Gold Kist*? There is no reason why the interpretation of essentially similar cases is not the same under the U.C.C. Perhaps, if a better method of filing and retrieval of information regarding debtor's collateral were available,[302] the inconsistent results in current cases would be remedied. Even if central filing with computer retrieval is not adopted, U.C.C. forms should have a provision which provides explicit terms with regard to waiver.[303]

Although the cases are not always consistent, in many instances courts have provided some relief from the harsh results of the farm product exception. Further, uniformity can also be achieved by the adoption of central

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299. North Cent. Kan. Prod. Credit Ass'n v. Washington Sales Co., 223 Kan. 689, 577 P.2d 35 (1978).

300. In Garden City Prod. Credit Ass'n v. Lannan, 186 Neb. at ____, 186 N.W.2d at 103, the court stated:

> Lannan, defendant here, must necessarily rely upon a previous course of dealing between the lender and the debtor, amounting to nothing more than a failure to object or rebuke the debtor for selling without written consent. At the same time PCA was entitled to rely upon its agreement and the provisions of the code giving it a continued perfected security interest in the identifiable proceeds of the sale. Considering the realities involved in accomplishing a simultaneous exchange of property for money, we can find nothing in PCA 's choice of alternatives in its previous course of dealing from which an inference could be drawn that it had waived its security agreement or that Lannan was entitled to ignore the provision of the code because of a private and undisclosed arrangement or course of dealing between the debtor and the lender alone. It must be borne in mind that in this case we are dealing with a controversy between the lender and a third party purchaser who had no knowledge of the course of dealing between the debtor and borrower. We are not called upon here to resolve a controversy between the lender and the debtor in which such agreement or arrangement of course of dealing might be relevant to the enforcement of a security interest against the debtor's property.
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> We are aware that Section 1-205 U.C.C. provides that a course of dealing which by previous conduct between the parties, may alter an agreement after the fact recognition. But, as we have said, we fail to see how a failure to rebuke or object contemporaneous with a delivery by the debtor and acceptance of the proceeds to which the security agreement attaches, can be construed as a voluntary and intelligent waiver by the lender of its rights under a perfected security agreement against a third party purchaser, and this is particularly true when the security agreement itself provides a specific means for obtaining such waiver.

Id.

301. First Tenn. Prod. Credit Ass'n v. Gold Kist, Inc., 653 S.W.2d at 421.

302. *See supra* notes 192-238 and accompanying text.

303. It is conceivable that coupled with EFT, the lender could say remit X% or $X to lender and remainder to debtor. Both could be done simultaneously. The material could also be in large print with a notice to the lender to read and discuss the issue with the debtor.

filing. Thus, the protection of the farm product buyer can be obtained without sacrificing the safeguards afforded agricultural lenders.

III. Protecting Farmers From Insolvent Buyers

The farm product seller often has a dilemma that he may not be aware of until it is too late—the buyer's check may be returned to the farmer-seller marked "insufficient funds" or the buyer may file for bankruptcy prior to the check being cashed by the seller. The U.C.C. provides the seller with a right of reclamation for nonpayment of goods sold to the buyer.[304] Additionally, some agricultural producers benefit from federal prompt and full payment legislation.[305] This section explores solutions to the farm product seller's dilemma when "buyers don't pay."

A. *Reclamation, Sellers' Liens, and Purchase Money Security Interest*

Under current law, a cash seller has a reclamation right to goods sold. U.C.C. section 2-705(2) provides that "[w]here payment is due and demanded on the delivery to the buyer of goods or documents of title, his right as against the seller to retain or dispose of them is conditional upon his making the payment due."[306] In the event goods are delivered and payment is not made, the seller may: (1) sue for the price under U.C.C. section 2-709,[307] or (2) replevin the goods from the buyer.[308] U.C.C. section 2-507(2) expressly limits the right of reclamation "as against the seller."[309] The merchant has the power to transfer title to any "buyer in the ordinary

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304. U.C.C. § 2-507 (1978).

305. 7 U.S.C. § 228B (1982) (livestock producers; 7 U.S.C. § 499B(4) (1982) (perishable agricultural product producers).

306. U.C.C. § 2-507(2) (1978).

307. U.C.C. § 2-709 (1978).

> Action for the Price—(1) When the buyer fails to pay the price as it becomes due the seller may recover, together with any incidental damages under the next section (2-710), the price (a) of goods accepted or of conforming goods lost or damaged within a buyer; and (b) of goods identified to the contract if the seller is unable after reasonable effort to resell them at a reasonable price or the circumstances reasonably indicate that such effort will be unavailing. (2) Where the seller uses for the price he must hold for the buyer any goods which have been identified to the contract and are still in his control except that if resale becomes possible he may resell them at any time prior to the collection of the judgement. The net proceeds of any such resale must be credited to the buyer and payment of the judgement entitles him to any goods not resold. (3) After the buyer has wrongfully rejected or revoked acceptance of the goods or has failed to make a payment due or has repudiated (2-610), a seller who is held not entitled to the price under this section shall nevertheless be awarded damages for nonacceptance under the preceeding section (2-708).

Id.

308. Replevin is a personal action brought to recover possession of goods unlawfully taken. U.C.C. § 2-507(2), comment 3 (1978).

309. U.C.C. § 2-507(2) (1978).

course of business," and under U.C.C. sections 2-493 and 2-507(2) a good-faith purchaser takes free of the seller's claims.[310]

Alderman[311] argues that an additional limitation on a cash seller's ability to reclaim its farm products is that payment must be "due and demanded."[312] The seller's absolute right to payment is necessary to establish a breach by the buyer.[313] In other words, if the seller demands payment before it is due, it is the seller not the buyer that has violated the contract. The strict requirement of a demand for payment is consistent with the cash nature of the exchange. Therefore, if the seller fails to require payment when due, prompt payment is deemed waived, and the delay can probably be viewed as an extension of credit.[314] To preserve the seller's reclamation rights against an insolvent buyer, the seller must demand the return of goods from an insolvent buyer within ten days of the delivery date.[315] The problem with the application of this section to the farm product transaction is that the farmer often does not know that the check is dishonored until more than ten days after the delivery date.[316] The ten-day provision remains an absolute requirement.[317]

Even if timely payment if demanded, the cash seller, in attempting to reclaim an interest in the goods, may run into the superior interest of a third party, such as other creditors who have obtained a judicial lien on the goods while they were in the hands of the buyer, secured parties who claim the goods pursuant to an after-acquired property clause in a security agreement entered into with the buyer, or a trustee in bankruptcy.[318] An Article 9 secured party obtains its rights through a voluntary agreement with the buyer.[319] The secured party takes free of the seller's reclamation rights.[320] A creditor whose lien was obtained by "attachment or execution probably will

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310. U.C.C. §§ 2-403, 2-507(2) (1978).

311. R. M. ALDERMAN, A TRANSACTIONAL GUIDE TO THE UNIFORM COMMERCIAL CODE § 1.80-10 2d ed. 1983) [hereinafter cited as ALDERMAN].

312. *Id.*

313. *Id.*

314. *Id.*

315. U.C.C. §§ 2-702, 2-507(2), comment 3 (1978). Comment 3 provides that "the provision of this Article for a ten day limit within which the seller may reclaim goods delivered on credit to an insolvent buyer is also applicable here." U.C.C. § 2-507(2), comment 3 (1978).

316. For example, a farmer delivers grain to an elevator on day one. He picks up the check on day three, and he deposits the check on day eight. It bounces on the ninth day and he finds out about it on the eleventh.

317. Stowers v. Mahon (*In re* Samuels & Co.), 526 F.2d 1238 (5th Cir.), *cert denied*, 429 U.S. 834 (1976).

318. ALDERMAN, *supra* note 311, at § 1.80-.20.

319. A "purchaser" is defined under the U.C.C. as one who takes by "sale, discount, negotiation, mortgage, pledge lien, issue or re-issue, gift or any other voluntary transaction creating an interest in property." U.C.C. §§ 1-201(32), 1-201(33) (1978). *See also* Stowers v. Mahon (*In re* Samuels & Co.), 526 F.2d at 1242-43 (5th Cir.), *cert. denied*, 429 U.S. 834 (1976).

