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Congress Takes Exception to the Farm Products Exception of the UCC

Drew L. Kershen, *University of Oklahoma College of Law*
J. Thomas Hardin



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The University of Kansas Law Review

CONGRESS TAKES EXCEPTION TO THE FARM PRODUCTS EXCEPTION OF THE UCC: RETROACTIVITY AND PREEMPTION*

Drew L. Kershen**

J. Thomas Hardin***

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Although interest rates have dropped during the last several years, farmers continue to experience severe financial difficulties. Large loan burdens, accompanied by depressed land values and low farm product prices, are leading to an accelerating number of farm loan defaults.¹ These defaults have focused renewed attention on the conflict between secured farm lenders and farm product buyers under the farm products exception of section 9-307(1) of the Uniform Commercial Code (the "Code").² Commentators have criticized both the theoretical support for and the practical effectiveness of the farm products exception the Code created.³ In a somewhat surprising move, in section 1324 of the Food Security Act of 1985, Congress preempted most state and federal laws dealing with the rights of farm products buyers.⁴ Whether Congress effectively answered criticisms of the Code's farm products rule or merely fueled the controversy remains to be seen.

This article first reviews the issues surrounding the enforcement

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** B.A. Notre Dame University; J.D. University of Texas; Professor of Law, University of Oklahoma.

*** B.S. Purdue University; J.D. University of Arkansas, Fayetteville; Director, Hartzog Conger & Cason, P. C., Oklahoma City, Oklahoma.

1. An article in *Time* magazine estimates that more than 50,000 (out of 2.3 million) farmers went out of business in 1985 and an equal number will leave the industry in 1986. Koepp, *Amber Waves of Strain*, *TIME*, July 21, 1986, at 46, 47.

2. Unless otherwise stated, citations to the Code are to the 1972 version of the Uniform Commercial Code as published in *SELECTED COMMERCIAL STATUTES* (West 1983). As of January 1984, 48 states had adopted all or a portion of the 1972 revisions.

3. See Coates, *Financing the Farmer*, 20 *PRAC. LAW.*, Nov. 1974, at 45; Dolan, *Section 9-307(1): The U.C.C.'s Obstacle to Agricultural Commerce in the Open Market*, 72 *Nw. L. REV.* 706 (1977); Dugan, *Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code*, 46 *U. COLO. L. REV.* 333 (1975); Hawkland, *The Proposed Amendment to Article 9 of the U.C.C.—Part I: Financing the Farmer*, 76 *COM. L.J.* 416 (1971); Meyer, *The 9-307(1) Farm Products Puzzle: Its Parts and Its Future*, 60 *N.D.L. REV.* 401 (1984); Skilton, *Some Comments on the Comments to the Uniform Commercial Code*, 1966 *Wis. L. REV.* 597; Uchtmann, Bauer, and Dudek, *The UCC Farm Products Exception—A Time to Change*, 69 *MINN. L. REV.* 1315 (1985). Early versions of the Code applied the farm products exception to all agricultural goods, whether farm products or inventory. See U.C.C. §§ 1-201(9), 9-307(1) (1951). The current limitation to only farm products (excluding inventory or equipment) was adopted in the 1957 version of the Code. See *id.* § 9-307(1) (1957). As late as 1970, a review committee appointed by the U.C.C. Permanent Editorial Board proposed that the sale of farm products be treated the same as other business sales. See PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, REVIEW COMMITTEE FOR ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE, PRELIMINARY DRAFT No. 2 (1970). The Board rejected this proposal.

4. Food Security Act of 1985, § 1324, Pub. L. No. 99-198, 99 Stat. 1324 (codified as 7 U.S.C.S. § 1631 (Law. Co-op. Supp. 1987)) [hereinafter Food Security Act of 1985]. Throughout this article, the authors will refer to the federal law and its subsections in the section 1324 style.

and interpretation of the Code's farm products exception. Cases in this area generally have arisen out of attempts by farm product buyers, commission merchants, or selling agents to escape direct liability to a lender. In these cases, a lender's security interest has survived the sale of a farmer-debtor's farm products because of the Code's farm products exception. Buyers, commission merchants, and selling agents have invoked defenses involving definitional classifications (*e.g.*, inventory versus farm product), doctrines of express and implied authorization of sale, and doctrines of express and implied waiver and estoppel. As this case law developed, some states responded by enacting nonuniform amendments to the Code's farm products exception, further confusing the picture. Analysis of these developments is important for at least the following three reasons: (1) existing precedent and laws govern cases already in court or arising before the effective date of section 1324; (2) courts can answer many of section 1324's interpretational questions only by reference to these developments; and (3) perhaps most importantly, section 1324 has not preempted the use of all Code precedents. For example, as Part II of this article will demonstrate, even if buyers, commission merchants, or selling agents receive notice meeting section 1324's requirements, they still should be able to assert such Code related defenses as consent, waiver, or estoppel.

Second, this article analyzes many of the issues posed by Congress's action, such as (1) the retroactive application of section 1324 to security interests granted before its effective date; and (2) section 1324's preemptive effect on the Code and the tort of conversion.

This two-part analysis will demonstrate that if Congress meant section 1324 to reduce uncertainty for farm product buyers, reduce litigation, and encourage uniformity, it failed. Section 1324, as written, does not achieve these goals. Rather the interpretational and preemption problems reviewed in this article may actually increase uncertainty for farm lenders and farm product buyers, thereby restricting the flow and raising the cost of operating capital available to the American economy's agricultural sector.

I. AN ANALYSIS OF THE CODE'S FARM PRODUCTS EXCEPTION

A. *Introduction—A Brief Review of the Farm Products Exception and Section 1324*

Code section 9-306(2) states that except as otherwise provided under Article 9, "a security interest continues in collateral notwithstanding sale, exchange or other disposition."⁵ A major exception to this general

5. U.C.C. § 9-306(2).

rule is the protection section 9-307(1) gives to buyers in the ordinary course of business,⁶ each of whom “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.”⁷ This exception encourages inventory financing by allowing buyers to take free and clear of a lender’s lien. Under pre-Code law, however, a buyer of farm products from farmers did not enjoy similar protection.⁸ Following this historic rule, the Code adopted the farm products exception in section 9-307(1). Section 9-307(1) excepts buyers “buying farm products from a person engaged in farming operations” from its protection. Farm product buyers, therefore, are subject to the continuing security interest of a secured lender under section 9-306. For example, a farmer buying a video camera from a dealer takes the camera free from any security interest created by that dealer, but that same dealer buying wheat from the farmer generally will take the wheat subject to any security interest the farmer has created.

As drafted, the Code gives a lender collateralized by farm products two potential avenues for recovery of its loan. Like a lender whose loan is secured by inventory, the farm products lender can first proceed against the farmer-debtor and identifiable proceeds of the collateral under Code sections 9-306(2) and 9-204(1).⁹ This road often leads to an insolvent borrower or is blocked by difficult tracing and perfection problems associated with proceeds. The farm products exception, however, allows the farm products lender to choose to sue the buyer of its collateral for either conversion or replevin.¹⁰ This dual track is unavailable to lenders whose claims are not collateralized by farm products and is designed to give incentive to lenders to make farm product loans. At the same time, however, it subjects farm products buyers “to double payment for the products, once at the time of purchase, and again when the seller [farmer] fails to repay the lender.”¹¹ Commentators have offered numerous policies and distinctions to support this result: (1) the farm products exception encourages lenders to finance farming operations;¹² (2) farm products are unique

6. See *id.* § 1-201(9) (defining both a “buyer in ordinary course of business” and “buying”).

7. *Id.* § 9-307(1).

8. See Dolan, *supra* note 3, at 711-12.

9. See U.C.C. § 9-306(2) (“identifiable” proceeds) and § 9-306(3) (continuity rules for the perfection of a security interest in proceeds).

10. See *id.* § 9-306 comment 3 (“The secured party may claim both proceeds and collateral, but may of course have only one satisfaction.”).

11. Food Security Act of 1985, *supra* note 4, at § 1324(a)(2).

12. See Note, *Agricultural Financing Under the U.C.C.*, 12 ARIZ. L. REV. 391 (1970). This goal assumes that the dual recovery path provided to a farm products lender will (i) encourage it to make loans to borrowers it might otherwise consider not to be creditworthy,

because of their perishability and fungibility;¹³ (3) purchasers of farm products are sophisticated buyers—packers, marketing agents, brokers, multinational grain and livestock dealers—who understand that the selling farmer probably granted a security interest in the farm products and who are fully capable of checking lien records and taking other steps to protect themselves;¹⁴ (4) because of seasonality, farm product sales more generally resemble bulk transactions than normal inventory sales;¹⁵ and (5) the purchasers understand that proceeds from the sale of farm products are commonly used to pay down existing loans rather than to purchase new inventory.¹⁶

Much debate has focused on whether these distinctions are valid and whether the farm products exception has achieved its goals. Courts have used the same Code definitions and rules to arrive at both pro-lender and pro-buyer results.¹⁷ In response to court rulings and difficult fact questions presented by the farm products exception, a significant number of farm-belt states have enacted nonuniform versions of the farm products exception.¹⁸

Congressional passage of section 1324 adds a new twist to the farm

and (ii) reduce the cost of such loans to farm products lenders, causing them to charge the farmer-borrower less. See B. CLARK, *THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE*, ¶ 8.4[3][g] (1980); Uchtmann, *supra* note 3, at 1320-22 nn. 28-32 ("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."). Although the farm products exception seems to meet this goal, its adverse impact on farm products buyers may reduce the price received by farmers and, consequently, farmers' ability to repay loans. See Food Security Act of 1985, *supra* note 4, at § 1324(a)(3) ("[t]he exposure of purchasers of farm products to double payment inhibits free competition in the market for farm products."); Uchtmann, *supra* note 3, at 1321 n. 30. It is difficult to quantify either of these effects on the farmer and, therefore, difficult to gauge whether the farm products exception ultimately benefits the farmer.

