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**Farm Products: Recent Legislative
Changes to Section 9-307**

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FARM PRODUCTS: RECENT LEGISLATIVE CHANGES TO SECTION 9-307

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This article provides a brief overview of the mortgaged farm products problem and surveys the legislation enacted by the various states to date to limit the liability of persons who buy encumbered farm products and of the commission merchants who act as intermediaries to transfer farm products from seller to buyer.

INTRODUCTION

As a general rule, Article 9 of the Uniform Commercial Code¹ fosters an open market rule which permits good faith purchasers to take goods free of perfected security interests.² This general rule does not, however, hold true for good faith purchasers of farm products.³ Nor does Article 9's general open market rule hold true for commission merchants⁴ who act as agents in selling farm products. According to the great weight of legal authority, buyers of farm products and commission merchants who act as agents in selling farm products are liable to the secured lender if the borrower-seller fails to account to the secured lender for the proceeds of sale, even though the buyer or commission merchant does not know that the farm products have been mortgaged.⁵ This liability⁶ is founded principally on the

* B.J., University of Missouri - Columbia, 1971; J.D., University of Missouri - Kansas City, 1977; Deas, Van Hooser & Olsen, P.C., Kansas City, Missouri.

1. The UNIFORM COMMERCIAL CODE is hereafter cited as "Code." Unless otherwise indicated, all section references are to the 1972 official version of the Code.

2. U.C.C. § 9-307(1), (2).

3. U.C.C. § 9-307(1). See § 9-307, comment 2. U.C.C. § 9-109(3) defines goods as farm products if they 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.

4. A commission merchant is "one who receives goods, chattels, or merchandise for sale, exchange, or other disposition, and who is to receive a compensation for his services, to be paid by the owner, or derived from the sale, etc., of the goods." BLACK'S LAW DICTIONARY 339 (4th ed. 1968).

As a general rule commission merchants, especially in the livestock industry, are auctioneers. They do not purchase (take title to) the goods; they act as selling agents only. See generally *Farmers State Bank v. Stewart*, 454 S.W.2d 908, 909 (Mo. 1978); *United States v. Gallatin Livestock Auction, Inc.*, 448 F. Supp. 616, 620 (W.D. Mo. 1978). *Greater Louisville Auto Auction, Inc. v. Ogle Buick, Inc.*, 387 S.W.2d 17 (Ky. 1965); *Commercial Credit Corp. v. Joplin Auto Auction, Co.*, 430 S.W.2d 440 (Mo. 1968).

5. See, e.g., *United States v. Sommerville*, 324 F.2d 712, 717-18 (3d Cir. 1963), cert. denied, 376 U.S. 909, (1964); *United States v. McCleskey Mills, Inc.*, 409 F.2d 1216 (5th Cir. 1969); *United States v. Gallatin Livestock Auction, Inc.*, 448 F. Supp. 616 (W.D. Mo. 1978); *Farmers State Bank v. Stewart*, 454 S.W.2d 908 (Mo. 1970); *Garden City Prod. Credit Ass'n v. Lannan*, 186 Neb. 668, 186 N.W.2d 99 (1971).

6. The liability faced by buyers of farm products and commission merchants who sell farm products is often referred to as "double jeopardy" because these persons risk paying for their purchases twice: once to the farmer and again to the lender who held a security interest in the farm products.

interaction of section 9-306(2) with section 9-307(1) and on the tort of conversion.⁷

Section 9-306(2) provides that a security interest continues in collateral notwithstanding sale, exchange or other disposition and in any identifiable proceeds therefrom unless the sale, exchange or other disposition was authorized by the secured party. A buyer of inventory in the ordinary course of business, however, is protected from this continuing security interest by section 9-307(1), which provides that such a buyer takes free of a security interest created by his seller; not so for a buyer of farm products. Because of the special rule for farm products set out in section 9-307(1),⁸ a buyer in ordinary course of farm products is not protected from the continuing secur-

7. *United States v. McCleskey Mills, Inc.*, 409 F.2d 1216, 1218-19 (5th Cir. 1969). Conversion is generally defined as tortious interference with the possessory rights of another to personal property. 18 AM. JUR. 2d *Conversion* §§ 1, 25 (1965). In other words, the gist of conversion is interference with control of the property. W. PROSSER, *LAW OF TORTS* § 15 at 93 (4th ed. 1971).

8. U.C.C. § 9-307(1) provides: "A buyer in ordinary course of business . . . other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence." (emphasis added).

The farm products exception of section 9-307 has been justified on the ground that buyers of farm products are sophisticated enough to know that their seller may have mortgaged the farm products he is selling. Coogan, *Public Notice Under the Uniform Commercial Code and Other Recent Chattel Security Laws, Including "Notice Filing,"* 47 IOWA L. REV. 289, 302 (1962); Hawkland, *The Proposed Amendment to Article 9 of the U.C.C.—Part I: Financing the Farmer*, 76 COM. L.J. 416, 418 (1971); Clark, *The Agricultural Transaction: Livestock Financing*, 11 U.C.C. L.J. 106, 112 (1978). The problem with this justification is that a buyer, no matter what his level of sophistication regarding agricultural financing, may not be able to determine whether the goods he is purchasing are mortgaged or not. If, for example, a broker is purchasing grain from an elevator, the broker would expect, as a buyer of inventory, to take free of any security interest in the grain. He would not know the identity of the farmers who had sold grain to the elevator so that he could run lien searches on all of them. Yet, if the elevator had purchased the grain from a farmer who had granted his bank a security interest in the grain, the broker would take subject to the security interest created by the farmer, because the broker only takes free of security interests created by his seller (the elevator), not prior sellers. See Coates, *Financing the Farmer*, 20 PRAC. LAW 45, NOV. 1974 at 49; Dugan, *Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code*, 46 U. COLO. L. REV. 333, 334 (1975); Dolan, *Section 9-307(2): The U.C.C.'s Obstacle to Agricultural Commerce in the Open Market*, 72 NW. U.L. REV. 706, 713 (1977) (Professor Dolan's article provides an excellent overview of how the farm products exception has "bred spawling diversity through legislation, common law exceptions, and provisions within the Code itself." *Id.* at 736).

