# The 9-307(1) Farm Products Puzzle: Its Parts and Its Future

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# THE 9-307(1) FARM PRODUCTS PUZZLE: ITS PARTS AND ITS FUTURE

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## I. INTRODUCTION

*When the farmer comes to town*
*with his wagon broken down,*
*Oh, the farmer is the man who feeds them all.*

*If you'll only look and see,*
*I think you will agree*
*That the farmer is the man who feeds them all.*

*The farmer is the man,*
*The farmer is the man, lives on credit til the fall;*

*Then they take him by the hand,*
*And they lead him from the land*
*And the middle man's the one who gets it all.*

*When the lawyer hangs around*
*While the butcher cuts a pound,*
*Oh, the farmer is the man who feeds them all.*

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*And the preacher and the cook*
*Go a-strolling by the brook,*
*Oh, the farmer is the man who feeds them all.*

*The farmer is the man,*
*The farmer is the man, lives on credit til the fall;*

*With the interest rate so high,*
*It's a wonder he don't die,*
*For the mortgage man's the one who gets it all.*

*When the banker says he's broke*
*And the merchant's up in smoke,*
*They forget that it's the farmer feeds them all.*

*It would put them to the test*
*If the farmer took a rest,*
*Then they'd know that it's the farmer feeds them all.*

*Oh, the farmer is the man,*
*The farmer is the man, lives on credit til the fall.*

*And his pants are wearing thin,*
*His condition it's a sin,*
*He's forgot that he's the man who feeds them all.*[1]

While farmers have experienced financial hard times over the years, none have been any worse than those experienced during the last three years. Large debt loads coupled with historically high interest rates and low farm product prices have produced an incredible number of financial difficulties for farmers. The question of whether the mortgage man "gets it all" is one that is asked with increasing frequency today. This question is particularly germane when a farmer sells farm products subject to a perfected security interest and does not remit the proceeds of the sale to the lender.

Ordinarily, if inventory is subject to a perfected security interest, a buyer in the ordinary course of business[2] takes free of

1. *The Farmer Is The Man*, a popular song with Midwestern farmers in the 1880's.
2. Section 1-201(9) of the Uniform Commercial Code provides in relevant part:

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

the security interest created by his seller.[3] When a farmer buys a combine from an implement dealer or a television for home use from an appliance dealer who granted a bank a security interest in its inventory, the sale to the farmer severs the bank's interest in the combine or television.[4] Farm products are treated differently under the Uniform Commercial Code (Code).[5] Assuming the secured party has in no way authorized the sale of the collateral, section 9-

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"Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

U.C.C. § 1-201(9) (1978).

3. U.C.C. § 9-307 (1978). Section 9-307(1) provides:

A buyer in ordinary course of business (subsection (9) of Section 1-201) 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.

*Id.*

4. *See id.*

5. *See* U.C.C. §§ 9-109(3) (definition of "farm products"); 9-203(1)(a) (formal requirement of security agreement covering crops); 9-307 (when a buyer of farm products takes free of security interest); 9-312(2) (priority of secured party who gives new value to enable debtor to produce crops); 9-401(1)(a), (b) (place of filing in order to perfect a security interest in farm products); 9-402(1), (3) (form of financing statement covering crops).

Unless otherwise indicated, the citations throughout this Article are to the Uniform Commercial Code. As of January 1984, 41 states and the District of Columbia have adopted the bulk of the 1972 official revisions to Article 9 of the Uniform Commercial Code. The states are: Alabama (*see* ALA. CODE §§ 7-9-101 to -507 (1977 & Supp. 1983)); Alaska (*see* ALASKA STAT. §§ 45.09.101 to .507 (1980 & Supp. 1983)); Arizona (*see* ARIZ. REV. STAT. §§ 44-3101 to -3153 (1967 & Supp. 1983)); Arkansas (*see* ARK. STAT. ANN. §§ 85-9-101 to -507 (1961 & Supp. 1983)); California (*see* CAL. COM. CODE §§ 9101 to 9508 (West 1964 & Supp. 1984)); Colorado (*see* COLO. REV. STAT. §§ 4-9-101 to -507 (1974 & Supp. 1983)); Connecticut (*see* CONN. GEN. STAT. ANN. §§ 42a-9-101 to -507 (West 1960 & Supp. 1983)); Florida (*see* FLA. STAT. ANN. §§ 679.9-101 to -507 (West 1966 & Supp. 1983)); Georgia (*see* GA. CODE ANN. §§ 109A-9-101 to -507 (1979 & Supp. 1982)); Hawaii (*see* HAWAII REV. STAT. §§ 490:9-101 to -507 (1976 & Supp. 1983)); Idaho (*see* IDAHO CODE §§ 28-9-101 to -507 (1980 & Supp. 1983)); Illinois (*see* ILL. ANN. STAT. ch. 26, §§ 9-101 to -507 (Smith-Hurd 1974 & Supp. 1983)); Iowa (*see* IOWA CODE ANN. §§ 554.9101 to .9507 (West 1967 & Supp. 1983)); Kansas (*see* KAN. STAT. ANN. §§ 84-9-101 to -508 (1983 & Supp. 1983)); Maine (*see* ME. REV. STAT. ANN. tit. 11, §§ 9-101 to -507 (1964 & Supp. 1983)); Maryland (*see* MD. COM. LAW CODE ANN. §§ 9-101 to -507 (1975 & Supp. 1983)); Massachusetts (*see* MASS. GEN. LAWS ANN. ch. 106, §§ 9-101 to -507 (West 1958 & Supp. 1983)); Michigan (*see* MICH. COMP. LAWS ANN. §§ 440.9101 to .9507 (1967 & Supp. 1983)); Minnesota (*see* MINN. STAT. ANN. §§ 336.9-101 to -508 (West 1966 & Supp. 1984)); Mississippi (*see* MISS. CODE ANN. §§ 75-9-101 to -507 (1981 & Supp. 1983)); Montana (*see* MONT. CODE ANN. §§ 30-9-101 to -511 (1983)); Nebraska (*see* NEB. REV. STAT. U.C.C. §§ 9-101 to -507 (1980 & Supp. 1980, 1982)); Nevada (*see* NEV. REV. STAT. §§ 104.9101 to .9507 (1979 & Supp. 1983)); New Hampshire (*see* N.H. REV. STAT. ANN. §§ 382-A:9-101 to -507 (1961 & Supp. 1983)); New Jersey (*see* N.J. STAT. ANN. §§ 12A:9-101 to -507 (West 1962 & Supp. 1983)); New York (*see* N.Y. U.C.C. LAW §§ 9-101 to -507 (McKinney 1964 & Supp. 1983)); North Carolina (*see* N.C. GEN. STAT. §§ 25-9-101 to -607 (1965 & Supp. 1983)); North Dakota (*see* N.D. CENT. CODE §§ 41-09-01 to -53 (1983)); Ohio (*see* OHIO REV. CODE ANN. §§ 1309.01 to .50 (Page 1979, Supp. 1983 & Interim Supp. 1983)); Oklahoma (*see* OKLA. STAT. ANN. tit. 12A, §§ 9-101 to -507 (West 1963 & Supp. 1983)); Oregon (*see* OR. REV. STAT. §§ 79.1010 to .5070 (1981)); Pennsylvania (*see* PA. STAT. ANN. tit. 13, §§ 9101 to 9507 (Purdon 1983)); Rhode Island (*see* R.I. GEN. LAWS §§ 6A-9-101 to -507 (1970 & Supp. 1983)); South Dakota (*see* S.D. CODIFIED LAWS ANN. §§ 57A-9-102 to -507 (1980 & Supp. 1983)); Texas (*see* TEX. BUS. & COM. CODE ANN. §§ 9.101 to .507 (Vernon 1968 & Supp. 1984)); Utah (*see* UTAH CODE ANN. §§ 70A-9-101 to -507 (1980 & Supp. 1983)); Virginia (*see* VA. CODE §§ 8.9-101 to -507 (1965 & Supp. 1983)); Washington (*see* WASH. REV. CODE ANN. §§ 62A.9-101 to -507 (1966 & Supp. 1983)); West Virginia (*see* W. VA. CODE §§ 46-9-101 to -507 (1966 & Supp. 1983)); Wisconsin (*see* WIS. STAT. ANN. §§ 409.101 to .507 (West 1964 & Supp. 1983)); Wyoming (*see* WYO. STAT. §§ 34-21-901 to -966 (1977 & Cum. Supp. 1983)).

307(1) of the Code allows the secured party, who has a perfected security interest, to pursue the farm products collateral into the hands of the buyer.[6] Accordingly, when a producer sells livestock or crops subject to a perfected security interest, but does not use the proceeds from the sale to repay the lender's loan and defaults, the secured party may successfully bring a conversion action against the buyer or replevin the goods.[7] This means the buyer must pay twice.

This rule has produced a great deal of litigation and much criticism. One wonders how to deal with this problem and whether the rule should be retained. This Article will analyze the requirements of the rule and suggest ways in which to deal with the problem. Then, the Article will examine the efficacy and desirability of the rule.

## II. THE OPERATION OF SECTION 9-307(1)

In analyzing how the farm products rule of the UCC operates, it is necessary to examine sections 9-306(2) and 9-307(1) of the UCC in some depth. Section 9-306(2) provides: "Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds. . . ."[8] The major exception to the provisions of section 9-306(2) exists in section 9-307(1), which provides:

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Since few states that adopted the 1972 revisions did so without making revisions of their own, the reader is warned not to rely upon any interpretations or quotations of the Uniform Commercial Code within this Article without first checking the local provision to see if in fact it is identical to sections referred to herein.

6. U.C.C. § 9-307(1) (1978). See *supra* note 3 for the text of § 9-307(1). *See also* U.C.C. § 9-301(1)(c).

7. *See* U.C.C. § 9-307(1). One commentator uses the following illustration of the § 9-307(1) rule:

> [A]ssume that Bank holds a perfected security interest in all of Farmer Jones's livestock. Farmer takes a load of hogs to the sale barn where the hogs are purchased by a packing house. Although the packing house is a buyer in the ordinary course of business, the good faith purchase does not cut off Bank's security interest in the hogs. Even after the hogs are slaughtered and hanging in the packing house the bank can repossess them and give them out as Christmas hams to its employees. Nor is that the full extent of the "farm products" exception. If the packing house is quick enough to package the meat and sell it to a grocery chain before bank's repossession, bank can repossess the pork chops from the grocery shelves, *if the meat is identifiable.* It can do so by virtue of the fact that under 9-307(1) a purchaser takes free only of security interests *created by his seller.* Since the security interest in the hogs was created by Farmer Jones, the grocery chain's purchase from the packing house is not free from and does not cut off Banker's security interest.

J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 25-13, at 1071 (1980) (emphasis added).

8. U.C.C. § 9-306(2) (1978).

> A buyer in ordinary course of business (subsection (9) of Section 1-201) 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.[9]

Thus, to qualify for this special protection, the lender must establish that the seller sold farm products and that the lender had a perfected security interest in the farm products sold.

A. FARM PRODUCTS DEFINED

The definition of farm products is found in section 9-109(3), which provides:

> "[F]arm products". . . are crops or livestock or supplies used or produced in farming operations or. . . are products of crops or livestock in their unmanufactured states (such as ginned cotton, wool-clip, maple syrup, milk and eggs), and. . . 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. . . .[10]

This definition contains three parts: (1) the goods must be "crops or livestock or supplies used or produced in farming operations or. . . are products of crops or livestock in their unmanufactured states. . .";[11] (2) the goods must be in the "possession of the debtor. . .";[12] and (3) the debtor must be "engaged in raising, fattening, grazing, or other farming operations."[13] These requirements are not self-defining: the Code does not define them and the comments to the Code provide only marginal assistance.[14]

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9. *Id.* § 9-307(1).
10. *Id.* § 9-109(3). Inventory is defined as:

> [Items] held by a person who holds them for sale or lease or to be furnished under contracts of service or if he has so furnished them, or if they are raw materials, work in process or materials used or consumed in a business. Inventory of a person is not to be classified as his equipment.

*Id.* § 9-109(4). Equipment is defined as "[items] used or bought for use primarily in business (including farming or a profession) or by a debtor who is a non-profit organization or a governmental subdivision or agency or if the goods are not included in the definitions of inventory, farm products or consumer goods. . . ." *Id.* § 9-109(2).
11. *Id.* § 9-109(3).
12. *Id.*
13. *Id.*
14. *See id.* § 9-109 comment 4.

Generally, the lender can satisfy the first criterion easily. Crops obviously include such things as feed grains (corn, grain sorghum, and soybeans), wheat, hay, vegetables, nuts, and fruits.[15] It is also clear under the Code with the 1972 revisions that crops include growing crops or crops to be grown.[16] It is not clear, however, whether harvested crops are crops within the meaning of the Code. Harvested crops could arguably be a product of a crop or the term "crops" could be construed broadly to include harvested crops.[17] In addition, "crops" would appear to cover payments in kind (PIK).[18] Livestock would include all types of animals: cattle,[19] swine, chickens,[20] domestic fish,[21] and unborn young of animals.[22]

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15. *See, e.g.*, United States v. Greenwich Mill & Elev. Co., 291 F. Supp. 609 (N.D. Ohio 1968) (soybeans are farm products).

16. U.C.C. §§ 9-105(1)(h); -203 (1). Section 9-105(1)(h) provides:

> "Goods" includes all things which are movable at the time the security interest attaches or which are fixtures (Section 9-313), but does not include money, documents, instruments, accounts, chattel paper, general intangibles, or minerals or the like (including oil and gas) before extraction. "Goods" also includes standing timber which is to be cut and removed under a conveyance or contract for sale, the unborn young of animals, and growing crops. . . .

*Id.* § 9-105(1)(h). Section 9-203(1) provides in part:

> Subject to the provisions of Section 4-208 on the security interest of a collecting bank, Section 8-321 on security interests in securities and Section 9-113 on a security interest arising under the Article on Sales, a security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless:
>
> (a) the collateral is in the possession of the secured party pursuant to agreement, or the debtor has signed a security agreement which contains a description of the collateral and in addition, when the security interest covers crops growing or to be grown or timber to be cut, a description of the land concerned.

*Id.* § 9-203(1)(a).

17. When grain is stored and a warehouse receipt or scale ticket represents an obligation of the warehouse to deliver, a question arises concerning whether the collateral is now the document of title. See *infra* notes 24-32 and accompanying text for a discussion of warehouse receipts. *See also* Meyer, *"Crops" as Collateral for an Article 9 Security Interest and Related Problems,* 15 U.C.C. L.J. 3, 6, 11-16, 23-24 (1982).