13. B. Clark, Memorandum to the American Bankers Association on the UCC Farm Products Rule, the Impact of the Food Security Act of 1985 on that Rule, and Suggested Amendments to the Federal Act 4 (March 17, 1986) [hereinafter Clark Memorandum].

14. Dolan, *supra* note 3, at 717; Uchtmann, *supra* note 3, at 1326-30. Some commentators have attacked this justification because (i) most states require local filings for perfection of a security interest on farm products, which are difficult to check because of farmers' mobility, (ii) unless updated, the records do not necessarily reflect whether a farmer's debt is still outstanding, and (iii) time pressures associated with a large number of sales over a short time period and statutory requirements for immediate payment upon sale make it difficult to check records. Uchtmann, *supra* note 3, at 1327-28.

15. Uchtmann, *supra* note 3, at 1323; Clark Memorandum, *supra* note 13, at 4.

16. Clark Memorandum, *supra* note 13, at 4.

17. See *infra* text accompanying notes 31-128.

18. After a pro-buyer decision in the leading case of *Clovis Nat'l Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726 (1967), the New Mexico legislature promptly amended section 9-306(2) to provide that a security interest holder cannot waive its interest in farm products by a course of dealing or trade usage. N.M. STAT. ANN. § 55-9-306(2) (1978). The New Mexico legislature amended this statute in 1985 and deleted this provision. *Id.* § 55-9-306(2) (Supp. 1986); see also *infra* text accompanying notes 129-56.

products debate. Section 1324 purports to preempt section 9-307(1)'s farm products exception. It provides that "notwithstanding any other provision of Federal, State, or local law, a buyer who in the ordinary course of business buys a farm product from a seller engaged in farming operations shall take free of a security interest created by the seller, even though the security interest is perfected; and the buyer knows of the existence of such interest."¹⁹ Congress further extended this protection to cover commission merchants and selling agents.²⁰ Section 1324 applies to disputes arising out of farm product buy/sell transactions that occur after December 24, 1986.²¹

Had it stopped with this rule, Congress would have treated farm products in the same way that section 9-307 treats all other inventory collateral. But Congress created its own exceptions under subsections 1324(e) and (g). A farm products buyer will take subject to a security interest created by the seller if: (1) he receives actual notice meeting certain requirements from the seller or secured party within one year before the sale;²² or (2) the state in which the farm product is produced has a certified centralized notification system, and (i) the buyer has registered with the system and received a similar actual notice from a designated agent of the state, or (ii) the buyer has not registered with the system and the secured party files an effective financing statement.²³ Congress created similar exceptions for commission merchants and selling agents.²⁴ Section 1324, therefore, is an attempt to impose order on increasingly nonuniform court decisions and statutory modifications to Code section 9-307(1).²⁵

Before examining the details of the Code's farm products exception and section 1324's effect on that exception, it is important to note what section 1324 does not do.

1. Article 9 of the Code and section 1324 operate simultaneously on parallel, but completely separate tracks. Section 1324 preempts the farm products exception but it does not replace any other Code provision. The farm products lender must still comply with all of the Code's rules for taking and perfecting a security interest. Because section 1324 is limited to buyers, commission merchants, and selling agents, the Code's rules still govern most priority issues.²⁶ Moreover,

19. Food Security Act of 1985, *supra* note 4, at § 1324(d).

20. *Id.* § 1324(g)(1).

21. *Id.* § 1324(j).

22. *Id.* § 1324(e)(1).

23. *Id.* § 1324(e)(2).

24. *Id.* § 1324(g)(2)(A), (D).

25. See *infra* text accompanying notes 150-56.

26. See U.C.C. § 9-312(5). Other examples include (i) judgment creditors, *id.* § 9-301(1)(b); (ii) buyers not in the ordinary course, *id.* § 9-301(1)(c); and (iii) a trustee in bankruptcy, *id.* § 9-301(1)(b), (3); 11 U.S.C. § 554(a)(1983).

section 1324 does not govern priority conflicts involving any collateral other than "farm products," as that term is defined in section 1324(c)(5).²⁷ Section 1324 affects only a priority dispute between a farm products buyer in the ordinary course of business, a farm products commission merchant, or a farm products selling agent and lenders with Article 9 security interests in farm products.²⁸

2. Even with section 1324, pre-existing court decisions and state laws cover buy/sell transactions that occurred prior to December 24, 1986.

3. Part II of this article will demonstrate that section 1324 does *not*: (i) relieve buyers, commission merchants, or selling agents from potential liability to statutory and landlord lienholders; (ii) protect buyers from Article 9 unperfected secured parties who provide proper notice under one of section 1324's mechanisms; (iii) preempt all state nonuniform amendments to the Code's farm products exception; (iv) preempt state buyer-protective procedural limitations, such as short statute of limitation periods or requirements that a lender first attempt recovery against the farmer-debtor before suing the buyer, commission merchant, and/or selling agent, even though states enacted such procedures in response to the Code's farm product exception; or (v) prohibit a buyer, commission merchant, or seller who has received proper section 1324 notice from asserting defenses based on express or implied authorization, waiver, or estoppel.

With these caveats in mind, this article will now review the Code's farm products exception and the case law and nonuniform legislation surrounding it.

As previously discussed, an agricultural lender faced with a defaulted loan secured by farm products that were sold prior to default, has two options: (1) recovery against the farmer-debtor and/or the proceeds of the collateral; or (2) recovery against the buyer for conversion or replevin (if appropriate).²⁹ While many cases involve suits against buyers, auctioneers and commission agents are at the same risk as buyers. They may be held liable for conversion, even though

27. See *infra* text accompanying notes 157-67.

28. Professor Barkley Clark notes that in a letter to Senator Garn dated October 15, 1985, the Comptroller of the Currency wrote that loans " 'will continue to be considered secured if liens are properly recorded with the state and county authorities, if lien searches are on file which document first lien positions, and if notification to potential buyers is made before sale.' " Clark Memorandum, *supra* note 13, at 26 (emphasis added). Professor Clark observes that this may be a warning that federal bank regulators may consider a loan for which the lender has not met section 1324's notification methods to be "unsecured." Although this appears to be somewhat of an overreaction (in light of inventory loans which favor the buyer in the ordinary course), a risk exists that noncompliance with section 1324's notification options will subject a lender to regulatory inquiries. *Id.*

29. See *supra* text accompanying notes 9-11.

they did not purchase the farm products or receive the sale proceeds.³⁰ When faced with a choice between an insolvent farmer-debtor and a solvent buyer, commission merchant, or selling agent, the lender probably will choose to seek recovery from the latter three. Because they have already paid for the farm products, buyers, commission merchants, and selling agents have fought aggressively to escape a second liability. They have invoked definitional classifications, doctrines of express and implied authorization of sale by the lender, and doctrines of express and implied waiver and estoppel to protect themselves.

B. Inventory v. Farm Products

The Code divides collateral into the following four mutually exclusive categories: consumer goods, inventory, farm products, and equipment.³¹ The classification of collateral is important in determining questions of perfection, priority, the rights of bona fide purchasers, and, in some cases, the rights of a creditor upon debtor default.³² In particular, a buyer can escape the operation of the farm products exception by showing that the lender's collateral was not farm products, but rather one of the other categories of goods.³³ If the buyer can make such a showing, the farm products exception to section 9-307(1) will not be available to the lender.

The Code's definition of goods implicitly recognizes that classification under the Code may change depending on the use to which the goods are put. For example, cattle fattening on a ranch are livestock within the farm products definition even though once they are sold to a packer, those same live cattle become inventory of the packer.³⁴ Moreover, when the packer sells those slaughtered cattle to farm families for use on their dinner tables, the meat becomes consumer goods.³⁵ The same goods, cattle, may change from farm products,

30. See *Duvall-Wheeler Livestock Barn v. United States*, 415 F.2d 226 (5th Cir. 1969) (auctioneer); *United States v. Topeka Livestock Auction, Inc.*, 392 F. Supp. 944 (N.D. Ind. 1975) (auctioneer); *North Cent. Prod. Credit Ass'n v. Washington Sales Co.*, 223 Kan. 689, 577 P.2d 35 (1978) (agent). Unless otherwise stated in this article, the concept of "buyer" will also include an auctioneer or commission agent.

