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The UCC Farm Products Exception –A Time to Change

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The UCC Farm Products Exception—A Time to Change

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The farm products exception of section 9-307(1)[1] of the Uniform Commercial Code[2] has become anything but uniform. More than one-third of the states, including many major agricultural states, have altered their commercial codes to address the growing dissatisfaction of farm products buyers with the farm products exception.[3] Most of these state modifications,

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1. U.C.C. § 9-307(1) (1978) 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.

(emphasis added).

> U.C.C. § 9-109(3) (1978) defines "farm products" as goods that 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.

Various aspects of the farm products exception have been discussed in several recent articles. *See* Geyer, *Proposals for Improvement in Agricultural Marketing Transactions*, 29 S.D.L. REV. 361 (1984); Meyer, *The 9-307(1) Farm Products Puzzle: Its Parts and Its Future*, 60 N.D.L. REV. 401 (1984); Van Hooser, *Problems Arising from the Sale of Mortgaged Farm Products*, 29 S.D.L. REV. 346 (1984).

2. All references to the Uniform Commercial Code (U.C.C.), unless otherwise indicated, are to the 1978 Official Text and Comments.

3. The following states have modified § 9-307(1) or some related state code section: California (CAL. COM. CODE § 9307 (West Supp. 1985)); Delaware (DEL. CODE ANN. tit. 6, § 9-307 (Supp. 1984)); Georgia (GA. CODE ANN. § 11-9-307 (1982)); Idaho (IDAHO CODE § 25-1117 (Supp. 1984)); Illinois (ILL. ANN. STAT. ch. 26, §§ 9-205.1, 9-307, 9-307.1, 9-307.2 (Smith-Hurd Supp. 1984-1985)); Indiana (IND. CODE ANN. § 26-1-9-307 (Burns Supp. 1984)); Iowa (IOWA CODE

ranging from changes in filing procedures to complete repeal of the farm products exception, have been enacted during the last two years in response to the depressed economic condition of American agriculture.[4] In addition, bills have been introduced in each of the last two Congresses that would repeal or modify the farm products exception nationally.[5]

The time has come for the U.C.C. Permanent Editorial Board[6] to design an alternative to section 9-307(1) that would be acceptable to most states. This Article proposes such an alternative. Section I of this Article examines the rationales advanced in support of the farm products exception and questions their continued validity in light of modern agricultural production and marketing practices. Section II surveys the modifications of the farm products exception made by the various states and evaluates their impact on the principal interested parties—agricultural lenders, farm products buyers, and farmers. Sections III and IV consider the need for uniformity and the most appropriate means of obtaining uniformity, or at least of minimizing nonuniformity. This Article concludes with a proposal for the amendment of section 9-307(1) to provide for three alternatives to the current farm products exception. Although the long-range solution to the farm products problem may be repeal of the farm products exception altogether, the proposed

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ANN. §§ 554.9307, 554.9407(2)-(4) (West Supp. 1984-1985)); Kansas (KAN. STAT. ANN. §§ 84-9-307, -401, -410 (1983 & Supp. 1984)); Kentucky (KY. REV. STAT. ANN. § 355.9-307 (Bobbs-Merrill Supp. 1984)); Louisiana (LA. REV. STAT. ANN. §§ 3:561(5), 3:568 (West Supp. 1985)); Montana (MONT. CODE ANN. § 81-8-301 (1983)); Minnesota (MINN. STAT. §§ 17A.04, 27.03, 223.17, 336.9-307, 336.9-402, 386.42, *as amended by* 1985 Minn. Laws ch. 233); Nebraska (NEB. REV. STAT. U.C.C. §§ 9-307, 9-413 to -415 (Cum. Supp. 1984)); North Dakota (N.D. CENT. CODE § 41-09-28 (1983)); Ohio (OHIO REV. CODE ANN. § 1309.26 (Page Supp. 1984)); Oklahoma (OKLA. STAT. ANN. tit. 12A, § 9-307 (West Supp. 1984-1985)); Oregon (OR. REV. STAT. § 79.3070 (1983)); South Dakota (S.D. CODIFIED LAWS ANN. §§ 57A-9-503.1, -503.2 (Supp. 1984)); Tennessee (TENN. CODE ANN. § 47-9-307 (Supp. 1984)).

4. Fourteen of the 19 states that have modified § 9-307(1) have done so since 1983. These states are Delaware, Illinois, Indiana, Iowa, Kansas, Louisiana, Minnesota, Nebraska, North Dakota, Ohio, Oklahoma, Oregon, South Dakota, and Tennessee. *See supra* note 3.

5. H.R. 1591, 99th Cong., 1st Sess. (1985) (reprinted in full *infra* note 143); H.R. 3296, 3297, 98th Cong., 1st Sess., 129 CONG. REC. 10,583 (1983). For discussions of these bills see *infra* notes 140-47 and accompanying text.

6. The Permanent Editorial Board members include Geoffrey C. Hazard, Chairman; Paul A. Wolkin, Secretary; Boris Auerbach, Marion W. Benfield, Jr., Peter F. Coogan, Ronald DeKoven, Robert Haydock, Jr., William E. Hogan, Albert E. Jenner, Jr., Homer Kripke, Frederick H. Miller, Donald J. Rapson, George R. Richter, Jr., and James Malcom Sibley, members; and Martin J. Aronstein and William D. Hawkland, alternates.

amendment is an appropriate first step toward reducing the confusion that results from the present lack of uniformity.

I. THE FARM PRODUCTS EXCEPTION: BUYER'S GAMBLE, LENDER'S SAFETY VALVE

A. THE FARM PRODUCTS EXCEPTION

The farm products exception[7] of section 9-307(1) is drafted as an exception to an exception. The general rule under Article 9 concerning the sale of goods subject to a security interest, stated in section 9-306(2),[8] provides that a security interest continues in collateral notwithstanding the sale, exchange, or other disposition of the collateral.[9] Section 9-307(1), the major exception to this rule,[10] permits a buyer in the ordinary course of business[11] to take goods free of any security interest created by the seller even though the security interest is perfected[12] and

7. The farm products exception is also referred to as the farm products rule. *See* Meyer, *supra* note 1, at 404.

8. U.C.C. § 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 including collections received by the debtor." Thus, because the sale of farm products is not within the exception of § 9-307(1), the first purchaser and all subsequent purchasers of the farm products take subject to the security interest and could face liability for conversion. *See infra* notes 14-23 and accompanying text.

9. U.C.C. § 9-306(2) provides an exception to this rule if "the disposition was authorized by the secured party in the security agreement or otherwise." *See* Meyer, *supra* note 1, at 420-28. Under § 9-306(2), the security interest also continues in identifiable proceeds.

10. For a discussion of the procedural history of U.C.C. § 9-307(1), see Dolan, *Section 9-307(1): The U.C.C.'s Obstacle to Agricultural Commerce in the Open Market*, 72 NW. U.L. REV. 706, 710-12, 719-20 (1977).

11. A buyer in the ordinary course generally is one who purchases from a merchant in good faith and without knowledge that the sale violates the security interest of a third party. *See* U.C.C. §§ 1-201(9); 1-201(19); 2-104(1). "Buying" includes purchases for cash or other property and may be on secured or unsecured credit but does not include bulk purchases or transfers in satisfaction of a money debt. U.C.C. § 1-201(9).

12. U.C.C. § 9-302(1) requires the secured party to file a financing statement to perfect a security interest in farm products. U.C.C. § 9-402 sets out the formal requirements of the financing statement. U.C.C. § 9-401(1) governs the place of filing. The Code provides three alternatives to § 9-401(1) among which the states may choose. The first alternative, central filing, requires filing with the secretary of state. For farm products, the second and third alternatives are identical:

> [W]hen 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,

the buyer knows of its existence; however, it excepts from the protection of this rule "persons buying farm products from a person engaged in farming operations."[13] Thus, a person buying a car from an automobile dealer takes the car free of any security interest created by the dealer, but a person buying corn from a farmer takes the corn subject to any security interest created by the farmer.

The problems caused by the farm products exception for buyers of such goods is well-illustrated by a 1973 Nebraska case, *Farmers State Bank, Aurora v. Edison Non-Stock Cooperative Association*.[14] In that case, the farmer executed a security agreement in April of 1969 giving Merchants Bank a security interest in the farmer's grain. The bank perfected its interest. Two months later, the farmer executed a second security agreement, this time with State Bank, giving State Bank a security interest in the same grain. State Bank also perfected its interest. The State Bank security agreement, however, expressly stated that the debtor would be deemed to have defaulted if the collateral was already subject to an adverse perfected security interest at the time of execution of the agreement.[15] Under the State Bank security agreement, in the event of default, which occurred here on the signing of the security agreement,[16] the farmer was required to obtain written authorization from State Bank before the collateral could be sold. In November 1969 the farmer sold the grain to an elevator without obtaining from State Bank written authorization to sell the collateral. The elevator's purchase of the grain therefore was in violation of the security agreement between the farmer and State Bank. State

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> then [the proper place to file in order to perfect a security interest is] 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.

U.C.C. § 9-401(1) (ellipsis in original).

13. U.C.C. § 9-307(1). "Farm products" is defined in § 9-109(3). *See supra* note 1. "Farming operations" is not defined in the Code; however, § 9-109 comment 4 provides that "it is obvious from the text that 'farming operations' includes raising livestock as well as crops."

14. 190 Neb. 789, 212 N.W.2d 625 (1973).

15. *Id.* at 790-91, 212 N.W.2d at 626-27.

16. The Nebraska Supreme Court actually found multiple defaults on the security agreement. The farmer defaulted by allowing a financing statement of another creditor to be filed, by selling to an elevator located in a different county, by further encumbering the collateral through accepting money from Merchants Bank subsequent to the execution of the agreement, and by defaulting in payment. *Id.* at 791-93, 212 N.W.2d at 627-28.

Bank then sued the elevator for conversion of its collateral in violation of the security agreement.

The Nebraska Supreme Court held in favor of State Bank, ruling that the elevator was liable to the bank for conversion.[17] Because the elevator purchased farm products from a person engaged in farming operations, the farm products exception applied to deprive the elevator of the protection generally afforded to buyers in the ordinary course of business under section 9-307(1). Consequently, under the general rule of section 9-306(2), State Bank's security interest continued in the grain.[18] Because the farmer was in default, State Bank had the right to take possession of the collateral.[19] The elevator's possession of the grain, therefore, was wrongful as against State Bank and subjected the elevator to liability for conversion.[20]

As the *Farmers State Bank* case illustrates, the effect of the farm products exception is to transform a buyer of farm products into a surety on the farmer's debt to the secured creditor.[21] If a farmer defaults,[22] the buyer is liable on the farmer's debt to the extent of the secured party's interest in the collateral. The farm products buyer thus may be required to pay for the same goods twice: once to the farmer-seller, and again to the farmer's lender for conversion of the collateral. The farm products buyer, however, presumably aware of the risk of double liability, will consider this as a factor in determining the

17. *Id.* at 795, 212 N.W.2d at 629.

18. *See supra* notes 8-9 and accompanying text. The elevator also argued that State Bank impliedly authorized the sale by its conduct and therefore waived its security interest in the grain. The court rejected this argument, however, holding that in order to establish a waiver of legal rights there must be a clear, unequivocal, and decisive act of a party showing such a purpose or acts amounting to an estoppel. *Farmers State Bank*, 190 Neb. at 794, 212 N.W.2d at 629.