18. In 1983, the United States Department of Agriculture (USDA) initiated a special program of Payment in Kind (PIK) for not planting 1983 crops of wheat, corn, grain sorghum, upland cotton, and rice. *See* 48 Fed. Reg. 1694 (1983). The USDA paid farmers in commodities as compensation for diverting a part of the land that was normally planted. *Id.* Much of the commodities were owned by the government, but some were owned by the farmer. The USDA was to send the farmer a "letter of entitlement" representing the right to receive a specific kind and quantity of commodity stored in a particular place. *Id.* A farmer receiving a letter had five months free storage. *Id.*

19. *See* U.C.C. §§ 9-105(1)(h); -109(3) (1978). See *supra* note 16 for the text of § 9-105(1)(h). Section 9-109(3) provides that:

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

U.C.C. § 9-109(3) (1978).

20. *See* U.C.C. § 9-109(3) comment 4.

21. For a general discussion of aquaculture, see Grossman & Westgren, *Aquaculture in Illinois: The State & Federal Legal & Regulatory Environment*, 1982 S. ILL. U.L.J. 193-248.

22. See U.C.C. § 9-105(1)(h). See *supra* note 16 for the text of § 9-105(1)(h).

The possession issue can arise when a farmer stores grain in a commercial warehouse or when a commercial feedlot is fattening the debtor's cattle. This Article will consider each of these situations.

At harvest, a grain farmer may store some or all of his crop on the farm or at a local elevator.[23] When the farmer stores the harvested grain on his farm, no problem with the possession requirement exists inasmuch as the debtor-farmer has physical possession of the grain. The grain stored in an elevator or warehouse is another matter.

Upon deposit of the grain in the elevator, the farmer will generally receive either a negotiable or nonnegotiable warehouse receipt.[24] While the grain is in the elevator the farmer still owns it and he will decide when to sell it, but obviously he does not have physical possession of the grain. Moreover, since grain is a fungible product, the exact grain that the farmer deposited will have been commingled with other similar grain. Assuming that elevator personnel issue a warehouse receipt,[25] a document of title[26] is now

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23. *See* Meyer, *supra* note 17, at 6.

24. *See* U.C.C. § 1-201(15), (45) (1978). A document of title, as defined in the Uniform Commercial Code, includes:

> [B]ill of lading, dock warrant, dock receipt, warehouse receipt or order for the delivery of goods, and also any other document which in the regular course of business or financing is treated as adequately evidencing that the person in possession of it is entitled to receive, hold and dispose of the document and the goods it covers. To be a document of title a document must purport to be issued by or addressed to a bailee and purport to cover goods in the bailee's possession which are either identified or are fungible portions of an identified mass.

*Id.* § 1-201(15). A warehouse receipt is a "receipt issued by a person engaged in the business of storing goods for hire." *Id.* § 1-201(45).

25. Usually the farmer will receive a weight or scale ticket first and later receive a warehouse receipt. A weight or scale ticket will normally show the date, the name of the depositor, gross weight of truck or wagon, net weight, test weight of the kind of grain, and the signature of the agent of the elevator. Normally these tickets will be serially numbered. The warehouse receipt, which will either be a state or federally approved form, will contain, among other things, a statement whether the grain received is to be delivered to bearer, to a specified person, or to his order; the date of the issuance of the receipt, the net weight of the grain along with the grade; and the words "negotiable" or "nonnegotiable." It must also be noted that section 7-202 prescribes a form for warehouse receipts. *See* U.C.C. § 7-202 (1978). The failure to follow this form will result in liability for any loss caused by the misdescription of the received goods. *Id.* § 7-203. Some state and all federally licensed elevators must issue warehouse receipts. Those that do not issue receipts rely on weight tickets and settlement sheets. Clearly, farmers should obtain warehouse receipts. For cases dealing with the rights of warehouse receipt holders and weight ticket holders, see *In re* Binecki Bros., 38 Bankr. 519 (Bankr. E.D. Mich. 1984) (relationship between elevator and farmer determined by intent of parties); *In re* Durand Milling Co., 9 Bankr. 669 (Bankr. E.D. Mich. 1981) (presumption of bailment when no warehouse receipt issued); Farmers Elev. Mut. Ins. Co. v. Jewett, 394 F.2d 898, 899-900 (10th Cir. 1968) (warehouseman gave depositors scale tickets rather than warehouse receipts; surety was required to pay the holders of the scale tickets since the warehouseman violated his duty under the applicable act by not issuing warehouse receipts as required); Hartford Accident & Indem. Co. v. Kansas, 274 F.2d 315 (10th Cir. 1957) (surety liable to holders of scale tickets because warehouse receipts were required by law); United States v. Luther, 225 F.2d 499, 504 (10th Cir. 1955) (title to milo and wheat in possession of bankrupt grain company belonged to holders of warehouse receipts since grain company only held the grain as bailee); *In re* Cheyenne Wells Elev. Corp., 251 F. Supp. 275, 278-79 (D. Colo. 1966) (holders of warehouse receipts entitled to pro rata

involved, which begs the question whether the grain is still a farm product. Ignoring the document of title question, a problem with the requirement that the grain be in the possession of a debtor engaged in farming arises when a crop or product of a crop exists.

The Code does not define possession and therefore it is unclear precisely what the drafters meant by its usage. If possession means physical possession by the farmer who owns the grain, it would mean the grain in the elevator ceases to be a farm product.[27] On the other hand, one may argue that the drafters wanted possession to be construed broadly, and thus, one should consider the warehoused grain to be in the "possession" of the farmer. The absence of the word "physical" in the definition section of the Code supports the broad interpretation.[28] In addition, some Code sections suggest a broad construction of "possession." One example is section 9-205, which allows the debtor significant control over the property.[29] Also, section 9-305 could support a broad construction of possession.[30] Section 9-305 provides that "[i]f such collateral other than goods covered by a negotiable document is held by a bailee, the secured party is deemed to have possession from the time the bailee receive notification of the secured party's interest."[31] While section 9-305 deals with perfection, one can argue that nonnegotiable warehouse receipts in the hands of a farmer should be sufficient to constitute possession for the purposes of the definition of "farm products." Moreover, if a warehouse issues a negotiable receipt, the negotiable receipt would represent ownership of the goods, and thus the farmer possessing title would be in possession of the goods.[32] In short, the

distribution of remaining grain in bankrupt elevator); Stevens v. Farmers Elev. Mut. Ins. Co., 197 Kan. 74, ____, 415 P.2d 236, 241 (1966) (holders of weight tickets able to recover against surety because warehouse receipts were required).

26. U.C.C. § 1-201(15) (1978) (definition of "document of title"). See *supra* note 24 for the text of § 1-201(15).

27. *See* U.C.C. § 9-109 comment 4 (1978). Comment 4 states that "[w]hen crops or livestock or their products come into the possession of a person not engaged in farming operations, they cease to be 'farm products.'" *Id.*

28. *See id.* § 1-201(15).

29. *See id.* § 9-205. Section 9-205 provides:

> A security interest is not invalid or fraudulent against creditors by reason of liberty in the debtor to use, commingle or dispose of all or part of the collateral (including returned or repossessed goods) or to collect or compromise accounts or chattel paper, or to accept the return of goods or make repossessions, or to use, commingle or dispose of proceeds, or by reason of the failure of the secured party to require the debtor to account for proceeds or replace collateral. This section does not relax the requirements of possession where perfection of a security interest depends upon possession of the collateral by the secured party or by a bailee.

*Id.*

30. *Id.* § 9-305.

31. *Id.*

32. *Id.* § 9-304 comment 2. *See also id.* § 9-305 comment 2. Comment 2 states that "[p]ossession

farmer is still the owner of the harvested crop and it is simply in the hands of an agent. The farmer must pay storage fees and the farmer, not the elevator, decides when to sell. One should also note that Professor Gilmore stated in his treatise, "Goods cease to be 'farm products' when they are subjected to any manufacturing operation. . . or when they move from the *possession and ownership* of a farmer to that of a non-farmer (canner, cooperative, etc.)."[33]

Assuming *arguendo* that a court determines that the stored crops are not "farm products," the court still must classify the crops. One possibility is that the court could consider the warehouse receipt proceeds of "farm products," since the farmer received the warehouse receipt in "exchange" for the crops.[34] This reasoning is improper because the apparent thrust of section 9-306 is that the debtor has given up all control and interest in the collateral, which is not the case with stored commodities.[35]

If courts considered stored grain a "good," the only possible category of goods it could belong to would be "inventory." Comment 3 to section 9-109 states, "The principal test to determine whether goods are inventory is that they are held for immediate or ultimate sale. Implicit in the definition is the criterion that the prospective sale is in the ordinary course of business."[36] Severe problems exist, however, by concluding that the grain is "inventory." While most grain farmers will hold their grain for sale, the drafters of the Code chose to treat the farmer differently by not defining the farmer's goods held for sale as "inventory."[37] Also, Professor Gilmore, in describing "farm products" stated, " 'Farm products' are in effect a farmer's inventory: although there is no 'held for sale' language in the definition, it is in the highest degree unlikely that farm products not destined for sale will ever show up as collateral for loans."[38] All this appears to establish

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may be by the secured party himself or by an agent on his behalf: it is of course clear, however, that the debtor or a person controlled by him cannot qualify as such an agent for the secured party. . . ." *Id.*

For cases dealing with perfection by possession, see, e.g., *In re* Copeland, 531 F.2d 1195 (3d Cir. 1976) (escrow agent can retain possession); Blumenstein v. Phillips Ins. Center, Inc., 490 P.2d 1213 (Alaska 1971) (possession not established by creditor removing equipment from boat and preparing it for winter); Lee v. Cox, 18 U.C.C. Rep. Serv. (Callaghan) 807 (M.D. Tenn. 1976) (registration papers of Arabian horses not possession).

33. 1 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 12.3, at 374 (1965) (emphasis added).

34. Section 9-306(1) of the Uniform Commercial Code provides in part: " 'Proceeds' includes whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds." U.C.C. § 9-306(1) (1978).

35. *See id.*

36. *Id.* § 9-109 comment 3.

37. *See id.* § 9-109.

38. 1 G. GILMORE, *supra* note 33, § 12.3, at 373-74. For a case dealing with when a good is "farm products" or "inventory," see United States v. Hext, 444 F.2d 804 (5th cir. 1971). In *Hext* the United States took a security interest in 578 bales of cotton as farm products knowing that Hext had

that courts and others should classify the stored grain as "farm products."

One case exists that implicitly held that stored commodities remain farm products. In *Oxford Production Credit Association v. Dye*[39] the purchaser argued that stored cotton was not a farm product. The court held otherwise, but gave no reasons for its holding other than that Dye had purchased the cotton from a farmer who had produced it.[40]

The recent case of *Garden City Production Credit Association v. International Cattle Systems*[41] involved the possession requirement when livestock was the collateral. Production Credit Association (PCA) had a security agreement that covered all of the debtor's cattle, including after-acquired cattle.[42] The cattle were not in the physical possession of the debtor-owner.[43] Rather, International Cattle Systems (ICS), a feedlot operation, apparently was fattening the cattle for the debtor and always had physical possession of the cattle.[44] ICS sold the cattle to meat packers and PCA did not receive payment for its loan.[45] PCA sued ICS and the packers in conversion.[46] The court held that the cattle were not farm products but were instead inventory.[47] The court reasoned that the debtor never had possession and ICS was not the debtor's agent for purposes of establishing possession.[48] In short, the court apparently read the possession requirement of section 9-109(3) to apply only to physical possession. The court did not, however, explain this conclusion.

While the facts are not entirely clear in *International Cattle Systems*, the analogy to the stored grain situation is striking. The farmer was apparently still the owner of the cattle, was undoubtedly

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the capability of transferring them into the inventory of his gin and selling them in the ordinary course of business. *Id.* at 814. Therefore, when Hext sold the cotton in the ordinary course of business, the buyers took free of any security interest and were thus insulated from a conversion suit brought by the government. *Id.*

*See also In re* K. L. Smith Enters., Ltd., 2 Bankr. 280 (Bankr. D. Colo. 1980) (laying hens were "livestock" and eggs "produce of livestock" within meaning of Uniform Commercial Code and could not be considered either "equipment" or "inventory" even though the egg production units were highly mechanized); First State Bank v. Producers Livestock Mktg. Ass'n Non-Stock Coop., 200 Neb. 12, 261 N.W.2d 854 (1978) (cattle purchased by cattle trader and offered for immediate sale are "inventory" and not "farm products").

39. 368 So.2d 241 (Miss. 1979).

40. Oxford Prod. Credit Ass'n v. Dye, 368 So.2d 241, 242 (Miss. 1979).

41. 32 U.C.C. Rep. Serv. (Callaghan) 1207 (D. Kan. 1981).

42. Garden City Prod. Credit Ass'n v. International Cattle Sys., 32 U.C.C. Rep. Serv. (Callaghan) 1207, 1208 (D. Kan. 1981).

43. *Id.* at 1209.

44. *Id.* at 1207.

45. *Id.* at 1211-12.

46. *Id.* at 1208.

47. *Id.* at 1209-10.

48. *Id.*

paying the feedlot for its services, and probably was determining when to sell the cattle. Consequently, the arguments made about possession and stored grain apply when owned livestock are not in the physical possession of the debtor. This all assumes that one could identify the cattle, which is normally the case.[49]

The final part of the definition, which the lender must also satisfy, is that the debtor must be "engaged in raising, fattening, grazing or other farming operations."[50] Again, the Code does not define these terms, but comment 4 to section 9-109 does provide some guidance. Comment 4 provides in part:

> Goods are "farm products" only if they are in the possession of a debtor engaged in farming operations. Animals in a herd of livestock are covered whether they are acquired by purchase or result from natural increase. Products of crops or livestock remain farm products so long as they are in the possession of a debtor engaged in farming operations and have not been subjected to a manufacturing process. The terms "crops", "livestock" and "farming operations" are not defined; however, it is obvious from the text that "farming operations" includes raising livestock as well as crops; similarly, since eggs are products of livestock, livestock includes fowl.
>
> When crops or livestock or their products come into the possession of a person not engaged in farming operations they cease to be "farm products". If they come into the possession of a marketing agency for sale or distribution or of a manufacturer or processor as raw materials, they become inventory.[51]

Courts having to define farming operations have reacted in different ways. Some have construed the term narrowly, concluding that it means a conventional farm operation and does not include farm-related or farm-like activities.[52] Others have construed the term quite broadly.[53] Some have not really defined it at all, apparently choosing to rely upon the rule, "I know it when I see it."[54]

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49. Cattle will be identifiable by pen number or by some other method.