31. See U.C.C. § 9-109; *id.* comment 2.

32. See *id.* § 9-102 comment 5, index.

33. The term goods "includes all things which are movable at the time the security interest attaches or which are fixtures . . . (and) includes . . . the unborn young of animals, and growing crops." *Id.* § 9-105(h).

34. See *Swift & Co. v. Jamestown Nat'l Bank*, 426 F.2d 1099 (8th Cir. 1970); *Cox v. Bancoklahoma Agri-Serv. Corp.*, 641 S.W.2d 400 (Tex. Ct. App. 1982) (cattle are farm products when used in farming operations); *First Nat'l Bank v. Smoker*, 153 Ind. App. 71, 286 N.E.2d 203 (1972) (cattle are inventory to packers). U.C.C. § 9-109(4) defines "inventory."

35. U.C.C. § 9-109(1) defines "consumer goods."

to inventory, to consumer products in the course of their birth, life, and death.³⁶

Because the use to which goods are put is controlling, the owner's status or occupation cannot change their classification under section 9-109(3). Hens and eggs used in farming operations, for example, are livestock and products of livestock within the farm products definition even when the debtor is an investor from the nonfarm sector who invested in the egg-laying operation solely for tax reasons. Thus, if a bank had looked solely at the debtor's status (investor) or occupation (nonfarm), it might have classified the eggs as inventory and the hens as equipment. To do so would have been erroneous under the Code.³⁷

Section 9-109(3) provides the following three-part definition of farm products: (1) the goods must be "crops or livestock or supplies used or produced in farming operations or . . . products of crops or livestock in their unmanufactured states;" (2) the goods must be "in the possession of a debtor;" *and* (3) that debtor must be "engaged in raising, fattening, grazing or other farming operations."³⁸ To qualify as a farm product, an item must satisfy all three elements simultaneously. Other than "goods" and "debtor," none of the terms used in section 9-109(3) are defined.³⁹

The first criterion is relatively easy to apply. Courts have held that the term "crops or livestock" includes feed grains such as soybeans,⁴⁰ cotton,⁴¹ plants, trees, shrubs and bushes,⁴² vegetables and fruits,⁴³ cattle,⁴⁴ (including dairy⁴⁵ and slaughter cattle⁴⁶), chickens⁴⁷ and

36. See *id.* comment 2.

37. See *In re K. L. Smith Enters., Ltd.*, 2 Bankr. 280 (D. Colo. 1980); *In re Anderson*, 6 U.C.C. Rep. Serv. (Callaghan) 1284 (Bankr. S.D. Ohio 1969). U.C.C. § 9-109(2) defines "equipment."

38. U.C.C. § 9-109(3).

39. See *id.* comment 4.

40. See *United States v. Greenwich Mill and Elevator Co.*, 291 F. Supp. 609, 613 (N.D. Ohio 1968).

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

42. Compare *In re Houts*, 31 U.C.C. Rep. Serv. (Callaghan) 338 (Bankr. N.D.N.Y. 1981) (plants, trees, shrubs, bushes cultivated for sale in landscaping and nursery business) *and In re Frazier*, 16 Bankr. 674 (M.D. Tenn. 1981) (plants, trees, shrubs, bushes if cultivated for nursery business, but possibly inventory once matured and available for resale in the nursery business) *with* *Mountain Credit v. Michiana Lumber & Supply, Inc.*, 498 P.2d 967 (Colo. Ct. App. 1972) (trees are not farm products in a commercial logging business because the business is not a farming operation).

43. See *In re Houts*, 31 U.C.C. Rep. Serv. (Callaghan) at 344-45.

44. See *Garden City Prod. Credit Ass'n v. Lannan*, 186 Neb. 668, 186 N.W.2d 99 (1971), *overruled on other grounds*, 225 Neb. 1, 402 N.W.2d 277 (1987).

45. See *United States v. Lindsey*, 24 U.C.C. Rep. Serv. (Callaghan) 1309 (N.D. Tex. 1978).

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

47. See *United States v. Pete Brown Enters.* 328 F. Supp. 600 (N.D. Miss. 1971).

numerous other specific farm products. The 1972 Code revisions make it clear that the definition includes growing crops, crops to be grown, and the unborn young of animals.⁴⁸ The term "crops" arguably may include harvested crops and crops received as payments in kind.⁴⁹

The second criterion, requiring "possession," increasingly has been questioned in today's complex agricultural economy. Farmers frequently store grain in commercial warehouses and ranchers keep cattle with commercial feedlots or grazing operations. Because the Code does not define possession, arguments have arisen over whether the Code requires physical possession or only constructive possession through a bailee or agent. In a case involving cotton in storage, the Mississippi Supreme Court rejected the argument that the cotton was no longer "farm products" because it was no longer in the farmer's physical possession.⁵⁰ In a similar bailment situation, a Kansas Federal District Court held that cattle which had never been in the rancher-debtor's physical possession (because he had bought the cattle through an agent for direct placement in a feedlot) were inventory, not farm products.⁵¹ Although these two cases are not directly in conflict and can be harmonized, they highlight the uncertainty surrounding the possession requirement of the Code's farm products classification.⁵²

Much of the farm products litigation, however, focuses on the requirement that the debtor be "engaged in raising, fattening, grazing or other farming operations." Although the Code does not define "farming operations," comment 4 to section 9-109 provides some guidance. Farming "includes raising livestock as well as crops."⁵³ Farm products which "come into the possession of a marketing agency for sale or distribution or of a manufacturer or processor as raw materials . . . become inventory."⁵⁴ Products of crops or livestock

48. U.C.C. § 9-105(1)(h) (unborn young of animals and growing crops); *id.* § 9-203(1)(a) (crops growing or to be grown).

49. See Meyer, *supra* note 3, at 406. Courts should consider harvested crops to be "products of crops . . . in their unmanufactured states" within the Code's farm products definition. However, two courts apparently have overlooked the "products of crops" part of the Code's definition. See *In re Tinsley and Groom*, 49 Bankr. 85, 92-93 (W.D. Ky. 1984) (grain grown in one county changes classification from farm products to inventory once harvested and stored in another county thereby necessitating filing in a different office); *In re Frazier*, 16 Bankr. 674 (M.D. Tenn. 1981) (trees, shrubs, plants, and bushes are farm products while being cultivated, but possibly inventory once matured and ready for resale in the retail end of the debtor's nursery business).

50. *Oxford Prod. Credit Ass'n v. Dye*, 368 So. 2d 241 (Miss. 1979). But see *United States v. Progressive Farmers Mktg. Agency*, 788 F.2d 1327 (8th Cir. 1986); *In re Walkington*, 62 Bankr. 989 (W.D. Mich. 1986).

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

52. For a discussion of the issues and implications arising from the definition of possession, see Meyer, *supra* note 3, at 407-11.

53. U.C.C. § 9-109 comment 4.

54. *Id.*

that are subjected to a "manufacturing process" are no longer farm products.⁵⁵ Unfortunately, such broad guidelines have provided little assistance to courts. The interpretative difficulties are aggravated because modern farmers have had to adopt a wide variety of new production and business management techniques to compete against large agribusiness ventures. Farmers increasingly are becoming involved in buying, fattening, grazing, or raising and selling livestock and crops with which they have only minimal contact.⁵⁶ Faced with these borderline situations, some courts have defined the phrase "farming operations" narrowly⁵⁷ while others have interpreted it very broadly.⁵⁸

As if all these classification issues were not enough, courts have created confusion in cases in which the use of collateral in the same debtor's hands changes subsequent to the grant of a security interest. For example, suppose a rancher with a horse breeding operation borrows money from a bank to purchase a mare for his children to ride. As a pleasure horse, the mare is a consumer product. Yet, suppose the moment the mare reaches the ranch, the rancher realizes that the mare has more breeding potential than riding potential and immedi-

55. *Id.* Similarly, the Code does not define "manufacturing process." U.C.C. § 9-109 comment 4 states:

Products of crops or livestock, even though they remain in the possession of a person engaged in farming operations, lose their status as farm products if they are subjected to a manufacturing process. What is and what is not a manufacturing operation is not determined by this Article. At one end of the scale some processes are so closely connected with farming—such as pasteurizing milk or boiling sap to produce maple syrup or maple sugar—that they would not rank as manufacturing. On the other hand an extensive canning operation would be manufacturing. The line is one for the courts to draw.

56. Examples of this situation include cattle feedlots and similar operations. *See* First Nat'l Bank v. Iowa Beef Processors, 626 F.2d 764 (10th Cir. 1980); *Garden City Prod. Credit Ass'n v. International Cattle Sys.*, 32 U.C.C. Rep. Serv. (Callaghan) 1207 (D. Kan. 1981); *In re Cadwell, Martin Meat Co.*, 10 U.C.C. Rep. Serv. (Callaghan) 710 (E.D. Cal. 1970). In other cases, the court has found that the farmer has turned himself into a cattle trader. *Compare* First State Bank v. Maxfield, 485 F.2d 71 (10th Cir. 1973); *First State Bank v. Producers Livestock Mktg. Ass'n Non-Stock Coop.*, 200 Neb. 12, 261 N.W.2d 854 (1978) *with* *Cox v. Bancoklahoma Agri-Serv. Corp.*, 641 S.W.2d 400 (Tex. Ct. App. 1982).