19. *See* U.C.C. § 9-503.

20. The wrongful refusal to surrender possession of property to one legally entitled to it constitutes a conversion. *See* W.P. KEETON, PROSSER AND KEETON ON THE LAW OF TORTS § 15, at 98-99 (5th ed. 1984).

21. Subsequent buyers also would be liable to the secured creditor for conversion. This result has lead some commentators to "speculate in mock horror that a Palm Beach at the haberdasher's, a box of cereal at the grocer's, and a sizzling ribeye on the platter may be subject to the lien of a farmer's lender." Dolan, *supra* note 10, at 713 (footnotes omitted).

22. Circumstances triggering default are defined by the security agreement. Default is not limited to nonpayment; in *Farmers State Bank*, for example, the debtor was in default immediately upon executing the security agreement with State Bank because of Merchant Bank's prior perfected security interest in the grain. Practically, however, the secured party is not likely to pursue the collateral unless the default is for nonpayment.

price the buyer will pay for the products.[23] Repeal of the farm products exception undoubtedly would benefit buyers of farm products, but so would less drastic alternatives. So long as buyers properly understand how to use liens and take the appropriate steps to avoid liability to lenders, the buyer's interest is protected.

For an agricultural lender, however, the farm products exception provides a valuable safety net. If the debtor-farmer sells the collateral but does not use the proceeds to repay the loan, the lender is not limited to "identifiable" proceeds[24] or an action against the borrower for damages,[25] but can proceed directly against the collateral or sue the buyer, or perhaps even commission merchants, auctioneers, and subsequent buyers, for conversion.[26] Because the lender is better protected, the farm products exception may be expected to result in a lower cost of borrowing for farmers. However, because buyers become sureties for their farmer-sellers, agricultural lenders may have less of an incentive to investigate diligently the creditworthiness of the borrower,[27] and the lender therefore may make more ill-advised loans than it otherwise would make were it not for the farm products exception.[28] Even so, lenders uniformly support

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23. The buyer, of course, may recover from the farmer-seller in restitution to the extent the buyer is liable to the lender. As a practical matter, however, this right will not likely be worth very much, for if the farmer-seller were able to pay the debt, the secured creditor presumably would not seek recovery from the buyer.

24. *See* U.C.C. § 9-306(2).

25. Of course, the debtor remains liable on the underlying transaction, but he or she may well be judgment-proof. *See supra* note 23.

26. Commission merchants, auctioneers, and subsequent buyers also may be liable in conversion. A commission merchant or auctioneer is one who sells livestock or agricultural products for another for a fee or commission. *See, e.g.*, GA. CODE ANN. § 11-9-307(3) (1982). For a discussion of conversion liability and § 9-307(1), see J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 20-5, at 818-25 (2d ed. 1980).

27. *See* B. CLARK, THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE ¶ 8.4[3][g], at 8-37 to 8-38 (1980).

28. *See Review of Problems Related to Purchase of Mortgaged Agricultural Commodities: Hearings Before the Subcomm. on Livestock, Dairy, and Poultry of the House Comm. on Agriculture*, 98th Cong., 1st Sess. 57-65 (1983) (statement of E.J. Strasma, vice president of Interstate Producers Livestock Association) [hereinafter cited as *Hearings*]; *id.* at 86 (statement of James McNeill for Midwest Livestock Producers) ("lending agencies are making some more questionable loans because [of the farm products exception]"); *id.* at 307 (statement of Harold J. Heinold, Heinold Hog Market, Inc.) ("another common thread [in claims against farm products buyers] is that banks and the

the farm products exception;[29] given the almost unlimited ability of secured lenders to recover against farm products buyers, virtually any modification would increase the risks for lenders.

The interests of farmers and producers, who sometimes are forgotten parties in discussions of the mortgaged farm products problem, also are effected by the farm products exception. First, they have an interest in maintaining the marketability of their products. Buyers and commission merchants may be less willing to deal with products that are subject to security interests unless they somehow can avoid the potential for double liability. To the extent that the farm products exception imposes additional costs on buyers, those costs of course will be reflected in the price buyers will be willing to pay for agricultural products.[30] Farmers and producers also have an interest in obtaining adequate financing at affordable costs. Farmers benefit, therefore, to the extent that the farm products exception reduces the cost of borrowing. Almost any alternative to the farm products exception will increase the risk of loss or cost of policing the loans, both of which may result in increased interest rates and reduced agricultural lending.[31]

Farmers Home Administration did not look to the commercial feasibility of a loan").

In *Farmers State Bank*, discussed *supra* notes 14-23 and accompanying text, State Bank's investigation seemed less than diligent. The farmer was immediately in default upon the signing of the security agreement with State Bank because he had executed a prior security agreement using the same grain as collateral. The prior agreement had been filed in the same county in which State Bank filed its agreement, and State Bank easily could have checked the county files to determine whether the farmer was in default. State Bank, however, conveniently chose to remain uninformed of prior interests of record. It instead waited until the farmer sold his grain to the defendant elevator and then recovered from the elevator by using the farm products exception. The elevator thus was liable to State Bank even though State Bank could have prevented the whole problem by searching the lien records in the same county in which it perfected its own interest.

29. *See Hearings*, *supra* note 28, at 24 (statement of Ross B. Anderson, vice president, credit, St. Louis Bank for Cooperatives); *id.* at 20 (statement of Delmar K. Banner, president, Farm Credit Council).

30. The effects of the farm products exception on buyers may go beyond price considerations. Some buyers of farm products argue that exposure to double liability will force such businesses, which traditionally operate at a low profit margin, to close. *See Hearings*, *supra* note 28, at 58-59, 236 (statement of E.J. Strasma, vice president of Interstate Producers Livestock Association); *id.* at 257 (statement of Dennis D. Casey, associate manager, Livestock Marketing Association).

31. *See id.* at 301 (testimony of Neal Conover, executive vice president, Hayesville Savings Bank) ("[a] farmer searching for a new credit source would probably find that creditors would not take him on"); *id.* at 310-11 (testimony of James D. Herrington, president, Independent Bankers Association); *id.* at

Any alternative to the farm products exception must balance the interests of the farmers, lenders, and buyers in such a way as to be acceptable to all three groups. In the absence of a congressional response,[32] any revision of section 9-307(1) will be left to the state legislatures. Given the political clout of each of these groups, an alternative that any of them finds extremely unacceptable stands little chance of adoption, or at least of widespread adoption. Thus, to achieve uniformity, the alternative to the farm products exception must be politically palatable.

B. RATIONALES FOR THE FARM PRODUCTS EXCEPTION

Two basic justifications have been offered in support of the farm products exception, although they are really opposite sides of the same coin. First, proponents of the farm products exception argue that the unique nature of agricultural financing requires that special protection be given to agricultural lenders; without this protection, it is argued, lenders may not be willing to extend credit to farmers.[33] Second, proponents of the farm products exception argue that buyers of farm products do not need the protection of section 9-307(1) because buyers can protect themselves from becoming sureties simply by checking the lien records.[34] Although the drafters may have been justified in including the farm products exception when the UCC was first promulgated,[35] its continued justification is questionable.

1. Farmers and Lenders

The most widely recognized justification for the farm products exception is the need to assure the availability of credit to farmers. Prior to enactment of the Code, land was the primary source of farmers' loan collateral,[36] and creditors could not obtain liens or interests in nonexisting collateral such as future

321 (testimony of American Bankers Association); *id.* at 332-34, 338-40 (statement of Donald E. Wilkinson, governor, Farm Credit Administration).

32. *See infra* notes 140-47 and accompanying text.

33. *See* Note, *Agricultural Financing Under the U.C.C.*, 12 ARIZ. L. REV. 391 (1970).

34. *Cf.* B. CLARK, *supra* note 27, ¶ 8.4[3][g], at 8-37 to 8-38 (noting the convenience argument but criticizing the farm products exception as "hard to justify on the merits").

35. *See* Dolan, *supra* note 10, at 708-10.

36. Land was, and still is, a farmer's most valuable asset. *See id.* at 711 & n.25.

crops.[37] Because farmers did not need large-scale financing before the widespread mechanization of agriculture,[38] however, the restriction against using crops as collateral did not seriously affect the ability of most farmers to obtain credit.

The need for agricultural credit grew rapidly as agricultural technology advanced and the use of large equipment, pesticides, herbicides, and fertilizers became more extensive. To increase the ability of farmers to obtain credit, the UCC permitted farmers to use their future crops as collateral.[39] The use of agricultural collateral, however, created special problems; livestock and crops cannot be locked in a vault, and lenders cannot easily designate the particular products in which they have a security interest. Moreover, unlike inventory, farm products are often sold en masse. A secured party thus is not able to detect by inspection any impairment of the collateral; the crops or livestock may be on the farm on one day and gone on the next. Despite security agreement provisions to the contrary, farmers may sell the collateral without the lender's knowledge or consent,[40] and, if the buyer takes free of the

37. *See* Coates, *Farm Secured Transactions Under the U.C.C.*, 23 BUS. LAW. 195, 196-98 (1967).

38. *See* Dolan, *supra* note 10, at 710 n.22 (noting that only in the last 40 to 50 years has the need for other than real estate financing developed).

39. Although the drafters of the U.C.C. attempted a uniform codification of the then-existing state common law, large-scale agricultural financing was a relatively new development when the Code was promulgated. The drafters therefore may have felt that it was necessary to treat farm products differently. *See* Dolan, *supra* note 10, at 708-10.

40. Most security agreements require that the lender's consent to sale be in writing. *See, e.g., Farmers State Bank*, 190 Neb. at 790-91, 212 N.W.2d at 626-27 (quoting security agreement requiring written approval of secured party). Lenders usually use the farmer or rancher as a selling agent. Although buyers may assert that under U.C.C. § 9-306(2) the lender waived its interest by its course of dealing, *see* U.C.C. § 1-205(1), because of the farm products exception in § 9-307(1), several courts have held that the waiver defense does not overcome the presumption in § 9-306(2) that the security interest continues in farm products. *See, e.g.*, North Central Prod. Credit Ass'n v. Washington Sales Co., 223 Kan. 689, 694, 577 P.2d 35, 38-39 (1978) (conditional authorization does not constitute waiver); Garden City Prod. Credit Ass'n v. Lannan, 186 Neb. 668, 675-76, 186 N.W.2d 99, 104 (1971) (no waiver even though lender knew of the sale, did not object to it, and received check from buyer made out to lender); Baker Prod. Credit Ass'n v. Long Creek Meat Co., 266 Or. 643, 653-54, 513 P.2d 1129, 1132 (1973) (conditional authorization does not amount to waiver); Fisher v. First Nat'l Bank of Memphis, 584 S.W.2d 515, 518 (Tex. Civ. App. 1979) (express terms of security agreement govern prior course of dealing or implied consent based on lender's prior approval of unauthorized sales). *But cf.* First Nat'l Bank & Trust Co. of Oklahoma v. Iowa Beef Processors, Inc., 626 F.2d 764, 769 (10th Cir. 1980) (buyer's failure to check records was excusable because secured party had given actual authorization to sell); Hedrick Savs. Bank

lender's interest, the lender's position would be much less secure. The farm products exception of section 9-307(1) thus was seen as a partial solution to the inability of lenders to effectively monitor collateral and as a means of increasing lenders' willingness to lend to farmers.[41]

The drafters of the Code also were guilty of treating farmers somewhat paternalistically.[42] Farmers were viewed as "sturdy yeomen," without the competency to market their own products or the business sense to handle financial matters adequately.[43] Consequently, the drafters feared that without some sort of statutory protection, such as the farm products exception, farmers would be unable to obtain adequate financing from lenders.[44]

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v. Myers, 229 N.W.2d 252, 256 (Iowa 1975) (secured party's prior conduct discharged buyer). New Mexico and Arkansas have further strengthened the lender's position by amending § 9-306(2) to provide that a secured creditor cannot waive or impliedly consent to a sale of collateral by a prior course of dealing or by trade usage. *See* ARK. STAT. ANN. § 85-9-306(2) (Michie Supp. 1983); N.M. STAT. ANN. § 55-9-306(2) (1978). New Mexico's revision was in response to Clovis Nat'l Bank v. Thomas, 77 N.M. 554, 425 P.2d 726 (1967), which held that the bank had waived its right to rely on the § 9-307(1) exception.