Even without the difficulties encountered as a subsequent purchaser, buyers and commission merchants are often simply not able, because of time constraints and cost, to check for liens on all the farm products they buy or sell. This is especially true for livestock markets, livestock dealers and packers. Under the Packers and Stockyards Act, livestock markets, dealers and packers are required to pay for livestock by the close of the next business day following the date of the transaction. See 7 U.S.C. 228b (1983).

Another justification often cited for the farm products exception is that sales of farm products are more closely akin to bulk sales than to sales of inventory. Thus, goes the argument, because farm products are not subject to the creditor protections afforded by Article 6 of the U.C.C., lenders must have the protection afforded by the farm products exception in order to protect their interests. Although this justification is more persuasive than the first, it also encounters problems when examined closely, especially with respect to livestock. For example, a dairy herd is a constantly changing asset. Poor producers are culled and replaced. Male increase, being outside the normal scope of a dairy farmer's business, are sold. It is difficult to see how this continuing turn over of a small number of animals is akin to a bulk sale. Even grain, because of the more sophisticated marketing techniques now being used by farmers, will often not be sold at one time; it will instead be sold over a period of months to take advantage of "off season prices" and to fulfill forward contracts. See Dolan, *supra* this note, at 717; Coogan and Mays, *Crop Financing and*

ity interest of subsection 9-306(2): he takes subject to the security interest. Thus, the secured party may reclaim the farm products from the buyer⁹ or he may hold the buyer accountable for the value of the security interest in those farm products. Additionally, if the security agreement makes the borrower's unauthorized sale of the farm products a default entitling the secured party to possession of the collateral and the buyer does not account to the secured party for the collateral, the secured party may hold the buyer liable for conversion because the buyer has wrongfully interfered with the secured party's right to possession of the collateral.¹⁰

Unlike a buyer of farm products, a commission merchant's liability for selling mortgaged farm products is not based principally on the interplay of subsection 9-306(2) and the farm products exception of section 9-307(1). A

Article 9: A Dialogue with Particular Emphasis on the Problems of Florida Citrus Crop Financing, 22 U. MIAMI L. REV. 13 (1967).

Yet another justification for the farm products exception is that agricultural enterprises will not be able to secure credit without this "favorable" agricultural lending rule. Presumably agricultural lenders are just as interested in promoting the sale of agricultural commodities as their borrowers are, it is difficult to see how a rule which hinders the ready flow of those commodities can help creditors. See Dolan, *supra* this note, at 716-17.

In sum, the justifications cited for the farm products exception rest on questionable grounds. When buyers cannot protect themselves without an inordinate expenditure of time and money the result is economic loss for the entire agricultural industry and all those associated with it.

9. See, e.g., *Garden City Prod. Credit Ass'n v. Lannan*, 186 Neb. 668, 186 N.W.2d 99 (1971) (A Kansas PCA successfully replevied 161 head of cattle from an innocent Nebraska purchaser, despite the fact that the Nebraska purchaser was a buyer in ordinary course from a middleman, rather than from the farmer/debtor).

10. See *United States v. McCleskey Mills, Inc.*, 409 F.2d 1216 (5th Cir. 1969). See also *Oxford Prod. Credit Ass'n v. Dye*, 368 So. 2d 241 (Miss. 1979). Compare *Hedrick Savings Bank v. Myers*, 229 N.W.2d 252 (Iowa 1975) (the Iowa Supreme Court struck down the continuance of a security interest in farm products because of a course of dealing not to enforce a requirement of prior written consent) and *Anon, Inc. v. Farmers Prod. Credit Ass'n of Scottsburg*, — Ind. App. —, 446 N.E.2d 656 (1983) (the Indiana First District Court of Appeals held that a secured party who allowed the debtor standing authority to sell hogs upon the condition that he promptly remit the proceeds of sale to the secured party waived its contractual right to require prior written consent for such sales and its security interest in the hogs was cut off by the sale).