57. *See, e.g., In re Butcher*, 43 Bankr. 513 (E.D. Tenn. 1984) (stallion syndication held not to be farming operations); *Farmers State Bank v. Webel*, 113 Ill. App. 3d 87, 446 N.E.2d 525 (1983) (background feeding operation for pigs from weaning to 120 pounds when the pigs are sold to a finishing feeder held not to be farming operations).

58. *See, e.g., Security Nat'l Bank v. Belleville Livestock Comm'n Co.*, 619 F.2d 840 (10th Cir. 1980) (background feeding operation for calves from weaning to 600 pounds when the calves are sold to feedlots for finishing held to be farming operations); *North Ridge Farms, Inc. v. Trimble*, 37 U.C.C. Rep. Serv. (Callaghan) 1280 (Ky. Ct. App. 1983) (stallion syndication held to be farming operations); *see also In re Charolais Breeding Ranches, Ltd.*, 20 U.C.C. Rep. Serv. (Callaghan) 193 (Bankr. W.D. Wis. 1976) (debtor operating breeding ranch for investor programs was engaged in farming operations).

ately uses the mare in his breeding operation. Under the Code, at what moment in time is the controlling use determined for classification purposes—when the rancher gave the security interest to the bank intending to use the mare for pleasure riding, or when he actually put the mare into use as breeding stock in his operation?”

Although the authors found no cases involving a change of use of farm products,⁶⁰ the authors did find cases involving changing uses of vehicles, such as trucks, tractors, and airplanes. In those cases, the debtor told the lender of an intended use for the vehicle but actually used the vehicle in another manner. In making classification determinations under such circumstances, courts have split three ways. Several have held that the “intended” use should control because doing so allows a definitive determination at the time the security interest is given and relieves the lender of the burden of constantly monitoring the collateral.⁶¹ One court has ruled that the “actual” use controls, at least when the bank simply let the borrower check a “use” box on the security agreement form and made no further inquiry.⁶² Finally, an Oklahoma bankruptcy court has rejected both the “intended” and “actual” use tests; it has held that the proper test is the “normal use” to which the goods are put.⁶³ Once a lender properly identifies the controlling use, a later change in use does not impair his position, if he properly perfected the security interest.⁶⁴

59. U.C.C. § 109 comment 2 states: “In borderline cases—a physician’s car or a farmer’s jeep which might be either consumer goods or equipment—the principal use to which the property is put should be considered as determinative.”

60. The two cases briefly described in Note 49 involve changes in classification due to change in status (growing versus harvested grain, immature versus mature trees, shrubs and plants) rather than change in use. By analogy these two cases are the closest two cases of which the authors are aware to a “change of use” fact pattern for farm products.

61. See *In re Barnes*, 11 U.C.C. Rep. Serv. (Callaghan) 670 (D. Me. 1972); *McGehee v. Exchange Bank & Trust Co.*, 561 S.W.2d 926 (Tex. Civ. App. 1978); *Commercial Credit Equip. Corp. v. Carter*, 83 Wash. 2d 136, 516 P.2d 767 (1973). Courts adopting the “intended use” approach recognize that other factors may overcome this approach. Such factors include a false declaration of intent and a creditor’s actual knowledge or detrimental reliance on an actual use different from the stated intended use. See also J. WHITE & R. SUMMERS, *UNIFORM COMMERCIAL CODE* § 23-13 (2nd ed. 1980).

62. *In re McClain*, 447 F.2d 241 (10th Cir. 1971), cert. denied, 405 U.S. 918 (1972).

63. *In re Burgess*, 30 Bankr. 364 (W.D. Okla. 1983).

64. U.C.C. § 9-401(3) in both its alternatives states that “[a] change in the use of the collateral does not impair the effectiveness of the original filing.” *Id.* second alternative subsection. The practical resolution to all of the questions discussed in the text has been for wary lenders to describe the collateral in properly descriptive, non-Code terms and then file in every geographically relevant local or central filing repository as if all possible Code classifications were applicable. The Code imposes no penalty for overfiling. See *id.* § 9-401(2). In effect, the payment of additional filing fees is like the payment of an insurance premium against being declared an unperfected security interest holder. As the case law testifies, not every lender has adopted the practical resolution to the questions.

A court must answer all of the preceding questions to decide whether a lender's collateral is farm products covered by section 9-307(1)'s exception. Even if a court answers all of these questions in the farm products lender's favor, however, a buyer might assert further defenses to avoid double liability.

C. Escape Routes: "Or Otherwise" Under Section 9-306(2) and Failing to Prove Conversion

When the section 9-307(1) exception is unavailable because the purchased goods are farm products, a buyer, auctioneer, or commission agent sued by a secured lender has the following possible escape routes available: (1) the farmer may have had the lender's express or implied consent to sell under section 9-306(2); (2) the lender may have expressly or impliedly waived its right to object to the sale of its collateral; or (3) the lender's actions may estop it from recovery. Even if these avenues are unavailable, courts sometimes have held that under certain circumstances commission merchants and selling agents, but not buyers, were free of double payment liability because the elements of the tort of conversion could not be proven.⁶⁵ On the other hand, lenders and buyers both should note that if the lender's security interest is unperfected under the Code, the ordinary course buyer, but not commission merchants or selling agents, should prevail, at least if the buyer does not have actual knowledge of the lien under section 9-301(1)(c).⁶⁶

1. Express or Implied Authorization Under Section 9-306(2)

Section 9-306(2) provides that a security interest will not continue in collateral if "the disposition was authorized by the secured party in the security agreement or otherwise."⁶⁷ Much of the farm products-buyer litigation centers around this "or otherwise" language, which invites buyers to argue, and courts to find, that the secured party has authorized the disposition outside the confines of the security agreement. No requirement exists that authorization be in writing, or even that it be express.⁶⁸ Whether a secured party authorized a

65. See *infra* text accompanying notes 264-88 (discussion of section 1324's impact upon the elements of the tort of conversion).

66. See *infra* text accompanying notes 208-18 (discussion of section 1324's effect on the section 9-301(1)(c) rule).

67. U.C.C. § 9-306(2).

68. The 1950 Proposed Final Draft of the Code stipulated that the taking of a security interest in proceeds constituted a waiver of the lender's security interest in the collateral upon the effectiveness of the sale. See *id.* § 9-306(2) (1950). Even though the drafters removed this concept from the 1957 official draft, the comments kept that notion alive until the 1972 version revisions deleted it. See *id.* § 9-306 comment 3 (1962).

sale or other disposition is generally a fact question,⁶⁹ and the buyer's knowledge or lack of knowledge of such authorization is immaterial.⁷⁰ The decision to authorize a disposition is within the creditor's discretion⁷¹ and, unlike the farm products exception, such authorization protects a buyer whether or not the disposition occurred in the ordinary course of business.⁷²

Because the buyer need not know that authorization exists, the authorization issue commonly is framed as one of consent. Clearly, in the absence of a contrary express provision in the security agreement, a court may find consent (or authorization) to sell by express oral or written agreement⁷³ or imply it from the parties' conduct.⁷⁴ In *Poteau State Bank v. Denwalt*⁷⁵ the Oklahoma Supreme Court stated:

69. See *Poteau State Bank v. Denwalt*, 597 P.2d 756, 760 (Okla. 1979) ("What act is sufficient to constitute an implied authorization to sell collateral under § 9-306(2) is an issue of fact.") (footnote omitted); see also *Benson County Coop. Credit Union v. Central Livestock Ass'n*, 300 N.W.2d 236 (N.D. 1980).

70. See *Matteson v. Harper*, 66 Or. App. 31, 672 P.2d 1219 (1983) (the buyer's innocence or bona fide nature is not relevant), *rev'd on other grounds*, 297 Or. 113, 682 P.2d 766 (1984); see also *Duvall-Wheeler Livestock Barn v. United States*, 415 F.2d 226 (5th Cir. 1969); *United States v. McCleskey Mills, Inc.*, 409 F.2d 1216 (5th Cir. 1969).