320. ALDERMAN, *supra* note 311, § 1.80-.40.

not qualify as a purchaser."[321] Equity favors the cash seller's reclamation rights over the execution lien creditor's interest.[322] Since the buyer is likely to have pledged his inventory (including the goods purchased from the seller) under Article 9, and the secured party is likely to be covered by an after-acquired property clause in the security agreement, the cash seller's reclamation right, vis-a-vis the consenting lien holder, is severly limited if not eliminated.[323]

In *Stowers v. Mahon* (*In re Samuels & Co.*)[324] C.I.T. Corp. had been financing the meat packing operation of Samuels.[325] C.I.T. had a perfected security interest in Samuels' inventory and after-acquired property, including livestock purchased for slaughter and processing.[326] For eleven days in May of 1969 various cattle farmers delivered cattle to Samuels with the understanding that they would be paid after slaughter when the carcasses were inspected, graded, and weighed.[327] These sellers did not reserve or perfect a purchase money or any other security interest under Article 9.[328] On May 23, 1969, C.I.T. learned that Samuels was going to file a plan of arrangement under Chapter 11 of the Bankruptcy Act, and C.I.T. refused to advance additional funds for cattle in his possession at that time.[329] Samuels filed for Chapter 11 on May 23, which ultimately ended in straight bankruptcy.[330]

The cattle sellers had received checks which were never paid.[331] The cattle, upon delivery to Samuels, became subject to C.I.T.'s perfected security interest which was superior to the cattle sellers' right of redemption.[332] The reaction to this case was the passage of prompt payment and statutory trust amendments to the Packers and Stockyards Act.[333] Thus, the result of *Stowers v. Mahon* has been modified with respect to the sale of livestock by the amendments to the Packers and Stockyards Act.[334] The case illustrates that U.C.C. reclamation rights afforded the farm product seller are of little value, however, in cases such as the sale of grain.[335]

Stowers v. Mahon also suggests an often overlooked solution to the cash sellers' problem. Cash sellers can protect their interest by complying with

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321. *Id.*
322. *Id.* "[T]he lien creditor relied on the credit of the buyer, [and] the cash seller did not" so the argument goes. *Id.*
323. *See* Peerless Equip. Co. v. Agle State Bank, 559 S.W.2d 114 (Tex. Civ. App. 1977).
324. 526 F.2d 1238 (5th Cir.), *cert. denied*, 429 U.S. 834 (1976).
325. *Id.* at 1242-43.
326. *Id.*
327. *Id.* at 1244.
328. *Id.*
329. *Id.*
330. *Id.*
331. *Id.* at 1246.
332. *Id.* at 1248.
333. *See* Geyer, *supra* note 14, at 250.
334. *Id.*
335. Stowers v. Mahon (*In re* Samuels & Co.), 526 F.2d at 1249.

U.C.C. section 9-312(3). The Code states that a "purchase money security interest in inventory collateral has priority over a conflicting security interest in the same collateral"[336] if Code provisions are met. Although slightly cumbersome in application, farmers should take advantage of the Code's provision and reduce their risk in agricultural product sales. This is particularly true for commodity sales on delayed or deferred pricing contracts.

The cash seller may also find himself competing for possession of the goods with the trustee in bankruptcy. Regardless of whether the seller has complied with all the requirements of U.C.C. section 2-507, the trustee may challenge the seller's reclamation right pursuant to provisions of the Bankruptcy Code.[337] Under the revised Bankruptcy Code, the seller's reclamation right is valid only in certain circumstances. Under the Bankruptcy Code, the reclaiming seller takes free of the trustee's avoidance powers as long as written demand for the goods is made by the seller within ten days and the buyer was insolvent at the time of purchase.[338] Specifically, the statute states:

> (c) The rights and powers of the trustee . . . are subject to any statutory right or common law of the seller, in the ordinary course of such seller's business, of goods to the debtor to reclaim such goods if the debtor has received such goods while insolvent, but—
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> (1) such a seller may not reclaim any such goods unless such seller demands in writing reclamation of such goods before ten days after

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336. U.C.C. § 9-312 (1978) provides for priorities among conflicting security interest in the same collateral. In particular, U.C.C. § 9-312(3) (1978) states:

> (3) A purchase money security interest in inventory collateral has priority over a conflicting security interest in the same collateral if (a) a purchase money security interest is perfected at the time the debtor receives possession of the collateral; and (b) any secured party whose security interest is known to the holder of the purchase money security interest or who, prior to the date of the filing made by the holder of the purchase money security interest, had filed a financing statement covering the same times or type of inventory, has received notification of the purchase money security interest before the debtor receives possession of the collateral covered by the purchase money security interest; and (c) such notification states that the person giving the notice has or expects to acquire a purchase money security interest in inventory of the debtor, describing such inventory by item or type.

Id. U.C.C. § 9-107 defines a purchase money security interest as follows:

> A security interest is a purchase money security interest to the extent that it is (a) taken or retained by seller of the collateral to secure all or part of its price or (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact to be used.

Id.

337. First, many farm cash sellers do not comply with U.C.C. § 2-507. If a seller, after making a conditional delivery, fails to follow up on his rights, the condition is waived. Article 2 limits a product sellers right to reclaim goods from an insolvent buyer to ten days after delivery. U.C.C. § 2-507, comment 3. *See also* ALDERMAN, *supra* note 311, § 1.80-50.

338. ALDERMAN, *supra* note 311 § 1.80-50.

> receipt of such goods by the debtor; and
> (2) the court may deny reclamation to a seller with such a right of reclamation that has made such a demand only if court—
> (A) grants the claim of such a seller priority as an administrative expense; or
> (B) secures such claim by a lien.[339]

As a practical matter, farmer sellers who know that a farm product buyer is insolvent won't sell to such a buyer; however, few farmers know the farm product buyer is insolvent until more than ten days after the sale. Moreover, many buyers of farm products may not have been solvent at the time of the purchase of the seller's product. Insolvency comes later. The cash seller who makes timely demand should prevail over the trustee in all other cases.[340]

In the case of a credit seller (deferred and delayed pricing contracts are credit sales) who delivers goods to a buyer who subsequently defaults, the credit seller may either sue for the price,[341] or seek reclamation. U.C.C. section 2-702(2) provides:

> (2) Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.[342]

The sale must be on credit, the buyer must receive the goods while insolvent within the meaning of U.C.C. section 1-201(23),[343] and the seller must demand goods within ten days after receipt unless there was a written misrepresentation of insolvency.[344] Thus, a prudent credit seller should always seek a written assurance of solvency from the buyer in the form of a letter or financing statement. Credit sellers must demand the goods within ten days after their receipt (three months if written misrepresentation of insolvency) and follow up their oral demand with legal action or self-help reclamation to

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339. 11 U.S.C. § 546(c) (1982).

340. ALDERMAN, *supra* note 311, § 1.80-50.

341. ALDERMAN, *supra* note 311, § 1.81-10 n. 1168 (citing U.C.C. § 2-709).

342. *Id.* (citing U.C.C. § 2-702(2)).

343. ALDERMAN, *supra* note 311, § 1.81-10 n. 1169. U.C.C. § 1-201(23) states that "a person is 'insolvent' who either has ceased to pay his debts in the ordinary course of business or cannot pay his debts as they become due or is insolvent within the meaning of the federal bankruptcy law." Federal bankruptcy law defines insolvency at 11 U.S.C. § 101(20) (1982). ALDERMAN, *supra* note 311, § 1.81-50 n. 991.

344. To fall within the exception, the statement of solvency must be in writing, addressed to the particular seller, and dated within three months of the delivery. U.C.C. 2-702, comment 2 (1978).

preserve their credit-seller's right.[345] Again, the application of these provisions has provided little help to the farmer-seller-creditor in delayed pricing or deferred payment contracts. Farmers have not relied on the provision and are not likely to know how to rely on the provision in the future.

As with the cash seller, the credit-seller's rights to reclaim the goods are limited by U.C.C. sections 2-403 and 2-702(3) which subject the reclaiming seller "to the rights of a buyer in ordinary course or other good faith purchaser."[346] The rights of a lien creditor vis-a-vis the creditor-seller are even more confusing. Section 2-702(3) provides:

> (3) The seller's right to reclaim under subsection (2) is subject to the rights of a buyer in ordinary course or other good faith purchaser (or lien creditor) under this title (2-403). Successful reclamation of goods excludes all other remedies with respect to them. (Lien creditor was deleted in 1966 Official Amendments).[347]

With or without the 1966 amendment, the law is in conflict in the various states.[348] As to bankruptcy and the seller-creditor, section 546(c) of the Bankruptcy Act[349] permits the seller-creditor to reclaim goods delivered to an insolvent buyer as long as written demand is made within ten days following receipt of goods by the buyer.[350] No exception is provided for cases in which a written misrepresentation is involved.[351] Thus, a seller-creditor's right to reclamation must be asserted within a narrow time frame if the right of reclamation is to defeat the trustee's power of avoidance. It provides little help to most delayed payment or deferred price contract sellers.[352] The right of reclamation, subject to the rights of good faith purchasers, buyers in the ordinary course, lien creditors, restrictions by trustees in bankruptcy, and commingling of fungible goods, has been of little value to the farmer-seller. It has seldom been used even when reclamation would have provided protection for the farmer-seller.