For additional cases dealing with the question of whether the secured lender had authorized sales, see *First Nat'l Bank & Trust Co. v. Iowa Beef Processors, Inc.*, 626 F.2d 764 (10th Cir. 1980); *United States v. Hansen*, 311 F.2d 477 (8th Cir. 1963); *United States v. Central Livestock Ass'n, Inc.*, 349 F. Supp. 1033 (D.N.D. 1972); *United States v. E.W. Savage & Son, Inc.*, 343 F. Supp. 123 (D.S.D. 1972), *aff'd*, 475 F.2d 305 (8th Cir. 1973); *United States v. Hughes*, 340 F. Supp. 539 (N.D. Miss. 1972); *United States v. Big Z Warehouse*, 311 F. Supp. 283 (S.D. Ga. 1970); *In re Cadwell, Martin Meat Co.*, 10 U.C.C. Rep. Serv. (Callaghan) 710 (E.D. Cal. 1970); *United States v. Greenwich Mill & Elevator Co.*, 291 F. Supp. 609 (N.D. Ohio 1968); *Planters Prod. Credit Ass'n v. Bowles*, — Ark. —, 511 S.W.2d 645 (1974); *Vermilion County Prod. Credit Ass'n v. Izzard*, 111 Ill. App. 2d 190, 249 N.E.2d 352 (1969); *Ottumwa Prod. Credit Ass'n v. Heinold Hog Market, Inc.*, 340 N.W.2d 801 (Iowa App. 1983); *Ottumwa Prod. Credit Ass'n v. Keoco Auction Co.*, — N.W.2d —, No. 83-181, Iowa Sup. Ct., March 28, 1984; *Lisbon Bank & Trust Co. v. Murray*, 206 N.W.2d 96 (Iowa 1973); *North Central Kansas Prod. Credit Ass'n v. Washington Sales Co.*, — Kan. —, 577 P.2d 35 (1978); *Wabasso State Bank v. Caldwell Packing Co.*, 308 Minn. 349, 251 N.W.2d 321, 19 U.C.C. Rep. Serv. (Callaghan) 315 (1976); *Charterbank Butler v. Central Cooperatives, Inc.* — S.W.2d —, No. 34442, Mo. App., March 13, 1984; *Farmers State Bank v. Edison Non-Stock Coop. Ass'n*, 190 Neb. 789, 212 N.W.2d 625 (1973); *Garden City Prod. Credit Ass'n v. Lannan*, 186 Neb. 668, 186 N.W.2d 99 (1971); *Cloviss Nat'l Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726 (1967); *Blubaugh v. Ponca City Prod. Credit Ass'n*, 9 U.C.C. Rep. Serv. (Callaghan) 786 (Okla. 1971); *Baker Prod. Credit Ass'n v. Long Creek Meat Co.*, 266 Or. 643, 513 P.2d 1129 (1973); *Central Washington Prod. Credit Ass'n v. Baker*, 11 Wash. App. 17, 521 P.2d 226 (1974). For a discussion of many of these cases, see Skilton, *Buyer in Ordinary Course of Business Under Article 9 of the Uniform Commercial Code (and Related Matters)*, 1974 WIS. L. REV. 1, 72-76.

commission merchant's liability is based on conversion.¹¹ If the security agreement makes the borrower's unauthorized sale a default entitling the secured party to possession of the collateral and the commission merchant does not account to the secured party for the collateral, the secured party may seek recovery against the commission merchant under either of two theories of conversion. Under the first theory, a commission merchant is liable for conversion because he has, by his exercise of dominion and control over the farm products during the selling process, interfered with the secured party's right to possession of the collateral.¹² Under the second theory, a commission merchant's liability is based on his acting as agent for the mortgagor. Thus, when a borrower sells mortgaged farm products without the secured party's consent, he is deemed to have tortiously interfered with the secured party's right to possession and the commission merchant, as the borrower's agent, stands in the shoes of his principal.¹³

STATE LEGISLATION

As the mortgaged farm products problem has grown, so has the concern of buyers and commission merchants.¹⁴ They have increasingly sought legislation to protect themselves and to unfetter the flow of agricultural commodities.

Pre-1983 Legislation

Prior to 1983 only six states had enacted legislation specifically aimed at limiting the liability of buyers and commission merchants who buy and sell farm products.

1. Nebraska

The first state to enact legislation relating to mortgaged farm products was Nebraska. In 1963, apparently in direct reaction to a four to three decision handed down by the Nebraska Supreme Court finding an auctioneer

11. See *Farmers State Bank v. Stewart*, 454 S.W.2d 908, 915 (Mo. 1970). The Missouri Supreme Court stated:

The almost universally accepted rule is that an agent, factor, commission merchant or auctioneer who receives property from his principal and sells it and pays the proceeds of the sale to him is guilty of conversion if the principal has no right to sell the property, even though the agent acts without knowledge of the defect in title.

Id. See also Annot., 96 A.L.R.2d 208 (1964).

12. See *United States v. Sommerville*, 324 F.2d 712, 718 (3d Cir. 1963) *cert. denied*, 376 U.S. 909 (1964).

13. *Id.* The rationale underlying the agency theory of liability is that inasmuch as an agent is free to deal with, or serve, whomever he pleases, he should be held liable if he chooses to assist a principal, even knowingly, in the commission of a tort.

14. According to statistics released by the Farmers Home Administration in 1983, the FmHA, at the end of fiscal year 1978, had claims valued at \$766,663 pending in the U.S.D.A.'s office of General Counsel against buyers and commission merchants for converting the FmHA's interest in secured livestock. At the end of fiscal year 1982, there were claims valued at \$6,581,968 pending. At the end of fiscal year 1978, the FmHA had no claims pending against buyers and commission merchants for converting the FmHA's interest in secured grain. At the end of fiscal year 1982, there were claims valued at \$7,194,321 pending.

liable to a secured party when the auctioneer sold mortgaged personal property for a farmer, Nebraska enacted section 69-109.01 of the Nebraska Revised Statutes.¹⁵ Section 69-109.01 provides protection for auctioneers and auction companies who sell personal property; it does not protect buyers of personal property. The protection given to auctioneers and auction companies is not absolute, however. In order to gain the protection of section 69-109.01, an auctioneer must (1) sell the personal property at auction, (2) in good faith and without knowledge of a security interest in the property, (3) for a principal whose identity has been disclosed, and (4) have no personal interest in the property being sold.¹⁶

2. California

In 1974, California enacted legislation (which became effective January 1, 1976) that amended California's version of Section 9-307(1) to read as follows: "A buyer in ordinary course of business (subdivision (9) of Section 1201) takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence."¹⁷ Thus, California became the first and to date the only state to simply delete the farm products exception from section 9-307(1) without making other statutory changes that affect farm products.