41. The drafters may have been reacting, in part, to pressures from the Farmer's Home Administration (FmHA), the Small Business Administration, and state lending agencies. The FmHA threatened to push for a federal exception statute that would preempt state law. *See* Meyer, *"Crops" as Collateral for an Article 9 Security Interest and Related Problems*, 15 U.C.C. L.J. 3, 33-34 (1982). In addition, various state agencies argued that without the exception the states would not uniformly adopt § 9-307(1). *See* Hawkland, *The Proposed Amendment to Article 9 of the U.C.C.—Part 1: Financing the Farmer*, 76 COM. L.J. 416, 420 (1971). Similarly, the 1970 proposed amendment to article 9 would have repealed the farm products exception. The Permanent Editorial Board did not adopt the proposed change, however, because it feared the states would not uniformly accept the revision. *See id.* (noting that feelings about the farm products exception run so strong that any change likely would result in nonuniform amendments).

42. *See* B. CLARK, *supra* note 27, ¶ 8.4[3][g], at 8-38 ("Farmers and ranchers are big kids these days. The farm products exception treats them like innocent consumers. . . . [and] it smacks of paternalism.").

43. *See* Dolan, *supra* note 10, at 717-18; Hawkland, *supra* note 41, at 416-17; Sorelle, *"Farm Products" Under the U.C.C.—Is A Specific Classification Desirable?*, 47 TEX. L. REV. 309, 311 (1969).

44. *See* Dolan, *supra* note 10, at 717-18. Agricultural lenders strongly supported § 9-307(1) and lobbied heavily for it. *See* B. CLARK, *supra* note 27, ¶ 8.4[3][a], at 8-22 to 8-23.

Moreover, the drafters of the Code perceived farm products buyers as more sophisticated than farmers and better equipped to ensure that the seller was honest when the buyer bought the goods. *See* Meyer, *supra* note 41, at 32-33; *see also* Clark, *The Agricultural Transaction: Equipment and Crop Financing*, 1 AGRIC. L.J. 172, 174-76 (1979) (outlining "the six paternal provisions of article 9" that indicate that "the farmer or rancher doesn't quite make it as

The continued validity of these rationales underlying the farm products exception is questionable. American agriculture has changed dramatically since the original drafting of the Code. Agribusiness ventures and farming corporations have displaced some family farms, and those family farms that remain have been forced to adopt new production and business management techniques. Farmers today are more knowledgeable in business matters, agricultural financing methods have become more established, and, most importantly, agricultural lenders are now in step with other commercial lenders.[45] Consequently, farmers and bankers should be able to transact business just as other businesspersons and bankers do. Moreover, because the clientele of most agricultural lenders is made up predominantly of agricultural borrowers,[46] these institutions would lose a significant portion of their business if they stopped lending to farm producers. Thus, the premise that the farm products exception is necessary to permit creditworthy farmers to obtain necessary financing is no longer viable.

The farm products exception can even be disadvantageous to lenders. An agricultural lender may use future crops as collateral, but under section 9-312,[47] a creditor that lends to a seller of farm products will not receive notification of certain subsequently perfected interests in the same crops. Sections 9-312(2) and (4)[48] provide that a purchase money security inter-

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a commercial operator under Article 9"). The validity of the assumption that buyers are in the best position to protect themselves is questionable. Many agricultural lenders were, and still are, state and federal loan agencies, which always have been sophisticated enough to deal with dishonest or bankrupt farmers. *See* Dolan, *supra* note 10, at 720-21. Dean William D. Hawkland asserts that the arguments for the farm products exception were not viable even when the exception was first drafted. *See* Hawkland, *supra* note 41, at 418.

45. *See* Thompson, *Farm Financial Distress: Nature, Scope, and Measurement of the Problem*, 4 AGRIC. L.J. 450 (1983); Trethewey & McCorkle, *Farm Products: U.C.C. Changes Applicable to Security Interests of Buyers and Sellers*, 56 OHIO ST. B.A. REP. 1253 (1983).

46. Most agricultural lenders are state or federal agencies such as the FmHA. *See* Dolan, *supra* note 10, at 716 n.61. Commercial banks also represent a significant source of farm credit, *see id.*, and many of these lenders are rural banks whose customers are primarily or exclusively farmers and ranchers. *See* Miller, *Farm Collateral Under the U.C.C.: "Those are Some Mighty Tall Silos, Ain't They Fella?"*, 2 AGRIC. L.J. 253, 276 (1980).

47. *See* U.C.C. § 9-312. Section 9-312 sets out a system of rules for determining priorities among competing creditors. For a discussion of the treatment of purchase money security interests in farm products, see B. CLARK, *supra* note 27, at ¶ 8.4[4].

48. Because of U.C.C. § 9-307(1), farm products are classified as noninven-

est[49] that is perfected at the time the crops come into being or within 10 days of that time[50] will have priority over a security interest in future crops.[51] The original lender thus will take subject to any subsequent purchase money secured party, and under section 9-312(4) the subsequently secured party is not required to give notice to the first.[52] If the Code did not contain a farm products exception, however, crops would be classified as inventory[53] and section 9-312(3) would require the subsequent purchase money secured party to notify the original lender.[54]

2. Buyers of Farm Products

Proponents of the farm products exception also argue that buyers of farm products can protect themselves adequately by checking lien records for prior perfected security interests in crops or livestock.[55] This argument initially seems persuasive; after all, most buyers must rely on the filing system to protect

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tory. Therefore, U.C.C. § 9-312(2) governs priorities in crops, and § 9-312(4) and (5) governs priorities in all other farm products, including livestock.

49. A security interest is a purchase money security interest to the extent that it is taken by the seller to secure all or part of the sale price or by a creditor who lends money actually used to enable the debtor to acquire rights in collateral. *See* U.C.C. § 9-107.

50. *See* U.C.C. § 9-312(4).

51. In *Farmers State Bank*, for example, discussed *supra* text accompanying notes 14-23, State Bank's security interest included future crops. Had the seller-farmer subsequently executed a purchase money security interest that was perfected while these "future" crops were growing, the creditor who perfected the purchase money security interest would have had priority over State Bank's interest. *See* U.C.C. § 9-312(4). Not only would this security interest take priority over State Bank's interest, but under § 9-312(4) the second creditor would not be required to give notice of the priority to State Bank. *See* B. CLARK, *supra* note 27, at ¶ 8.4[4]; *cf.* U.C.C. § 9-312(3) (to protect its priority in *inventory*, purchase money secured party must notify other secured parties).

52. Lack of notice or knowledge of the second security interest could cause various problems for the first lender. Suppose, for example, that the first security agreement required the farmer to obtain a joint check from the buyer, but the second agreement did not impose this requirement. If the buyer makes the check jointly payable to the first secured creditor and the farmer, the first creditor could be liable to the second creditor in conversion if it retains the proceeds from the check, even though it had no knowledge of the second security interest.

53. U.C.C. § 9-109(3) defines farm products as "neither equipment nor inventory." *See supra* note 1.

54. *See supra* note 51. The first secured creditor can, of course, require in its security agreement that the farmer give it notice of any subsequent purchase money security interests. The lender cannot be sure, however, that the farmer will comply with the terms of the security agreement.

55. *See supra* text accompanying note 34.

against the risk of buying goods that are subject to a prior security interest. Moreover, the rationale for the exception created in favor of buyers in the ordinary course of business does not seem to apply in the case of farm products. Unlike a customer who buys a pair of shoes in a department store, or even a new car from a car dealer, a buyer of farm products generally has both the incentive and knowledge to search the filing records. Although technically the farm products exception would apply to a consumer buying a dozen ears of corn from a farmer's roadside stand, most agricultural purchasers are elevators, packers, or processors who buy all or most of the farmer's production, so the amount of money at stake justifies the additional cost for a records search.

In practice, however, reliance on the filing system to protect buyers of farm products is unrealistic. The required search of lien records is too expensive and time-consuming a burden on buyers to be practical. Before a buyer of farm products can check lien records for a prior security interest, the buyer must first know the county in which such records would be kept.[56] Because grain and livestock sellers are increasingly mobile, grain and livestock sales may take place far from the county in which they were grown or from the county of the seller's residence.[57] Even if the records can be located, they often lack the information needed by buyers.[58] Once the security interest has been perfected, the secured party is not required to update the information. The buyer thus cannot determine from the records whether the farmer's debt is still outstanding, whether the lien has been terminated because the debtor has repaid the debt, or whether the lender has authorized the debtor to make the sale.[59] Thus, requiring farm products buyers to search for UCC records to protect themselves from buying products subject to a security interest is neither as simple or reliable as the proponents of the farm products exception suggest.

In *Farmers State Bank*,[60] for example, the defendant-eleva-

56. *See* U.C.C. §§ 9-103, 9-401. Most states require local filing for farm products. *See supra* note 12.

57. *See supra* note 12.

58. Only minimal information is required to be included in the financing statement. *See* U.C.C. § 9-402.

59. *Id.* Many lenders use the farmer as a selling agent. Although most security agreements require the secured party's written authorization before the farmer may sell the collateral, buyers often simply may assume that any sale is authorized.

60. 190 Neb. 789, 212 N.W.2d 625 (1973); *see supra* notes 14-23 and accompanying text.

tor would have encountered substantial difficulty even if it had checked the farmer's lien records. The State Bank security agreement on file authorized the farmer to sell the collateral in the ordinary course of business;[61] written authorization for sale was required only if the farmer was in default.[62] Therefore, to fully protect itself, the elevator not only would have had to locate the lien records but also would have been required to determine independently whether the farmer had defaulted under the security agreement. Given the numerous events that could trigger a default,[63] this could be an expansive undertaking.

In addition to the expense of doing an adequate lien search and follow up, time pressures also preclude buyers of farm products from checking lien records. Because of the seasonal nature of the agricultural industry, grain elevators, livestock commission merchants, and agricultural auctioneers process a large volume of farm products at certain times of the year. Grain elevators profit by buying and selling grain quickly; faced with lines of impatient farmers at harvest time waiting to sell or deposit[64] grain, elevator managers often may be forced to forego the necessary effort and time required to search the seller's lien records.