The right of reclamation would be unnecessary for a farmer cash-seller who used the electronic funds option[353] or a farmer credit-seller who filed a purchase money security interest to cover the delayed or deferred pricing

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345. *Id.*

346. U.C.C. § 2-702(3) (1978). At least 20 states have deleted the words "lien creditor" from their provisions in accordance with the 1966 amendments. *See* ALDERMAN, *supra* note 311, § 1.81-40.

347. U.C.C. § 2-702(3) (1978).

348. ALDERMAN, *supra* note 311, § 1.80-40.

349. 11 U.S.C. § 546(c) (1982).

350. *Id.*

351. *Id.*

352. A farmer selling under a delayed pricing or deferred payment contract could, of course, secure a purchase money security interest when the grain is delivered. *See supra* notes 24-36 and accompanying text.

353. *See infra* § IV of the text.

contract.[354] Without legal protection, such as acquisition of a security interest or when reclamation fails, the seller (cash or credit) is limited only to remedies available against the insolvent buyer's property in competition with the claims of other unsecured creditors.

B. *Federal Prompt and Full Payment Legislation*

Livestock producers are accorded prompt and full payment protection for the sale of livestock products under the Packers and Stockyards Act.[355] Prompt payment for livestock purchased by a packer, market agency, or a dealer is required by law.[356] Timely payment may be made by:

1. Actual delivery of a valid check;
2. Funds wire-transferred to seller; or
3. Valid check is placed in mail where it is scheduled to be collected before the next business day following the purchase and transfer of possession of the livestock in question.[357]

If the seller authorizes the mailing of a check rather than payment at the time of transfer, his actions do not constitute an extension of credit.[358] Absent an express written agreement, payment must be made by check or wire.[359] A payment by a mere draft, which is not a check, may be deemed an extension of credit which will defeat seller's eligibility for the benefits provided in the trust provisions discussed below.[360] The prompt payment provisions of the Packers and Stockyards Act strengthen the ability of the seller to withstand pressure from the packer to extend credit or allow delay in payment. The prompt payment provisions, however, do not guarantee that the check received will not be dishonored when the seller attempts to deposit or cash it. The adoption of a statutory trust, on the other hand, provides surety for the seller of livestock in the event the check is dishonored.[361]

To protect the innocent seller of livestock, Congress created the "Packer Trust" in 1976.[362] "Packers with average annual livestock purchases of over $500,000 are required to hold all livestock, meats and receivables, or proceeds from the livestock in trust until all the sellers of livestock have received full payment for their livestock."[363] Of course, the benefits of the trust are not available to "[s]ellers who expressly extend credit to the pack-

354. *See supra* note 336 and accompanying text.
355. 7 U.S.C. § 228b (1982).
356. *Id.*
357. Geyer, *supra* note 14, at 250.
358. 9 C.F.R. § 203.16 (1983).
359. *Id.*
360. *Id.* § 201.200(b) (1983).
361. 7 U.S.C. § 196(b)-(c) (1982).
362. *Id.*
363. 7 U.S.C. § 196(b) (1982).

ers."[364] Likewise, the farmer-seller must present checks for payment within thirty days to remain eligible for the benefit of the trust.[365] If the seller is unable to cash the check because of insufficient funds, the seller is required to notify the Packers and Stockyards Administration within fifteen days.[366] The trust provision of the Packers and Stockyards Act guarantees that farmers will receive payment for livestock sold.[367]

The Perishable Agricultural Commodity Act (PACA) requires merchants, dealers, and brokers to make full payment promptly to producers of perishable agricultural commodities.[368] Payment must be made within ten days, unless an express agreement to the contrary is negotiated by the parties.[369] The broker, merchant, or dealer's license to purchase may be suspended for thirty to ninety days for failure to make prompt payment.[370] Because the late payment trends in the perishable agricultural product market have ranged from only thirty percent to fifty percent paid after thirty days,[371] and because $64,000,000 was lost to fruit and vegetable producers in 1982 due to slow and no pay,[372] it was proposed that a statutory trust similar to the Packers and Stockyards Act[373] be created under PACA.[374]

PACA[375] was amended in 1984 to provide a trust on perishable agricultural commodities[376] for the benefit of the unpaid farmer-seller.[377] The

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364. *Id.* § 196(c) (1982).

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

366. 7 U.S.C. § 196(b) (1982).

367. "In the minds of farmers, this provision rectified the results of being treated like unsecured creditors in bankruptcy proceedings for the sale of farm products." Geyer, *supra* note 14, at 280 n.30 (citing H. Rep. No. 94-1043, 94th Cong. 2d Sess. (1976)).

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

Geyer, *supra* note 14, at 252.

368. 7 U.S.C. § 499b(4) (1982).

369. 7 C.F.R. § 46.2 (aa)(9)(1983).

370. Marvin Tragash Co. v. USDA, 524 F.2d 1255, 1257 (5th Cir. 1975); *In re* Kafcsak, 39 Agric. Dec. 683, 685-86 (1980), *appeal docketed*, No. 80-3406 (6th Cir., June 26, 1980).

371. 62 FARM BUREAU NEWS 157 (1983).

372. 129 CONG. REC. H9901 (daily ed. Nov. 15, 1983) (statement of Rep. Emerson).

373. *See supra* notes 357-67 and accompanying text.

374. 62 FARM BUREAU NEWS 157 (1983). *See* H.R. 3867, 98th Cong., 1st Sess. (1983); S. 2052, 98th Cong., 1st Sess. (1983).

375. 7 U.S.C. § 499a-S (1982).

376. 7 U.S.C. § 499(a)(4) (1982).

377. 7 U.S.C. § 499a-s (1982) *amended by* Pub. L. No. 98-273, 98 Stat. 165 (1984).

PACA trust is a "nonsegregated floating trust" that applies to the commodities, products of the commodities, receivables, or proceeds from their sale in the hands of a commission merchant, dealer, or broker.[378] This Act removes the farmer-seller from his unsecured status in the cash sale of fresh fruits and vegetables by means of a provision similar to the trust provisions of the Packers and Stockyards Act.[379] This Act applies to credit as well as cash transactions, if the extension of credit is only an incidence of the original sale and is only for a reasonable time.[380]

Farmer-producers of storable agricultural commodities generally have the option of selling or storing their commodities at the end of the production cycle. When a farmer sells the storable commodity, he has no special statutory trust protection for the nonpayment of his product by the buyer. A farmer-seller who has not been paid for his goods in a cash transaction,[381] due to the buyer's insolvency or failure to pay, must pursue his creditor rights under state law[382] or the bankruptcy law,[383] as is appropriate. Neither remedy results in satisfaction for most cash sellers. With the return of a check by an insolvent buyer or the inability to pay on a delayed pricing contract or deferred payment contract by an insolvent buyer, the farmer-producer has often unwillingly or unknowingly extended credit to the farm product buyer. Although legislative remedies[384] have been proposed to resolve the differential treatment of livestock and other farm producers, farmers still receive different treatment depending upon the type of commodity produced.

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378. *Id.*

379. H. Rep. No. 98-543, 98th Cong., 2d Sess. at 3 (1984).

380. *Id.* at 6-7. This provision should be read in light of the prompt payment requirements under 7 U.C.C. § 499b(4), and the regulations issued under that section. *See* H. REP. No. 98-543, 98th Cong., 2d Sess., at 6-7 (1984).

381. This includes a payment by check which is subsequently dishonored. Deferred payment and delayed pricing contracts for storable commodities are treated the same if the buyer becomes insolvent. A seller who sells on a delayed pricing contract or deferred payment contract is extending credit to the buyer. As such, protection accorded to cash buyers should not be extended to them as alternative protection, though a purchase money security interest is available to them. *See supra* note 36 and accompanying text.