50. U.C.C. § 9-109(3) (1978). See *supra* note 10 and accompanying text for a definition and discussion of "farm products."

51. U.C.C. § 9-109 comment 4 (1978).

52. *In re* Collins, 3 Bankr. 144 (Bankr. D.S.C. 1980); *In re* Blease, 24 U.C.C. Rep. Serv. (Callaghan) 450 (D.N.J. 1978).

53. *In re* K. L. Smith Enters., Ltd., 2 Bankr. 280 (Bankr. D. Colo. 1980).

54. *See, e.g.*, Oxford Prod. Credit Ass'n v. Dye, 368 So.2d 241 (Miss. 1979); Belgrade State

In the ordinary case when the debtor lives on the land and its sole business is the production of crops such as wheat, cotton, or corn, or the raising or fattening of cattle for slaughter, no problem exists in holding that it is "engaged in farming operations."[55] All cases, however, are not this clear. One illustration of this is when the good being produced is one not traditionally associated with farming, such as raising catfish for sale in a man-made pond. It would seem that the fish could be either livestock or crops, and the debtor's purpose is raising crops or fattening livestock: Accordingly, one should consider the fish farm products.[56] This is considerably different from the pet shop that buys fish for immediate resale. One should consider these fish inventory to the pet shop.[57]

The farm operation issue can also exist when considering animals that one customarily associates with the farm. *In re K. L. Smith Enterprises*[58] illustrates this situation. In *Smith Enterprises* the debtor was in the egg production business.[59] The egg producing chickens were housed in production units that were "large, circular structures containing four concentric circles of caged hens, 10 tiers high."[60] In addition to chickens, the debtor always had eggs in its possession.[61] The court had to determine whether farm products were involved.[62] Utilizing section 9-109(3) and the official comments to that section, the court reasoned that the hens were "livestock" and the eggs were "products of livestock."[63] The court also determined that the debtor was engaged in "farming operations."[64] In reaching this conclusion, the court rejected the bank's argument that the eggs lost their characteristic as farm products because the debtor's sole business was the sophisticated, mechanized production of eggs, and that no one was living on the property where the egg production units were located.[65] In short,

Bank v. Elder, 157 Mont. 1, 482 P.2d 135 (1971). Another approach to the definition is found in *In re* Butler, 3 Bankr. 182, 183-84 (Bankr. E.D. Tenn. 1980).

55. There should be no problem if the person farming the land does not live on the land but owns it. Also, if a farmer has leased land on a cropshare basis, the crop he receives as rent is farm products. See *infra* notes 82-83 and accompanying text for a discussion of various problems that can arise under a cropshare farming operation.

56. *See* U.C.C. § 9-109(3) comment 4. *See also* Grossman & Westgren, *supra* note 21, at 193-248.

57. *See* U.C.C. § 9-109(4) comment 3. See *supra* note 10 for the definition of "inventory."

58. 2 Bankr. 280 (Bankr. D. Colo. 1980).

59. *In re* K.L. Smith Enters., Ltd., 2 Bankr. 280, 281 (Bankr. D. Colo. 1980).

60. *Id.*

61. *Id.*

62. *Id.* at 282-83. The bank contended that the eggs were "inventory" and the chickens were "equipment." *Id.* at 282. The debtor contended they were "farm products" within the meaning of the Uniform Commercial Code. *Id.*

63. *Id.* at 284. The court noted the biological link between the chicken and the egg. *Id.* at 283.

64. *Id.* at 283-84.

65. *Id.* at 283.

the bank argued that the debtor's business was not a traditional farming operation. The bank premised its argument upon the conclusion "that only conventional farming techniques which are unmechanized, sophisticated, and labor intensive can produce farm products. . . ."[66] The court chose not to define farming operations in this manner. Rather, it relied upon cases that defined farming operations in a broad manner.[67] The court referred to cattle feeding operations[68] and a tree nursery[69] as illustrations of farming operations. The court also specifically noted that the loan involved was made through the bank's agriculture loan department.[70] Consequently, describing the eggs as "inventory" and the chickens as "equipment" was wrong and the security agreement was defective.[71]

Cattle feedlots and similar operations raise issues concerning farm products. Clearly, cattle in the possession of a person whose sole business is feeding cattle are farm products and cattle in the hands of a cattle trader whose sole business is marketing are inventory.[72] It is unclear, however, what type of collateral is involved when the debtor fattens animals and is also a trader or marketer of animals. Arguably, the real issue is whether the animals are inventory and the principal test is whether they are held for immediate sale.[73] When the debtor holds the animals for lengthy periods of time and its profit motive relates to the fattening or producing of progeny rather than making money on marketing,

66. *Id.*

67. *Id.* at 283-84.

68. *Id. See* Swift & Co. v. Jamestown Nat'l Bank, 426 F.2d 1099 (8th Cir. 1970) (bank failed to perfect security interest in cattle being fattened in feedlots; therefore, its security interest in those "farm products" was cut off when sold to an innocent purchaser). It should be noted that once cattle go into the possession of a packer, the cattle cease to be classified as "farm products" and become part of the packer's inventory notwithstanding the fact that there was an oral agreement between the seller and the packer that the title would not pass and price would not be determined until carcass grade was determined. First Nat'l Bank v. Smoker, 153 Ind. App. 71, ____, 286 N.E.2d 203, 209-11 (1972).

69. *See* Mountain Credit v. Michiana Lumber & Supply, 31 Colo. App. 112, 498 P.2d 967 (1972) (logging operation not a farming operation but nursery may be).

70. 2 Bankr. at 283. There was a large amount of money involved in this case in that the bank originally loaned the debtor $2,400,000. *Id.* at 281. The safest thing for a secured party to do if there is any doubt as to whether collateral is farm products or inventory is to describe the collateral generically in both the security agreement and financing statement. Then if farm products are filed in the county where the debtor resides and inventory is filed with the secretary of state, the secured creditor should file in both places.

71. *Id.* at 284.

72. *See, e.g.*, Security Nat'l Bank v. Belleville Livestock Comm'n, 619 F.2d 840 (10th Cir. 1979) (person was a cattle feeder and the cattle were "farm products"); First State Bank v. Maxfield, 485 F.2d 71 (10th Cir. 1973) (cattle owned were used in ranching operation but were "inventory"); Swift & Co. v. Jamestown Nat'l Bank, 426 F.2d 1099 (8th Cir. 1970) (when cattle are purchased for fattening, they are classified as "farm products"); United States v. Mid-States Sales Co., 336 F. Supp. 1099 (D. Neb. 1971) (cattle purchased as part of dairy herd are "farm products"); *In re* Cadwell, 10 U.C.C. Rep. Serv. (Callaghan) 710 (E.D. Cal. 1970) (cattle being fattened are "farm products").

73. *See* U.C.C. § 9-109 comment 3.

a farming operation exists and the animals held for fattening are farm products and animals being traded are inventory.[74] As one court observed in this regard, "In borderline cases the principal use to which the property is put should be considered determinative."[75]

If a court finds that the debtor is a marketing agency it may also consider all animals in its possession inventory even though some of them are being fattened. The court considered this situation in *Farmers State Bank v. Webel*,[76] in which the lender had a security agreement with a business, Pigs, which bought and sold feeder pigs.[77] One of the questions in this case was whether Pigs' pigs were farm products.[78] The court stated that Pigs was only a marketing agent who sold inventory, not farm products. That Pigs was also engaged in fattening operations, the court determined, "was at most incidental to the marketing operation and came about only because some of its inventory (feeder pigs) was unsold and the only feasible disposition was to fatten and market."[80] This would suggest that if the primary business of the operation in question is the fattening or raising of animals, the fact that it trades or markets small numbers of animals will not make it a nonfarm operation. One probably should not consider a business a marketing agency until its marketing becomes more than fifty percent of its business. It must be stressed that comment 4 to section 9-109 provides in part: "If [livestock] come into the possession of a marketing agency for sale or distribution. . . they become inventory."[81]

Another situation that might raise the "farm operations" issue is when the prospective debtor owns 240 acres of land but is a full-time employee of a nonfarm business and lives in town. The debtor

74. *In re* Charolais Breeding Ranches, Ltd., 20 U.C.C. Rep. Serv. (Callaghan) 193, 196 (W.D. Wis. 1976). The court did not feel the result would change because Charolais Breeding Ranches was not "a farmer in the conventional sense." *Id.* So long as the cattle were not held for marketing, the cattle could be classified as "farm products." *Id.*

75. First State Bank v. Producers Livestock Mktg. Ass'n, 200 Neb. 12, 16, 261 N.W.2d 854, 858 (1978). Using this test, the court found some cattle to be "farm products" and others to be "inventory." *Id.* at ____, 261 N.W.2d at 858. Note, however, "farm products" is the only definition that attempts to describe a type of goods rather than a use to which goods are put. *See* 1 G. GILMORE, *supra* note 33, at 373.

76. 113 Ill. App. 3d 87, 446 N.E.2d 525 (1983).

77. Farmers State Bank v. Webel, 113 Ill. App. 3d at ____, 446 N.E.2d at 526-27 (1983). Pigs basically bought and sold feeder pigs. *Id.* at ____, 446 N.E.2d at 526. Some fattening of the pigs, however, was necessary. *Id.* If, due to market conditions, a feeder pig exceeded 120 to 130 pounds, it would be retained and fattened to a weight of 200 to 250 pounds and sold. *Id.* This "fattening operation" constituted about five percent of Pig's operation. *Id.*

78. *Id.* at ____, 446 N.E.2d at 528-30.

79. *Id.* at ____, 446 N.E.2d at 529.

80. *Id.* For other trader or market agent cases, see National Livestock Credit Corp. v. First State Bank, 503 P.2d 1283 (Okla. Ct. App. 1972) (when debtor executed security agreement with bank and purchased cattle for another, debtor did not have a sufficient interest in the cattle such that they could be covered under security agreement); Poteet v. Winter Garden Prod. Credit Ass'n, 546 S.W.2d 650 (Tex. Civ. App. 1977) (security interest attached to 254 cattle even though debtor purchased the cattle as agent for a third party).

81. U.C.C. § 9-109 comment 4 (1978).

rents the tillable land on a cropshare basis. The landowner seeks a loan from a bank and wants to put up his share of the winter wheat currently growing on the land as collateral. Apparently the winter wheat is a farm product but there are some potential problems. The first question the court must consider is whether the debtor is engaged in a farming operation. Since the landlord and tenant have a cropshare arrangement, the landlord is probably participating in the major decisions, paying part of the expenses, and deciding when to sell his grain. Apparently, this would satisfy the farming operations requirement, notwithstanding the fact that the landlord does not live on the farm and does not farm the land himself. Moreover, it is clear under the law of many states that the landlord has an interest in the crop after it has been planted and he can sell it or put it up as collateral for a loan.[82] A possible problem with the possession requirement also exists because the landlord does not have the right to possess the land and thus, cannot possess the crop. To be sure, the landlord gave the tenant the right to possess the land, but it would seem that because the wheat is growing on his ground and he owns part of the crop, he is in possession or, at least, constructive possession of the farm products.[83]

Finally, section 9-307(1) requires the farm products to be purchased "from a person engaged in farming operations."[84] This seems to be redundant. Once the court establishes that the seller sold farm products, the seller would have to be engaged in farming operations since to have farm products the crops and livestock must be in the possession of one engaged in farming operations.[85]

### B. Perfected Security Interest

Section 9-307(1) requires that the goods sold must be farm

82. *E.g.*, Finley v. McClure, 222 Kan. 637, 567 P.2d 851 (1977). North Dakota allows the landlord to take a security interest in growing and unharvested crops. Section 35-05-01 of the North Dakota Century Code provides:

> Security interests in growing and unharvested crops are prohibited, and any security agreement purporting to create a security interest therein shall be void. The provisions of this section shall not apply to any security interest or lien in favor of the United States, this state, any county, or any department or agency of any of them, including the Bank of North Dakota, nor to any banking institution as defined by section 6-01-02, nor to any other agricultural lending agency, nor to any security interest created by contract to secure money advanced or loaned for the purpose of paying government crop insurance premiums or to secure the purchase price or the rental or improvement of the land upon which the crops covered by the contract are to be grown.

N.D. Cent. Code § 35-05-01 (1980).

83. None of the other categories of goods would seem to apply. The closest would be inventory. The cheapest insurance for the lender is to describe the collateral generically and perfect it as both.

84. *See* U.C.C. § 9-307(1) (1978).

85. See *supra* notes 52-83 and accompanying text for a discussion on what constitutes a farming operation.

products purchased from a person engaged in farm operations, but the rule will not benefit the lender unless the lender has a perfected security interest.[86] This is the negative inference of 9-307(1), and section 9-301(1)(c) provides that an unperfected secured party is subordinate to a buyer of farm products in the ordinary course of business.[87]

A perfected security interest is established when there is attachment and perfection.[88] In general, attachment occurs when value has been given, the debtor has rights in the collateral, and the debtor has signed a written security agreement creating a security interest and correctly describing the collateral.[89] The description of collateral is very important; the agreement should reflect what the intent of the parties was when they signed the agreement. For a description to be adequate under the Code, it must reasonably identify the collateral.[90] The Code does not require that an agreement use the terms of the code; also, it is much easier to ascertain what the intent of the parties was at the signing of the agreement when utilizing non-Code terms. In short, the description should be all-encompassing and describe the collateral in terms that a lay person can understand.

When growing crops or crops to be grown are the collateral, the security agreement must include a description of the real estate involved.[91] The Code does not require a metes and bounds or legal description.[92] Parties have frequently litigated the adequacy of the

86. *See* U.C.C. § 9-307(1) (1978). See *supra* note 3 for the text of § 9-307(1).

87. The 1962 version of § 9-301(1)(c) does not refer to farm products. *See* U.C.C. § 9-301(1)(c) (1962) (current version at U.C.C. § 9-301 (1978)).