Similarly, buyers of livestock must comply with section 228b of the Packers and Stockyards Act[65] and similar state laws[66] that require payment for livestock by the next business day after the sale is made. Thus, packers would have only twenty-four hours within which to search the UCC records,

61. *Farmers State Bank*, 190 Neb. at 79-91, 212 N.W.2d at 626-27.

62. *Id.*

63. *See supra* notes 16 & 22.

64. When farmers sell their grain to a grain elevator, payment may be either immediate or deferred, or it may be made under a deferred-pricing arrangement. Alternatively, farmers may choose to store their grain in an elevator. Upon depositing the grain at the elevator, the farmer receives a weight or scale ticket, which is functionally similar to a deposit slip at a bank. The elevator thus becomes a bailee for the farmer, and the farmer becomes a tenant in common in all of the stored grain; each farmer's share in the tenancy in common is the amount of grain recorded on the scale ticket. *See* Hamilton & Looney, *Federal and State Regulation of Grain Warehouses and Grain Warehouse Bankruptcy*, 27 S.D.L. REV. 334 (1982).

65. 7 U.S.C. § 228b (1982). Section 228b of the Packers and Stockyards Act requires each packer, market agency, and dealer of livestock to pay for any purchased livestock by the close of the next business day. *Id.*

66. *See, e.g.*, Illinois Slaughter Livestock Buyers Act, ILL. REV. STAT. ch. 111, § 517 (1983) (requiring all persons engaged in the business of buying or brokering slaughter livestock to pay for livestock purchases by the next business day).

perhaps located in a distant county or state, for outstanding liens and to determine whether the sale would trigger a default.[67] Confronted with a complicated search process, inadequate recorded information, and industry pressure to buy and sell quickly, buyers of agricultural products may find that it is wiser to simply not bother with a UCC lien search.

Proponents of the farm products exception also argue that buyers may protect themselves by issuing joint checks[68] payable to both the seller-debtor and the secured party. This argument presupposes that buyers can identify the secured party; as indicated above, however, that often will not be the case. Moreover, even if they could identify the secured parties,[69] buyers may be reluctant to issue joint checks because farmers may be unwilling to accept them. A single sale may constitute the bulk of a farmer's income for the year, and farmers understandably are quite anxious to get paid and do not want to have to deal with the secured party before cashing their checks. Buying and selling farm products is a highly competitive industry. Buyers therefore may be hesitant to initiate practices that may cause the seller to go elsewhere next season.[70]

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67. The variety of events triggering a default may make it difficult for buyers to determine whether a default had occurred within the 24-hour deadline. In *Farmers State Bank*, for instance, discussed *supra* text accompanying notes 14-23, the elevator would have had no way of knowing whether State Bank had actual knowledge of the prior perfected security interest of Merchants Bank; knowledge of the prior interest by State Bank could have been a waiver of the default term. *See supra* note 40.

68. *See* U.C.C. § 3-116 (checks payable jointly to two or more persons may be negotiable instruments).

69. If the debtor has more than one secured party, the buyer must determine to whom the check should be payable. In *Farmers State Bank*, for instance, both State Bank and Merchants Bank had security interests in the farmer's grain. Thus, the elevator would have had to decide whether to make out a check to State Bank and the farmer, or Merchants Bank and the farmer, or State Bank and Merchants Bank and the farmer. Although the Nebraska Supreme Court did not determine whether State Bank or Merchants Bank had the prior security interest, the elevator was found liable to State Bank and a joint check payable only to Merchants Bank and to the farmer presumably would not have satisfied the court, even though Merchants Bank was indeed a secured creditor of record. *See Farmers State Bank*, 190 Neb. at 792, 212 N.W.2d at 628.

70. Competition also may prevent agricultural lenders from insisting in their security agreements that sellers obtain joint checks from the buyers of their farm products. Farmers may be more likely to borrow from a lender that does not require joint checks. In fact, the farm products exception of § 9-307(1) places lenders in the ideal position. Because the lender has the buyer as a surety if the debtor defaults, the lender is not required to risk alienating farmers by insisting on joint checks.

Buyers of farm products thus may have no practical means of protecting themselves from becoming unwilling sureties on the loans of their sellers. With the dramatic increase in agricultural bankruptcies in recent years,[71] the dissatisfaction of buyers with section 9-307(1) has become even more acute. When a farmer or rancher becomes bankrupt or is unable to repay a loan, a lender understandably will use the farm products exception to collect from the buyer or commission merchant. Buyers quite justifiably object to having thrust upon them the consequences of a lender's failed judgment in lending to a financially insecure debtor, particularly because they perceive the lender as being in a better position to protect itself from defaulting debtors. The only practical way for buyers to protect themselves is by lowering the price they pay to farmers for farm products to take account of the risk of defaulting debtors. Given the recent state of the agricultural economy, however, this can hardly be considered a positive development.

II. STATE MODIFICATIONS OF THE FARM PRODUCTS EXCEPTION

Recognizing the problems caused by the farm products exception, the legislatures of several states have amended section 9-307(1) or the state's equivalent to afford greater protection to buyers of farm products. Many of these modifications have been enacted in the past two years in response to the depressed economic condition of American agriculture. The solutions have ranged from minor adjustments to complete repeal. This section surveys the various state modifications and evaluates their impact on farmers, lenders, and buyers.

A. EXEMPTING AUCTIONEERS AND COMMISSION MERCHANTS

Three states—Georgia,[72] Louisiana,[73] and Nebraska[74]—

71. The U.S. Department of Agriculture reported that between 1975 and 1981, 175 grain elevators closed or reorganized. *See* U.S. DEPT. OF AGRIC., FARMLINE, KEEPING HARVESTS SAFE FROM FAILING ELEVATORS (1981). A recent Illinois study concluded that the most common cause of elevator bankruptcy is speculation in the commodities market. ILLINOIS LEGISLATIVE COUNCIL, GRAIN ELEVATOR BANKRUPTCIES IN THE U.S. 1974 THROUGH 1979, File No. 90,179 (1981). When the elevator speculates and loses, it sells farmers' stored grain to cover its losses. *See supra* note 64. The elevator then owes to farmers a greater amount of grain than it has on hand; that is, the elevator's liabilities exceed its assets. *See* Hamilton & Looney, *supra* note 64, at 335.

72. GA. CODE ANN. § 11-9-307 (1982). Section 11-9-307(3) provides:

> A commission merchant who shall sell livestock or agricultural products for another for a fee or commission shall not be liable to the

have exempted commission merchants and auctioneers from liability for selling farm products subject to a security interest. Georgia amended section 9-307 to grant relief only to commission merchants who sell the farm products of another for a fee.[75] Under the Georgia scheme, the commission merchant also must satisfy two criteria to escape liability to secured creditors:[76] (1) the commission merchant must sell in the ordinary course of business,[77] and (2) the merchant must not have knowledge of the security interest when the sale is made.[78] Similarly, Nebraska amended UCC section 9-109 to exempt auctioneers from liability for selling products subject to a security interest if the auctioneer acts in good faith[79] and without knowledge of the security interest.[80]

Exempting auctioneers and commission merchants from liability is a step, albeit a small one, in the right direction. Auc-

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holder of a security interest created by the seller of such livestock or products even though the security interest is perfected where the sale is made in ordinary course of business and without knowledge of the perfected security interest.

73. LA. REV. STAT. ANN. §§ 3:561(5), 3:568 (West Supp. 1984). Section 3:561(5) provides:

> "Security device" means any lien, mortgage, pawn, pledge, privilege, or other instrument by which an interest in livestock is used to secure the performance or payment of any obligation.

The central provision is LA. REV. STAT. ANN. § 3:568(A), which provides:

> Notwithstanding any provision of law to the contrary, no owner or operator of a market agency shall be liable to any person who holds a security device affecting livestock that are sold through the market agency on a commission or consignment basis unless the owner or operator receives notice as provided in this Section.

Subsection (B) of § 3:568 sets out various requirements for giving and the contents of notices of security devices. Subsection (C) requires checks payable jointly to the livestock seller and the holder of the security interest. Subsections (D) and (E) of § 3:568 provide enforcement mechanisms to guard against providing false and misleading information and imposes a criminal penalty for violation.

74. NEB. REV. STAT. § 69-109.01 (Supp. 1983). Section 69-109.01 provides:

> The auctioneer, who in good faith and without notice of a security interest therein, sells personal property at auction, which is in fact subject to a security interest, for a principal whose identity has been disclosed, in which property the auctioneer has no interest but acts only as an intermediary of the owner is not liable to the holder of the security interest for any damage sustained as a result of such sale.

75. GA. CODE ANN. § 11-9-307(3) (1982).

76. *Id.*

77. *See* GA. CODE ANN. § 11-1-201(9) (1982); *supra* note 11.

78. *See* GA. CODE ANN. § 11-1-201(25) to (27) (1982); U.C.C. § 1-201(25) to (27) (knowledge and notice provisions).

79. *See* U.C.C. § 1-201(19).

80. *See* NEB. REV. STAT. § 69-109.01 (Supp. 1983); *supra* note 74.

tioneers and commission merchants act merely as agents; they generally do not take title to the products they sell. To expose mere sales agents to liability for mortgages on products they sell is exceptionally unfair. Their connection with the collateral is so transitory that requiring them to check the UCC lien records is unrealistic and inefficient.

Although the exemption of auctioneers and commission merchants from the farm products exception would decrease the protection afforded lenders, its effect likely would not be strong enough to evoke serious opposition from agricultural lenders. Lenders still would retain the right to seek recovery from buyers of farm products. Such an amendment, then, would not seem so politically unpalatable as to preclude its uniform adoption. This modification, however, does not help the majority of those affected by the farm products exception—purchasers of farm products. Thus, although its adoption would not raise significant opposition, neither would it do much good.

B. CENTRAL FILING

Four states—Montana,[81] Kansas,[82] Iowa,[83] and Ne-

81. MONT. CODE ANN. § 81-8-301 (1983). This section provides:

(1) The department of livestock shall accept and file notices of security agreements, renewals, assignments, and satisfactions covering livestock owned by a person, firm, corporation, or association and bearing its recorded brand and shall list the notices on the official records of marks and brands kept by it. The department shall transfer a copy of the notices and their accompanying brands to the central livestock markets. All forms on which the notices are given shall be prescribed by the department and furnished by the secured party who gives the notice. A livestock market to which livestock is shipped may not be held liable to any secured party for the proceeds of livestock sold through the livestock market by the debtor unless notice of the security agreement is filed and a copy is transferred as hereinbefore provided. The department of livestock may not be held liable to any secured party for the proceeds of livestock sold through a livestock market by the debtor.

(2) Notices of security agreements must be renewed every 5 years commencing on January 1, 1983, by notifying the department in a manner prescribed by it and by paying the fee set pursuant to 81-8-304 not more than 30 days before or 90 days after January 1.

(3) Assignments of security interests must be renewed every 5 years commencing on January 1, 1983, by notifying the department and paying the fee set pursuant to 81-8-304 not more than 30 days before or 90 days after January 1.