382. For an extended discussion of this issue, see Geyer, *supra* note 14; Bird & Looney, *Protecting the Farmer in Grain Marketing Transaction*, 31 DRAKE L. REV. 519-45 (1981-82), Hamilton & Looney, *Federal and State Regulation of Grain Warehouses and Grain Warehouse Bankruptcy*, 27 S.D.L. REV. 334-75 (1982); Note, *Dealing with Grain Dealers: The Use of State Legislation to Avert Grain Elevator Failures*, 68 IOWA L. REV. 305-32 (1983), Note, *Grain Elevator Bankruptcies: How can the Grain Producer be Better Protected?* 31 U. KAN. L. REV. 157-82 (1982); and Note, *A Survey of Current Issues of Legislation Concerning Grain Elevator Insolvencies*, 8 J. CORP. L., 111-44 (1982). *See also, supra* notes 306-53 and accompanying texts.

383. *See supra* note 382.

384. Geyer, *supra* note 14, at 266-77. *See infra* notes 454-86 and accompanying text.

C. *Buyers Who Don't Pay—Legislative Solutions*

Livestock producers, and to some degree perishable agricultural producers, have federal protection for prompt and full payment for the sale of farm products.[385] The producers of storable agricultural products do not have such protection.[386] Because of current financial problems in the grain industry,[387] many proposals have been made to provide protection for the farm grain product seller. Several writers[388] have outlined the steps that were proposed administratively or legislatively during the 97th Congress. This section will review the proposals of the 98th Congress and the administrative steps which have been undertaken to date.[389]

The legislation is generally directed towards either preventing elevator bankruptcy or bailing out the unsecured farm grain product seller when bankruptcy occurs.[390] The legislation, however, fails to address the needs of the farm product sellers and, more importantly, fails to address the issue of prompt and full payment for farm product sellers (other than livestock and perishable commodity sellers). All farm product sellers should be treated equally with respect to prompt and full payment for farm products sold.

Historically, federal and state legislation has been enacted to address the "inequity of market power, [to] assure fairness in the market [for farm products, and to] protect farmers that were not considered to have the sophistication of merchants."[391] In the area of storable farm commodities, regulatory activity at the federal level[392] and in the majority of states[393] is lim-

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385. *See supra* notes 357-80 and accompanying text.

386. The trading of storable agricultural commodities such as sugar, grain, and dried beans can be divided into the merchandizing and storing or warehouse operations. The merchandizing of storable commodities is covered under the common law of the states and primarily U.C.C. article 2. Geyer, *supra* note 14, at 256-61. Most states provide voluntary or mandatory regulation of storable commodity warehouses. *Id.* The federal government has a voluntary regulatory system for storable commodities. 7 U.S.C. §§ 241-273 (1982).

387. *Report of the Ad Hoc Subcommittee on Grain Elevator Bankruptcy: Hearings Before the House Committee on Agriculture*, 98th Cong., 1st Sess. 10-13 (1983) [hereinafter cited as *Grain Bankruptcy*].

388. *See supra* note 382.

389. *More Can Be Done to Protect Depositor at Federally Examined Grain Warehouses*, (report by General Accounting Office) CED—81-112, June 19, 1981 [hereinafter cited as *Grain Warehouse*]. The business of storing and marketing often becomes inseparable and likewise the funds available to the total business are not separated. *Id.* at 30. These situations create continuous, and at times uncertain obligations. *See Review of Grain Elevator Bankruptcies: Hearings Before the Ad Hoc Subcommittee on Grain Elevator Bankruptcy of the House Committee on Agriculture*, 98th Cong., 1st Sess. 56-66 (1984) Serial 98-6, (report of Professor Dennis M. Conley and Richard Casey) [hereinafter cited as *Elevator Bankruptcy Hearings*].

390. *Grain Warehouse*, *supra* note 389, at 81-112.

391. Geyer, *supra* note 14, at 266.

392. The United States Warehouse Act, 7 U.S.C.A. §§ 241-273 (West 1980), authorizes the Secretary of Agriculture to license warehousemen engaged in the storing of agricultural commodities who voluntarily apply for a license and who are found to qualify.

393. Geyer, *supra* note 14, at 260-61. At least 12 states regulate grain merchandizing. *Id.*

ited to the warehousing (as contrasted to the merchandising) or storage operation of a business. In the case of grain, recent bankruptcies indicate that "losses in the grain merchandising area, or other outside business interests," were often a major factor leading to bankruptcy.[394] Yet, few states regulate or monitor grain merchandising, and the federal government provides no assurance of the integrity of the grain merchandising industry.

The USDA's 1981 Grain Elevator Task Force[395] report suggested the following administrative alternatives to alleviate problems in the storable commodities area:

> 1. Positive actions relating to helping farmers:
>
> a) USDA could initiate immediate action that would ultimately coordinate Federal-State efforts with regard to minimum licensing or agreement in merchandising operations. . . .
>
> b) (1) Increasing net worth requirement of the U.S. Warehouse Act. . . .
>
> c) Develop a comprehensive information package to be used for the instruction and education of users of warehouse receipts. . . .
>
> 2. Internal USDA needs:
>
> a) Amend the Commodity Credit Corporation Standards for approval of a warehouse for grain, rice, dry edible beans and seed. . . .
>
> b) Establish a special USDA team consisting of ASCS, AMS, OGC, and OIG representatives reporting directly to the Secretary with the specific purpose of dealing with warehouses, problems when a suspension of the license or contract has been initiated by USDA. . . .
>
> c) Initiate a policy position pertinent to bankrupt elevator cases where USDA has a vested interest. . . .
>
> d) Create an ad hoc committee to study USDA audit costs and sources as they relate to user fees posted by the USDA.
>
> e) As to the CCC approval standards: (1) require performance bonds; and, (2) require that all warehouses are either licensed by the U.S. Warehouse Act or by a state which has laws and regulations comparable to the U.S. Warehouse Act as determined by AMS.
>
> f) A clearing house for information on bankruptcy.[396]

The Task Force suggested that all of the administrative proposals be

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394. *Grain Warehouse*, *supra* note 389, at 30; *Elevator Bankruptcy Hearings*, *supra* note 389, at 55-66.

395. GRAIN ELEVATOR TASK FORCE, UNITED STATES DEP'T OF AGRICULTURE, REPORT TO THE SECRETARY OF AGRICULTURE, August 18, 1981 [hereinafter cited as ELEVATOR TASK FORCE].

396. ELEVATOR TASK FORCE, *supra* note 395. The recomendations made in the report to the Secretary of Agriculture included additional requirements and standards to be imposed on the various participants in the storable commodity industry. ELEVATOR TASK FORCE, *supra* note 395. It is intended that these suggestions will better protect farmers by increasing the integrity of the storable commodity warehousing industry. *See infra* text accompanying notes 397-400.

adopted, except the changes in Commodity Credit Corporation (CCC) approval standards and a clearing house for information on bankruptcy.[397]

Currently, farmers receive unequal protection depending upon the warehousing and grain merchandiser with which they deal. This situation could be remedied by: (a) an educational program to alert farmers as to the differences in licensing, bonding, net worth standards of warehousemen and dealers; and (b) uniformity in licensing, bonding, and net worth requirements among the industry and states either through a federal, federal-state, or uniform state program.

The Task Force recommendation did not attempt to deal with the need to develop better financial predictors to forecast potentially insolvent warehouses and merchandising operations.[398] On the other hand, the adoption of requirements such as "increased net worth requirements, unqualified financial statements, and improved identification of scale tickets" constitute sound recommendations for the warehouses covered.[399] The report did not recommend any change in the Bankruptcy Code; it also did not recommend the establishment of an insurance or indemnity fund, or the establishment of a licensing/bonding/inspection program.[400]

In July of 1983, the USDA reported that it had made substantial progress in implementing the seven recommendations that it had undertaken.[401] The USDA's own report card indicated the following progress:

> 1(a) Work is ongoing to develop cooperative agreements between USDA and the States.
> 1(b) Effective July 1, 1982 minimum financial net worth requirements for warehouse licenses under the U.S. Warehouse Act were increased from $10,000 to $25,000. Warehousemen are required to file an audit by a certified public accountant. However, an audit or review by an independent public accountant would be acceptable with the understanding that the warehouseman would be subject to an additional on-site examination by the Secretary, and to an audit by the Secretary.
> 1(c) The Extension Service has prepared a publication for farmers on grain elevator bankruptcies.
> 2(a) Effective July 1, 1983, Uniform Grain Storage Agreement (UGSA) financial net worth requirements were increased from ten cents per bushel times the approved capacity of the warehouse to twenty cents per bushel, and an irrevocable letter of credit would be accepted in lieu of a surety bond in cases where warehouses could not meet the minimum fi-

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397. ELEVATOR TASK FORCE, *supra* note 395, at ii.