88. U.C.C. § 9-203 (1978). Section 9-203 provides in pertinent part:

> (1) Subject to the provisions of Section 4-208 on the security interest of a collecting bank, Section 8-321 on security interests in securities and Section 9-113 on a security interest arising under the Article on Sales, a security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless:
>
> (a) the collateral is in the possession of the secured party pursuant to agreement, or the debtor has signed a security agreement which contains a description of the collateral and in addition, when the security interest covers crops growing or to be grown or timber to be cut, a description of the land concerned;
>
> (b) value has been given; and
>
> (c) the debtor has rights in the collateral.
>
> (2) A security interest attaches when it becomes enforceable against the debtor with respect to the collateral. Attachment occurs as soon as all of the events specified in subsection (1) have taken place unless explicit agreement postpones the time of attaching.

*Id.* § 9-203(1),(2).

89. *Id.* For a thorough discussion of attachment and perfection involving crops, see Meyer, *supra* note 17.

90. U.C.C. § 9-110 (1978).

91. *Id.* § 9-203(1)(a). See *supra* note 88 for the text of § 9-203(1)(a).

92. U.C.C. §§ 9-110; 9-402 comment 5. Section 9-110 states that any description of real estate is

real estate description. Descriptions that courts have typically upheld indicate the name of the owner of the land, approximate number of acres, the county the land is in, popular name, and the approximate distance from a named town or well-known landmark.[93]

Establishing attachment of the security interest is only half the battle. Perfection is needed to protect the security interest against competing third parties such as purchasers, other creditors, and the trustee in bankruptcy. Perfection occurs when both attachment and the other steps necessary for perfection have been completed.[94] Filing is essentially the only way to perfect when the debtor is a farmer.[95] The key to determining where to file is correct classification of the collateral under the Code.

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sufficient if it reasonably identifies the land. *Id.* § 9-110. Comment 5 to § 9-402 states that the description need not be by "metes and bounds" but only that it "be sufficient to identify it." *Id.* § 9-402 comment 5. Some states have changed § 9-402.

93. *See, e.g.*, United States v. Oakley, 483 F. Supp. 762 (E.D. Ark. 1981) (real estate description that included name of debtor, approximate number of acres, county and state, and approximate distance from a specified town was sufficient); Piggott State Bank v. Pollard Gin Co., 243 Ark. 159, 419 S.W.2d 120 (1967) (description that referred only to seven acres of cotton to be produced by the debtor on the lands of a third party was insufficient); *In re* Voelker, 252 N.W.2d 400 (Iowa 1977) (description that referred only to 60 acres of growing corn was defective); First State Bank v. Waychus, 183 N.W.2d 728 (Iowa 1971) (since there is no requirement that the location of livestock be described in financing statement the fact that the bank listed the wrong legal description in the financing statement which covered hogs did not diminish the bank's security interest in the livestock); Bank of Danville v. Farmers Nat'l Bank, 602 S.W.2d 160 (Ky. 1980) (description that described location as "farm of Dale Wilson on Lancaster Road, 4 miles from Danville, Boyle County, Kentucky" was sufficient).

94. U.C.C. § 9-303 (1978).

95. *See id.* § 9-401 (proper place of filing). The Code has three alternatives for subsection (1) of § 9-401. They are as follows:

*First Alternative Subsection (1)*

(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 in 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].

*Second Alternative Subsection (1)*

(1) 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 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].

*Third Alternative Subsection (1)*

(1) 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

There are essentially three possible classifications when dealing with crops and livestock: farm products,[96] inventory,[97] and documents of title.[98] Each is generally perfected differently.[99]

As for farm products, there are at least three different filing rules utilized in the United States. In many states, the creditor must file a financing statement in an office in the county in which the debtor resides.[100] If growing crops or crops to be grown are the collateral and the land is located in a different county than the debtor's residence, the creditor must file a second financing statement in the county in which the land is located.[101] The creditor may also need to double file if the debtor is incorporated and the land upon which crops are growing, or will be grown, is located in a county other than the corporation's place of business.[102] The practitioner should be careful to check the local state's requirements on filing as it may have a combination of central filing and local filing for farm products or it may have only central filing.

In addition to filing in the appropriate place, the financing statement must comply with the provisions of section 9-402. According to section 9-402, the financing statement must contain "a statement indicating the types, or describing the items of collateral."[103] The function of the description is to put third parties

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 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.

U.C.C. § 9-401(1) (1978).

96. *See* U.C.C. § 9-109(3) (1978) (definition of farm products).

97. *Id.* § 9-109(4) (definition of inventory).

98. *Id.* §§ 9-105(1)(f); 1-201(15) (definitions of document of title).

99. Inventory is normally perfected with the secretary of state. *Id.* § 9-401(1). Perfection of documents of title turns on whether they are negotiable or nonnegotiable. *Id.* §§ 7-104; 9-304.

100. *See id.* § 9-401(1) (second and third alternatives of subsection (1)).

101. *Id.*

102. *See id.* § 9-401(1), (6).

103. *Id.* § 9-402(1). Section 9-402 provides:

(1)A financing statement is sufficient if it gives the names of the debtor and the secured party, is signed by the debtor, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral. A financing statement may be filed before a security agreement is

on notice of the secured party's claim. Comment 2 to section 9-402

made or a security interest otherwise attaches. When the financing statement covers crops growing or to be grown, the statement must also contain a description of the real estate concerned. When the financing statement covers timber to be cut or covers 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, the statement must also comply with subsection (5). A copy of the security agreement is sufficient as a financing statement if it contains the above information and is signed by the debtor. A carbon, photographic or other reproduction of a security agreement or a financing statement is sufficient as a financing statement if the security agreement so provides or if the original has been filed in this state.

(2) A financing statement which otherwise complies with subsection (1) is sufficient when it is signed by the secured party instead of the debtor if it is filed to perfect a security interest in

(a) collateral already subject to a security interest in another jurisdiction when it is brought into this state, or when the debtor's location is changed to this state. Such a financing statement must state that the collateral was brought into this state or that the debtor's location was changed to this state under such circumstances; or

(b) proceeds under Section 9-306 if the security interest in the original collateral was perfected. Such a financing statement must describe the original collateral; or

(c) collateral as to which the filing has lapsed; or

(d) collateral acquired after a change of name, identity or corporate structure of the debtor (subsection (7)).

(3) A form substantially as follows is sufficient to comply with subsection (1):

Name of debtor (or assignor) . . . . . .
Address . . . . . .
Name of secured party (or assignee) . . . . . .
Address . . . . . .

1. This financing statement covers the following types (or items) of property:
   (Describe) . . . . . .
2. (If collateral is crops) The above described crops are growing or are to be grown on:
   (Describe Real Estate) . . . . . .
3. (If applicable) The above goods are to become fixtures on
   (Describe Real Estate) . . . . . and this financing statement is to be filed [for record] in the real estate records. (If the debtor does not have an interest of record) The name of a record owner is . . . . . .
4. (If products of collateral are claimed) Products of the collateral are also covered.

(use whichever is applicable)

. . . . . .
Signature of Debtor (or Assignor)
. . . . . .
Signature of Secured Party (or Assignee)

(4) A financing statement may be amended by filing a writing signed by both the debtor and the secured party. An amendment does not extend the period of effectiveness of a financing statement. If any amendment adds collateral, it is effective as to the added collateral only from the filing date of the amendment. In this Article, unless the context otherwise requires, the term "financing statement" means the original financing statement and any amendments.

(5) A financing statement covering timber to be cut or covering minerals or the like (including oil and gas) or accounts subject to subsection (5) of Section 9-103, or a financing statement filed as a fixture filing (Section 9-313) where the debtor is not a transmitting utility, must show that it covers this type of collateral, must recite that it is to be filed [for record] in the real estate records, and the financing statement must contain a description of the real estate [sufficient if it were contained in a mortgage of the real estate to give constructive notice of the mortgage under the law of this state]. If the debtor does not have an interest of record in the real estate, the financing statement must show the name of a record owner.

(6) A mortgage is effective as a financing statement filed as a fixture filing from the date of its recording if

(a) the goods are described in the mortgage by item or type; and

(b) the goods are or are to become fixtures related to the real estate described in the mortgage; and

makes clear that the Code adopted a "notice filing" system.[104] The filed notice is sufficient when it indicates that a secured party may have a security interest in the collateral described.[105] Section 9-110 and its comment show that the Code does not contemplate exact and detailed descriptions.[106] The description must reasonably identify what is described. Merely indicating the types of collateral should be enough. The practitioner should remember that the functions of the financing statement are significantly different from those of the security agreement.[107]

While the function of the security agreement and the financing statement are different, the same description used in the security agreement can and should be used in the financing statement. Again, it is not necessary to use Code terminology. The financing statement must also have a real estate description when growing crops or crops to be grown are involved.[108]

## III. THE EXCEPTION TO THE EXCEPTION — 9-306(2) — THE FARM PRODUCTS RULE

Under section 9-307(1) the buyer of "farm products from a person engaged in farm operations" will take subject to a perfected

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(c) the mortgage complies with the requirements for a financing statement in this section other than a recital that it is to be filed in the real estate records; and

(d) the mortgage is duly recorded.

No fee with reference to the financing statement is required other than the regular recording and satisfaction fees with respect to the mortgage.

(7) A financing statement sufficiently shows the name of the debtor if it gives the individual, partnership or corporate name of the debtor, whether or not it adds other trade names or names of partners. Where the debtor so changes his name or in the case of an organization its name, identity or corporate structure that a filed financing statement becomes seriously misleading, the filing is not effective to perfect a security interest in collateral acquired by the debtor more than four months after the change, unless a new appropriate financing statement is filed before the expiration of that time. A filed financing statement remains effective with respect to collateral transferred by the debtor even though the secured party knows of or consents to the transfer.

(8) A financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading. Amended in 1972.

*Id.* § 9-402.

104. *See id.* comment 2.

105. *Id.*

106. *See id.* § 9-110 & comment.

107. *Compare id.* § 9-203 and comments (requirements of a valid and enforceable security agreement) *with* § 9-402 and comments (requirements of a sufficient financing statement).

108. *See id.* § 9-402(1) & comments. See *supra* notes 103 for the text of § 9-402(1). Section 9-402(8) provides that a financing statement containing minor errors, not seriously misleading, which substantially complies with § 9-402(1) is still valid. *See id.* § 9-402(8). The omission of any real estate description, however, would not be considered a minor error. *See, e.g.*, First Nat'l Bank v. Calvin Pickle Co., 516 P.2d 265 (Okla. 1973) (financing statement that failed to describe lands on which "secured" crops were grown was not a "minor error" and thus did not convey a security interest in those crops). *Cf.* U.C.C. § 9-203(1)(a) (security interest will not attach unless security agreement contains description of the land when security agreement covers growing crops).

security interest.[109] There is, however, a major exception to this rule in section 9-306(2), which provides: "[A] security interest continues in collateral notwithstanding sale . . . unless the disposition was authorized by the secured party in the security agreement *or otherwise,* and also continues in any identifiable proceeds. . . ."[110]

Inasmuch as security agreements almost never specifically authorize sale of farm products,[111] the crucial words in this section are "or otherwise."[112] Neither the Code nor the comments define "otherwise" or give any guidance to its meaning. Courts have generally considered the issue to be whether the secured party has in any way authorized the sale. Some courts have imported to the Code the common law notions of waiver,[113] estoppel,[114] and consent.[115] If the sale was authorized, the secured party loses the right to seek redress from the buyer. Sometimes courts have considered the question of authorization as a question of fact.[116] In any event, the courts are split concerning what is authorization and when it exists.

Many cases have involved situations in which the security agreement either specifically prohibited the sale of collateral or required the prior written consent of the secured party; the debtor sold covered collateral in the past; and the lender knew of the debtor's prior sales, but made no objection to those sales and accepted either checks made out to the debtor and endorsed by the debtor to the lender or took the debtor's checks. Some courts in these circumstances have construed the prohibition literally and

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109. *See id.* § 9-307(1).

110. *Id.* § 9-306(2) (emphasis added).

111. *But see* Swift & Co. v. Jamestown Nat'l Bank, 426 F.2d 1099 (8th Cir. 1970) (security agreement contained power of sale clause).

112. *See* U.C.C. § 9-306(2).

113. *See, e.g., In re* Coast Trading Co., 36 U.C.C. Rep. Serv. (Callaghan) 1753 (D. Or. 1983) (secured party did not waive its security interest in wheat by permitting debtor to sell the collateral without obtaining the written consent of the secured party as required by the security agreement even though the debtor for the past 18 years sold the collateral without getting written consent because the debtor and the secured party had an understanding that the proceeds of such sales would always be turned over to the secured party; National Livestock Credit Corp. v. Schultz, 34 U.C.C. Rep. Serv. (Callaghan) 317 (Okla. 1982) (secured party waived provision of security agreement, which required the buyer of cattle to pay secured party and debtor jointly, by failing to object to the debtor's practice of accepting checks payable only to it and either remitting check to secured party or issuing a different check to the secured party).

114. *See, e.g.*, Anon, Inc., v. Farmers Prod. Credit Ass'n, ____ Ind. ____, 446 N.E.2d 656 (1983) (secured party not estopped from asserting its rights under a security agreement against the purchaser of collateral where the buyer could not show detrimental reliance).

115. *See, e.g.*, Citizens Savings Bank v. Sac City State Bank, 315 N.W.2d 20 (Iowa 1982) (prior course of dealing may overcome express terms in a security agreement and constitute consent or authorization for a sale of collateral free of liens).

116. *See* Benson County Coop. Credit Union v. Central Livestock Ass'n, Inc., 300 N.W. 2d 236 (N.D. 1980) (whether secured party waived requirement of written consent by knowingly allowing debtor to sell a portion of the assets securing a loan was a question of fact); Mammoth Cave Prod. Credit Ass'n v. Oldham, 569 S.W.2d 833 (Tenn. Ct. App. 1977) (case remanded to trial court for clarification of whether secured party authorized the sale of tobacco).

held that the sale of the collateral was unauthorized because the security agreement had an express prohibition against sales.[117] Other courts have held that no authorized sale can exist absent written consent.[118] A number of courts on the above facts, however, have held for the purchaser on the theory that the sale, in which the debtor does not remit the proceeds, was authorized by the prior course of dealing.[119] Some courts have rejected this approach[120] and have criticized those who ignore section 1-205(4), which provides:

> 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.[121]

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117. *See, e.g.*, North Central Kansas Prod. Credit Ass'n v. Washington Sales Co., 223 Kan. 689, 577 P.2d 35 (1978) (creditor did not waive consent requirement by failing to remonstrate with debtor following debtor's unauthorized sale of collateral); Wabasso State Bank v. Caldwell Parking Co., 308 Minn. 349, 251 N.W.2d 321 (1976) (secured party, under agreement which prohibited sale of collateral without secured party's written approval, did not authorize debtor to sell collateral by not objecting to course of dealing in which borrower previously sold collateral without consent); Garden City Prod. Credit Ass'n v. Lannan, 186 Neb. 668, 186 N.W.2d 99 (1971) (creditor's failure to object to debtor's sale of collateral did not alone equal written consent to dispose of collateral).