71. See *Layne v. Fort Carson Nat'l Bank*, 655 P.2d 856 (Colo. Ct. App. 1982).

72. See *Finance Am. Commercial Corp. v. Econo Coach, Inc.*, 118 Ill. App. 3d 385, 454 N.E.2d 1127 (1983).

73. See, e.g., *First Nat'l Bank v. Iowa Beef Processors*, 626 F.2d 764, 767 (10th Cir. 1980) (the court relied on the following exchange: Question: "Did the [debtor] have the authority from the bank to open the gate and let the cattle out into the chute to be loaded onto the truck without checking with the bank?" Answer: "So long as they got me the check for the proceeds within seven days."); *Swift and Co. v. Jamestown Nat'l Bank*, 426 F.2d 1099 (8th Cir. 1970) (security agreement, adapted from an inventory financing form, allowed sales by the debtor in the ordinary course of business); *North Cent. Kan. Prod. Credit Ass'n v. Washington Sales Co.*, 223 Kan. 689, 577 P.2d 35 (1978) (a PCA officer told the debtor that the debtor had permission to sell the collateral without prior written consent, provided the debtor used the sale proceeds to pay on the loan). Even before adoption of the Code, Oklahoma recognized that "a mortgagee surrenders his lien when he gives his express or implied consent to the mortgagor to sell the property." *Credit Plan, Inc. v. Hall*, 9 U.C.C. Rep. Serv. (Callaghan) 514, 516 (Okla. Ct. App. 1971). *Accord* *United States v. Hughes*, 340 F. Supp. 539 (N.D. Miss. 1972) (the lending officer exceeded his authority in granting consent, and, therefore, the consent was ineffective); *First Nat'l Bank v. Waco-Pacific, Inc.*, 9 U.C.C. Rep. Serv. (Callaghan) 1064 (Okla. Ct. App. 1971). See *infra* text accompanying notes 104-107 for a discussion of the effectiveness of conditional authorizations. See *infra* text accompanying notes 108-13 (discussion of consent by a person who is exceeding his authority to consent).

74. See U.C.C. § 1-205 (Course of Dealing and Usage of Trade); *id.* § 2-208 (Course of Performance); see also *id.* § 1-201(3) (an agreement is "the bargain of the parties . . . as found in their language or by implication from other circumstances."); see *infra* text accompanying notes 84-95; *cf. id.* § 9-307 comment 2 (in proving a course of dealing for implied authorization, the buyer will have similar problems as discussed in implying a waiver from a course of dealing).

75. 597 P.2d 756 (Okla. 1979).

Before adoption of the Uniform Commercial Code, a secured party could impliedly consent to the sale of collateral. There is no post-Code case law reaffirming the continued viability of this rule. Nothing in the Code itself suggests that recognition of the implied authorization doctrine was intended to be withheld and § 9-306(2) places no limit upon the manner in which authorization may be "otherwise" given. In accord with § 1-103 of the Code, we hence hold that the doctrine of implied authorization has been allowed to remain in force under the Uniform Commercial Code.⁷⁶

In finding an implied authorization, courts have relied on both the Code's course of dealing⁷⁷ and course of performance⁷⁸ sections.

Express or implied authorization cases usually involve fact patterns in which the security agreement fails to prohibit or place conditions on sales of the farm products collateral. A more difficult issue arises when the security agreement does authorize the farmer-debtor to sell the collateral, but only if certain conditions (such as prior written consent from the secured party, or joint payee checks to farmer and secured party) are satisfied before the sale is made or completed. Courts have rendered diametrically opposed decisions on this issue. Such cases typically are classified as cases of express or implied waiver.

2. Express or Implied Waiver

a. Private lenders

The leading pro-buyer, implied waiver case is *Clovis National Bank v. Thomas*.⁷⁹ In that case, a bank collateralized by a perfected security interest in cattle brought a conversion action against an auctioneer who sold the cattle. The security agreement restricted the farmer-debtor from selling the cattle without the bank's express prior written consent. In violation of that restriction, the farmer-debtor received the sale proceeds, but, unfortunately, failed to pay them to the bank. The New Mexico Supreme Court in finding a waiver noted the following pattern, which is common to many section 9-306(2) farm products cases:

[The bank] not only permitted [the debtor], but permitted all of its other debtors who granted security interests in cattle, to retain possession of the cattle and to sell the same from time to time as the debtor chose, and it relied upon the honesty of each debtor to bring in the proceeds from his sales to be applied on his indebtedness.⁸⁰

76. *Id.* at 760 (footnotes omitted).

77. *See, e.g.,* Larsen v. Warrington, 348 N.W.2d 637 (Iowa Ct. App. 1984); *see also infra* text accompanying notes 83-94.

78. *See, e.g.,* Ottumwa Prod. Credit Ass'n v. Heinhold Hog Mkt., 340 N.W.2d 801 (Iowa Ct. App. 1983); National Livestock Credit Corp. v. Schultz, 653 P.2d 1243 (Okla. Ct. App. 1982); *see also infra* text accompanying notes 83-94.

79. 77 N.M. 554, 425 P.2d 726 (1967).

80. *Id.* at 560, 425 P.2d at 730.

The court ruled that, by acquiescing in this pattern of conduct, the bank had waived the condition of prior written consent and once it had done so, it had impliedly authorized the sale.⁸¹ In essence, the court found a course of conduct (or course of dealing) sufficient to trigger the traditional common law doctrine of waiver, as incorporated under Code section 1-103.⁸² This reasoning prompted almost immediate critical reaction.⁸³

The New Mexico Supreme Court's reasoning can be attacked on a number of grounds. First, section 1-205(4) provides that even if a court finds a course of dealing,⁸⁴ it must construe it, wherever reasonable, as consistent with the express terms of the agreement under review. If such a construction is unreasonable, express terms control over a course of dealing.⁸⁵ In *Clovis*, the security agreement expressly required written consent. Because the *Clovis* court found a course of dealing inconsistent with the security agreement, the agreement's express terms should have controlled.⁸⁶

Second, section 1-205(1) requires the conduct creating a course of dealing to have been "*between the parties* to a particular transaction."⁸⁷ The course of dealing in *Clovis* was between the bank and the farmer-debtor, not the bank and the defendant-auctioneer. The requirement of privity protects the parties' reasonable expectations when they do not expect their pre-agreement conduct to affect the rights of persons not parties to the transaction.⁸⁸

81. *Id.*

82. *Id.* at 562-63, 425 P.2d at 731-32; *see also* U.C.C. § 1-103.

83. The New Mexico legislature's response was to amend the uniform language of section 9-306(2) by adding a sentence which read as follows: "A security interest in farm products . . . shall not be considered waived . . . by any course of dealing between the parties or by any trade usage." Act approved Feb. 13, 1968, ch. 12, 1968 N.M. Laws. In 1985, the New Mexico legislature once again changed section 9-306(2). This time it deleted the sentence it had added in 1968. N.M. STAT. ANN. § 55-9-306 (Supp. 1986). Arkansas has a history similar to that of New Mexico. In 1974, the Arkansas Supreme Court rendered a decision that followed the *Clovis* decision's reasoning and holding. *Planters Prod. Credit Ass'n v. Bowles*, 256 Ark. 1063, 511 S.W.2d 645 (1974), *superseded by statute as stated in*, 261 Ark. 27, 546 S.W.2d 414 (1977). Within a year, the Arkansas legislature reversed this ruling by adding a sentence to section 9-306(2) that reads almost identically to the sentence the New Mexico legislature appended to 9-306(2) in 1968. ARK. STAT. ANN. § 85-9-306 (Supp. 1985).

84. Section 1-205(1) defines a course of dealing as "a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expression and other conduct." U.C.C. § 1-205(1). The *Clovis* court used the term "course of conduct" rather than "course of dealing."

85. *Id.* § 1-205(4).

86. The *Clovis* court's reference to the pattern of relationship between the bank and other debtors is not relevant to finding a course of dealing. *See supra* text accompanying note 80. It is relevant, however, to finding a usage of trade as provided in section 1-205(2). The same rules of interpretation from section 1-205(4), discussed in the text, also apply to usage of trade.

87. U.C.C. § 1-205(1) (emphasis added).

88. *See Weidinger Chevrolet, Inc., v. Universal C.I.T. Credit Corp.*, 501 F.2d 459 (8th

Third, a course of dealing must arise from "previous conduct between the parties."⁸⁹ The term "previous" means "previous to the agreement."⁹⁰ Although the *Clovis* case apparently involved pre-agreement conduct, most section 9-306(2) farm product cases involve post-agreement conduct.

In response to these three criticisms, one commentator contends that in situations similar to *Clovis* courts should invoke the Code's course of performance provision (section 2-208) instead of its course of dealing section.⁹¹ Unlike course of dealing, course of performance involves post-agreement conduct.⁹² The course of performance section, however, is subject to the same problem posed by *Clovis*—it indicates that express terms control if a court cannot reasonably construe the express terms and the course of performance together.⁹³ Section 2-208(3), however, unlike the course of dealing section, suggests that course of performance may be relevant to show "a waiver or modification of any term inconsistent with such course of performance."⁹⁴ Although this reasoning may be correct, it arguably only applies to contracts for sale because the Code's course of performance section is in Article 2.⁹⁵

The dissent in *Clovis* proposed a final criticism when it suggested that the bank did not make an intentional waiver.⁹⁶ The doctrine of waiver includes a requirement of knowledge.⁹⁷ Because the bank did

Cir.), *cert. denied*, 419 U.S. 1033 (1974). This reasoning is in line with traditional concepts of third party beneficiaries of a contract. *See also* U.C.C. § 2-208 comment 3.