3. Georgia

In 1978, Georgia amended section 9-307 of its version of the Code by adding a new subsection (3) which provides:

A commission merchant who shall sell livestock or agricultural products for another for a fee or commission shall not be liable to the 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.¹⁸

Like the Nebraska statute, the Georgia statute does not provide protection for persons who purchase; it protects only commission merchants. Unlike the Nebraska statute, the Georgia statute does not protect intermediaries who sell all types of personal property; it protects only those who sell livestock or agricultural products. Further, unlike the Nebraska statute which would appear to protect the intermediary against liability for any security interest, regardless of whether that security interest was created by the immediate seller or some prior seller, the Georgia statute specifically limits protection to situations where the security interest was created by the immediate seller.

15. *State Securities Co. v. Svoboda*, 172 Neb. 526, 110 N.W.2d 109 (1961).

16. NEB. REV. STAT. § 69-109.01 (1981); *State Securities Co. v. Norfolk Livestock Sales Co., Inc.*, 187 Neb. 446, 191 N.W.2d 614, 617 (1971).

17. CAL. COM. CODE § 9307 (West 1964 & Supp. 1984).

18. GA. CODE ANN. § 109A 9-307 (Supp. 1982).

4. Montana

Montana, as part of a comprehensive livestock marketing law, enacted section 81-8-301 of the Montana Code Annotated, which provides in pertinent part:

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. . . . *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.*¹⁹

The Montana statute, unlike the Nebraska and Georgia statutes, does not base the commission merchant's exemption from liability on whether or not the intermediary had actual notice of the security interest. The Montana statute's exemption is based on whether notices of security agreements are filed with the state's department of livestock and copies of those notices are transferred to the livestock markets prior to the time of sale.

According to the Montana Supreme Court, when ruling on an earlier version of this statute in *Montana Meat Co. v. Missoula Livestock Auction Co.*,²⁰ the failure of the mortgagee to record as required by the statute precludes liability even when the intermediary had actual notice of the mortgage. Thus, it appears that Montana law requires dual filing (under section 87A-9-401 and 81-8-301) in order for a secured party to have a perfected security interest in livestock.

5. Idaho

Following Montana's lead, Idaho passed legislation in 1981 which provides for the filing of security agreements covering livestock with the state brand board.²¹ However, that is where the similarity ends. The Idaho legislation does not provide that a market will not be liable unless the security agreement is filed with the brand board. In fact, the Idaho legislation specifically provides that "the provisions of this section shall not affect the rights and responsibilities of any party under chapter 9, title 28 of the Idaho Code, nor does filing pursuant to this section perfect a security agreement thereunder."²²

19. MONT. CODE ANN. § 81-8-301(1) (1983) (emphasis added).

20. 125 Mont. 66, 230 P.2d 955 (1951). See also *Batey Land & Livestock Co. v. Nixon*, 172 Mont. 99, 560 P.2d 1334 (1977); *United States v. Public Auction Yard*, 637 F.2d 613 (9th Cir. 1980).

21. IDAHO CODE § 25-1117 (Supp. 1983).

22. *Id.* § 25-1117(6).

6. Kentucky

In 1982, Kentucky amended section 9-307 of its version of the Code to provide protection to bona fide purchasers of grain and livestock, as well as to the selling agents who sell livestock.²³ Under the amended Kentucky law, persons who hold either "a current grain storage license issued by the Commonwealth of Kentucky or a current federal warehouse storage license," take title to grain free of any security interest unless, prior to payment of the proceeds, that person receives written notice by certified mail of the security interest.²⁴ If mortgaged livestock is sold "at public auction through a [duly licensed stockyard] in the ordinary course of business," bona fide purchasers of the livestock take title free of any security interests and the stockyards and selling agents are not liable to the secured party, unless written notice of the security interest is given prior to the time of sale.²⁵

1983 Legislation

In 1983, eleven states enacted legislation to help buyers or commission merchants limit their potential liability with respect to mortgaged farm products.

1. South Dakota

In March 1983, South Dakota enacted legislation which provides that a secured party cannot commence an action against an innocent purchaser of farm products, nor against a livestock auction market, nor a public grain warehouse, public terminal grain warehouse or grain dealer unless the action is commenced within twenty-four months from the date the farm products were sold and the secured party has, prior to commencing the action, offered to file a criminal complaint against the seller.²⁶ In addition, the legislation makes it a crime to sell livestock or grain through any of the entities listed above without notifying them of a security interest in the farm products being sold.²⁷

2. North Dakota

Like South Dakota, the North Dakota legislation²⁸ includes a criminal provision²⁹ and requires a lender to make an effort to collect from the borrower before the lender tries to collect from the buyer of farm products.³⁰ At that point, however, the similarity to South Dakota's legislation ends.

The basic element of the North Dakota legislation requires "a merchant

23. KY. REV. STAT. § 355.9-307 (Supp. 1982).

24. *Id.* § 355.9-307(3).