118. *See, e.g.*, Oxford Prod. Credit Ass'n v. Dye, 368 So.2d 241 (Miss. 1979) (absent evidence of written consent, creditor's acquiesence in the sale of encumbered assets did not constitute waiver of written consent requirement); First Nat'l Bank v. Calvin Pickle Co., 11 U.C.C. Rep. Serv. (Callaghan) 1245, *rev'd on other grounds*, 516 P.2d 265 (Okla. 1973) (to extinguish creditor's possessory rights in collateral, creditor must consent in writing to debtor's sale of collateral regardless of whether creditor establishes custom of allowing debtor to sell collateral without written consent upon debtor's promise to pay over sale proceeds).

119. *See, e.g.*, Planters Prod. Credit Ass'n v. Bowles, 256 Ark. 1063, 511 S.W.2d 645 (1974) (Arkansas legislature responded by amending § 9-306(2) to eliminate course of dealing authorizations); Hedrick Savings Bank v. Myers, 229 N.W.2d 252 (Iowa 1975) (prior course of dealing may constitute authority to sell pledged collateral under § 9-306(2)); Clovis Nat'l Bank v. Thomas, 425 P.2d 726 (N.M. 1967) (legislature amended § 9-306(2) to read "a security interest in farm products and the proceeds thereof shall not be considered waived by the secured party by any course of dealing between the parties or by any trade usage"); National Livestock Credit Corp. v. Schultz, 653 P.2d 1243 (Okla. App. 1982) (creditor's long-term course of conduct allowing debtor to disregard written consent requirement in security agreement was a waiver of that requirement). *But cf.* United States v. Hext, 444 F.2d 804 (5th Cir. 1971). In *Hext* the defendant, Walter Hext, was a cotton farmer and was also the sole owner of a cotton ginning business. *Id.* at 806. In 1962 the Farmers Home Administration (FmHA) loaned Hext $38,720 to finance his farming operation, taking back a chattel mortgage in Hext's forthcoming cotton crop. *Id.* FmHA was aware at the time of the loan that the cotton would be ginned and marketed by Hext through his own ginning company. *Id.* The court held that FmHA took a security interest in goods as farm products, knowing that Hext was capable of transferring them into the category of inventory and selling them in the ordinary course of business, and therefore the buyers of the cotton took free of the security interest. *Id.* at 814.

120. *See, e.g.*, North Central Kansas Prod. Credit Ass'n v. Washington Sales Co., 223 Kan. 689, 577 P.2d 35 (1978) (creditor did not waive consent requirement by failing to remonstrate with debtor following debtor's unauthorized sale of collateral); Fisher v. First Nat'l Bank, 584 S.W.2d 515 (Tex. Civ. App. 1979) (creditor's prior course of conduct allowing debtor to sell collateral without creditor's written consent was not a waiver of written consent requirement); Southwest Wash. Prod. Credit. Ass'n. v. Seattle-First Nat'l, 19 Wash. App. 397, 577 P.2d 589 (1978) (prior course of dealing without more does not constitute a waiver of security agreement term requiring written consent prior to sale of collateral).

121. U.C.C. § 1-205(4)(1978).

Even courts rejecting the prior course of dealing rationale have apparently concluded that a course of performance or showing of acquiescence to the sale after the execution of the security agreement can establish a waiver of the security interest.[122]

An interesting and instructive case is *North Central Production Credit Association v. Washington Sales Co.*[123] In *Washington Sales* a farmer granted a security interest to North Central Production Credit Association (PCA) in his cows, crops, and milk.[124] PCA filed the proper financing statement in the appropriate place and, therefore, PCA perfected its security interest in the collateral.[125] The security agreement contained the following provision:

> The Debtor. . . will not. . . dispose of [the property described] without the written consent of the Secured Party; however, permission is granted for the Debtor to sell the property described herein for the fair market value thereof, *providing that payment for the same is made jointly to the Debtor and the Secured Party*. . . .[126]

The farmer sold wheat twice to the local elevator, receiving from the elevator checks made payable only to him.[127] The farmer deposited one of the checks in his own account and wrote PCA a personal check for the amount of the sale.[128] He endorsed the other check to PCA.[129] The farmer also sold a total of thirty-five head of cattle, at separate times over a one-year period, which he did not report to PCA and for which he did not remit the proceeds.[130] The sale of cattle that caused the litigation was transacted through the Washington Sales Company.[131] It was clear that neither the sales company nor the buyers of the cattle had actual knowledge of PCA's security interest.[132] They were, however, on constructive

122. *See* Southwest Wash. Prod. Credit Ass'n v. Seattle-First Nat'l, 19 Wash. App. 397, 577 P.2d 589 (1978). The court stated that "any course of *performance*. . . or other conduct *subsequent* to the agreement can amount to a waiver." *Id.* at 593 (citations omitted) (emphasis in original).

123. 223 Kan. 689, 577 P.2d 35 (1978).

124. North Central Prod. Credit Ass'n v. Washington Sales Co., 223 Kan. 689, 690, 577 P.2d 35, 36 (1978).

125. *Id.* PCA filed the financing statement with the register of deeds. *Id.*

126. *Id.* (emphasis in original).

127. *Id.* at 691, 577 P.2d at 37.

128. *Id.*

129. *Id.*

130. *Id.*

131. *Id.*

132. *Id.* at 691-92, 577 P.2d at 37-38. The president of Washington Sales Co. testified that he had no knowledge of PCA's lien and that he was not told of PCA's lien by the farmer when the cattle were sold. *Id.* at 691-92, 577 P.2d at 37. The president of Washington Sales Co. knew, however, that financing statements on cattle were recorded in the register of deeds but stated that he never checked the records when cattle were sold at his sales barn. *Id.*

notice of PCA's security interest because PCA had properly filed the financing statement in the appropriate place.[133]

Although the Kansas Supreme Court held for the buyer, it made several conclusions favoring creditors. First, it determined that a security agreement clause, authorizing the farmer to sell the collateral with prior written consent or permitting a sale if the payment for the collateral was made jointly to the farmer, did not amount to a waiver of PCA's security interest and was not a consent to the sale in violation of the express terms of the agreement.[134] Also, PCA's conduct did not amount to an implied consent to the sale of the livestock.[135] Third, PCA's past conduct did not amount to a course of dealing that showed it impliedly waived its security interest.[136] Then, turning to the notice filing concept of the Code, the court stated that the equitable doctrine of waiver is not available to a buyer who has constructive notice of a lien and does not check the public records, which are in part maintained for a buyer's protection.[137] Thus, the case is a strong creditor case concerning what constitutes implied consent and past course of conduct.

Yet, the court held that PCA relinquished its security interest. The basis for this decision was the testimony of the president of PCA, which established that PCA told the farmer he could sell the cattle provided he remitted the proceeds or had the check made jointly payable.[138] The fact that the farmer could sell the cattle provided he remitted the proceeds was considered by the court to be an express consent to the sale and cut off PCA's security interest.[139] PCA never warned or reminded the farmer that taking payment in

133. *Id.* at 693, 577 P.2d at 38.

134. *Id.* at 693-94, 577 P.2 at 39.

135. *Id.* at 697, 577 P.2d at 41.

136. *Id.* The court determined that for a waiver to exist, the party must have "voluntarily and intentionally renounced or given up a known right, or. . . caused or done some positive act or positive inaction which is inconsistent with the contractual right." *Id.* (citations omitted). The court, using this test, determined that the actions of PCA in accepting several payments could not be construed as a "voluntary and intentional renouncement" of its security interest in the collateral. *Id.*

137. *Id.*

138. *Id.* The president of PCA, James D. Ganson, testified at the lower court hearing in part as follows:

> Q. Did you, Mr. Ganson, ever have any conversation at all with Mr. Uffman regarding his not selling cattle?
> A. We told him he could sell cattle providing he applied the proceeds from that sale or had the check made jointly.
> Q. When was he told that, sir?
> A. He was told at the beginning of the loan when Mr. Rightmeier was out there, and I can remember visiting with him in that regard on one of my visits out there.

*Id.*

139. *Id.* at 697-98, 577 P.2d at 41.

his name only was a violation of the express terms of the security agreement.

One of the strongest cases for lenders is *Garden City Production Credit Association v. Lannan.*[140] In *Lannan* Murlin and Doris Carter obtained a loan from Garden City Production Credit Association (PCA) and signed a security agreement that prohibited the sale of Carter's cattle without PCA's prior written consent.[141] Yet, the Carters sold cattle at various times without obtaining the necessary written permission. PCA knew about the prior sales but made no objections and accepted the checks that the Carters endorsed over to it.[142] This case arose when the Carters sold 161 head of cattle, with PCA's knowledge, to Western Cattle Company (Western), a large livestock brokerage firm operating primarily in Kansas. Western negotiated a contract between Carter and Augustin Brothers, of Nebraska, who in turn sold the cattle to the defendant, Lannan, a farmer in Nebraska.[143] Western issued a sight draft for the cattle payable to Carter. Carter endorsed the draft over to PCA and PCA sent the draft through the regular banking channels for collection. Approximately two weeks later, PCA learned that the draft was being returned for insufficient funds.[144] At this point, PCA recorded its financing statement in Nebraska, thus perfecting its security interest in the cattle pursuant to the Uniform Commercial Code, and made a demand for the cattle.[145] The district court found that PCA had knowledge of the proposed sale, failed to rebuke or object to the sale, and therefore, had waived its

140. 186 Neb. 668, 186 N.W.2d 99 (1971).

141. Garden City Prod. Credit Ass'n v. Lannan, 186 Neb. 668, 669, 186 N.W.2d 99, 100-01 (1971).

142. *Id.* at 670, 186 N.W.2d at 101. Carter had never requested written consent to sell cattle nor had PCA ever rebuked Carter for failure to secure the written consent. *Id.*

143. *Id.* Carter informed PCA of the intended sale three months before the sale. *Id.*

144. *Id.*

145. *Id.* Section 9-103(1)(d) of the Uniform Commercial Code provides for the perfection of security interests in multiple state transactions. This section provides:

> When collateral is brought into and kept in this state while subject to a security interest perfected under the law of the jurisdiction from which the collateral was removed, the security interest remains perfected, but if action is required by Part 3 of this Article to perfect the security interest,
>
> (i) if the action is not taken before the expiration of the period of perfection in the other jurisdiction or the end of four months after the collateral is brought into this state, whichever period first expires, the security interest becomes unperfected at the end of that period and is thereafter deemed to have been unperfected as against a person who became a purchaser after removal;
>
> (ii) if the action is taken before the expiration of the period specified in subparagraph (i), the security interest continues perfected thereafter;
>
> (iii) for the purpose of priority over a buyer of consumer goods (subsection (2) of Section 9-307), the period of the effectiveness of a filing in the jurisdiction from which the collateral is removed is governed by the rules with respect to perfection in subparagraphs (i) and (ii).

U.C.C. § 9-103(1)(d) (1978).

security interest in the cattle.[146] Nonetheless, the Supreme Court of Nebraska held that PCA did not waive its perfected security interest in the cattle.[147] The court relied upon section 9-307(1) of the Code and gave literal effect to the prohibition in the PCA security agreement against sale without prior written consent.[148]

This case illustrates the harshest effect of section 9-307(1) in that Lannan was really powerless to protect himself. If he checked the financing statements he would not have found PCA's interest because PCA did not file in Nebraska until after Lannan purchased the cattle. PCA filed in Nebraska immediately upon learning where the cattle were located. Also, what rancher would think it had to check the records when it was buying from either a cattle trader or another cattle feeder? An interesting twist in this case was that Lannan, a cattle operator, bought the cattle from a seller who purchased the cattle with a draft that was not honored.[149] It is unfortunate that the court was not confronted with an argument that section 2-403(1)(b) of the Code gave Lannan's seller the ability to pass better title than he had.[150]

While many section 9-307(1) cases involve suits against buyers, the farm products rule applies to auctioneers as well as purchasers in many states. Thus, a court may hold an auctioneer or commission agent liable for conversion when the secured party has not authorized the sale.[151]

A major problem for the secured party is that in reality it must expect and want the debtor to sell collateral to make payments on

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146. 186 Neb. at 671, 186 N.W.2d at 101.

147. *Id.* at 676, 186 N.W.2d at 104. The court stated that "in order to establish a waiver of legal right there must be a clear, unequivocal and decisive act of a party showing such a purpose, or acts to an estoppel on his part." *Id.*

148. *Id.*

149. *Id.* at 671, 186 N.W.2d at 101.

150. *See* U.C.C. § 2-403(1)(b) (1978). Section 2-403(1)(b) provides:

> A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good faith purchaser for value. When goods have been delivered under a transaction of purchase the purchaser has such power even though
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> . . . .
>
> (b) the delivery was in exchange for a check which is later dishonored. . . .