89. U.C.C. § 1-205(1).

90. *Id.* comment 2.

91. Dugan, *Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code*, 46 U. COLO. L. REV. 333 (1975).

92. U.C.C. § 2-208(1) provides:

Where the contract for sale involves *repeated occasions for performance* by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement. (emphasis added)

Id. § 1-205 comment 2 states that "provisions of the [Code] on course of performance make it clear that a sequence of conduct *after* or under the agreement may have equivalent meaning." (emphasis added); *see* *National Livestock Credit Corp. v. Schultz*, 653 P.2d 1243 (Okla. Ct. App. 1982).

93. U.C.C. § 2-208(2).

94. *Id.* § 2-208(3); *see also* Dugan, *supra* note 91, at 340-41.

95. *See* U.C.C. § 2-102 (Article Two's provisions, "unless the context otherwise requires," apply only to contracts for sale and not to security transactions). *But see National Livestock Credit Corp.*, 653 P.2d at 1247 (suggestion that Article Nine incorporates course of performance through § 1-201(3)'s definition of agreement).

96. *Clovis*, 77 N.M. at 566-67, 425 P.2d at 734 (Carmody, J., dissenting).

97. Under section 9-306(2), the Kansas Supreme Court has defined waiver to mean " 'that a party has voluntarily and intentionally renounced or given up a known right, or has caused or done some positive act or positive inaction which is inconsistent with the contractual right.' "

not know of the particular sale in advance, it could not intentionally waive its prior right of approval.⁹⁸ It is not necessary to show, however, that the lender knew it was waiving its security interest. Rather, the waiver doctrine only requires that the lender knew it was waiving the prohibition against sale.⁹⁹ Nothing in section 9-306(2) suggests that the waiver applies only if the lender intends to waive its security interest.

Although some critics have attacked the *Clovis* rationale, courts in Arkansas, California, Iowa, North Dakota, and Washington have followed its approach.¹⁰⁰ These cases, however, represent a minority rule. A majority of courts have rejected the implied waiver theory of *Clovis*, in part because of the criticisms previously discussed. But at heart, the courts rejecting *Clovis* have done so based on a basic policy difference. They disagree with the *Clovis* court's conclusion that the lender should bear the risk that the farmer-debtor will fail to apply the proceeds gained from the collateral's sale against the loan for which the lender granted the security interest.¹⁰¹ As the Kansas Supreme Court stated in *North Central Kansas Production Credit Association v. Washington Sales Co., Inc.*:¹⁰²

Waiver generally implies "that a person has voluntarily and intentionally renounced or given up a known right, or has caused or done some positive act or positive inaction which is inconsistent with the contractual right." The action of [the secured party], in accepting payment for the isolated wheat sales . . . can hardly be construed as a voluntary and intentional renouncement of its interest in all of the collateral. . . .¹⁰³

North Cent. Kan. Prod. Credit Ass'n v. Washington Sales Co., 223 Kan. 689, 696-97, 577 P.2d 35, 41 (1978) (quoting United Am. State Bank and Trust v. Wild West Chrysler Plymouth, 221 Kan. 523, 526, 561 P.2d 792, 795 (1977)). The Kansas court then ruled that waiver was inapplicable to the fact situation of the case. *Id.* at 697, 577 P.2d at 41.

98. *Clovis*, 77 N.M. at 566, 425 P.2d at 734 (Carmody, J., dissenting).

99. *But see* United States v. Sommerville, 324 F.2d 712, 718 (3rd Cir. 1963); Vermillion County Prod. Credit Ass'n v. Izzard, 111 Ill. App. 2d 190, 195, 249 N.E.2d 352, 355 (1969).

100. *Arkansas*: See *supra* note 83. *California*: *In re Caldwell*, Martin Meat Co., 10 U.C.C. Rep. Serv. (Callaghan) 710 (E.D. Cal. 1970). *Iowa*: Hedrick Sav. Bank v. Meyers, 229 N.W.2d 252 (Iowa 1975); Lisbon Bank and Trust Co. v. Murray, 206 N.W.2d 96 (Iowa 1973). *North Dakota*: United States v. Central Livestock Ass'n, 349 F. Supp. 1033 (D.N.D. 1972) (applying North Dakota law). *Washington*: Central Washington Prod. Credit Ass'n v. Baker, 11 Wash. App. 17, 521 P.2d 226 (1974).

101. See, e.g., *In re Ellsworth*, 722 F.2d 1448 (9th Cir. 1984); Colorado Bank and Trust Co. v. Western Slope Inv., 36 Colo. App. 149, 539 P.2d 501 (1975); Vermillion County Prod. Credit Ass'n v. Izzard, 111 Ill. App. 2d 190, 249 N.E.2d 352 (1969); Wabasso State Bank v. Caldwell Packing Co., 308 Minn. 349, 251 N.W.2d 321 (1976); First Nat'l Bank v. Calvin Pickle Co., 11 U.C.C. Rep. Serv. (Callaghan) 1245 (Okla. Ct. App.), *rev'd on other grounds*, 516 P.2d 265 (Okla. 1973); Blubaugh v. Ponca City Prod. Credit Ass'n, 9 U.C.C. Rep. Serv. (Callaghan) 786 (Okla. Ct. App. 1971).

102. 223 Kan. 689, 577 P.2d 35 (1974).

103. *Id.* at 696-97, 577 P.2d at 41 (citations omitted); see also *Farmers State Bank v. Edison Non-Stock Coop. Ass'n*, 190 Neb. 789, 212 N.W.2d 625 (1973), *rev'd*, 225 Neb. 1, 402 N.W.2d 277 (1987).

This quotation illustrates that, contrary to the *Clovis* court, the Kansas Supreme Court balanced the equities in favor of the secured party who made the loan to the farmer-debtor.

In addition to cases like *Clovis* and *North Central*, which discuss express or implied waiver created by a course of dealing, another line of cases addresses express or implied waiver when the lender has given conditional consent to the sale of the collateral. Lenders have given such consent on conditions such as that the farmer-debtor have the buyer's check made to a joint-payee,¹⁰⁴ that the farmer-debtor promptly remit the proceeds of the buyer's check to the lender, or that the buyer's bank honor the buyer's check.¹⁰⁵

In conditional consent cases, the courts generally have protected the secured party provided the farm products buyer could have discovered or exercised control over the condition prior to the purchase. Under those circumstances, if the farmer-debtor or buyer fails to abide by the conditions, the courts are likely to rule that a secured party did not consent to the sale and, therefore, did not waive its security interest.

In contrast, courts have not protected secured parties who have granted consent on the condition that the farmer-debtor promptly remit the proceeds to pay against the loan. The courts have held that this condition is not a "true condition" because it effectively makes the farm products buyer the farmer-debtor's insurer. Such a condition permits the lender to place the buyer in a position where the buyer is at the farmer-debtor's mercy with respect to actions required after the sale.¹⁰⁶ In effect, these courts have treated a secured party's granting of consent conditioned on the farmer-debtor's prompt remittance of the proceeds as express consent rather than as a conditional sale.¹⁰⁷

104. See *First Nat'l Bank & Trust Co. v. Atchison County Auction Co.*, 10 Kan. App. 2d 382, 387, 699 P.2d 1032, 1037 (1985); cf. *United States v. Pirnie*, 339 F. Supp. 702, 710 (D. Neb. 1972).

105. See *Baker Prod. Credit Ass'n v. Long Creek Meat Co.*, 266 Ore. 643, 651, 513 P.2d 1129, 1133 (1973); cf. *South Omaha Prod. Credit Ass'n v. Tyson's, Inc.*, 189 Neb. 702, 704, 204 N.W.2d 806, 808 (1973); *Southwest Wash. Prod. Credit Ass'n v. Seattle-First Nat'l Bank*, 92 Wash. 2d 30, 32, 593 P.2d 167, 169 (1979).

106. See *First Nat'l Bank v. Iowa Beef Processors*, 626 F.2d 764, 769 (10th Cir. 1980); *Western Idaho Prod. Credit Ass'n v. Simplot Feed Lots, Inc.*, 106 Idaho 260, 678 P.2d 52, 55-56 (1984) (quoting *First Nat'l Bank*, 626 F.2d at 769); *Anon, Inc. v. Farmers Prod. Credit Ass'n*, 446 N.E.2d 656, 662 (Ind. Ct. App. 1983) (quoting *First Nat'l Bank*, 626 F.2d at 769). But see *Southwest Wash. Prod. Credit Ass'n*, 92 Wash. 2d at 32, 593 P.2d at 169.