(4) Failure to comply with the provisions of subsection (2) or (3) will result in the termination of the notice on the 91st day following the applicable January 1 without notification by the department.

(5) Satisfactions of security agreements must be filed immediately with the department of livestock.

braska[84]—have revised the method by which a secured creditor must file to perfect its security interest in farm products to enable farm products buyers to obtain the information they need. This revision typically involves the adoption of some type of central filing system. Such a system is designed to alleviate some of the search and time problems normally encountered by

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82. KAN. STAT. ANN. §§ 84-9-401, -410 (Supp. 1984).

83. IOWA CODE ANN. § 554.9407(2)-(4) (West Supp. 1984-1985).

84. NEB. REV. STAT. U.C.C. §§ 9-413 to -415 (Cum. Supp. 1984). Nebraska's § 9-413 provides:

> It is the intent of the Legislature to create a readily available system of filing under the Uniform Commercial Code which will provide for original filings to be made in the office of the county clerk where the debtor resides when the collateral is:
>
> (1) Equipment used in farming operations;
>
> (2) Farm products, including, but not limited to, crops growing or to be grown;
>
> (3) Farm products which have become inventory of a person engaged in farming;
>
> (4) Accounts or general intangibles arising out of or relating to the sale of farm products by a person engaged in farming; or
>
> (5) Consumer goods.
>
> The original filing in all other cases shall be in the office of the Secretary of State.
>
> It is the intent of the Legislature that sufficient information relative to items described in subdivisions (1) to (4) of this section be transmitted by the county clerk to the Secretary of State to permit determination of whether or not financing statements, assignments, and other Uniform Commercial Code documents have been filed and where they are located and that the information be readily accessible by various means of inquiry, including, but not limited to, in person, mail, and telephone and other electronic media including computers.

Id. NEB. REV. STAT. U.C.C. § 9-414 (Cum. Supp. 1984) provides:

> (1) Upon receipt of a financing statement, an amendment to a financing statement, an assignment, a continuation statement, a termination statement, or a release of collateral, relating to (a) equipment used in farming operations, (b) farm products, including crops growing or to be grown, (c) farm products which become inventory of a person engaged in farming, or (d) accounts or general intangibles arising from or relating to the sale of farm products by a farmer, each county clerk shall immediately transmit to the Secretary of State the following document information:
>
> (i) Identification of the document and the county where the original document may be found;
>
> (ii) Document number;
>
> (iii) Name and address of the debtor or debtors;
>
> (iv) Name and address of the creditor or creditors;
>
> (v) Type or types of goods covered;
>
> (vi) Date and time of filing; and
>
> (vii) Social security or federal identification number of the debtor or debtors, if available.
>
> (2) Upon receipt of a lien filed pursuant to Chapter 52, article 5, 7, 9, 10, or 11 or Chapter 54, article 2, or an amendment, release, or

buyers.[85] These modifications attempt to retain the protection for lenders afforded by the farm products exception while allowing buyers a more realistic opportunity to protect themselves.

Nebraska modifies the traditional filing procedures more than any other state.[86] In Nebraska, the secured party still must file in the county of the debtor's residence, but the new law requires the county clerk to relay the information to the secretary of state, who must then index the filing information on a computer system.[87] Buyers can request the information in person, in writing, by telephone, or by other electronic media, such as a computer.[88] A buyer of farm products therefore can directly access the state's central files via computer-telephone

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termination of such lien, the county clerk shall immediately transmit to the Secretary of State the following document information:

(a) Identification of the document and the county where the original document may be found;

(b) Document number;

(c) Name and address of the debtor or debtors;

(d) Name and address of the creditor or creditors;

(e) Type or types of goods covered;

(f) Date and time of filing; and

(g) Social security or federal identification number of the debtor or debtors, if known.

. . . .

(4) Upon receipt of information transmitted pursuant to this section, the Secretary of State shall record and index the information so that on or before January 1, 1986, such information shall be available for the following types of inquiry: In person, written, and telephone and other electronic medium, including computers, except that information relative to security interests in crops growing or to be grown shall continue to be available for inquiry in the same manner as provided in section 9-411 before July 1, 1983.

NEB. REV. STAT. U.C.C. § 9-415 (Cum. Supp. 1984) provides:

The Secretary of State shall, on or before January 1, 1986, implement a centralized computer system as developed or recommended by the Uniform Commercial Code Filing Council for the accumulation and dissemination of information relative to financing statements and other necessary Uniform Commercial Code documents whenever the collateral is equipment used in farming operations, farm products, farm products which have become inventory of a person engaged in farming, or accounts or general intangibles arising from or relating to the sale of farm products by a farmer. Such a system shall include the entry of information relative to notice of liens into the computer system by county clerks and the dissemination of such information by a computer system or systems, telephone, mail, and such other means of communication as may be deemed appropriate. Such system shall be designed as an interactive system.

85. *See supra* notes 56-67 and accompanying text.

86. *See supra* note 84.

87. NEB. REV. STAT. U.C.C. § 9-414(1), (2), (4) (Cum. Supp. 1984).

88. *Id.* §§ 9-414, 9-415.

link. In addition, the secured party must supplement the financing statement when the need arises so that the information obtained by the buyer will be more reliable.[89]

Filing system modifications adopted by the other states are different from those under the Nebraska system, but the underlying purpose of these laws essentially is the same: to enable buyers of farm products to obtain reliable information quickly and inexpensively. Kansas, for example, also requires central filing, but the creditor sends the financing statement directly to the secretary of state.[90] In Montana, creditors must file with the Department of Livestock instead of the county office. The department transfers the information to the central livestock market,[91] and the buyer takes free of any security interests that are not on file with the central market.[92] Under the Iowa Statute, security interests in farm products may be perfected by central filing, and interested parties are provided ready access to filed information.[93]

Changing the filing procedures to provide for easier and cheaper access to more reliable information is a positive step toward alleviating the problems created by the farm products exception. The amendments afford buyers a realistic opportunity to protect themselves without placing a significant burden on lenders or farmers. Requiring central filing for farm products reduces the search burden on the buyer; with telephone or computer access to a state's central files, a farm products buyer should be able to obtain up-to-date information in a matter of minutes.[94] Although lenders must bear the attendant costs of updating files and removing notices when the loans are paid, these costs are minimal in relation to the potential for loss of the right to recover from farm products buyers.

Implementing the new filing procedures may create some

89. *Id.* § 9-414(1).

90. KAN. STAT. ANN. §§ 84-9-401, -410 (Supp. 1984). The Kansas statute did not require immediate transfer of the interests already filed in county records office before January 1, 1984; instead, those records will remain in the county files until the creditors must renew them. *Id.* § 84-9-410(b). Thus, Kansas' filing system will not be totally centralized until 1989.

91. *See* MONT. CODE ANN. § 81-8-213(6) (1983) (defining "livestock market").

92. *Id.* § 81-8-301(1); *see supra* note 81.

93. IOWA CODE ANN. §§ 554.9401, .9407(2)-(4) (West Supp. 1984-1985). Information may be obtained by telephone or wire, for example. *Id.*

94. The amendments noted of course do not foreclose written requests for information, but written requests would take considerably more time to process.

new complications. States will have to deal with problems of computer breakdowns and access to information after business hours and on weekends. Furthermore, computer searches must be very precise; errors in spelling or inexact names could frustrate the accurate reporting of liens.[95] Shifting to central filing also may be expensive, and it may be opposed by counties that will lose the revenue obtained from UCC searches.

Despite these potential problems, modifying the filing procedure seems unobjectionable enough that some degree of uniformity among the states could be achieved. Modification of the required filing procedures so as to provide quick and easy access to accurate information accomodates the buyer's informational interest and also retains the lender protection features of the farm products exception. Such a modification, therefore, should be acceptable to both buyers and lenders.

C. REQUIRING BUYERS TO OBTAIN THE NAMES OF ANY SECURED CREDITORS FROM SELLERS

Four states—Nebraska,[96] Oklahoma,[97] South Dakota,[98] and

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95. Such concerns were voiced during the hearings on H.R. 3296. *See Hearings, supra* note 28, at 151 (Preliminary Report of the Task Force on Farm Products Liens to the Farm Credit Council); *see also id.* at 242 (statement of E.J. Strasma, vice president, Interstate Producers Livestock Association).

96. NEB. REV. STAT. U.C.C. § 9-307(4) (Cum. Supp. 1984). Nebraska also has adopted a central filing system. *See supra* notes 84-88 and accompanying text. Nebraska's § 9-307(4) provides:

> A buyer who purchases farm products or a person who sells farm products for another for a fee or commission shall require that the seller identify the first security interest holder with regard to the farm products being sold. If such seller is then paid the total purchase price by means of a check payable to such seller and the named first security interest holder and if the named first security interest holder authorizes the cashing of such check, the buyer of such farm products so purchased shall take free of any security interest. Any endorsement for payment made on such check shall not serve to establish or alter in any way security interest priorities under Nebraska law.

97. OKLA. STAT. ANN. tit. 12A, § 9-307 (West Supp. 1984-1985).

98. S.D. CODIFIED LAWS ANN. §§ 57A-9-503.1; -503.2 (Supp. 1984). Section 57A-9-503.1 provides:

> No cause of action for recovery of security or its value may be commenced by a secured creditor against an innocent third-party purchaser of farm products as defined in subsection (3) of § 57A-9-109, nor may such a cause of action be commenced against a livestock auction agency, as defined in chapter 40-15 and § 301 of the Packers and Stockyards Act (7 USC 201), or a public grain warehouse, or a public terminal grain warehouse, or a grain dealer as defined by chapters 49-43, 49-44 and 49-45 respectively, unless such action is commenced

North Dakota[99]—have retained the farm products exception

within twenty-four months from the date the farm products are sold and unless such action is preceded by the secured creditor offering to file against the debtor a complaint as defined by § 23A-2-1.

S.D. CODIFIED LAW ANN. § 57A-9-503.2 (Supp. 1984) provides:

Any person who for himself, or through an agent, sells livestock through a livestock auction agency, as defined in chapter 40-15 and § 301 of the Packers and Stockyards Act (7 USC 201), or who so sells grain through a public grain warehouse, or through a public terminal grain warehouse, or a grain dealer as defined in chapters 49-43, 49-44 and 49-45 respectively, without notifying the livestock auction agency or the grain warehouse or grain dealer of a security interest in such farm products, and with intent to defraud, is guilty of farm products fraud. The failure of the seller to give written notice of a security interest in the farm products prior to the date of the sale by the livestock auction agency, or the grain warehouse, or grain dealer, is prima facie evidence of intent to defraud.

A violation of this section is a Class 1 misdemeanor.

99. N.D. CENT. CODE § 41-09-28 (1983). Section 41-09-28(4)-(8) provides:

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 issued 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.

7. A merchant who purchases from or a commission merchant who sells farm products for another for a fee or commission takes free of a 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

but provide that a buyer of farm products in the ordinary course of business takes free of any security interests if the buyer requests the name of the secured creditor from the seller and makes the check payable jointly to the creditor and the seller. The drafters of these statutes apparently recognized the ineffectiveness of the "notice" provided by the UCC filing system in the case of farm products and allowed the buyers instead to rely on the representations made by sellers.