*Id.*

151. *See, e.g.*, Duvall-Wheeler Livestock Barn v. United States, 415 F.2d 226 (5th Cir. 1969) (auctioneers held liable in conversion when livestock was sold at public auction in disregard of the Government's recorded bills of sale); United States v. Topeka Livestock Auction, Inc., 392 F. Supp. 944 (N.D. Ind. 1975) (auctioneer who sold livestock in which the Government held a security interest was liable in conversion notwithstanding its want of any knowledge of the Government's security interest); North Central Prod. Credit Ass'n v. Washington Sales Co., 223 Kan. 689, 577 P.2d 35 (1978) (an agent who received property from his principal, sold it under the principal's instructions, and paid the proceeds to the principal was liable for conversion when the principal had no right to sell the property).

the outstanding debt. Obviously, if the secured party gives a blanket consent to sales, it will lose its security in the collateral upon sale and the right to seek redress from the purchaser should the debtor default. Recognizing this, lenders have attempted to protect themselves by giving conditioned authorizations. Courts have upheld some conditional authorizations as valid and concluded that the secured party, by allowing sales in this manner, has not waived its security interest. Examples of valid conditions are authorization to sell if payment is made jointly to seller and secured party;[152] authorization to sell conditioned upon whether buyer's drafts drawn on defendant bank were honored and paid;[153] and consent to sell so long as no prior default had occurred.[154]

The United States Court of Appeals for the Tenth Circuit rejected a conditional authorization argument in *First National Bank & Trust Co. v. Iowa Beef Processors, Inc.*[155] In *Iowa Beef* Iowa Beef Processors (IBP) bought, without checking the records, cattle that were subject to a perfected security interest.[156] Although the court noted that the buyer of farm products had the burden of checking to see whether the farm products were subject to a perfected security interest, it concluded that IBP's failure to check the records was irrelevant because the secured party gave the debtor actual authority to sell the collateral, irrespective of whether that consent was communicated to IBP.[157] The secured party argued that it did not consent to the sale inasmuch as the debtor did not remit the proceeds of the sale and the consent to allow the debtor to sell in his own name was conditioned upon the debtor remitting the proceeds by his own check.[158] The court rejected this argument, stating: "A secured party has an interest in protecting its security by conditioning its consent, but it can place conditions that would afford it protection without great unfairness to the good faith purchaser."[159] The court appeared to distinguish the conditional

152. *See, e.g.*, North Central Prod. Credit Ass'n v. Washington Sales Co., 223 Kan. 689, 577 P.2d 35 (1978) (security agreement condition authorizing sales of collateral if payment is made jointly to the debtor and the secured party is permissible).

153. *See, e.g.*, Baker Prod. Credit Ass'n v. Long Creek Meat Co., 226 Or. 643, 513 P.2d 1129 (1973) (authorization to sell collateral conditioned upon payment of dishonored drafts is not prohibited under the Uniform Commercial Code).

154. *See, e.g.*, Farmers State Bank v. Edison Non-Stock Coop. Ass'n, 190 Neb. 789, 212 N.W.2d 625 (1973) (authorization to sell upon condition that no event of default had occurred is permissible).

155. 626 F.2d 764 (10th Cir. 1980).

156. First Nat'l Bank & Trust Co. v. Iowa Beef Processors, Inc., 626 F.2d 764, 766 (10th Cir. 1980).

157. *Id.* at 768.

158 *Id.* at 767.

159. *Id.* at 769.

authorization cases by noting that in those cases the condition was discoverable prior to the sale or the condition was within the control of the buyer.[160] It must be emphasized that First National's security agreement *did not* require prior written consent.[161] Interestingly, the court was not impressed with the fact that if IBP had checked the records, it would have known about First National's security interest.[162]

Another current issue related to sections 9-307(1) and 9-306(2) is the use of the so-called borrowers lists. Many elevators and other purchasers of large quantities of grain or livestock have directly contacted large lenders who might be financing producers in their area, asking them to furnish a list of all borrowers in whose crops or livestock the lender claims an interest. This has presented some practical problems for lenders. On the one hand, the lender does not want to be uncooperative and is probably tempted to believe that direct notification may well be the most effective way of assuring that its security interest is noted by the purchasers. On the other hand, the lender must be concerned about such questions as: 1) will this violate any confidence on the part of a borrower; 2) will furnishing the list obligate the lender to update the lists; 3) will the unintentional omission of a debtor preclude the lender from asserting its properly perfected security interest against a purchaser if the lender has otherwise not consented or waived its interest.

A recent case dealing with this last question is *United States v. Riceland Foods, Inc.*[163] The court in *Riceland Foods* concluded that when both the "borrowers list" and a letter transmitted with the list include a statement that the list is supplied as a convenience and is not necessarily complete, a purchaser receiving these documents cannot rely on the list.[164] Rather, to be completely protected, the purchaser must check the appropriate records.[165] In other words, the purchaser or third party will still be subject to a perfected security holder even though the seller-debtor was not on the list when a perfected secured party is involved.

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160. *See id.* The court stated that consent allowing the debtor to sell in its own name, provided the debtor remits by its own check, makes the buyer an insurer of acts beyond its control. *Id.* Such an arrangement is not a "true conditional sales authorization." *Id.*

161. *See id.* at 768. In fact, the security agreement made no reference at all to sales of collateral. *Id.*

162. *Id.*

163. 504 F. Supp. 1258 (E.D. Ark. 1981).

164. United States v. Riceland Foods, Inc., 504 F. Supp. 1258, 1263 (E.D. Ark. 1981). Because the letter stated that the list was not necessarily complete, it was not reasonable for the purchaser of crops subject to a security interest to rely on the "borrowers list." *Id.*

165. *Id.*

### A. Methods to Deal with the Rule

Notwithstanding the farm products rule, buyers can adopt procedures that will minimize their risk. For example, the buyer can search the appropriate financing statement records. This procedure is particularly onerous when local filing is involved[166] or when a livestock operator is buying livestock in a number of states. Yet, business practices could be adjusted to give the buyer time to check the records. People argue competition will not permit this. If everyone followed this practice, however, this would not be a problem. A buyer may also obtain borrowers lists from local lenders. This will not relieve a buyer of the responsibility of checking the records,[167] but it will help buyers know who some of the borrowers are. If the buyer knows a lender has a security interest, it should determine if a joint payee check is to be issued. The sellers should be informed of the buyer's policy and the reasons for it. Another possibility is for buyers not to buy farm products from unfamiliar producers or truckers.[168] Buyers not covered by the Packers & Stockyard Act prompt payment rule[169] could pay

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166. Many local filing officers will not provide the information by phone. Written requests sometimes take as long as two weeks. It may be the same situation if central filing is involved. Remember, if crops are involved, the debtor's residence and the county where the land is located must be checked. *See* U.C.C. § 9-401(1) (1978).

167. *See* United States v. Riceland Foods, Inc., 504 F. Supp. 1258 (E.D. Ark. 1981).

168. For an interesting case involving a trucker who sold a load of beans he was trucking without permission of the owner, see Simonds-Shields-Theis Grain Co. v. Far-Mar Co., 575 F. Supp. 290 (W.D. Mo. 1983) (farmer could not recover from the buyer).

169. *See* 7 U.S.C. § 228b (1982). Section 228b provides:

> (a) Each packer, market agency, or dealer purchasing livestock shall, before the close of the next business day following the purchase of livestock and transfer of possession thereof, deliver to the seller or his duly authorized representative the full amount of the purchase price: *Provided*, That each packer, market agency, or dealer purchasing livestock for slaughter shall, before the close of the next business day following purchase of livestock and transfer of possession thereof, actually deliver at the point of transfer of possession to the seller or his duly authorized representative a check or shall wire transfer funds to the seller's account for the full amount of the purchase price; or, in the case of a purchase on a carcass or "grade and yield" basis, the purchaser shall make payment by check at the point of transfer of possession or shall wire transfer funds to the seller's account for the full amount of the purchase price not later than the close of the first business day following determination of the purchase price: *Provided further*, That if the seller or his duly authorized representative is not present to receive payment at the point of transfer of possession, as herein provided, the packer, market agency or dealer shall wire transfer funds or place a check in the United States mail for the full amount of the purchase price, properly addressed to the seller, within the time limits specified in this subsection, such action being deemed compliance with the requirement for prompt payment.
>
> (b) Notwithstanding the provisions of subsection (a) of this section and subject to such terms and conditions as the Secretary may prescribe, the parties to the purchase and sale of livestock may expressly agree in writing, before such purchase or sale, to effect payment in a manner other than that required in subsection (a) of this section. Any such agreement shall be disclosed in the records of any market agency or dealer selling the livestock, and in the purchaser's records and on the accounts or other documents issued by the purchaser related to the transaction.
>
> (c) Any delay or attempt to delay by a market agency, dealer, or packer

subsequent to checking the records. This may be a major problem, however, if it takes a long time to determine if a security interest is involved.[170] In any event, purchasers should seriously consider obtaining insurance, which appears to be readily available.

When a buyer is sued by a secured party, it may have a valid defense. For example, the goods may *not* be farm products, the lender may not have a perfected security interest, or the lender may have authorized the sale. If the purchaser must pay twice, it always has a claim against its seller under section 2-312 of the Code for breach of a warranty of title.[171] This is probably not much protection when the farmer is already in default.

The secured party, who wants to utilize the special rule, must have a perfected security interest. The secured party should supply purchasers in its area with a list of borrowers making the appropriate caveats indicating that it is not necessarily a complete list and is supplied only for the buyer's convenience. The lender should make sure its borrowers know about the list and the reasons for the list before it is released. The security agreement should contain a specific provision concerning the sale of farm products, which the lender should rigidly follow. The agreement should also provide when sales are allowed and make clear how the buyer is to pay. For example, if all sales by a debtor are to be for cash only, the agreement should specify whether the buyer is to make the lender the sole payee or a joint payee on remittances and checks and whether the buyer is to send them directly to the lender.

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> purchasing livestock, the collection of funds as herein provided, or otherwise for the purpose of or resulting in extending the normal period of payment for such livestock shall be considered an "unfair practice" in violation of this chapter. Nothing in this section shall be deemed to limit the meaning of the term "unfair practice" as used in this chapter.

*Id.* (emphasis in original).

170. See *supra* note 166 for a discussion of the delays involved in determining the existence of a security interest.

171. *See* U.C.C. § 2-312 (1978). Section 2-312 provides:

> (1) Subject to subsection (2) there is in a contract for sale a warranty by the seller that
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> (a) the title conveyed shall be good, and its transfer rightful; and
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> (b) the goods shall be delivered free from any security interest or other lien or encumbrance of which the buyer at the time of contracting has no knowledge.
>
> (2) A warranty under subsection (1) will be excluded or modified only by specific language or by circumstances which give the buyer reason to know that the person selling does not claim title in himself or that he is purporting to sell only such right or title as he or a third person may have.
>
> (3) Unless otherwise agreed a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications.

*Id.*

### B. Legislative Reactions to U.C.C. § 9-307(1)

State legislatures have reacted in a variety of ways to the litigation and controversy generated by the farm products rule. California has eliminated the rule.[172] Arguably, California is not an appropriate benchmark. Unlike many states, California has relatively few buyers of crops such as vegetables, grains, nuts, and fruit, and many of its farmers are members of cooperatives that have mandatory marketing contracts requiring that all commodities be sold to the cooperative. Moreover, many lenders will not extend credit unless the debtor, prior to planting, has a buyer committed to buy the crop at harvest. Lenders also obtain a written assignment of the crop proceeds from the farmer, which authorizes the buyer to make direct payment to the lender. Normally, the lender forwards the crop assignment to the buyer who acknowledges it and agrees to send the crop proceeds directly to the lender in an amount stipulated in the assignment.

Other states have modified section 9-307(1).[173] Some states have required the farmer to submit a list of potential buyers to the lender who must notify these buyers. If the buyers are notified, they must write a joint payee check unless otherwise directed.[174] In Ohio and Indiana, the farmer is required to furnish a list of buyers to the secured party and cannot sell to someone not on the list without being guilty of a crime.[175] The Delaware version of 9-307(1) provides that if a grain buyer registers with the secretary of state, the buyer will take free of a perfected security interest unless it receives written notice within one year of the sale.[176] Under the Delaware system, the secured party can determine who the potential buyers are. This is not the case in Kentucky, where

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172. *See* Cal. Com. Code § 9307(1) (West Supp. 1984). The California version of § 9-307(1) of the Uniform Commercial Code provides: "A buyer in the ordinary course of business (subdivision (9) of Section 1201) 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." *Id.*

173. For example, Kansas excludes milk, cream, and eggs from the definition of farm products. Kan. Stat. Ann. § 84-9-307(1) (1983). Oklahoma has changed the rule so it only applies to "a person buying livestock from a person engaged in farming or ranching operations. . . ." A merchant purchasing or a commission agent selling farm products other than livestock must obtain a certificate from the seller listing security interest holders. The certificate shall indicate the security interest holders because it is a felony to give false information. Okla. Stat. Ann. tit. 12A § 9-307(1), (3) (West Supp. 1983). Oregon and Montana have special rules for livestock. Or. Rev. Stat. § 79.3070 (1981); Mont. Code Ann. § 81-8-301 (1983). Other states have exempted commission merchants. *See, e.g.*, Ga. Code 109A-9-307(1) (Supp. 1982).

174. Ohio is an example of this. For a discussion of Ohio's law, see Note, *H.291: Ohio's Attempt to Remedy Problems of Security Interests in Farm Products Under the UCC*, 9 U. Dayton L. Rev.____ (1984).

175. *See* Ind. Code Ann. § 26-1-9-307 (Burns Supp. 1983); Ohio Rev. Code Ann. § 1309.26 (Page Interim Supp. 1983).

176. *See* Del. Code Ann. tit. 6, § 9-307(2) (Supp. 1983).

duly licensed tobacco warehouses, grain storage warehouses, stockyards, and race horse auctions take free of a perfected security interest unless the secured party gave them written notice of the security interest.[177] The statute has no mechanism for secured parties to determine who the potential buyers are.[178] The Kentucky approach seems to have effectively repealed section 9-307(1). Under this approach there is no effective way that secured parties can determine who the buyers are and who should be given the written notice. This approach completely ignores the notice function that filed financing statements have under the Code. Irrespective of one's position regarding the proper function of section 9-307(1), it is possible under the Code for the buyers of farm products to determine who the secured party is by checking the filed financing statement.

North Dakota has perhaps the strangest version of section 9-307.[179] The merchant-buyer or the commission merchant selling

177. *See* KY. REV. STAT. § 355.9-307 (Supp. 1982).