25. *Id.* § 355.9-307(4).

26. S.D.C.L. § 57A-9-503.1 (Supp. 1983).

27. *Id.* § 57A-9-503.2.

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

29. *Id.* § 41-09-28.4 and § 12.1-23-08 (Supp. 1983).

30. *Id.* § 41-09-28.6 (1983).

who purchases or a commission merchant who sells farm products for another"³¹ to obtain from the seller, prior to payment, a certificate of ownership, which discloses "the names, social security numbers, addresses and home counties of the owners for five years prior thereto (completion of the certificate), 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 such farm products. . . ."³² After obtaining the certificate of ownership, the merchant or commission merchant must "enter on the check or draft (as a joint payee) the name of the secured party disclosed in the certificate, or actually known by the merchant at the time" to exempt himself from liability.³³ However, a merchant or a commission merchant cannot stop once he has obtained the certificate of ownership, because the statute goes on to provide:

A merchant who purchases from or a commission merchant who sells farm products for another for a fee or commission takes free of security interest created by the seller if:

- a. The merchant has complied with the requirements of subsection 4 [of this section];
- b. In the case where the seller disclosed no security interests, the merchant has requested information from the register of deeds in the counties of the sellers' residences over the five years prior thereto, as disclosed in the certificate, (or from the office of secretary of state if section 41-09-40 provides for filing in that office) as to the existence of financing statements naming the seller, and has received from the filing officer a certificate verifying disclosures obtained by such inquiry, and has entered on the check or draft the names of any secured parties named in the certificate as payees with the seller;
- c. The merchant does not have actual knowledge at the time of transaction of the existence of security interests;
- d. The merchant maintains records of such actions to support any criminal proceedings against the seller for violation of section 12.1-23-08.³⁴

3. Tennessee

Tennessee amended its version of section 9-307 by deleting the farm products exception and adding several new subsections which, in essence, provide that if livestock, grain or tobacco is sold through specified entities, bona fide purchasers take free of any security interest in those farm products and selling agents are not liable to the holders of such security interests unless prior written notice is given.³⁵ The required notice must be given to parties entitled to the notice that are located within seventy-five miles of the

31. *Id.* § 41-09-28.4.

32. *Id.*

33. *Id.*

34. *Id.* § 41-09-28.7.

35. TENN. CODE ANN. § 47-9-307 (1), (2)(a)-(c) (Supp. 1983).

creditor's principal place of business, must be renewed annually and must include the name and address of the debtor, a proper description of the collateral and the location of the collateral.³⁶ Moreover, even if the secured party has complied with the notice requirements, he will not be permitted to seek recovery from a public livestock market, buying station, community sale yard, meatpacker, public grain warehouse, or tobacco warehouse unless he has first attempted to collect from the debtor."³⁷

4. Nebraska

For the purposes of this article, the most significant portion of the legislation enacted by Nebraska in 1983 is that which adds a fourth subsection to Section 9-307.³⁸ The new 9-307(4) imposes a duty on buyers of farm products and persons who sell farm products for a fee or commission to require the seller to identify the person who holds the first security interest in the farm products being sold. If the seller is then paid with a check drawn payable to the seller and the named first security holder *and* if the named first security holder authorizes the negotiation of the check, the buyer of the farm products takes free of any security interest.³⁹ However, the new subsection 4 goes on to state that "[a]ny endorsement for payment made on such check shall not serve to establish or alter in any way security interest priorities under Nebraska law. Unless amended or postponed, section 9-307(4) will terminate on September 1, 1987."⁴⁰

In addition to amending section 9-307 of Nebraska's Code, the new legislation establishes an eighteen month statute of limitations for actions to recover collateral if "(a) the possession and ownership of which a debtor has in any way transferred to another person and (b) which was used as security for payment pursuant to an agreement, contract, or promise in writing which covers farm products . . . or farm products which become inventory of a person engaged in farming."⁴¹

Finally, with regard to the legislation enacted by Nebraska, it should be noted that although the county clerk's office is still the proper place to file a financing statement on farm products, the county clerk must now transmit financing statements and other documents relating to farm products to the Secretary of State's office so that on or before January 1, 1985 such information will be available through the Nebraska Secretary of State's office.⁴²

5. Indiana

The legislation enacted in Indiana during 1983 deletes the farm prod-

36. *Id.* § 47-9-307 (2)(d).

37. *Id.* § 47-9-307 (2)(e).

38. NEB. REV. STAT. U.C.C. § 9-307(4) (Supp. 1983).

39. *Id.*

40. *Id.*

41. *Id.* § 25-205.

42. *Id.* U.C.C. §§ 9-401(1), 9-411(3).

ucts exception.⁴³ However, it then goes on to add that a person buying farm products from a person engaged in farming operations is not protected if he has received prior written notice of the security interest.⁴⁴ To qualify as prior written notice, a notice must be received before the buyer has paid for the farm products and must contain all of the following information:

- (1) [t]he full name and address of the debtor, (2) [t]he full name and address of the security party, (3) [a] description of the collateral, (4) [t]he date and location of the filing of the security interest, (5) [t]he date and signature of the secured party and (6) [t]he date and signature of the debtor.⁴⁵

The notice expires eighteen months after the date the secured party signs it or at the time the debt for which the farm products stand as collateral is satisfied, whichever occurs first.⁴⁶

So that secured parties will be able to determine to whom notice should be sent, the Indiana law requires the debtor to provide the secured party with a written list of potential buyers of the farm products if the secured party asks for such a list.⁴⁷ If a debtor has given a secured party such a list, he cannot then sell to any buyer who is not on the list unless the secured party has given prior written permission for the debtor to do so or the debtor accounts to the secured party for the sales proceeds within fifteen days of the date of sale.⁴⁸ A knowing and intentional violation of this requirement is a class C misdemeanor.⁴⁹

One unique feature in the Indiana legislation is the provision which makes it a class C infraction for a buyer of farm products, on which there is a security interest, to withhold any part of the sales proceeds in order to satisfy a prior debt owed by the seller to the buyer.⁵⁰

Unlike most of the other states that have passed legislation related to the mortgaged farm products problem, Indiana did not address the liability of commission merchants. Its legislation provides protection only for buyers.