398. ELEVATOR TASK FORCE, *supra* note 395.

399. *Id.*

400. *Id.*

401. *Senate Committee on Agriculture, Forestry, and Nutrition; Subcommittee on Agricultural Production, Marketing, and Stabilization of Prices*, 98th Cong., 1st Sess. (July 28, 1983) (statement by Merrill Marxman, Deputy Administrator, Commodity Operations, Agricultural Stabilization and Conservation Service).

nancial requirements. Warehousemen are required to file an independent public accountant (PA) review statement on their warehouse operations. USDA will examine all UGSA warehouses once a year with the option of additional reviews requested by the Commodity Credit Corporation (C.C.C.).

2(b) A REACT Team was established (within USDA) to deal with problem warehouses.

2(c) This matter is under study and no decision has been made.

2(d) Review was made prior to announcement of the user fee schedule.[402]

Changes in commercial law and mandated changes in licensing/bonding requirements have not been proposed in the 98th Congress.[403] Proposals in the 98th Congress can be divided into insurance funds, government aid, and bankruptcy changes.

1. *Insurance Funds*

Insurance funds enjoy a considerable amount of popular appeal. Several states have implemented such funds. Because of the problems in at least one state,[404] private insurance activity,[405] unanswered questions about merchandising, cost, and feasibility,[406] not to mention the possibility of federal activity, state action in this area has slowed or ceased. Two basic types of insurance funds were proposed in the 98th Congress.

Senate bill 550[407] and House of Representatives bill 1753[408] would have created a federal grain storage insurance program similar to the Federal Deposit Insurance Corporation (FDIC).[409] Both bills provided coverage for a depositor[410] who is the owner or holder of a scale ticket, warehouse receipt, or other original source document issued by a certified[411] or public[412] ware-

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402. *Id.*

403. For a discussion of these concepts, see *Grain Warehouse*, *supra* note 389; Geyer, *supra* note 14, at 270-72.

404. Geyer, *supra* note 14, at 272-74; *Grain Bankruptcy*, *supra* note 387. One bankruptcy, in Oklahoma, created liabilities in excess of several years expected revenue. *Grain Bankruptcy*, *supra* note 387, at 192. Oklahoma had established a fund that levied one mill per bushel on all producers until the fund reached $250,000. *Id.* Shortly after the fund was established, a 1.8 million dollar claim was filed against it because of the Boise City bankruptcy. The law was changed to require two mill per bushel, however, the fund is still in trouble. *Id.* at 192.

405. *See Grain Bankruptcy*, *supra* note 387, at 17.

406. Hamilton & Looney, *supra* note 382, at 373-75; Geyer, *supra* note 14, at 272-74.

407. S. 550, 98th Cong., 1st Sess. § 1 (1983).

408. H.R. 1753, 98th Cong., 1st Sess. (1983).

409. 12 U.S.C. §§ 1811-32 (1982).

410. S. 550, 98th Cong., 1st Sess., § 2(5) (1983); H.R. 1753, 98th Cong., 1st Sess., § 8(2) (1983).

411. S. 550, 98th Cong., 1st Sess., § 10 (1983). A warehouse must be licensed under the United States Warehouse Act or submit an application and meet the eligibility qualifications of the United States Warehousing Act as a state statute which is at least equal to the United States Warehousing Act. *Id.*

house for grains[413] and who is entitled to possession or payment for the grain represented by the scale ticket, warehouse receipt, or other document.[414] Senate bill 550 provided for a fee "assessment based on the amount of grain"[415] and a levy prescribed by the Federal Grain Storage Insurance Corporation on each depositor (seller) to support the insurance program.[416] In contrast, House of Representatives bill 1753 provided that each owner or operator of a public warehouse would be assessed a per bushel fee not to exceed one-fourth of one cent for each bushel of grain deposited.[417] Senate bill 550 provided for a fifty percent referendum vote to establish and maintain the fund.[418]

The bills limit the types of crops that are covered.[419] In addition, House of Representatives bill 1753 would collect one-fourth of one cent per bushel fee regardless of whether the commodity is traded in bushels, pounds, or the relative value of the commodity.[420] Thus, a $7.50 bushel of soybeans is charged the same rate as a $2.50 bushel of corn. Private insurance, on the other hand, is available for $36 for $50,000 coverage, $54 for $100,000, $70 for $150,000, and $87 for $200,000.[421] The average price of corn, soybeans, and wheat in 1981 was $2.45, $7.59, and $3.66 respectively.[422] Under the proposed one-fourth percent per bushel rate, premiums of $51.02 (corn), $16.47 (soybeans), and $34.15 (wheat) would have been collected on $50,000 worth of commodities. Under private insurance, the policy would cost everyone a flat $36.[423] For a $100,000 crop, a public sector policy would have cost $102.04 (corn), $32.94 (soybeans), and $68.30 (wheat), compared to only $54 for the private insurance.[424] Insurance based on value is more logical than insurance based on bushels. House of Representatives bill 1753 seemingly indicates that the fee is collected only on stored grain, yet the payment is made on the product's fair market value to both sellers and storers of grain in the event of bankruptcy.[425]

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412. H.R. 1753, 98th Cong., 1st Sess. § 8(3) (1983).

413. Under S. 550, *supra* note 407, § 2(6), cotton is defined as grain; but unless "peanuts" are a "dry edible bean," peanuts are excluded. H.R. 1753, *supra* note 408, § 8(6), includes "oilseeds" and therefore by implication peanuts. Cotton, however, is excluded from coverage.

414. S. 550, *supra* note 407, § 9(2).

415. *Id.*

416. *Id.* § 11.

417. H.R. 1753, *supra* note 408, § 3(b).

418. S. 550, *supra* note 407, § 14.

419. *Id.* § 2(6); H.R. 1753, *supra* note 408, § 8(3).

420. H.R. 1753, *supra* note 408, § 3(b).

421. *Elevator Bankruptcy Hearings*, *supra* note 389, at 201.

422. USDA, AGRICULTURAL STATISTICS 1982. An EFT payment is equal to the cost of a check and payment is assured. *Elevator Bankruptcy Hearings*, *supra* note 389, at 201.

423. Premiums based on the bill were calculated by the author. For private sector insurance rates, see *Elevator Bankruptcy Hearings*, *supra* note 389, at 201.

424. *Elevator Bankruptcy Hearings*, *supra* note 389, at 201.

425. H.R. 1753, *supra* note 408, §§ 1(b), 3(a), 7(2).

Senate bill 550 limited the payments under the act to the average fair market value of the grain for the ninety days preceding the insolvency with no upper limit in the amount paid to a depositor.[426] This section implies that a seller who had a subsequent check dishonored would not be paid at the sales price for the commodity represented by the check, but at a ninety-day average.[427] House of Representatives bill 1753 has no method for determining fair market value, but does limit a depositor to a $100,000 payment.[428] The status of delayed pricing or deferred payment contracts is uncertain under these proposals.

The Secretary of Agriculture indicated opposition to the FDIC grain type insurance proposal by recommending against enactment of Senate bill 550 and the creation of a new federal bureaucracy.[429] The Secretary also stated that there is a serious question as to whether the levy upon depositors could be set at a level adequate to provide a self-sustaining Grain Storage Insurance Fund.[430] If the levy is too high, certified warehouses will be at a competitive disadvantage, vis-a-vis, those warehouses which do not certify.[431] This would result in few warehouses seeking certification. On the other hand, if the levy is too low, the corporation will be forced to absorb some of the cost of grain elevator bankruptcies, thus increasing budget outlays.[432] The Secretary reiterated his support for the department's administrative actions to resolve the problem.[433]

A second type of insurance bill to resolve the problem of farm elevator and warehouse bankruptcies would amend the Federal Crop Insurance Act to allow the Federal Crop Insurance Corporation to insure producers against losses of stored commodities.[434] House of Representatives bill 4284[435] would have authorized but not mandated that the Federal Crop Insurance Corporation offer insurance to producers of "wheat, feed grains, soybeans, rice and upland cotton" for the loss of stored commodities due to insolvent warehousemen.[436] Only eligible products stored at facilities approved under the United States Warehouse Act or by the CCC would have been covered.[437] The bill provided a twenty percent subsidy of producers' premiums.[438]

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426. S. 550, *supra* note 407, § 9(c).