178. *Id.*

179. *See* N.D. CENT. CODE § 41-09-28 (1983). Section 41-09-28 provides:

1. A buyer in ordinary course of business (subsection 9 of section 41-01-11) 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.
2. In the case of consumer goods, a buyer takes free of a security interest even though perfected if he buys without knowledge of the security interest, for value and for his own personal, family or household purposes or his own farming operations unless prior to the purchase the secured party has filed a financing statement covering such goods.
3. A buyer other than a buyer in ordinary course of business (subsection 1 of this section) takes free of a security interest to the extent that it secures future advances made after the secured party acquires knowledge of the purchase, or more than forty-five days after the purchase, whichever first occurs, unless made pursuant to a commitment entered into without knowledge of the purchase and before the expiration of the forty-five-day period.
4. Before a merchant who purchases or a commission merchant who sells farm products for another for a fee or commission issues a check or draft to the seller in payment for farm products, the merchant must require the seller to execute a certificate of ownership, on the form as prescribed by the commissioner of agriculture, disclosing the names, social security numbers, addresses and home counties of the owners for five years prior thereto, the county of location of the property prior to the sale, and the names of the parties to whom security interests have been given against the farm products or representing that security interests do not exist. The merchant is required to enter on the check or draft the name of the secured party disclosed in the certificate, or actually known by the merchant at the time, as payee with the seller. The certificate must include a warning to the seller that an untrue statement as to any portion of the certificate constitutes a class C felony if the value of the property exceeds five hundred dollars, or a class A misdemeanor if the property does not exceed five hundred dollars in value.
5. A lender who relies upon a security interest shall advise the borrower at the time the loan is made that the law requires the borrower to disclose to the purchasers or merchants of the collateral the names of the secured parties, and that the purchasers or commission merchants are required to enter the names of the secured parties on the check or draft issues in payment for the farm products, and that failure to make the disclosure will constitute a crime.
6. A lender shall make a good faith effort against the borrower of funds, where farm products are used as collateral, for collection of any loss sustained by the lender through the transaction, before the lender pursues collection from the merchant.

farm products must, before issuing a check, obtain from the seller a certificate of ownership "disclosing the names, social security numbers, addresses and home counties of the owners for five years prior thereto, the county of location of the property prior to sale and the names of parties to whom security interests have been given. . . or representing that security interests do not exist."[180] The certificate must include a warning that false statements constitute a Class C felony if the value of the property sold is over $500.[181] If a secured party is involved, the buyer must make the check jointly payable. In addition, the statute requires the lender to advise the borrower of this crime at the time a loan is made.[182] The strange part is that when the farmer-rancher discloses no security interest, the buyer or commission merchant must obtain a statement from the appropriate filing officer that no financing statement has been filed if it wants to take free of a perfected security interest that the debtor did not disclose.[183] Also, the merchant loses if it has actual knowledge of a security interest.[184] Of import is that the knowledge requirement does not refer to a *perfected* security interest.[185]

As of the fall of 1983, at least sixteen states had changed

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7. A merchant who purchases from or a commission merchant who sells farm products for another for a fee or commission takes free of security interest created by the seller if:
   a. The merchant has complied with the requirements of subsection 4;
   b. In the case where the seller disclosed no security interests, the merchant has requested information from the register of deeds in the counties of the sellers' residences over the five years prior thereto, as disclosed in the certificate, (or from the office of secretary of state if section 41-09-40 provides for filing in that office) as to the existence of financing statements naming the seller, and has received from the filing officer a certificate verifying disclosures obtained by such inquiry, and has entered on the check or draft the names of any secured parties named in the certificate as payee with the seller;
   c. The merchant does not have actual knowledge at the time of transaction of the existence of security interests; and
   d. The merchant maintains records of such actions to support any criminal proceedings against the seller for violation of section 12.1-23-08.
8. In order to comply with the provisions of subsection 7, inquiry need not be made of the register of deeds office one year after the effective date of the Act which provides for filing in the office of the secretary of state. Certified copies of security documents filed with the register of deeds may be filed with the secretary of state and the priority of filing of such documents will be based on the original filing date with the register of deeds.

*Id.*

180. *Id.* § 41-09-28 (4).
181. *Id.*
182. *Id.* § 41-09-28(5).
183. *Id.* § 41-09-28(7)(b).
184. *Id.* § 41-09-28(7)(c).
185. *Id.* § 41-09-28(7). *Cf.* U.C.C. §§ 9-301(1)(c) (1978) (unperfected secured creditor's interest is subordinated to the rights of a buyer of farm products in ordinary course of business to the extent the buyer gives value and takes delivery of the collateral without knowledge of the security interest); 9-307(1) (purchaser of farm products in ordinary course of business does not take free of a perfected security interest).

section 9-307(1) in some manner.[186] This, coupled with the strong push of the livestock industry, apparently prompted legislators to introduce bills in the United States Senate and House of Representatives to federally repeal the farm products portion of 9 307(1).[187]

With some understanding of the farm products rule and the reactions of courts and legislatures to it, it is appropriate to consider briefly the validity of the rule and who should evaluate its efficacy and desirability. This will be the focus of the remaining portion of this Article.

### C. ARGUMENTS FOR AND AGAINST THE FARM PRODUCTS RULE

A number of arguments have been advanced for not changing the farm products rule. Some parties have argued that buyers from farmers should be treated differently because farmers sell their products through agents or sell to financially sophisticated buyers.[188] These business operators are, or should be, aware of the need to check the readily available filed financing statements, which is not the case with most other buyers. Another consideration is that many farm and ranch operations are cyclical in nature and there is no steady flow of income. Most of the products come into

186. The following states have modified § 9-307(1): Arkansas (9-306(2)), California, Delaware, Georgia, Illinois (9-205.1, 9.301.01-.02, 9-307), Indiana, Kansas, Kentucky, Nebraska, New Mexico, North Dakota, Ohio, Oklahoma, Oregon, South Dakota, and Tennessee. Also see *supra* notes 172-79.

187. *See* S.2190, 98th Cong., 1st Sess., 129 CONG. REC. 16,953 (1983) (attempt to amend the Agriculture & Food Act of 1981); H.R. 3296, 3297, 98th Cong., 1st Sess., 129 CONG. REC. 10, 583 (1983). The House Bills were the subject of an exploratory hearing. *See Problems Relating to Purchase of Mortgaged Agricultural Commodities: Hearing on H. R. 3295 and H.R. 3297 Before the Subcomm. on Livestock, Dairy and Poultry of the House Comm. on Agriculture*, 98th Cong., 1st Sess. (Nov. 16, 1983).

188. *See generally* Hawkland, *The Proposed Amendments to Article 9 of the U.C.C. — Part I: Financing the Farmer*, 76 COMM. L.J. 416 (1971). *See also* 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 26.10, at 707 (1965). Gilmore made the following observations about the farm products rule:

> There may seem to be a formal resemblance between the situation of the business which holds goods for sale as inventory and that of a farmer or stockman who raises and sells crops or livestock. If the ordinary buyer takes free of a perfected security interest in the inventory case, he should, it would seem, take free in the farm products case. Yet, rightly or wrongly, and for reasons that are never precisely articulated, the agricultural financer comes off much better than the inventory financer. There has been, it should be added, a meager harvest of litigation in recent years, but decision, whenever the issue has been raised, has gone for the crop or livestock mortgage against the good faith buyer. Perhaps a small country bank holding a small country mortgage makes a more appealing plaintiff than a national finance company doing a multi-million dollar business in inventory financing; but in fact these days the mortgagee is apt to be one of the many agencies of the United States which dabble in farm credit business. Or it may be that a buyer who is a large cannery or agricultural cooperative — in any case a professional who knows the facts of life — makes a less appealing defendant than the untutored consumer who is the chief beneficiary of the inventory rule.
>
> *Id.*

existence at one time of the year and often are sold in a large unit. Farm lenders recognize this and generally expect payments only when products are sold. Thus, the lender has all its expectations and security tied up in one asset. Some parties have argued that this is like a bulk sale and deserves to be treated differently.[189]

Another argument for the preservation of the rule is that it protects the federal government, which is a large lender through the Farmers Home Administration and the Commodity Credit Corporation. The 1971 Final Report of the Review Committee for Article 9 stated: "The federal government, an important farm lender. . . insists on the preservation of its security interest on farm products as against buyers or auctioneers, in reliance on a federal rule independent of the state rule embodied in Section 9-307(1)."[190] No special federal rule, however, exists today. In *United States v. Kimbell Foods, Inc.*[191] the United States Supreme Court considered whether contractual liens arising from certain federal loan programs take precedence over private liens, absent a federal statute to the contrary.[192] A unanimous Court held that federal law controlled the federal government's priority rights and, absent federal legislation, courts must determine the relative priority of private liens and consensual security interests on personal property arising from Small Business Administration and the Farmers Home Administration loans under nondiscriminatory state law.[193] Thus, the same priority rules found in the Code apply to private as well as to federal security interests.

189. *See* U.C.C. art. 6 (1978) (bulk transfers).
190. U.C.C. app. II, at 881 (1978) (comments of the Review Committee for Article 9).
191. 440 U.S. 715 (1979).
192. United States v. Kimbell Foods, Inc., 440 U.S. 715, 718 (1979).
193. *Id.* at 740. The United States Supreme Court noted:

> To resolve this question, we must decide first whether federal or state law governs the controversies; and second, if federal law applies, whether this Court should fashion a uniform priority rule or incorporate state commercial law. We conclude that the source of law is federal, but that a national rule is unnecessary to protect the federal interests underlying the loan programs. Accordingly, we adopt state law as the appropriate federal rule for establishing the relative priority of these competing federal and private liens.

*Id.* at 718. The Court continued by stating:

> Undoubtedly, federal programs that "by their nature are and must be uniform in character throughout the Nation" necessitate formulation of controlling federal rules. . . . Conversely, when there is little need for a nationally uniform body of law, state law may be incorporated as the federal rule of decision. Apart from considerations of uniformity, we must also determine whether application of state law would frustrate specific objectives of the federal programs. If so, we must fashion special rules solicitous of those federal interests. Finally, our choice-of-law inquiry must consider the extent to which application of the federal rule would disrupt commercial relationships predicated on state law. . . . Because the state commercial codes "furnish convenient solutions in no way inconsistent with adequate protection of the federal

If the farm products rule were totally eliminated, the lender would lose a substantial protection. Moreover, the lender would have no leverage with the potential buyers concerning who the buyer should name as payee of the check when the debtor sells products subject to a security interest. Also, the creditor would not be able to determine who all of the potential buyers are because grain and livestock can be transported out of the local area without these buyers registering with any single office.[194] This is in marked contrast to the Code notice filing system that makes it possible to determine who might have a security interest.

Assuming that the creditor would not be able to ascertain who the buyers are, the creditor would be unable to ensure being named as a joint payee on the check. Thus, the creditor would have to establish procedures to assure that the proceeds from the sale of the covered collateral would be identifiable as required by section 9-306(2). The contrast to other businesses is arguably striking. In many other business operations, particularly dealing with expensive goods, the proceeds will consist of chattel paper,[195] which is fairly easy to police and identify. For the farm lender to keep proceeds identifiable, however, it must keep the farmer from commingling the proceeds with other funds. This historically has been difficult in most agricultural sales since farmers are generally paid by check, which is deposited in a general checking account. This can pose significant troubles for a lender because of section 9-306(4)(d), which provides that, in insolvency proceedings, a party with a perfected security interest in proceeds has a perfected security interest in all cash and bank accounts if the debtor commingled the proceeds within ten days before filing the bankruptcy petition.[196]

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> interest[s]". . . we decline to override intricate state laws of general applicability on which private creditors base their daily commercial transactions.

*Id.* at 728-29.

194. *But see* DEL. CODE ANN. tit. 6, § 9-307(2) (Interim Supp. 1983) (buyer who registers with secretary of state may purchase grain in the ordinary course of business for value free of any security interest unless the secured creditor sends notice to the buyer within one year prior to the payment of proceeds to the seller).

195. *See* U.C.C. § 9-105(1)(b). Chattel paper is defined in the Uniform Commercial Code as:

> A writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods, but a charter or other contract involving the use or hire of a vessel is not chattel paper. When a transaction is evidenced both by such a security agreement or a lease and by an instrument or a series of instruments, the group of writings taken together constitutes chattel paper. . . .

*Id.*

196. *Id.* § 9-306(4)(d). For purposes of the Uniform Commercial Code, insolvency occurs when either the debtor ceases to pay its debts in the ordinary course of business, is unable to pay his or her debts as they come due, or is insolvent under federal bankruptcy law. *Id.* § 1-201(23).

The Court of Appeals for the Ninth Circuit considered section 9-306(4)(d) in *In re Gibson Products.*[197] In that case, a secured party claimed a $20,000 bank account in which only ten dollars had come from the sale of the secured party's collateral during the ten days prior to the bankruptcy petition.[198] The court held that under section 9-306(4)(d) a secured party has a claim to all of the proceeds deposited in a commingled account during the ten days preceding bankruptcy so long as the party can show that the debtor deposited *some* proceeds from the sale of its collateral in the commingled account during the time period.[199] The court, however, allowed the secured creditor to keep only ten dollars because the debtor had derived the other money from the sale of collateral not covered by the security agreement, and therefore, the other money was considered a voidable preference under the old bankruptcy act since the interest in the other money arose within ninety days of bankruptcy.[200] Apparently, the same result would occur today under the current bankruptcy law.[201] Moreover, the secured party has no control over when the farmer files for bankruptcy in that no one can file an involuntary bankruptcy petition against a farmer.[202]

Finally, assuming that a change of section 9-307(1) would create substantially more risk for the lender, it would appear that the lender would loan less, require more in the way of collateral, require guarantors, raise its charges, or combinations of these. This could well put pressure on the federal government to get more involved in the lending business since the Farmers Home Administration's current requirements are that borrowers are not eligible unless credit is otherwise not available.[203] Of course, there is always the possibility of the creditor being able to obtain an insurance policy to cover this risk.

Buyers and commission agents make many arguments supporting their view that the rule is unjustifiable. The risk of nonpayment has, in effect, been shifted to the buyer. The free flow of commerce principle, which is recognized in other sections of the Code and is the basis for the ordinary buyer taking free of a prior

197. 543 F.2d 652 (9th Cir. 1976), *cert. denied*, 430 U.S. 946 (1977).

198. *In re* Gibson Prods., 543 F.2d 652, 654 (9th Cir. 1976), *cert. denied,* 430 U.S. 946 (1977).

199. 543 F.2d at 657.

200. *Id.* at 656-57.

201. *See* 11 U.S.C. § 547(b), (e)(3) (1982). *See also* J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 24-6, at 1012-17 (1980).

202. 11 U.S.C. §§ 101(17)-(18); 303 (1982). *See In re* Johnson, 13 Bankr. 342, 346-47 (Bankr. D. Minn. 1981) (when court granted involuntary bankruptcy petition due to default by debtor, debtor cannot later argue that the bankruptcy court's finding that he was not a farmer was incorrect). *See also* Pearson, *Is a Man Out Standing in His Field a Farmer for Bankruptcy Purposes?*, 5 J. AG. TAX'N & LAW 305 (1984) (discusses who is a farmer for purposes of the federal bankruptcy code).