6. Ohio

Under legislation enacted by Ohio in 1983 a buyer in ordinary course of business of farm products from a person engaged in farming operations takes free of a security interest created by his seller unless the buyer (1) has received written notice as specified by the statute within eighteen months prior to payment of the sales proceeds and (2) fails to make payment in

43. IND. CODE ANN. § 26-1-9-307(1) (Burns Supp. 1983).

44. *Id.* § 26-1-9-307(1)(a).

45. *Id.*

46. *Id.*

47. *Id.* § 26-1-9-307(1)(b).

48. *Id.* § 26-1-307(1)(c).

49. *Id.*

50. *Id.* § 26-1-307(1)(d).

accordance with the notice.⁵¹ Unlike Indiana, Ohio specifically addressed the potential liability of commission merchants. It accomplished this by providing that the term "buyer of farm products" includes a buying or selling agent.⁵²

If a secured party wants to protect its security interest in farm products, it can ask its debtor for a written list of potential buyers of the farm products and give the required written notice to such buyers.⁵³ A debtor must provide the list of potential buyers if the secured party requests it and is prohibited under first degree misdemeanor penalties from selling farm products to buyers who are not on the list without the prior written permission of the secured party.⁵⁴

The new Ohio law also contains a number of other provisions which address additional concerns of buyers and sellers. One of the new provisions protects buyers who comply with the payment instructions set out in the notice against a seller who might otherwise assert that his lender was not entitled to be paid according to the stated instructions at the time of sale.⁵⁵ Another new subsection prohibits buyers from publicly disclosing the identity of persons named in the prescribed notice.⁵⁶

7. Louisiana

Effective August 30, 1983, owners and operators of livestock marketing agencies in Louisiana cannot be held liable to the holder of a security device affecting livestock which are sold through the marketing agency unless the owner or operator has received a written notice, by certified mail or hand delivery, which sets forth (1) the name and address of the secured party, (2) the name and address of the person who granted the security device, (3) the parish of residence of the person who granted the security device, and (4) information concerning the security device.⁵⁷ If a livestock market agency has received the prescribed notice, it must make payment jointly to the owner of the livestock and to the secured party.⁵⁸

Any person who provides false or misleading information concerning the name of the owner of any livestock or the existence of any security device affecting livestock with intent to deprive the secured party of its security subjects himself to a fine of not more than five thousand dollars (\$5,000) or imprisonment, with or without hard labor, for not more than ten years, or both.⁵⁹

51. OHIO REV. CODE ANN. § 1309.26(B)(1)(a), (b) (Page Supp. 1983).

52. *Id.* § 1309.26(B)(5).

53. *Id.* § 1309.26(B)(4).

54. *Id.* § 1309.26(B)(4), (8).

55. *Id.* § 1309.26(B)(3).

56. *Id.* § 1309.26(B)(6).

57. LA. REV. STAT. ANN. § 3: 568(A), (B) (Supp. 1984).

58. *Id.* § 3:568(C).

59. *Id.* § 3:568(F).

8. Oklahoma

Whereas Louisiana sought to protect only those who deal with livestock, Oklahoma amended its version of section 9-307 to protect those who deal with all farm products except livestock.⁶⁰ In order to obtain the protection afforded by the new Oklahoma law, however, a merchant who is purchasing or a commission merchant who is selling farm products (other than livestock) (1) must require the seller to provide a "certificate of ownership" which discloses the names of all lenders, if any, who hold a security interest in those products and (2) must enter as a joint payee on the payment instrument the name of any lender disclosed in the certificate.⁶¹ Any merchant or commission merchant who fails to obtain the certificate and to issue the payment instrument accordingly is liable to the secured party.⁶²

9. Oregon

In some respects, the legislation enacted by Oregon⁶³ is quite similar to that enacted by Montana.⁶⁴ Basically, it provides that "livestock auction market operators, purchasers of livestock and their agents are not liable to any secured party for proceeds from the sale of cattle, horses or sheep" unless security interest statements have been filed with the Oregon Department of Agriculture, in addition to the required governmental office set forth in Article 9 of the Code.⁶⁵ Information regarding the financing statements so filed must be given to livestock auction markets and livestock dealers who request it and must be furnished at sales at locations other than licensed livestock auction markets by notations on brand inspection certificates.⁶⁶ The law carries an automatic termination date of July 1, 1987.