427. *Id.*

428. H.R. 1753, *supra* note 408, § 1(b).

429. Letter from Secretary John R. Block to The Honorable Jessie Helms, Chairman, Committee on Agriculture, Nutrition, and Forestry (June 28, 1983) [hereinafter cited as Block].

430. *Id.*

431. *Id.*

432. *Id.*

433. *Id.*

434. H.R. 3049, 98th Cong., 1st Sess. (1983); H.R. 4284, 98th Cong., 1st Sess. (1983).

435. H.R. 4284, *supra* note 434.

436. *Id.*

437. *Id.* § 1(a)(3). Only about sixty-five percent of the approximately 10,000 grain warehouses receive federal examination. Geyer, *supra* note 14, at 257.

438. H.R. 4284, *supra* note 434, § 1(8).

House of Representatives bill 3049[439] would have amended the Federal Crop Insurance Act to allow a producer's insurance program under the terms and conditions as the Crop Insurance Board may determine for commodities stored under "a storage contract or warehouse receipt."[440] It is arguable that only commodities stored in warehouses licensed by the U.S. government would be eligible for coverage.[441] The insurance provided would have covered eighty percent of the loss sustained by an insured party based on the local market price on the day insolvency or bankruptcy is publicly declared.[442] The bill provided authority for such a program until 1986 and required a report by February 1, 1985 as to the advisability of continuing the program.[443] The bill did not define the commodities to be covered.[444]

Both of these crop insurance proposals focused on stored agricultural commodities.[445] Generally, the major problem has been on the merchandising side, both in terms of problem elevators and unpaid farmers.[446] A well-run warehouse should not become insolvent if the storage charge per bushel is equal to or greater than the cost of storage and anticipated storage losses. Both insurance concepts (Grain Insurance FDIC program and crop insurance) face several unanswered questions. Are the programs actuarially sound? Why should the programs be limited to only certain crops? Should the program be mandatory or voluntary? Should taxpayers, merchants, or farmers pay? Can the administrative cost be justified in terms of farmer interest and potential farmer losses? Would the program work without a comprehensive regulatory and examination program of farm product buyers? Can the administrative cost of the program be justified? Can it be accomplished without coercing all merchants into the system? Would an indemnity fund have a negative impact on the dealer's business practices thus, creating an incentive to be careless? Does the program create the "moral hazard" of insurance?[447]

2. *Government Aid*

Proposals to provide government aid to producers with stored commodities have been introduced again in the 98th Congress. One proposal would require the United States government to pay any producer the market price upon bankruptcy, minus applicable storage costs, in cash or an equivalent

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439. H.R. 3049, 98th Cong., 1st Sess. (1983).

440. *Id.* § 2(b).

441. *Id.*

442. *Id.* § 2(b)(H), (L).

443. *Id.* § 3.

444. *Id.* § 2(a)(G). The section implies that products stored at warehouses which have a uniform grain or rice or dry edible bean storage agreement are eligible for coverage. *Id.*

445. *See supra* note 434.

446. *Elevator Bankruptcy Hearings*, *supra* note 389, at 61-66.

447. *Elevator Bankruptcy Hearings*, *supra* note 389, at 235.

amount and quality of the commodity involved; provided that the commodity was stored in a federally or comparable state licensed warehouse.[448] The Grain Warehouse Insolvency Payment-In-Kind Act of 1983[449] and the Grain Storage Compensation Act of 1983[450] would have provided CCC grain to depositors who lose commodities stored in insolvent warehouses. Both bills list the commodities that are to be covered.[451] A third variation of government aid was Senate bill 596[452] which would have loaned surplus commodities to depositors who lose commodities stored in insolvent warehouses.[453]

It is against public policy to raid the United States Treasury with a preference of this kind. This does not remove the moral hazard of insurance. These bills fail to address the needs of those farmers who have sold but have not been paid for their commodity, and they fail to protect farmers who store commodities in warehouses not licensed by the USDA.[454] In addition, the farmer might be better off if he has the grain returned to him and sells it later, rather than having a buyer's bankruptcy arbitrarily determine his marketing strategy. This type of proposal was withdrawn during debate over the 1981 farm bill.[455]

3. *Bankruptcy Changes*

Three companion bills[456] were introduced during the 98th Congress to amend the Bankruptcy Act[457] in order to provide an expedited determination in grain elevator bankruptcy, a priority determination in grain elevator bankruptcy, a priority in distribution for unsecured farm producers, and define acceptable documents of title.[458] The Department of Agriculture[459] and

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448. S. 1726, 98th Cong., 1st Sess. (1983).

449. H.R. 1886, 98th Cong., 1st Sess. (1983).

450. S. 596, 98th Cong., 1st Sess. (1983).

451. In House Bill 1886, section 3(2) lists the covered commodities. *See supra* note 449. In Senate Bill 596, the covered commodities are listed in section 2(2). *See supra* note 450.

452. S. 596, 98th Cong., 1st Sess. (1983).

453. *Id.*

454. H.R. 1886, *supra* note 449; S. 1762, *supra* note 448; and S. 596 *supra* note 450.

455. *See* 128 CONG. REC. S4518-19 (daily ed. May 5, 1982) (Senator Eagleton stated it was withdrawn due to lack of support).

456. S. 445, 98th Cong., 1st Sess. (1983); H.R. 1800, 98th Cong., 1st Sess. (1983); and H.R. 1031, 98th Cong., 1st Sess. (1983).

457. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549.

458. Specifically, the proposals were designed to do the following:

(1) The bill would require bankruptcy courts, upon request in a case involving a grain storage facility to establish a timetable for the performance of all judicial and administrative functions in connection with the abandonment or other distribution of grain assets from such a facility;

(2) The bill would require the court to distribute grain assets or the proceeds of such assets first to producers who have merely stored their grain in such a facility upon a contract of bailment;

(3) The bill mandates distribution of grain within 120 days of the filing in bankruptcy

the House Agriculture Committee's Ad Hoc Committee on Grain Elevators[460] supported the enactment of the amendments to the Bankruptcy Code which would provide procedures for expedited distribution of grain stored in bankrupt elevators. Senate bill 445 would have reaffirmed the fact that "bailed grains" are not a part of the bankrupt estate available to creditors.[461] This concept should be expanded to all "bailed farm commodities" covered by adequate document of title of warehouse receipts.[462] The Senate bankruptcy provisions were less ambitious in protecting farmers in 1983 than they were in 1982.[463] The changes in the Bankruptcy Code were tied up with the politics of change, the bankruptcy court structure, and a disagree-

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except in cases involving special circumstances requiring more time;
(4) The bill contains measures requiring the court to allow state or federal agencies charged with the responsibility of liquidating farm product storage facilities to participate in the distribution process;
(5) The bill contains measures which would strengthen present provisions of the Code allowing a right of reclamation to producers who have sold goods to a debtor in bankruptcy who have not received payment;
(6) The bill contains measures requiring the bankruptcy court to accept valid warehouse receipts and scale tickets as proof of ownership of crop assets pos[s]essed by the debtor upon contracts of bailment where they were issued for that purpose;
(7) The bill incorporates measures which would act to prohibit an involuntary bailment of crop assets owned by producers to a farm produce storage facility which is the subject of reorganization proceedings under Chapter 11 of the Bankruptcy Act; and,
(8) The bill grants farm producers a priority position in the distribution of assets of the bankrupt to general unsecured creditors when those farm producers have suffered a loss as a result of the sale or conversion of farm produce to or by a debtor operating a storage facility, after trustee and court expenses, wages of employees, and pension plan payments.

Senate Committee on the Judiciary, Omnibus Bankruptcy Improvements Act of 1983. S. REP. No. 65, 98th Cong., 1st Sess. 26 (1983).S. 445 and H.R. 4286 provided for expedited determinations of interest in and disposition of "grain"—"wheat, corn, grain sorghum, barley, oats, rye, soybeans" and rice—within 120 days of a debtor filing for bankruptcy. S. 445, 98th Cong., 1st Sess. § 237(a) (1983); H.R. 4286, 98th Cong., 1st Sess. (1983).