203. *See, e.g.*, 7 U.S.C. §§ 1922, 1927, 1941 (1982).

perfected security interest, applies to farm products as well as to the inventory of the appliance store; farmers should be treated as any other business. The Code has, after all, generally protected the buyer in the ordinary course of business or the good faith purchaser.[204] The lender has not lost everything because it will still have a security interest in the proceeds. Requiring purchasers of farm products to check the appropriate records is too costly and impractical. Also, farmers do not tell the buyers in advance of sale dates. This is a particular problem for the livestock industry in that many packers buy from multistate areas and many are required to pay before the close of the next business day.[205] The lenders are in a better position to absorb the loss and, after all, it was their decision to lend the money. Others believe this rule is particularly hard on small buyers who do not have the profit margin and financial resources to absorb the loss. While many have insurance, some insurance companies are having second thoughts about writing policies to cover these risks. Finally, the buyers complain that they may be sued a very long time after they have purchased the farm products subject to a perfected security interest. This is possible because most of the claims against the buyers are based on conversion, which is normally a tort. Consequently, the tort statute of limitations applies.[206]

Clearly, some state legislatures have been persuaded that the rule is bad. As indicated previously, some states have placed the burden on the farmer to provide a list of buyers to the lender who must notify potential buyers.[207] At least two states make it a crime

204. *See, e.g.*, U.C.C. §§ 2-403(2) (entrusting possession of goods to a merchant who deals in goods of the kind gives the merchant power to transfer all rights of the entruster to a buyer in the ordinary course of business); 2-702(3) (seller's right to reclaim goods sold to an insolvent buyer is subject to the rights of a buyer in ordinary course or other good faith purchaser); 3-305 (rights of a holder in due course); 5-114 (issuer's duty and privilege to honor letters of credit); 6-110(2) (purchaser for value in good faith and without notice of a defect by reason of transferee's non-compliance with the requirements of Article 6 takes free of the defect); 7-205 (buyer in the ordinary course of business of fungible goods sold and delivered by a warehouseman who is also in the business of buying and selling such goods takes free of any claim under a warehouse receipt even though it has been duly negotiated); 7-502 (rights acquired by due negotiation of warehouse receipts); 8-301 (purchaser of a security acquires the rights in the security that his transferor had or had actual authority to convey); 8-302 (a bona fide purchaser of a security acquires the security free of any adverse claim); 9-308 (purchaser of chattel paper who gives new value and takes possession in the ordinary course of business has priority over a security interest in the chattel paper); 9-309 (holder in due course of a negotiable instrument and bona fide purchaser of a security take priority over an earlier security interest even though perfected). *But see id.* § 7-503 (document of title confers no right in goods against a person who before issuance of the document had a legal interest or a perfected security interest in the goods and had not given up its interest).

205. 7 U.S.C. § 228b (1982). See *supra* note 169 for the text of § 228b.

206. *See, e.g.*, N.D. CENT. CODE § 28-01-16 (Supp. 1983) (cause of action must be brought within six years after the cause of action has accrued). *But see* IOWA CODE ANN. § 25A.13 (West 1978) (shortened the statute of limitations to two years).

207. See *supra* notes 174-75 and accompanying text.

for the farmer to sell to anyone not on the list.[208] Using the criminal process is probably inappropriate when considering a creditor's rights problem. Unless retribution is the major justification of the punishment, the purpose of the punishment is lacking. Most farmers are eternal optimists. Their motto is "wait until next year, the yields and prices will be up. All that we need is a little time." Also, prosecutions of this type will not be popular and jury nullification is a real possibility.

Moreover, before the criminal process is invoked or the rule is eliminated, central filing for financing statements covering farm products with easy and quick access to the filed financing statements should be tried. One state, Iowa, has used this procedure for some time. Farm products are filed with the secretary of state and there is a private search firm that will provide the information immediately by phone.[209] All concerned seem to be satisfied with this practice.

Also, with the advance of the computer age, it should be easy technically to provide in-state access to filed information through what are called dumb terminals, or some other means. One problem cited by opponents to the use of computer technology is cost, but apparently, if the legislature will not siphon the revenue, the users, those searching as well as filing, would be willing to pay for the system.

## IV. THE ROLE OF THE PERMANENT EDITORIAL BOARD OF THE CODE

A critical analysis of the farm products issue is necessary, but it should not, at least initially, occur in the political arena. The issue must be examined in a setting in which political weight and savvy are not of paramount importance. The Permanent Editorial Board of the UCC is the appropriate place for this evaluation to begin. Interestingly, the Board considered the farm products rule in 1970-71, but none of the 1972 amendments to the Code affected section 9-307(1).[210]

208. *See* IND. CODE ANN. § 26-1-9-307 (Burns Supp. 1983); OHIO REV. CODE ANN. § 1309.26 (Page Interim Supp. 1983).

209. A search service has developed in Des Moines, Iowa. Phone searches through this private company are rapid; a request about a debtor is made in the morning and in the afternoon of the same day the person making the request has the information. In fact, if one is willing to hold, the information can be obtained while the caller waits. It also appears that the service will be computerized and the information will be available soon through computer terminals. The search firm is Iowa Public Record Search, Inc., Box 6129, East Des Moines States, Des Moines, Iowa 50309. Telephone: 515-244-2463. Other states are developing computer data bases.

210. A provision dealing with farm products was added to § 9-301(1)(c). See *supra* note 87 and accompanying text. The Review Committee recommended that the farm products rule be an

Today problems of uniformity exist and the whole agricultural marketing and credit structure needs evaluation. This means examining more than sections 9-307(1) and 9-306(2). Examples of areas that should be considered are: 1) the impact of sections 2-403 and 7-205, which prevent the unpaid farmer from reclaiming warehoused grain sold by the warehouseman to a good faith purchaser or buyer in the ordinary course of business;[211] 2) the impact of the inability of creditors to force farmers into bankruptcy;[212] 3) the impact of 9-306(4)(d) upon the farm lender;[213] 4) the impact of a rule requiring instantaneous money transfers by the use of some method like debit or bank cards when farm products are sold; and 5) the problems presented when sellers from multiple states are involved. Although 9-307(1) is much maligned, there is virtually no empirical evidence concerning the magnitude of the losses caused by 9-307(1) or whether buyers or commission merchants really have tried to utilize the Code's notice system. On the other hand, no evidence exists showing that money

optional amendment to 9-307(1) instead of remaining as part of 9-307(1). U.C.C. app. II, at 882 (1978) (comments of the Review Committee for Article 9). It was recognized that there was sharp division concerning the rule. *Id.* The Permanent Editorial Board rejected this optional amendment and concluded that 9-307(1) should not be changed. *Id.* n.5 *See* U.C.C. § 9-307 (1978). The American Law Institute's discussion of the farm products rule is interesting:

> JUDGE BRAUCHER: If we may go on to 9-307 we now get to the protection of buyers of goods as against a security interest in those goods. I think I should call your attention to a non-change in 9-307, Subsection (1). As we submitted it to you a year ago we proposed the deletion of the words in the second and third line "other than a person buying farm products from a person engaged in farming operations."
>
> This would allow the usual inventory principle to operate in cases of farm products. That was the proposal a year ago.
>
> On Page 209, beginning on 208 and running over to 209, there is an explanation of why the committee recommended that. But the committee, at least one member of the committee, became more dubious about this. This is the one item where we really did get to a contest between identifiable economic interests and what we were doing was taking on the organized farm lenders on behalf of the organized processors of farm products. And when the giants collide, the ordinary people should get out of the way.
>
> And the Permanent Editorial Board, as shown in the footnote on Page 209, took that view of it and deleted the recommendation which had been watered down by that time to a recommendation that this be optional. And we left it to a contest of strength. And all that remains is that if you are going to do it, these are the words you do it with.
>
> I think it is fair to say that the committee still thinks the change they recommended a year ago was sound in principle. But it obviously does involve the difference of economic interests between highly organized groups. It is not a mere technical matter, and we do not propose it to you at this time.

Braucher, *Discussion of Final Report of Review Committee for Article 9 of the Uniform Commercial Code*, 48 A.L.I. PROC. 327 (1971).

211. *See* U.C.C. §§ 2-403, 7-205. Section 2-403 of the Uniform Commercial Code provides that the "entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business." *Id.* § 2-403(2).

Section 7-205 provides: "A buyer in the ordinary course of business of fungible goods sold and delivered by a warehouseman who is also in the business of buying and selling such goods takes free of any claim under a warehouse receipt even though it has been duly negotiated." *Id.* § 7-205.

212. See *supra* note 202 and accompanying text for a discussion of the special protections for farmers under bankruptcy.

213. See *supra* notes 196-202 and accompanying text for a discussion of § 9-306(4)(d) of the Uniform Commercial Code.

will dry up if the farm products rule is made permanent. Of course, the presence and impact of the computer age cannot be ignored. One possible approach for the Board is to recommend that Congress federalize section 9-307(1). Legislators have introduced bills designed to accomplish this in the past.[214]

There are a number of legitimate arguments supporting the view that Congress should act. There is a need for a uniform law not only because state laws vary, but also because farm products can easily be, and are, moved from one state to another to be sold. Packers,[215] market agencies,[216] and dealers[217] purchasing livestock have a peculiar problem in that under the Packers & Stockyard Act they must pay for their purchases within twenty-four hours.[218] This, they argue, makes it impossible to verify the existence of security interests because many buy from producers located in different states. Filing rules vary from state to state and many filing officers will not provide information over the phone.

There are, however, a number of reasons why Congress should not be involved. Traditionally, commercial transactions have been regulated at the state level. Second, the fact that the states have different versions of section 9-307(1) does not justify federal legislation because this is not the only part of the Code that is non uniform. More than twenty states have amended Code section 2-315, which deals with implied warranties when livestock is sold. There are three basic filing rules in effect.

There is also a split in the states concerning whether a farmer is a merchant.[219] Finally, farmers are upset about sections 2-403 and 7-205, which provide that farmers cannot retrieve their stored grain, sold by the storing warehouse, from a good faith purchaser

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214. *See, e.g.*, S.2190, 98th Cong., 1st Sess., 129 CONG. REC. 16,953 (1983); H.R. 3296, 3297, 98th Cong., 1st Sess., 129 CONG. REC. 10,583 (1983).

215. A packer is defined as:

> [A]ny person engaged in the business (a) of buying livestock in commerce for purposes of slaughter, or (b) of manufacturing or preparing meats or meat food products for sale or shipment in commerce, or (c) of marketing meats, meat food products, or livestock products in an unmanufactured form acting as a wholesale broker, dealer, or distributor in commerce.

7 U.S.C. § 191 (1982).

216. Market agency is defined as "any person engaged in the business of (1) buying or selling in commerce livestock on a commission basis or (2) furnishing stockyard services. . . ." 7 U.S.C. § 201(c) (1982).

217. A dealer is "any person, not a market agency, engaged in the business of buying or selling in commerce livestock, either on his own account or as the employee or agent of the vendor or purchaser." 7 U.S.C. § 201(d) (1982).

218. *See* 7 U.S.C. § 228b (1982). See *supra* note 169 for the text of § 228b.

219. *Compare* Nelson v. Union Equity Coop. Exch., 548 S.W.2d 352 (Tex. 1977) (farmer is a merchant) *with* Decatur Coop. Ass'n v. Urban, 219 Kan. 171, 547 P.2d 323 (1976) (wheat farmer is not a merchant). *See also* Annot., 95 A.L.R.3D 484 (1979) (whether farmers are "merchants" within meaning of Article 2 to the Uniform Commercial Code).

or buyer in the ordinary course if the warehouse fails to pay the farmer.[220] State legislatures have been asked to reverse this rule and will be asked again to change the rule. If farmers are unsuccessful at the state level, they would surely seek federal legislation to change section 9-307(1). Consequently, the only way to create a uniform law would be for Congress to enact a federal UCC.

Even if Congress were to change section 9-307, buyers of crops produced on rented land would still have to contend with unpaid landlords and landlord liens in many states. Landlord liens are excluded from coverage of the Code by section 9-104(b).[221] Thus, a court would decide priority battles by some other law. Some states have provided by statute that a purchaser of crops, produced on rented land, takes subject to a landlord's lien.[222]

Even if the farm products rule were eliminated, the buyer could still lose. This could result when the buyer purchased goods paying with a single payee check knowing the goods were subject to a perfected security interest.[223]

The Board could, after considering all the possible ramifications of the farm products rule, recommend that the rule be abandoned or retained. A compromise may be retention of the rule with required central filing for farm products and instant access to the information via the telephone or through computer terminals. Iowa's experience with central filing and instant access of information through telephone searches has apparently been positive. No doubt local filing officers who do not want to lose revenue and believe the public is best served by local officials will resist these changes. Others may resist because it is too costly to change. If the states do not want to appropriate enough money or are unwilling to permit the filing officers to charge enough and keep the revenue to operate the offices, then perhaps the Board should recommend that Congress adopt and create a central filing system similar to the one used for airplane security interests.[224] Of course, Congress would be required to fund the office appropriately to keep

220. U.C.C. §§2-403, 7-205 (1978). See *supra* note 211 and accompanying text for a discussion of §§ 2-403, 7-205.

221. U.C.C. § 9-104(b) (1978). Section 9-104(b) provides: "This Article does not apply . . . to a landlord's lien. . . ." *Id.*

222. *See, e.g.*, KAN. STAT. ANN. § 58-2526 (1983). Section 58-2526 provides: "The person entitled to the rent may recover from the purchaser of the crop, or any part thereof, with notice [actual and constructive] of the lien the value of the crop purchased, to the extent of the rent due and damages." *Id.*

223. *See* U.C.C. §§ 9-307(1) comment 1 ("buyers of goods take free of a security interest even though perfected"); 1-201(2) (definition of "aggrieved party"); 1-201 (19) (definition of "good faith"); 1-201 (25) (definition of "notice").

224. *See generally* 49 U.S.C. § 1403 (1976); 14 C.F.R. Pt. 49 (1983).

filing and searches up to date and provide quick and easy access to the records. The users apparently could provide this financing.

## V. CONCLUSION

While there is no doubt that the economic hard times on the farm have caused many to focus on the farm products rule, the rule should not be rejected without some serious thought being given to what impact it will have upon the availability of credit. Credit has become an essential part of most farm operations today; if the lenders were to severely cut back on loans, it could have a substantial impact on farmers. Those particularly vulnerable are the younger and unestablished farmers. Moreover, there are few cases in which buyers were required to pay twice. Finally, if buyers and lenders alike could be protected by central filing and quick access to the filed information, it should be tried. In any event, there is a need for a uniform law and the appropriate body to consider the problem is the Permanent Editorial Board of the Uniform Commercial Code.