Of the four states, North Dakota provides the most detailed statute.[100] To take free of prior security interests, a buyer of farm products in North Dakota must satisfy five prerequisites. First, the buyer must ask the seller for the names of all creditors that have security interests in the farm products. Second, if the seller does not disclose any names, the buyer must check the county records for the five-year period preceding the transaction. Third, the buyer must make the check payable jointly to the seller and all secured creditors. Fourth, the buyer must not have actual knowledge of the existence of any secured creditor whose name is not included on the joint check. Finally, the buyer must maintain records in support of its defense under the statute.[101] The North Dakota statute also requires that a lender advise sellers to disclose the existence of prior security interests to their buyers,[102] and that the lender make a good faith effort to recover the money from the debtor-seller before filing a suit against a buyer.[103]

The Oklahoma, Nebraska, and South Dakota statutes are

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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 payees 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.

100. *See supra* note 99.

101. N.D. CENT. CODE § 41-09-28(4), (7) (1983).

102. *Id.* § 41-09-28(5).

103. *Id.* §41-09-28(6).

similar in effect to the North Dakota statute. Sellers in Oklahoma must fill out a form disclosing the names of secured creditors; however, if the seller does not reveal any secured creditors, the farm products[104] buyer is not required to check past records.[105] A false statement by the seller as to the identity of a secured party is a felony.[106] Similarly, buyers in Nebraska do not have to check past records if, after inquiry, the seller fails to disclose the identity of any secured creditors.[107] Under Nebraska's statute, the buyer must obtain the name of the first secured creditor and is only required to make the check payable jointly to the seller and the first secured creditor.[108] In South Dakota, the seller must disclose any interests to the buyer, and the seller is subject to criminal penalties for failing to disclose a security interest,[109] but a farm products buyer still takes the products subject to the secured party's interest.[110]

These statutes attempt to deal with the search and time pressure problems usually faced by buyers of farm products by transferring to the secured creditor some of the risks of a dishonest seller.[111] By forcing all sellers to disclose the existence

104. The Oklahoma statute is limited to farm products other than livestock. OKLA. STAT. ANN. tit. 12A, § 9-307(3)(a) (West Supp. 1984).

105. *Id.* Oklahoma's § 9-307(3)(a) provides:

> Before issuing an instrument in payment for farm products other than livestock, a merchant purchasing such products from a seller or a commission merchant selling such products as an agent for a seller shall require said seller to execute a certificate disclosing the names of all lenders, if any, to whom security interests have been given in such farm products. If no security interests exist the certficate shall so state. The certificate shall include a warning that any false statement as to the identity of the lenders is a felony and is punishable by imprisonment in the state pentitentiary for a period not to exceed three (3) years or in the county jail for a period not to exceed one (1) year, or by a fine not to exceed Five Hundred Dollars ($500.00).

The Oklahoma statute also sets out a model form satisfying the requirements of the statute. *See id.*

106. *Id.*

107. NEB. REV. STAT. U.C.C. § 9-307(4) (Cum. Supp. 1984); *see supra* note 96.

108. *Id.*

109. S.D. CODIFIED LAWS ANN. § 57A-9-503.2 (Supp. 1984). In South Dakota, a seller of farm products who does not disclose secured creditors to the buyer commits a Class 1 misdemeanor. Although the state must prove the seller acted with an intent to defraud, the failure of the seller to give written notice of a security interest is prima facie evidence of intent to defraud. *Id.*

110. *Id.* To recover from buyers, however, the lender must commence suit within 24 months of the purchase date and must first offer to file against the debtor. *Id.* § 57A-9-503.1.

111. In Oklahoma and Nebraska, for example, the buyer takes free of the

of security interests covering the farm products, this alteration of UCC section 9-307(1) allays the fears of buyers that forcing disclosure would be bad for business. It does not, however, eliminate the potential for abuse; even solvent farmers may choose not to disclose the existence of prior security interests covering farm products to avoid receiving jointly payable checks. Whether the threat of criminal sanctions will provide an effective counterweight to potential abuses remains to be seen. Furthermore, in states such as North Dakota, where the buyer is required to search lien records if the seller does not disclose any names, the buyer still faces search and time pressure problems to avoid the risk of double liability.

The inquiry system also raises several problems for lenders. If the farm products buyer's duty ends with asking for the names of secured creditors, the risk of sellers' dishonesty falls entirely on the lenders. Moreover, lenders that establish a pattern of accepting payment directly from the farmer rather than insisting on a jointly payable check issued by the buyer may be deemed to have waived the right to collect from farm products buyers should the farmer later default on the loan.[112]

It remains unclear whether the inquiry system could gather the support, or at least the acquiescence, of the affected parties necessary for its uniform adoption. As presently designed, the system either harms lenders or leaves the current system virtually unchanged. Moreover, it creates potential criminal liability for farmers. Consequently, all three groups may oppose the modification. Although the legislatures of four major agricultural states have enacted a form of the inquiry system, the system does little to fairly accommodate the interests of the affected parties.

D. REQUIRING LENDERS TO GIVE NOTICE TO BUYERS OF SECURITY INTERESTS

Six states—Ohio,[113] Illinois,[114] Tennessee,[115] Kentucky,[116]

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security interest even if the seller does not disclose all security interests covering the farm products collateral. *See* NEB. REV. STAT. U.C.C. § 9-307(4) (Cum. Supp. 1984); OKLA. STAT. ANN. tit. 12A, § 9-307(3)(a) (West Supp. 1984).

112. For a further discussion of the waiver theory, see *supra* note 40; *see also Hearings*, *supra* note 28, at 101-02 (statement of Prof. Ralph J. Rohner).

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

114. ILL. ANN. STAT. ch. 26, §§ 9-205.1, 9-306.01, 9-306.02, 9-307, 9-307.1, 9-307.2 (Smith-Hurd Supp. 1984-1985).

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

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

Indiana,[117] and Delaware[118]—place the burden of disclosure on the lender by requiring the lender to give notice to the buyer of its security interest in particular agricultural products. These statutes generally require the farmer to provide the lender with a list of potential buyers, to whom the lender must in turn give notice of its security interest. If the lender does not provide such notice, the buyer takes free of the lender's security interest. These statutes thus permit a secured creditor to condition the sale of farm products on the buyer's agreement to take the goods subject to a prior lien.

In Illinois, buyers[119] and agents[120] take free of any security interest unless within 5 years prior to sale the lender sends to the buyer notice of its security interest in the farm products.[121] Under the Illinois statute, lenders also may require farmer-debtors to list potential buyers,[122] and it is unlawful for farmers to sell to buyers not on the list.[123] Farmers may amend the list of potential buyers, but any amendments must be made at least seven days before sale.[124] Buyers[125] in Illinois are required to post a "Notice to Seller of Farm Products" to inform sellers of the law and its penalties.[126]

The basic provisions of the Ohio, Indiana, and Delaware

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

118. DEL. CODE ANN. tit. 6, § 9-307(2) (Supp. 1984).

119. *See* ILL. REV. STAT. ch. 26, § 9-307(4) (Smith-Hurd Supp. 1984-1985). Illinois' § 9-307(4) provides:

> A person buying farm products in the ordinary course of business from a person engaged in farming operations takes free of a security interest created by the seller even though the security interest is perfected unless, within 5 years prior to the purchase, the secured party has given written notice of his security interest to the buyer, sent by registered or certified mail. Such notice shall contain the name and address of the seller, a statement generally identifying the farm products subject to the security interest, and an address of the secured party from which information concerning the security interest may be obtained.

120. *See id.*, § 9-307.1 (Smith-Hurd Supp. 1984-1985). Illinois § 9-307.1 is identical to Illinois § 9-307(4) except that it applies to commission merchants and selling agents who sell livestock or other farm products for others.

121. *Id.* § 9-307(4), 9-307.1.

122. *Id.* § 9-306.02.

123. *Id.* The debtor is guilty of a Class A misdemeanor if the debtor sells to a buyer not on the list. *Id.* § 9-306.02(2). The debtor has available an affirmative defense, however, if he or she pays the secured party the proceeds from the sale within 10 days after the sale. *Id.* § 9-306.02(5).

124. *Id.* § 9-205.1.

125. "Buyers" include commission merchants, selling agents, or any buyer of farm products in the ordinary course of business who buys from a person engaged in farming operations. *Id.* § 9-307.2.

126. *Id.* Illinois' § 9-307.2 provides:

statutes are much like those of the Illinois statute, except that the statutory time periods differ.[127] Buyers in Ohio and Indiana also must make joint payment to the seller and the secured creditor.[128] Tennessee has repealed the farm products exception for all buyers except buyers of livestock,[129] grain or soybeans,[130] and tobacco,[131] who take free of security interests only if they have not received notice from the lender. Tennessee also requires the lender to first attempt to secure payment from the debtor before seeking recovery from the buyer.[132]

A commission merchant or selling agent who sells farm products for others, and any person buying farm products in the ordinary course of business from a person engaged in farming operations, shall post at each licensed location where said merchant, agent or person buying farm products in the ordinary course of business does business a notice which shall read as follows:

"NOTICE TO SELLERS OF FARM PRODUCTS

It is a criminal offense to sell farm products subject to a security interest without making payment to the secured party. You should notify the purchaser if there is a security interest in the farm products you are selling."

Such notice shall be posted in a conspicuous manner and shall be in contrasting type, large enough to be read from a distance of 10 feet.

127. Lenders in Ohio and Indiana must give notice of security interests within 18 months before the purchase, and Ohio and Indiana debtors have 15 days to amend their buyers lists. IND. CODE ANN. § 26-1-9-307 (Burns Supp. 1984); OHIO REV. CODE ANN. § 1309.26 (Page Supp. 1984). Under the Delaware statute, notice must be received one year prior to payment. DEL. CODE ANN. tit. 6, § 9-307(2)(a) (Supp. 1984).

In its most recent legislative session, Minnesota joined this group of states that require lenders to give notice to farm buyers of security interests in crops or livestock. Amending various provisions of the prior Minnesota statutes, 1985 Minn. Laws ch. 233 permits farm products buyers to be registered in as many counties as they choose. Registered buyers take free of prior perfected security interests even if they are aware of such interests, unless the secured lender notifies the buyer of its interest. Once notified, a registered buyer must issue a jointly payable check to the seller and the secured party in order to protect itself from double liability. *Id.* secs. 1-12. The new law became effective as of July 1, 1985.

128. IND. CODE ANN. § 26-1-9-307(d) (Burns Supp. 1984); OHIO REV. CODE ANN. § 1309.26 (Page Supp. 1984).

129. Bona fide purchasers of livestock take free of any lien if they buy livestock in the ordinary course of business at public auction, through a public livestock market chartered in the state, or through a buying station, community sale yard, or meat packer licensed by the state. TENN. CODE ANN. § 47-9-307(2)(a) (Supp. 1984).

130. Bona fide purchasers of grain or soybean take free of any lien if they hold a current public grain warehouse license issued by Tennessee or a current federal warehouse storage license. *Id.* § 47-9-307(2)(b).

131. The bona fide purchaser of tobacco sold at public auction takes free of any lien on tobacco sold through a tobacco warehouse pursuant to Tennessee law governing such sales. *Id.* § 47-9-307(2)(c).

132. *Id.* § 47-9-307(2)(e).