107. See *supra* note 73 (express consent cases). The fact patterns of cases cited in notes 73 and 106 are almost identical.

b. Federal lenders

When the lending agency is a federal entity, the issue of express or implied waiver is further complicated.¹⁰⁸ In accordance with *Clearfield Trust v. United States*,¹⁰⁹ federal law, not state law, governs cases involving federal lending agencies. But federal law may or may not incorporate the commercial laws, such as the Uniform Commercial Code, of the state where the federal court sits. When federal statutes or regulations specifically address issues before the court, it is bound to apply them. When no federal statutes or regulations specifically address issues before the court, it can adopt state law. In the latter instance, federal law would be identical to state law.¹¹⁰

In cases involving the sale of farm products collateralized to federal lending agencies, federal courts have held that specific federal regulations do exist,¹¹¹ and the courts must, under *Clearfield Trust*, apply them in determining whether the government has waived its security interest. Applying these federal regulations, federal courts have held that Farmers Home Administration (the "FmHA") personnel have no authority to waive security interests on behalf of the federal government unless the debtor uses and applies the proceeds in accordance with the controlling regulations. Hence, even when a FmHA supervisor has expressly consented to the sale of the collateral, courts have held a buyer or a commission merchant liable in replevin or conversion because the debtor failed to comply with the federal regulations and misused or misapplied the proceeds of the sale.¹¹² For all practical purposes, these federal agency case rulings mean that federal courts will not find express or implied authorization *or* express or implied waiver of security interests by federal lending agencies.¹¹³

108. The federal agencies involved in agricultural lending are the Farmers Home Administration (FmHA), the Commodity Credit Corporation (CCC), and the Small Business Administration (SBA). FmHA is by far the largest federal lending agency in agriculture.

109. 318 U.S. 363 (1943).

110. See *United States v. Kimbell Foods, Inc.*, 440 U.S. 715 (1979); B. Keedy, Determining the Tort Liability of Commission Merchants Selling Farm Products Mortgaged to Federal Agency Lenders: Should the Government Be Allowed to Play the Game Using Its Own Rules? (student paper in the authors' possession).

111. The courts refer to regulations controlling the use and application of proceeds from farm products sales made by debtors financed by federal agencies. 7 C.F.R. §§ 1962.17(a), .17(b), .18(b) (1987).

112. See *United States v. E.W. Savage & Son, Inc.*, 475 F.2d 305, 307-08 (8th Cir. 1973); *United States v. New Holland Sales Stable, Inc.*, 40 U.C.C. Rep. Serv. (Callaghan) 715, 721-22 (E.D. Pa. 1984); *United States v. Gallatin Livestock Auction, Inc.*, 448 F. Supp. 616, 622 (W.D. Mo.), *aff'd*, 589 F.2d 353 (8th Cir. 1978); *United States v. Hughes*, 340 F. Supp. 539, 544 (N.D. Miss. 1972).

113. Clark Memorandum, *supra* note 13, at 16-17. But see *United States v. Lindsey*, 455 F. Supp. 449, 454 (N.D. Tex. 1978).

3. Estoppel

The Code incorporates the doctrine of estoppel via section 1-103.¹¹⁴ Estoppel situations, however, are much less common than waiver situations. Estoppel issues only arise when a creditor's behavior induces action (or inaction) on the buyer's part. In *Clovis*, the trial court found that in addition to implied waiver, the bank's conduct had created an estoppel. The New Mexico Supreme Court, however, specifically rejected the estoppel argument.¹¹⁵

Most other courts also have rejected estoppel arguments.¹¹⁶ In *United States v. Riceland Foods, Inc.*,¹¹⁷ for example, Riceland purchased soybeans from a farmer financed by the FmHA. Because it had requested a list of borrowers from FmHA and the farmer's name was not on the list, Riceland did not check for a financing statement. Consequently, it failed to learn of the properly filed statement. The FmHA inadvertently omitted the farmer's name from its list. Riceland contended that the FmHA was estopped from arguing conversion because Riceland had relied to its detriment on the FmHA-supplied borrowers' list. The court ruled that the government was not estopped because the borrowers' list explicitly stated that the FmHA furnished it only as a convenience to potential farm products buyers and that it should not be considered complete.¹¹⁸ Thus, the court decided the Riceland had constructive notice of the security interest and was liable to the FmHA in conversion.¹¹⁹ Other federal courts have simply refused to apply estoppel against the federal government.¹²⁰

At least one court, however, has accepted the estoppel argument. In *United States v. Gleaners & Farmers Cooperative Elevator Co.*,¹²¹ the United States Department of Agriculture (the "USDA") claimed a security interest in grain and soybeans sold by its farmer-debtor

114. U.C.C. § 1-103 provides that "[u]nless displaced by the particular provisions of this Act, the principles of law and equity, including . . . the law relative to . . . estoppel . . . shall supplement its provisions." Oklahoma courts have held that section 1-103 incorporates the doctrines of waiver and estoppel into the Oklahoma Code. See *Central Nat'l Bank & Trust Co. v. Community Bank & Trust Co.*, 528 P.2d 710 (Okla. 1974); *Peoples Nat'l Bank v. Uhlenhake*, 712 P.2d 75 (Okla. Ct. App. 1985).

115. *Clovis Nat'l Bank v. Thomas*, 77 N.M. 554, 560, 425 P.2d 726, 730 (1967).

116. See, e.g., *United States v. Topeka Livestock Auction, Inc.*, 392 F. Supp. 944, 949 (N.D. Ind. 1975); *United States v. E. W. Savage & Son, Inc.*, 343 F. Supp. 123, 126-27 (D.S.D. 1972), *aff'd*, 475 F.2d 305 (8th Cir. 1973); *Blubaugh v. Ponca City Prod. Credit Ass'n*, 9 U.C.C. Rep. Serv. (Callaghan) 786, 792-93 (Okla. Ct. App. 1971).

117. 504 F. Supp. 1258 (E.D. Ark. 1981).

118. *Id.* at 1263.

119. *Id.*

120. See, e.g., *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).

121. 314 F. Supp. 1148 (N.D. Ind. 1970).

to the defendant grain elevator. Prior to making the purchase, the elevator discovered a financing statement filed by the Department of Agriculture that contained a general collateral description. The grain elevator then called and asked the appropriate government agent whether the financing statement covered the crops the grain elevator wished to purchase. Because the agent replied that it did not cover the crops, the grain elevator purchased them. Without discussing the Code, the court held that the USDA was estopped from bringing an action for conversion based on its properly perfected security interest. The court applied estoppel because the grain elevator had reasonably relied to its detriment on the incorrect representations of the Department of Agriculture's authorized agent.

4. Limitations on Conversion Liability

As previously indicated, case law clearly establishes that an auctioneer or other agent is liable in conversion to a lender when he sells secured farm products as an agent for a farmer-debtor who then fails to use the sale's proceeds to pay the debt.¹²² Yet some courts, reacting unfavorably to this legal doctrine, have taken a very careful, technical look at the elements of conversion so as to protect the auctioneer or other agent from liability.

In *Production Credit Association v. Equity Coop Livestock Sales Association*,¹²³ the Wisconsin Supreme Court relied upon section 9-311 of the Code to find that no conversion had occurred. The court reasoned that because section 9-311 provides that a "debtor's rights in collateral may be voluntarily or involuntarily transferred . . . notwithstanding a provision in the security agreement prohibiting any transfer or making the transfer constitute a default," the auctioneer is not liable for conversion.¹²⁴ The comments to section 9-311, however, make this decision questionable. That provision's limited purpose is to clarify that the debtor maintains an interest in collateral pledged to a secured party and that the debtor's other creditors can reach such an interest.¹²⁵ Section 9-311 was not directed towards the question of whether any transfer of the pledged collateral by the debtor, or the debtor's agent, was a lawful act which prevented conversion liability.

In a similar fashion, a federal district court held in *United States*

122. See cases cited *supra* note 30.

123. 82 Wis. 2d 5, 261 N.W.2d 127 (1978); cf. *United States v. Kramel*, 234 F.2d 577 (8th Cir. 1956) (pre-Code case).

124. *Equity Coop*, 82 Wis. 2d at 13, 261 N.W.2d at 130 (quoting WIS. STAT. § 409.311 (1979)).

125. Section 9-311 reversed pre-Code law in some jurisdictions providing differently. U.C.C. § 9-311 comment 2.

v. *Lindsey*¹²⁶ that although an FmHA supervisor could not waive a governmental lien (because the debtor had not followed the federal regulations relating to the use and application of sale proceeds)¹²⁷ the supervisor did have authority to allow the sale by the farmer-debtor. The court then reasoned that once the farmer-debtor had authorization to sell, the auctioneer did so on the farmer-debtor's behalf. Thus, the auctioneer did not sell the cattle without authorization as required to meet the elements of conversion. According to the *Lindsey* court, however, an unauthorized act constituting conversion did occur when the farmer-debtor failed to remit the proceeds as required by the regulations.¹²⁸

D. Nonuniform State Legislative Responses to the Farm Products Exception

This article has demonstrated that there has been extensive litigation concerning the definition of farm products and the farm products exception's scope. Despite individual court decisions favoring farm products buyers and auctioneers who sold farm products, the majority of courts have implemented the policy decision of the Code's drafters. They have favored properly secured lenders over buyers or auctioneers in situations in which farmer-debtors have failed to repay farm products loans. Thus, farm products buyers and auctioneers or other agents who sell farm products for farmer-debtors have lobbied state legislatures to reverse the Code's fundamental policy decision and to enact modifications to section 9-307's farm products exception. In twenty-three states, these lobbying efforts have been successful. States have responded in varied ways, ranging from total repeal of the farm products exception to minor adjustments. The following section summarizes state responses through 1986.¹²⁹

126. 455 F. Supp. 449 (N.D. Tex. 1978).