459. Block, *supra* note 429.

460. *Grain Bankruptcy*, *supra* note 387, at 16-17.

461. S. REP. 168, 97th Cong., 1st Sess., p. 8 (1981).

Abandonment is currently available to a bankruptcy trustee so that he can divest himself of property in the possession of the debtor that is burdensome or of consequential value to the estate. This procedure is routinely employed by trustees where property is so heavily mortgaged, or encumbered that it has no value to the trustee. The bill proposes to expand this concept to provide for expedited abandonment of farm produce in the possession of the bankrupt but owned by others, and farm produce presumably owned by the bankrupt but encumbered by a lien for a loan received from another.

Id.

462. *Elevator Bankruptcy Hearings*, *supra* note 389, at 229, 234, 242.

463. *Compare* S. REP. No. 65, 98th Cong., 1st Sess. 22-26 *and* S. 445, 98th Cong., 1st Sess., § 237 *with* S. Rep. 97-168, 97th Cong., 1st Sess., 127 CONG. REC. S10229-S10235 (daily ed. Sept. 22, 1981).

ment between the chairmen of the House and Senate Judiciary Committees as to how farm bankruptcy revision should protect farmers.[464] On July 10, 1984, however, the Bankruptcy Amendments and Federal Judgeship Act of 1984[465] were enacted; they incorporated several proposals to provide additional protection to farmers who sell or store grain.[466] Grain is defined under the Act as "wheat, corn, flaxseed, grain sorghum, barley, oats, rye, soybeans, other dry edible beans, or rice."[467] The law provides farmer producers[468] of grains[469] with fifth priority[470] up to $2,000 per farmer[471] when a grain merchant is insolvent.[472]

The law also provides for "expedited determination of interest in and abandonment or other disposition of grain assets" by the trustee in a bankrupt grain storage facility.[473] The court, on its own motion or upon petition,[474] is to establish a timetable that does not exceed 120 days[475] to determine the interest of the grain producer[476] in stored commingled grain. In all cases where the quantity of a single type of grain held by a grain storage operator-debtor exceeds ten thousand bushels,[477] the trustee is required to sell the grain and distribute the proceeds as required under the code.[478] "To the extent not inconsistent with the United States Warehouse Act or applicable State law, a warehouse receipt, scale ticket, or similar document"[479] issued by a grain storage facility is "prima facie evidence of the validity and

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464. Hyde, *Bankruptcy and Politics*, Washington Post, Sept. 22, 1983, at A21, col. 2.

465. Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (1984).

466. *Id.* § 350, 98 Stat. 333, 358 (1984).

467. *Id.* § 352(a), 98 Stat. 333, 359 (1984).

468. *Id.* § 350, 98 Stat. 333, 358 (1984).

469. *Id.* Note cotton, peanuts, honey and other storable commodities are not covered under the act. *Id.*

470. 11 U.S.C. § 507(a) (1982) *as amended by* Bankruptcy Amendments, *see supra* note 456, and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 350, 98 Stat. 333, 358 (1984).

471. *Id.* A farmer's unsecured claim in excess of $2,000 remains with the claims of all other unsecured parties upon liquidation of a debtor's estate. *Id.*

472. *Id.*

473. 11 U.S.C. § 507(a) (1982) *as amended by* Bankruptcy Amendments, *see supra* note 456, and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 352(a), 98 Stat. 333, 359 (1984).

474. *Id.*

475. Federal Judgeship Act of 1981, Pub. L. No. 98-353, 352(a), 98 Stat. 333, 360 (1984). The court may extend the period for final disposition of grain or the proceeds of grain under this section beyond 120 days if the court finds that—

> (1) the interests of justice so require in light of complexity of the case; and
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> (2) the interests of those claimants entitled to distribution of grain or the proceeds of grain will not be materially injured by such additional delay.

Id.

476. *Id.* § 359.

477. *Id.* § 361.

478. *Id.*

479. *Id.*

amount of a claim of ownership of a quantity of [stored] grain."[480] The goal of the amendment is to quickly determine a farmer's interest in his grain stored with a debtor-grain storage facility and abandon the grain to the farmer in kind or cash.[481] Expedited determination of the interest in grain can be criticized because of its limited definition of storable commodities.[482] For example, peanuts, cotton, and apples are not included, but rice and beans are included.[483] The expedited determination of interest in the commodities will alleviate only some of the problems farm-producers are currently experiencing.

House of Representatives bill 4285[484] would have required USDA to monitor futures trading of licensed or approved warehouses. These warehouses would have been required to demonstrate that they engage in prudent hedging practices. The bill failed to define prudent hedging practices. The bill provided no guarantee of prompt or full payment for sold commodities and would have involved approximately sixty-four percent of the nation's grain elevators.[485] The grain trade is likely to oppose this type of interventionist legislation.

During the 98th Congress, the House Agriculture Ad Hoc Committee on Grain Elevators reported its support for the following measures previously discussed:

> 1. Stronger U.S.D.A. administrative interest.
> 2. The development of legislation directing the Agriculture Department's Federal Crop Insurance Corporation to offer farmers a chance to buy insurance against losses resulting from grain warehouse failures.
> 3. Directing the Government Accounting Office to study the desirability of establishing for the grain storage industry an insurance program similar to the Federal Deposit Insurance Corporation program which insures deposits in banks.
> 4. The development of legislation requiring USDA to monitor grain futures-related activity of grain warehouses licensed under the U.S. Warehouse Act or approved for Uniform Grain Storage Agreements, and to require such warehouses to demonstrate that they engage in prudent hedging practices.[486]

In addition to the support for these programs, the Ad Hoc Committee recommended the following actions:

> 1. Writing into law an existing USDA policy under which the Department will not hold the bearer of a USDA price support loan responsible

480. *Id.*
481. *Id.* § 359-61.
482. *Id.* § 359.
483. *Id.*
484. H.R. 4285, 98th Cong., 1st Sess. (1983).
485. *See supra* text accompanying notes 434-37.
486. *Grain Bankruptcy*, *supra* note 387 at 13-18.

> if his commodity collateral is lost due to a warehouse failure.
> 2. USDA making information on warehouse hedging and futures practices available to farmers if this can be done without compromising the legitimate rights of warehousemen to the confidentiality of proprietary business data.
> 3. USDA making a further study of the adequacy of its bonding program for warehouses and to clarify for farmers legal status of grain certificates issued under the Payment In Kind program.[487]

Several of these proposals call for a more activist and interventionist role on the part of the government. The USDA does not hold the bearer of a USDA price support loan responsible if his commodity is lost due to a warehouse failure. This position is inconsistent with the USDA's opposition to bills which would provide CCC commodities, in the cases of bankruptcy, to farmers who have stored commodities pledged to other lenders or who have stored unpledged commodities.[488] Why the unequal treatment of farmers?

The proposals discussed in this section will not resolve the prompt and full payment problems for producers of storable agricultural products without transferring money from the taxpayer to the farmer or creating transaction costs for the farmer in the form of insurance premiums. The bankruptcy provisions will help alleviate confusion, provide increased but minimal protection for unsecured grain sellers, and in bankruptcies, encourage quicker determinations of farmers' rights in grain. The bankruptcy changes also continue the unequal treatment of farm producers and fail to provide for prompt and full payment to producers of storable agricultural commodities. There are, however, more equitable and cheaper methods to solve the problem of buyers who do not pay.

IV. An Electronic Solution

Transaction risk can be reduced for both the seller and the buyer of farm products. The problem of sellers who do not tell and the buyers who do not pay can be resolved with modern technology. Use of the computer can return the "cash" to a cash transaction. Both the buyer and the seller could enter electronic signature cards into a computer terminal and type in their personal identification numbers. A search of a centralized farm products lien file could then be undertaken. As soon as the search is finished, if no lien is found, the buyer would transfer the sale price to the seller's bank account. The merchant would electronically transfer the funds and simultaneously issue an "electronic check"—a facsimilie of what is transferred electronically. If a lien is found, the lien holder could provide instructions via the computer to the farm product buyer as to the method of payment. The lender would be in a position to enter the central file and change the pay-

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487. *Id.*

488. *See supra* text accompanying notes 448-55.

ment method at any time. The farmer may be required to tell the lender of sales or pending sales. That is, the words written on the security agreement would be enforced and acknowledged. If the banker is not going to enforce and the borrower is not going to honor the words on the security agreement, then those words should be omitted. A transfer of clear title for cash could remove credit (even checks are a form of credit) from a cash transaction.