10. Illinois

The legislation enacted by Illinois in 1983⁶⁷ changes the Illinois U.C.C. by amending sections 9-306.01 and 9-307 and adding sections 9-205.1, 9-306.02, 9-307.1 and 9-307.2. In substance, the new legislation (1) allows secured parties to require that before debtors sell secured collateral, they disclose to the secured parties the names of the persons to whom they intend to sell the collateral;⁶⁸ (2) imposes criminal sanctions on debtors who sell to persons other than those disclosed to the secured party;⁶⁹ (3) provides that a person buying farm products in the ordinary course of business from a person engaged in farming operations takes free of any security interest created

60. OKLA. STAT. ANN. tit. 12A, § 9-307(1) (West 1981).

61. *Id.* § 9-307(3)(a), (b).

62. *Id.* § 9-307(3)(e).

63. 1983 Or. Laws ch. 626.

64. MONT. CODE ANN. § 81-8-301(1) (1983).

65. 1983 Or. Laws Ch. 626, §§ (2),(6).

66. *Id.* §§ (2),(5).

67. 1983 Ill. Laws 83-69.

68. 1983 Ill. Laws 83-69 (to be codified at ILL. REV. STAT. ch. 26 § 9-205.1).

69. 1983 Ill. Laws 83-69 (to be codified at ILL. REV. STAT. ch. 26 § 9-306.02(1)-(5)).

by the seller, unless, within five years prior to the purchase, the secured party has sent written notice of his interest to the buyer by certified or registered mail;⁷⁰ (4) provides that a commission merchant or selling agent shall not be liable to the holder of a security interest in farm products for selling those products in the ordinary course of business unless the secured party has sent written notice of his interest to the commission merchant or selling agent within five years prior to the sale;⁷¹ and (5) requires commission merchants or selling agents who sell farm products and persons who buy farm products in the ordinary course of business to post a notice warning sellers that it is a criminal offense to sell farm products subject to a security interest without making payment to the secured party.⁷²

11. Delaware

Delaware amended its version of section 9-307 by adding a new subsection 2 which provides, in substance, that a buyer in ordinary course of grain who is registered with the Delaware Secretary of State as registered grain buyer takes free of any security interest in the grain unless written notice of the lien is mailed, by certified or registered mail, to the grain buyer within one year prior to the time he pays for the grain.⁷³ Secured parties may obtain a list of all registered grain buyers from the Secretary of State's office upon request.⁷⁴

OTHER RELATED LEGISLATION

In addition to the legislation noted above, at least twelve states have enacted legislation during the past twenty years that requires central filing of financing statements relating to farm products.⁷⁵

70. 1983 Ill. Laws 83-69 (to be codified at ILL. REV. STAT. ch. 26 § 9-307(1), (4)).

71. 1983 Ill. Laws 83-69 (to be codified at ILL. REV. STAT. ch. 26 § 9-307.1).

72. 1983 Ill. Laws 83-69 (to be codified at ILL. REV. STAT. ch. 26 § 9-307.2).

73. DEL. CODE ANN. tit. 6, § 9-307(2)(a) (Supp. 1983).

74. *Id.* § 9-307(2)(b).

75. California (central filing, except crops); CAL. COM. CODE § 9401 (1964 & Supp. 1984); Connecticut: CONN. GEN. STAT. ANN. § 42a-9-401 (West Supp. 1984); Delaware: DEL. CODE ANN. tit. 6, § 9-401 (1975); Hawaii: HAWAII REV. STAT. § 490: 9-401 (1976); Iowa: IOWA CODE ANN. § 554.9401 (West 1967); Maine: ME. REV. STAT. ANN. tit. 11, § 9-401 (1964); Mississippi (dual filing on farm products): MISS. CODE ANN. § 75-9-401(1)(a) (1981); Nevada: NEV. REV. STAT. § 104.9-401 (1979); Oregon: OR. REV. STAT. § 79.4010 (1983); South Dakota: S.D.C.L. § 57A-9-401 (1980); Utah: UTAH CODE ANN. § 70A-9-401 (1980); Washington, WASH. REV. CODE ANN. § 62A.9-401 (1981).

Although central filing somewhat eases the burden of checking for liens on a county by county basis, it leaves many unsolved problems. In many cases, buyers and commission merchants cannot obtain the information on a timely basis because they are buying and selling at times when the central filing office is closed. This makes it especially difficult for livestock markets and dealers because they are required to pay by the close of the next business day after the transaction. *See supra* note 8. Additionally, central filing, just as local filing, leaves the burden and expense of policing a lender's loan on a buyer or commission merchant rather than the lender who stands to profit by the loan. As stated by one commentator, "the risks inherent in the business of money-lending should be borne by money-lenders, not by innocent buyers in the market place." Knapp, *Protecting the Buyer of Previously Encumbered Goods: Another Plea for Revision of UCC Section 9-307(1)*, 15 ARIZ. L. REV. 861, 892 (1973).

FEDERAL GOVERNMENT AS SECURED PARTY

Notwithstanding all of this new legislation by the individual states, the mortgaged farm products problem has not disappeared. Not only have several major agriculture producing states not passed any legislation in this area, but there is genuine concern that the state legislation which has been passed will not protect buyers and commission merchants from one of the nation's largest agricultural lenders, the federal government.

It is a well settled proposition that federal law governs questions involving the rights of the federal government arising under nationwide federal programs such as the FmHA's farm loan programs.⁷⁶ What is not so well settled, is what is that federal law? Is it a judicially constructed uniform rule of law or is state law incorporated as the applicable federal law?⁷⁷

Prior to 1979, seven Circuits had ruled on this question. Five of the seven favored a judicially constructed uniform rule of law;⁷⁸ two incorporated state law as the applicable federal law.⁷⁹

In 1979, the United States Supreme Court handed down *United States v. Kimbell Foods, Inc.*⁸⁰ The question before the Court in *Kimbell* was whether contractual liens arising from certain federal loan programs take precedence over private liens, absent a federal statute that sets priorities. In reaching its decision, the Court analyzed three factors: the need for uniformity in operating the federal loan programs, whether the application of state law would frustrate the specific objectives of the federal programs, and the extent to which the application of a federal rule would disrupt commercial relationships predicated on state law.⁸¹ Based on this analysis, the Court adopted state law as the appropriate federal rule for establishing the relative priority of the competing liens.