Kentucky has retained the farm products exception generally but protects certain buyers of tobacco, grain or soybean crops, and livestock.[133] The Kentucky statute shields from liability buyers in the ordinary course of business of the listed farm products unless the secured creditor provides written notice of its interest to the warehouseman, grain storage company, or stockyard before the owner or producer is paid the proceeds of sale.[134]

Although the lender notice statutes do not solve all of the problems created by the farm products exception, they do strike a sensible balance of the interests of the lenders, buyers, and farmers. The burden of searching records remains with the farm products buyer, but that burden is reduced substantially. Because buyers need only search their own records, the required search will be easier and cheaper, and the buyer will have control over the accuracy of the records. Although lenders will incur the additional costs of obtaining and maintaining buyers lists from debtors and of notifying buyers of their security interests,[135] they retain the right to recover from farm products buyers. Lenders still must bear the risk that dishonest farmers may take their products to a different county and sell to buyers who did not receive notice, but this risk may be minimized by the lender's screening out of potentially dishonest borrowers and by the existence of criminal sanctions against sellers for such conduct.[136] The burden on farmers also is reduced to supplying and maintaining a list of potential buyers, although some farmers may be concerned with the stigma associated with a lender's selectively sending notices to only their most financially troubled borrowers. Of the various modifications to section 9-307(1), the lender notice scheme is presently the most popular variation on section 9-307(1) and thus would appear to have good chances for uniform adoption on the state level, and, as discussed below, Congress presently is considering legislation that is similar in operation to these lender-notice statutes.

133. KY. REV. STAT. ANN. § 355.9-307(1)-(4) (Bobbs-Merrill Supp. 1984).

134. *Id.*

135. Lenders can incur this cost selectively, however, by choosing to give notice of liens only on high risk loans.

136. *See, e.g.*, ILL. REV. STAT. ch. 26, § 9-306.02 (Smith-Hurd Supp. 1984-1985); IND. CODE ANN. § 26-1-9-307(2) (Burns Supp. 1984).

E. Repeal of the Farm Products Exception

California presently is the only state that has excised the farm products exception of section 9-307(1) from its commercial code.[137] In California, buyers of farm products in the ordinary course of business, like all other buyers in the ordinary course of business, take free of any security interest in the collateral. Buyers in California, therefore, are not required to check county or central records, obtain the name of secured parties from sellers, or maintain files of lender notification. Tennessee also has repealed the farm products exception, but only with respect to buyers of farm products other than tobbacco, grain or soybeans, and livestock.[138] Congress in 1983 considered a bill that would have repealed the farm products exception nationally. Texas presently is considering a similar measure.[139]

F. Proposed Federal Legislation

Bills to repeal or modify the farm products exception nationally have been introduced in each of the last two Congresses.[140] The Farm Products Buyers' Protection Act of 1983 would have preempted the various state modifications of section 9-307(1) by providing that

> a buyer in the ordinary course of business who buys farm products from a person engaged in farming operations shall own such goods free of any security interest in such goods created by his seller even though the security interest is perfected in accordance with applicable state law and even though the buyer knows of its existence.[141]

As under the California statute, buyers of farm products thus would have received the same protection as do other buyers in the ordinary course of business.[142]

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137. *See* CAL. COM. CODE § 9307 (West Supp. 1985).

138. *See* TENN. CODE ANN. § 4-9-307 (Supp. 1984); *supra* notes 129-131 and accompanying text.

139. Telephone interview with Mr. Ross Wilson, lobbyist associated with the Texas Cattle Feeders Ass'n (April 5, 1985).

140. H.R. 1591, 99th Cong., 1st Sess. (1985); H.R. 3296, 3297, 98th Cong., 1st Sess., 129 CONG. REC. 10,583 (1983). H.R. 3297, introduced at the same time as H.R. 3296, was virtually identical to H.R. 3296 except that it covered only livestock purchases.

141. H.R. 3296, 98th Cong., 1st Sess., 129 CONG. REC. 10,583 (1983). The House sponsor of this bill was Rep. Tom Harkin (D., Iowa).

142. H.R. 3296, sec. 2 stated that the farm products exception burdened commerce in farm products and advanced several reasons in support of its repeal: (1) The exception burdens the buyer regardless of whether the buyer has knowledge of any security interests, any practical method for obtaining the information, or any means to assure that the debtor makes payment to the lender; (2) the exception subjects purchasers to possible double liability—pay-

The 1985 bill,[143] by contrast, would provide a lender notice type provision similar to those presently in effect in seven states.[144] A buyer in the ordinary course of business of farm products who buys from a person engaged in farming operations would take free of any security interests in the products unless within twelve months prior to the sale the secured creditor gives notice to the buyer of its security interest and any payment obligations the buyer must satisfy to avoid potential liability.[145] The bill also would extend similar protection to commission merchants and selling agents.[146] Under the 1985 bill, however, the secured creditor in its notice to the buyer, commission merchant, or selling agent may condition release on the performance of payment obligations.[147] The proposed legisla-

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ment to the seller and to the lender or subsequent buyers; and (3) the buyer's exposure to double liability inhibits free-market competition by discouraging purchasers from dealing with sellers who have defaulted or may default. *Id.*

143. H.R. 1591, 99th Cong., 1st Sess. (1985), introduced by Rep. Charles W. Stenholm (D. Tex), would amend the Agriculture and Food Act of 1981 by adding a new § 1123. The bill provides:

> SEC. 1123. (a) Notwithstanding any provision of Federal, State, or local law, a buyer in the ordinary course of business who buys farm products from a seller engaged in farming operations shall take free of a security interest created by the seller even though the buyer knows of its existence: *Provided, however,* That a buyer of farm products takes subject to a security interest created by the seller if: (i) within twelve months prior to the sale of the farm products the buyer has received from the secured party or the seller written notice of the security interest and of any payment obligations imposed on the buyer by the secured party as conditions for waiver or release of the security interest; and (ii) the buyer has failed to perform those obligations.
>
> (b) Notwithstanding any provisions of Federal, State, or local law, a commission merchant or selling agent who sells farm products for others shall not be liable to the holder of a security interest in such farm products even though the security interest is perfected and even though the commission merchant or selling agent knew of its existence, if the sale is made in the ordinary course of business: *Provided, however,* That a commission merchant or selling agent of farm products takes subject to a security interest created by the seller if: (i) within twelve months prior to the sale of the farm products the commission merchant or selling agent has received from the secured party or the seller written notice of the security interst and of any payment obligations imposed on the commission merchant or selling agent by the secured party as conditions for waiver or release of the security interest; and (ii) the commission merchant or selling agent has failed to perform those obligations.
>
> (c) This section shall become effective thirty days after enactment, except that liens made prior to the effective date shall be exempt from the provisions of this section.

144. *See supra* notes 113-36 and accompanying text.

145. H.R. 1591, 99th Cong., 1st Sess. (1985); *see supra* note 143.

146. H.R. 1591, 99th Cong., 1st Sess. (1985).

147. *Id.* As presently drafted, then, secured creditors presumably could

tion also exempts from its provisions security interests already in existence.[148]

Repeal of the farm products exception, either directly or through a lender notice statute, would shift the loss resulting from a borrower's default from the farm products buyer to the lender. Although buyers no longer would face the threat of double liability, lenders may lose the security of having recourse against farm products buyers who in effect have acted as sureties on borrowers' loans. Proponents of repeal, however, point to California's experience[149] in asserting that repeal of the exception would not affect the availability of agricultural credit.

The failure of any other states to follow California's lead in repealing the farm products exception suggests, however, that repeal may be politically unpalatable at present and that repeal of the farm products exception by the UCC Permanent Editorial Board would not result in immediate adoption in many states. A review of California's unique agricultural system and its history suggests a possible explanation for California's repeal of the exception. Prior to adoption of the Code, California law severely restricted the rights of secured parties in crops once severed or sold. Unlike lenders in most agricultural states, California lenders have long relied on crop and dairy assignments or notice to buyers to protect their interests. The diversity of agricultural products, together with more limited marketing alternatives, make an assignment system a more feasible method of protecting lenders' interests in California than

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avoid the statute entirely by conditioning release on the buyer's agreement to stand as a surety on the underlying obligation of the seller. Because such a practice would discourage potential buyers from purchasing farm products subject to security interests, however, secured creditors may not often resort to such measures, or they may use them only when the seller is a particularly high risk borrower. *See supra* note 135 and accompanying text.

148. H.R. 1591, 99th Cong., 1st Sess. (1985). The widespread use of after-acquired property clauses in security agreements covering agricultural products, coupled with the practice of extending perfection of an existing security agreement by filing a continuation statement every five years, *see* U.C.C. § 9-402(2), (3), conceivably could allow lenders to escape the proposed federal law for decades.

149. Address by Larry Hultquist, General Counsel for the Federal Intermediate Credit Bank of Sacramento, American Agricultural Law Association 5th Annual Conference (Oct. 25-26, 1984). In his address, Mr. Hultquist considered California's favorable experience with repeal of the farm products exception. He emphasized, however, that the California experience should not necessarily be used as a basis for predicting the impact of repeal by other states because of the unique circumstances of California.

in most states. Moreover, California's geographical isolation from other agricultural markets reduces the number of interstate transactions, thereby increasing the likelihood that buyers will be aware of liens covering farm products.[150] California's marketing structure, however, may not remain unique among the states. As the national farm economy responds to the present state of despair, structural changes in marketing channels for agricultural products are to be expected. California's marketing structure thus may be a precursor to the future marketing structure in other states.

III. A UNIFORM FARM PRODUCTS EXCEPTION

A. THE NEED FOR UNIFORMITY

The current and increasing nonuniformity of section 9-307(1) may be the single greatest problem with the farm products exception. Interstate buyers of farm products and commission merchants cannot easily remain familiar with the various procedures they must follow to avoid liability to lenders under differing state laws. Moreover, the differences inevitably will cause conflict of laws problems, interjecting even more uncertainty into this area.[151] Section 9-307(1) no longer fulfills the Code's purpose of "mak[ing] uniform the law among the various jurisdictions."[152]

Consider, for example, an interstate buyer located in a state such as Missouri, which maintains the original farm products exception of section 9-307(1). Filing in Missouri is by the county of the debtor's residence, or, in the case of growing crops, in the county where the land is located.[153] If the buyer purchases farm products subject to a security interest perfected in Missouri, then, because Missouri retains the farm products exception,[154] the buyer would be subject to any security interests. The buyer's only means of protection is to undertake a diligent search of the lien records in the appropriate county. If, however, the same buyer purchases farm products subject to a security interest perfected in Kansas, it must be aware that information must be obtained from the secretary of state rather

150. *See Id.*

151. *See* U.C.C. § 9-103; J. WHITE & R. SUMMERS, *supra* note 26, at § 23-18 (discussing conflict of laws provisions of U.C.C. § 9-103).

152. U.C.C. §1-102(2)(c).

153. *See* MO. ANN. STAT. ch. 26, § 9-401(1)(a) (Vernon Supp. 1985).