The time for electronic marketing of agricultural products has come. Electronic funds transfer (EFT), however, has been used since 1918.[489] The physical cost of EFT compared to checks is competitive.[490] The loss of or reduction in float is often used as an argument against electronic funds transfer.[491] Float is a credit extension activity which results from the use of checks instead of handling transactions by cash.[492] Float is not a legal right, but rather a characteristic of the present system.[493] As a company takes in float, it also gives it out. Therefore, float may well balance for most companies. The cost of float, however, is ultimately born by the unwary recipient of a check that is dishonored.

The right to request electronic funds transfer for payment in lieu of checks could be provided for under U.C.C. section 2-507(4).[494] An additional provision of U.C.C. section 2-507 should read "sellers may demand electronic fund transfer payment upon delivery of goods in a cash market" or "sellers of farm products may demand electronic funds transfer payment

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489. Schroeder, *Developments in Consumer Electronic Fund Transfer*, FED. RESERVE BULL., June, 1983, at 395.

490. The Bank Administration Institute estimated the cost to the bank of an EFT deposit at $.07, $.24 for an over-the-counter teller deposit, and $.59 for a bank-by-mail deposit. Trotter, *Cost and Benefits of Direct Deposit*, MAG. OF BANK AD. July, 1981, at 41-43; Schroeder, *Developments in Consumer Electronic Fund Transfer*, FED. RESERVE BULL., June, 1983, at 395.

491. Schroeder, *supra* note 489. Float is a term used to refer to those funds that have been credited to one account before they have been debited from another account, and therefore, are temporarily accredited to two accounts. As the banking industry has developed more rapid means of clearing checks, float has decreased. Many companies feel that float is an important issue, but that they can compensate for the loss of float. Trade terms or prices can be renegotiated to compensate for the float loss. Eleven companies in a recent interview thought that float was not an impediment to corporate use of EFT. Special Report, *New Field for ACHS Corporation-to-Corporation Payments*, A.B.A. BANKING J., March, 1982, at 133.

492. *Electronic Funds Transfer Systems: Hearings Before the Subcommittee on Financial Institutions of the Senate Committee on Banking, Housing, and Urban Affairs*, 95th Cong., 1st Sess. 380 (1977).

493. *Id.*

494. U.C.C. § 2-507 (1978) now reads:

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

Id.

upon delivery of farm products when the sales transaction is for cash." Such a change would provide equal treatment to all agricultural product producers; it would provide parity of bargaining power for farm product sellers[495] and allow the farmer to receive immediate payment for the sale of goods. Other remedies to protect the innocent seller of farm products from an insolvent or a soon-to-be insolvent buyer would not be needed. The cash sale of farm products was never meant to be a credit transaction. This would be an optional way to allocate or reduce risk. Allowing the farmer (and others) to request cash (or its equivalent) is not inconsistent with the position of other market place participants. Merchants generally are in a position to enforce their credit policies. The extension of credit through credit cards, credit policies, or cash only sales is enforceable by merchant sellers. Farmers should be provided the same protection.

What happens if the farmer-seller has deposited the farm products in the hands of the buyer and after the product is weighed the buyer and seller immediately consult the computer terminal for the completion of the transaction? If the merchant is insolvent or short of cash, or does not have the purchase price available in his account to transfer to the farmer, the merchant can readily transfer money from other accounts or from a prearranged loan fund with the bank. If no funds are available, the farmer-seller can reclaim his farm products under U.C.C. section 2-507(2).[496] The now illusive reclamation rights of the seller would, in fact, provide protection for the farmer-seller.[497]

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

The right to privacy must be dealt with in both central filing and electronic funds transfer issues. No major problems appear to exist in the states where central filing of secured transactions has been undertaken. The very concept of secured transactions requires public notification and to some extent, a loss of privacy. That is also true of mortgages, where the dollar amount and the identity of both the secured party and the borrower are part of the public record. Making this type of information available centrally and electronically, however, will not publicize information that is now private. The traditional rules of privacy would not be suspended. The rules

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495. *See* Geyer, *supra* note 14, at 247, for a discussion of legislation to provide farmers with increased authority to demand prompt and full payment for livestock and perishable commodities. The principle has been established. The issue is whether to provide the same protection to other farm product producers. *Id.*

496. U.C.C. § 2-507(2) (1978); Bankruptcy Amendments *see supra* note 456; Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 350, 98 Stat. 333, 358-59 (1984).

497. U.C.C. § 2-507(2) (1978).

that would cover EFT may also apply to privacy and the central filing of other secured transactions. Telecommunications, credit cards, computers, and EFT all provide a focus for consent about the coupling of technology and sensitive information. EFT would vastly improve existing capabilities for documenting financial transactions. This could be both good (as shown earlier in this article) and bad (loss of privacy and private and governmental access to information). The solution is to implement the necessary technology to solve our needs. For example, access to centrally filed lien material could be limited to the lender or the borrower via an electronic signature card. The solution is to carefully draft legislation with the appropriate degree and nature of governmental and private access and use of such information. The technical and legal aspects of implementing EFT, however, are beyond the scope of this article.[498]

V. Conclusion

Many writers have chosen to write about either the problem of farmers who do not tell or about the problem buyers who do not pay. The issues should be linked, and resolved jointly. The cost of a cash transaction must be reduced for both parties by removing the incidental extension of credit.

Most of the proposed solutions merely shift the transaction risk from one party to another without resolving the problem. Many of the proposals do not put "cash" back into the cash transaction. Additionally, a movement away from the lender protection is likely to cost the taxpayer more through greater losses by governmental agencies. Such a shift is also likely to reduce the availability of funds and to raise the interest rate on loans to non-land owning farmers, to young farmers, and to less capitalized farmers. This would have both positive and negative effects. Lenders would need to police their loans with greater care. Promising young farmers might have greater difficulty borrowing money. A transfer of the transaction risk away from the buyer, who fails to comply with the notice provisions of Article 9, is essentially a transfer of risk, via the banks, to the innocent farmer-borrower. The borrower is likely to pay more as these losses are reflected in higher interest rates. Thus, it appears that any approach to these problems should not abandon the protection afforded lenders in the farm product exception.

Farmers need a more ordered marketing system that is composed of nationally uniform scale tickets indicating a legal transfer of title for commodities sold, and valid documented warehouse receipts for commodities

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498. The Privacy Protection Study Commission Report, *Personal Privacy in an Information Society*, (1977); Heller, "*EFT, Privacy, and the Public Good*, Computers & Banking, at 81 (Colton & Kraemer ed. 1980); N. Penny & D. Baker, The Law of Electronic Fund Transfer Systems. 15.01, 15.05 (1980); Palmer & Palmer, *Complying with the Right to Financial Privacy Act of 1978*, 96 Banking L.J. 196-224 (1979); Scaletta, *Privacy Rights And Electronic Funds Transfer Systems—An Overview*, 25 CATH. U.S. REV. 801-11 (1976). *See also* Right to Financial Privacy Act of 1978, 12 U.S.C. § 3401-22 (1982).

stored. Federally issued uniform warehouse receipts numbered on bond paper should be the only valid evidence of a stored commodity. The above, coupled with a warehouse receipts audit program, would provide stability to the warehouse storage system and provide the lender with confidence in the integrity of the warehouse receipt. Electronic funds transfer and prompt payment provisions should be extended to all farm produce sellers. A statutory trust or priority in bankruptcy should also be established for the innocent seller of all farm products, not just livestock and perishable agricultural product sellers. Finally, all lien information must be consolidated into a central filing system that can be easily accessed by all participants to a farm product transaction. Computerized searches of a central file would provide buyers with an efficient and effective means of assuring that the commodities they purchase are free from all security interests. If a security interest is found, the buyer can take appropriate action to protect both his own and the lender's interests.

An appropriate solution to the dual problem of sellers who do not tell and buyers who do not pay has not been found to date. The solution to this problem may well require the use of electronics. The law of sales and security interests must balance the competing interests of many parties. The law can be used to redress the differences in the bargaining position of the farmer-seller and the purchaser of farm products. Farmers face a degree of vulnerability that has historically been addressed by federal and state legislation, such as prompt and full payment for livestock producers. There is no reason why similar protection should not be extended to all farm product producers. The marketing of agricultural products requires a uniform state approach or the federal government should assert its role of balancing the needs of the farm product seller, buyer, and lender through uniform federal legislation.