Since *Kimbell* three of the seven circuits noted previously have decided cases involving the liability of commission merchants for selling mortgaged farm products.⁸² The Fourth Circuit, which already used incorporated state

76. *United States v. Kimbell Foods, Inc.*, 440 U.S. 715 (1979); *Clearfield Trust Co. v. United States*, 318 U.S. 363 (1943); *D'Oench, Duhme & Co v. Federal Deposit Insurance Corp.*, 315 U.S. 447 (1942). See Mishkin, *The Variosness of "Federal Law": Competence and Discretion in the Choice of National and State Rules for Decision*, 105 U. PA. L. REV. 797, 798-801 (1957).

77. See Comment, *Adopting State Law as the Federal Rule of Decision: A Proposed Test*, 43 U. CHI. L. REV. 823 (1976).

78. Third Circuit: *United States v. Sommerville*, 324 F.2d 712 (3d Cir. 1964); Fifth Circuit: *United States v. Hext*, 444 F.2d 804 (5th Cir. 1971); Sixth Circuit: *United States v. Burnette-Carter Co.*, 575 F.2d 587 (6th Cir. 1978) and *United States v. Carson*, 372 F.2d 429 (6th Cir. 1967); Ninth Circuit: *United States v. Matthews*, 244 F.2d 626 (9th Cir. 1957); Tenth Circuit: *Cassidy Commission Co. v. United States*, 387 F.2d 875 (10th Cir. 1967).

79. Fourth Circuit: *United States v. Union Livestock Sales Co.*, 298 F.2d 755 (4th Cir. 1962); Eighth Circuit: *United States v. Gallatin Livestock Auction, Inc.*, 448 F. Supp. 616 (W.D. Mo. 1978), *aff'd*, 589 F.2d 353 (8th Cir. 1978) and *United States v. Chappell Livestock Auction, Inc.*, 523 F.2d 840 (8th Cir. 1975).

80. 440 U.S. 715 (1979).

81. *United States v. Kimbell Foods, Inc.*, 440 U.S. at 728. See also Comment, *supra* note 77, at 830-34.

82. Fourth Circuit: *United States v. Friend's Stockyard, Inc.* and *United States v. Grantsville Community Sale, Inc.*, 600 F.2d 9 (4th Cir. 1979); Fifth Circuit: *United States v. Southeast Missis-*

law as the applicable federal law, cited *Kimbell* as requiring the incorporation of state law.⁸³ The Fifth and Ninth Circuits, which had used uniform federal law prior to *Kimbell*, now use incorporated state law.⁸⁴ Thus, at this time three circuits have decisions on the books whereby the liability of commission merchants for selling mortgaged farm products is determined under a uniform federal rule of law and four circuits have incorporated state law to determine this liability.

Clearly, until federal legislation is enacted⁸⁵ or additional cases are decided by the Courts of Appeal, the question of which law applies to mortgaged farm products cases is open to speculation. As Professor Wright has stated, "Whether state or federal law controls on matters not covered by the Constitution or an Act of Congress is a very complicated question, which yields to no simple answer"⁸⁶

CONCLUSION

As a result of the farm products exception, secured parties and buyers not in ordinary course receive better treatment than buyers in ordinary course of farm products.⁸⁷ Commission merchants, as a result of causes of action related to the farm products exception, become "involuntary guarantors of the debtor's compliance with the security agreement."⁸⁸

Many of the individual states have enacted legislation, especially within the previous year, which is aimed at alleviating the Code's bias against those who buy and sell farm products. However, because of the disparate approaches used by the individual states the value of all this legislation is uncertain—the Uniform Commercial Code has become even more disuniform and the federal government's argument against application of state law to federal lenders has been strengthened.⁸⁹ The mortgaged farm products problem, albeit changed to some degree, remains.

Mississippi Livestock Farmers Ass'n, 619 F.2d 435 (5th Cir. 1980); Ninth Circuit: *United States v. Public Auction Yards*, 637 F.2d 613 (9th Cir. 1980).

83. *United States v. Friend's Stockyard, Inc.*, 600 F.2d at 10.

84. *United States v. Southeast Mississippi Livestock Farmers Ass'n*, 619 F.2d 435 (5th Cir. 1980); *United States v. Public Auction Yard*, 637 F.2d 613 (9th Cir. 1980).

85. In 1983, Congressman Tom Harkin introduced two bills, H.R. 3296 and H.R. 3297. H.R. 3296 would basically repeal the farm products exception from the federal level. H.R. 3297 would amend the Packers and Stockyards Act, 7 U.S.C. § 181 et. seq. (1982) to accomplish the same result with respect to livestock.

86. C. WRIGHT, *LAW OF THE FEDERAL COURTS* 388 (4th ed. 1983).

87. Dugan, *supra* note 8, at 362.

88. *Id.*

89. *United States v. Kimball Foods, Inc.*, 440 U.S. 715 (1979). See also Comment, *supra* note 77.