154. *Id.* § 9-307(1).

than from the county recorder.[155] If the farm products are subject to interests perfected in North Dakota or Oklahoma, the buyer must know that it must request the name of the secured party from the seller.[156] And North Dakota requires a search of county records if the seller fails to voluntarily disclose the existence of liens, whereas Oklahoma does not.[157] In addition, if interests in the particular farm products were perfected in Illinois, Ohio, Kentucky, or Indiana, the buyer must check its own files for notification from the creditor to avoid liability.[158] Finally, the buyer must also be aware of the variations, however slight, among statutes of the same general type.

The Missouri interstate buyer, faced with the difficulty of remaining informed of the subtle differences of all the various state provisions, simply may forego the protections the state modifications were intended to provide. In that case, the reforms will have been of no value whatsoever. Even if a buyer were to research the applicable law of each state involved and conform with the requirements of local law, the increased protection obtained may be offset by the increased transaction costs. In either case, the current nonuniformity creates a heavy burden on interstate agricultural commerce.

B. THE ROAD TO UNIFORMITY

Two approaches are available for achieving uniformity: adoption of an amended section 9-307(1) by all or most of the states, or federal preemption. Although federal preemption offers some apparent advantages over state adoption, for now at least the problem is best left to the Permanent Editorial Board and the state legislatures. If the Permanent Board fails to act, or if it acts but a significant number of states refuse to follow its lead, federal action then may be appropriate.

The major advantage of federal legislation eliminating or modifying the farm products exception is the speed with which uniformity could be achieved. It has been estimated that it would take three to five years for states to adopt a proposed uniform modification of the UCC on a widespread basis.[159]

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155. *See supra* text accompanying notes 82 & 90.

156. *See supra* notes 97 & 99 and accompanying text.

157. *Compare* N.D. CENT. CODE § 41-09-28(4) (1983), *with* OKLA. STAT. ANN. tit. 12A, § 9-307(3) (West Supp. 1984). *See supra* text accompanying notes 100-06.

158. *See supra* text accompanying notes 119-28 & 133-34.

159. *Hearings*, *supra* note 28, at 275 (statement of American Feed Mfrs. Ass'n).

Congress, however, may not be much faster; the bills proposed in 1983 never reached the House floor before Congress adjourned in 1984, and the fate of the 1985 bill remains to be seen.

The second major advantage of federal legislation would be the clarification of the law applicable to federal lenders, such as the Farmer's Home Administration (FmHA). Federal law applies to the federal government acting through agencies such as the FmHA.[160] Thus, even if the states adopted a uniform provision, uniformity would be lost if the federal courts were to apply a different rule. In that case, whether a buyer of farm products would be subject to a security interest on the products could depend on whether the seller borrowed from a private lender or from the federal government.

This problem, however, may be more apparent than real. In *United States v. Kimbell Foods, Inc.*,[161] the Supreme Court held that the federal government's priority rights are decided by federal law but that state law—the UCC—applies to determine priority conflicts between the federal government and private lenders if no federal law has set the priorities.[162] The Court focused on three factors in determining whether to formulate a uniform national rule: (1) the need for uniformity; (2) whether applying state law would frustrate the specific objectives of the federal program; and (3) the extent to which applying a federal rule would disrupt commercial relationships predicated on state law.[163] Because state commercial codes "furnish convenient solutions in no way inconsistent with adequate protection of the federal interest[s],"[164] the Court held that state law provided the appropriate rule for the federal courts.[165]

Since the *Kimbell Foods* decision, three circuit courts have decided cases involving the liability of commission merchants to the FmHA for selling mortgaged farm products, and each court applied state law as the federal rule.[166] These decisions appropriately reflect the concern that the buyer's liability should not

160. *See* United States v. Kimbell Foods, Inc., 440 U.S. 715, 727 (1979).
161. 440 U.S. 715 (1979).
162. *Id.* at 740.
163. *Id.* at 727-33.
164. *Id.* at 729 (quoting United States v. Standard Oil Co., 332 U.S. 301, 309 (1947)).
165. *Id.* at 733.
166. United States v. Public Auction Yard, 637 F.2d 613 (9th Cir. 1980); United States v. Southeast Mississippi Livestock Farmers Ass'n, 619 F.2d 435 (5th Cir. 1980); United States v. Friend's Stockyard, Inc., 600 F.2d 9 (4th Cir. 1979).

depend on the status of the seller's lender. The problem of applying the farm products exception in cases involving federal lenders, therefore, is no longer an obstacle in the path of uniformity.[167]

Undue emphasis on uniformity may oversimplify the problem. The current multiplicity of approaches undoubtedly exacerbates the problem caused by the farm products exception, but the present lack of uniformity does not by itself necessarily indicate that a single federal provision, such as absolute repeal or a lender notice provision, is desirable. Most of the state modifications have been enacted only within the last few years, and greater experience under the various state approaches may be desirable before a single version is adopted. Moreover, even if a substantively acceptable federal statute could be enacted to solve the present problem, more than a temporary bandage is necessary. Without the benefit of the states' experience with various solutions, Congress, preferring to avoid "untested" alternatives, may be slow to amend any federal statute once in place. The logical consequence of an immediate federal solution thus may be a rigid statute poorly adapted to a constantly changing situation. The present nonuniformity must be diminished, but absolute uniformity should not come at the expense of a hastily-adopted, poorly-adapted version. For the present, then, the problem is best left to the UCC Permanent Editorial Board and the state legislatures.

Proponents of federal legislation often point to the reluctance of the UCC's Permanent Editorial Board to act on the problem, noting specifically the Board's failure to revise the current section 9-307(1) after receiving such a recommendation in 1970.[168] Several factors, however, make revision by the

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167. For additional discussion of the federal law issue, see Van Hooser, *supra* note 1, at 359-60.

The presence of the federal government as a major agricultural lender presents a potential obstacle to the congressional modification or repeal of the farm products exception. The FmHA and other federal agencies probably would lobby strongly against any modifications. Dean Hawkland has noted that the federal government was the chief proponent of the present system in 1970 when the Permanent Editorial Board considered and ultimately rejected a modification of the farm products exception. *See* Hawkland, *supra* note 41, at 420. Congress may well be unwilling to impair the collateral of federal lenders in a year in which the federal government is carefully scrutinizing its expenditures to balance the budget.

168. The 1970 proposed amendment would have eliminated the farm products exception, but the Board rejected the proposal because it feared that states would not uniformly adopt the revision. *See* Hawkland, *supra* note 41, at 420.

Board far more likely in 1985 than it was in 1972. Most states and Congress did not take any steps towards modification until 1983,[169] suggesting that the problem only recently has been perceived as critical. The depressed farm economy undoubtedly has aggravated the problem. Furthermore, not until 1976 did Congress amend the Packers and Stockyards Act to require packers and dealers to pay for livestock purchases by the close of the next business day.[170] Dean William D. Hawkland has suggested that the Board's failure to amend section 9-307(1) in 1972 stemmed from a belief that virtually all states desired a farm products exception. Some of those states would have retained the exception, it was believed, resulting in a nonuniform section 9-307(1).[171] Time has dispelled this theory.

Perhaps the most persuasive reason for leaving the farm products exception to the states is Congress's traditional reluctance to involve itself in commercial laws. Nonuniformity among state laws does not alone justify federal intervention. Other sections of the UCC affecting agriculture currently are nonuniform, and Congress has made no move toward preempting those provisions.[172] Congress likewise should defer to the individual states and the Permanent Editorial Board with respect to section 9-307(1).[173] The Board must do its part, however, if federal preemption is to be avoided.

IV. PROPOSED ALTERNATIVE FOR THE PERMANENT EDITORIAL BOARD

The widespread dissatisfaction with the current farm products exception indicates that the time has come for the Permanent Editorial Board to modify section 9-307(1). Because no

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169. *See supra* notes 4-5.

170. *See supra* note 65 and accompanying text (prompt payment provisions of the Packers and Stockyards Act).

171. *See* Hawkland, *supra* note 41, at 420.

172. U.C.C. § 9-401, for example, provides three alternatives to govern the place for filing to perfect security interests in different classes of collateral. Similarly, U.C.C. § 2-318 provides three alternative sets of warranty provisions for third parties injured by the seller's breach of warranty.

173. The sponsor of the Farm Products Buyers' Protection Bill of 1983, Rep. Tom Harkin, suggested during congressional hearings that the federal government defer to the states on the farm products exception if the states were to act on the problem. He stated:

> To the extent that we can get the American Law Institute and the commissioners . . . who decide on the changes in the Uniform Commercial Code . . . to address this problem and to take care of it in the normal fashion, that would be fine.

Hearings, supra note 28, at 88.

alternative fully satisfies the interests of all effected parties, and because different states have determined that different alternatives best meet their needs, the choice of a single approach may be unwise at this time. The best approach would be for the Permanent Editorial Board to promulgate a revised section 9-307(1) providing three alternatives:

(1) Retain the farm products exception for buyers of farm products but require central filing. Provide also that commission merchants and auctioneers would no longer be subject to liability to lenders.

(2) Retain the farm products exception for buyers of farm products but require lenders to notify buyers of liens. Also provide that commission merchants and auctioneers would no longer be subject to liability to lenders. The method of giving notice (for example, registered or certified mail return receipt requested), the frequency with which notice must be given (for example, every five years), requirements for voiding the notice once payment is made, and other details that currently vary among the states that have adopted the principal of this alternative would be made uniform.

(3) Repeal the farm products exception.[174]

Revising section 9-307(1) in such a way would reduce the confusion resulting from the current nonuniformity. Buyers of farm products would need to know of only three alternatives and two places to search to avoid liability to lenders. The availability of three sound alternatives also would virtually guarantee that every state legislature could find a politically palatable approach without having to resort to a nonuniform provision. Until more experience is gained with the various alternatives, limited nonuniformity among the states seems desirable. If experience proves that one of the alternatives is preferable, the Permanent Editorial Board could amend section 9-307(1) again at a later time to implement the preferable method. Finally, all three alternatives relieve commission merchants and auctioneers of potential liability to lenders. This result is desirable in

174. Inclusion of the third alternative, repeal of the farm products exception, may seem peculiar in light of the previous discussion of this alternative and the apparent reluctance of states to adopt it. Repeal of the farm products exception, however, may be the long-range solution to the problem. *See* Geyer, *supra* note 1, at 361-77; *supra* text accompanying notes 159-71. For the reasons stated above, however, repeal is not the optimum short-range option, unless the Permanent Editorial Board fails to amend § 9-307(1) or the states fail to adopt the suggested replacement.

light of the unfairness of forcing sales agents to pay for products they never owned.

CONCLUSION

The confusion resulting from the several nonuniform versions of section 9-307(1) places an unnecessary burden on agricultural commerce that, given the current state of agriculture, is particularly undesirable. Regardless of the continued validity of the justifications originally advanced in support of the farm products exception, it is clear today that the exception's burdens on the effected parties outweigh its purported benefits. The time has come for the Permanent Editorial Board of the UCC to amend section 9-307(1). Adoption of the three proposed alternative provisions as the new section 9-307(1) would reduce the nonuniformity to a manageable level and still provide states with the flexibility to choose a version that best fits the the needs of their particular agricultural industries and marketing systems. Although a completely uniform section 9-307(1) may be the ultimate goal, the proposed amendment is a desirable and necessary first step. If, however, the Permanent Editorial Board fails to act, federal preemptive legislation may be preferable to no action at all.