127. See *supra* text accompanying notes 108-13.

128. *Lindsey*, 455 F. Supp. at 454. The *Lindsey* judge recognized that his ruling drew a distinction between the auctioneer freed from liability due to the FmHA supervisor's permission to sell and the buyer who continued to be liable because the FmHA supervisor has no authority to waive the government lien. *Id.* at 454-55. *Contra* *United States v. New Holland Sales Stable, Inc.*, 603 F. Supp. 1379, 1385 (E.D. Pa. 1985), *rev'd on other grounds*, 800 F.2d 1232 (3d Cir. 1986).

129. For two excellent surveys of these nonuniform state amendments and an evaluation of their impact on farmers, lenders and buyers, see Richards, *Federal Preemption of the U.C.C. Farm Products Exception: Buyers Must Still Beware*, 15 STETSON L. REV. 371, 396-409 (1986); Uchtmann, *supra* note 3.

The discussion in the text is meant to cover nonuniform legislation through December 1986. It does not cover state actions taken to comply with section 1324.

1. Repeal of the Farm Products Exception

California completely repealed the farm products exception from its Code effective on January 1, 1976. As a result, in California, buyers of farm products in the ordinary course of business take free of any security interest in the farm products. They are treated in the same way as buyers of inventory.¹³⁰ Apparently in response to the passage of section 1324, Minnesota and Virginia also completely repealed the farm products exception.¹³¹ Tennessee's repeal of the farm products exception covered all farm products except tobacco, grain, soybeans, and livestock.¹³² Michigan too has repealed the farm products exception but with several unique twists. In Michigan, secured parties are permitted to give farm product buyers notice of security interests,

130. CAL. COM. CODE § 9307 (West Supp. 1987). Two commentators have argued that the structure of California agriculture is unique and makes feasible a complete repeal of the farm products rule for California lenders, farmers, and buyers. These commentators conclude, however, that the California experience is not an appropriate model for other states with a different agricultural structure. Hultquist & Heringer, *Uniform Commercial Code Section 9307: Can California's Experience Be Used to Justify the Repeal of the Farm Products Exception?*, 7 J. AGRIC. TAX'N & L. 221 (1985).

Under U.C.C. § 9-307, an inventory purchaser (and a farm products purchaser if a state completely repeals the farm products exception) takes free of the security interest if he is a "buyer in the ordinary course of business." U.C.C. § 1-201(9) defines "buyer in the ordinary course of business" as a person who buys "without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party." (emphasis added). If the buyer knows of the security interest, he still qualifies as a "buyer in the ordinary course of business" under section 9-307's language. But if the buyer also knows, probably due to a notification received from the lender, of specific payment obligations (such as a joint payee check) set forth in the security agreement and fails to abide by these payment obligations, he does not qualify as a "buyer in the ordinary course" under section 9-307. *Id.* § 9-307 comment 2. In this latter instance, the buyer will take subject to the security interest and will be liable for conversion to the lender if the farmer-debtor does not repay the loan.

The scenario described in the preceding paragraph is a form of "buyer pre-notification" under the Uniform Commercial Code to which the buyer is bound, even in instances in which he ordinarily would take free of a pre-existing properly perfected security interest. When California repealed its farm products exception, California lenders simply began to use the Code's buyer pre-notification to maintain their preferred position over farm products buyers. After the 1976 repeal of the farm products exception, California lenders could no longer rely upon constructive notice of properly filed financing statements to establish their preferred status, but they could, and did, through Code pre-notification to buyers basically attain the same protection. Clark Memorandum, *supra* note 13, at 30, 41-42.

131. MINN. STAT. ANN. § 336.9-307(1) (West 1987) (effective March 15, 1986); VA. CODE ANN. § 8.9-307(1) (Supp. 1987) (effective December 24, 1986).

132. TENN. CODE ANN. § 47-9-307 (Supp. 1986). Tennessee has adopted prior notice of security interests by lenders to buyers for tobacco, grain, soybeans, and livestock. *Id.* § 47-9-307(2)(a)-(c).

For a discussion of section 1324's impact upon those states that have completely or partially repealed 9-307's farm products exception, see *infra* notes 183-92 and accompanying text.

and buyers then are required to issue joint payee checks when purchasing those farm products. If a buyer fails to make joint payee checks the buyer has committed a crime. Moreover, if a Michigan buyer sets off part of all of the purchase price proceeds to satisfy a debt owed to the buyer by the farm product seller, then for the set-off amount the buyer buys subject to the security interests of which the buyer has received notice.¹³³

2. Prior Notice of Security Interests by Lenders to Buyers

To preserve its security interest in the states of Ohio, Illinois, Kentucky, Tennessee, Washington, Indiana, and Delaware,¹³⁴ a lender must give notice of its security interest in farm products to the buyer prior to sale. In general, under these states' statutes, a farmer must provide his lender with a list of potential buyers, and in turn, the lender must give written notice of its security interest to those buyers prior to a sale.¹³⁵ If the lender fails to provide proper notice in a timely manner, the buyer takes free of the lender's security interest. Under this system, the lender bears the risks of (1) the farmer selling to a buyer not on the list, (2) the list becoming outdated and inaccurate, (3) proving that the buyer received the required notice in proper form, (4) insuring that the form and substance of the notice meets any statutory requirements, and (5) repeating the notice prior to the expiration of its effectiveness. Creating a monitoring system that minimizes lenders' risks may prove costly to farm lenders at a time when many of them are experiencing the same depressed economic conditions as their farmer-debtors. Notwithstanding these potential problems, however, section 1324 adopted prior notice of security interests by lenders to buyers as one notification alternative.¹³⁶

133. MICH. COMP. LAWS ANN. § 440.9307 (West Supp. 1987). The Michigan law further defines buyer to include commission merchants and selling agents so that the repeal of the farm products exception also protects them from tort liability for conversion. *Id.* § 440.9307(11).

134. DEL. CODE ANN. tit. 6, § 9-307(2) (Supp. 1986); ILL. ANN. STAT. ch. 256, paras. 9-307.1-2 (Smith-Hurd Supp. 1987); IND. CODE ANN. § 26-1-9-307 (Burns Supp. 1987); KY. REV. STAT. ANN. § 355.9-307 (Michie/Bobbs-Merrill Supp. 1986); OHIO REV. CODE ANN. § 1309.26 (Anderson Supp. 1987); TENN. CODE ANN. § 47-9-307 (Supp. 1986) (the Tennessee provisions on prior notice to buyers from lenders only applies to tobacco, grain, soybeans and livestock); WASH. REV. CODE ANN. § 62A.9-307(4)(a) (Supp. 1987) (the Washington provisions on prior notice to buyers from lenders only applies to livestock and livestock products). Minnesota had a lender notice system prior to its repeal of the farm products exception in 1986. MINN. STAT. ANN. §§ 336.9-307, 223A.01, 386.42 (West 1987).

135. Illinois requires that the lender give notice within five years prior to a sale. ILL. STAT. ANN. ch. 26, paras. 9-307.1-2 (Smith-Hurd Supp. 1987). Ohio and Indiana require notice within the 18 months prior to a sale. IND. CODE ANN. § 26-1-9-307 (Burns Supp. 1987); OHIO REV. CODE ANN. § 1309.26 (Anderson Supp. 1987).

136. Food Security Act of 1985, *supra* note 4, at § 1324(e)(1), (g)(2)(A)-(B).

3. Notice of Security Interests by Sellers to Buyer

Statutes in Oklahoma and Nebraska have retained the farm products exception, but provide that the farm products buyer in the ordinary course of business will take free of any security interests if, prior to sale, (1) the buyer requests that the seller disclose the names of any secured creditors, and (2) the buyer makes the proceeds payable jointly to the seller and any such secured creditors.¹³⁷ Oklahoma's scheme is typical. Before making payment, a buyer must obtain a certificate from the seller disclosing the names of any secured lenders or, if none exist, a statement to that effect. This certificate must meet certain statutory requirements as to form and content, including a warning that any false statement by the seller is a criminal offense.¹³⁸ Oklahoma does not require the buyer to check any Code filing records if the seller states that there are no secured creditors.¹³⁹ This seller-notice system seems to acknowledge that the notice provisions of the Code's farm products filing system are ineffective. Farmers may oppose seller-notice because it burdens them and because states have created criminal sanctions to "encourage" compliance. Lenders, however, may oppose the system because they bear all the risk of nondisclosure without any control over disclosure.

4. Exempting Auctioneers and Commission Merchants

Georgia, Louisiana, Maryland, and Nebraska have modified the farm products exception to exempt commission merchants and auc-

137. NEB. REV. STAT. § 9-307(4) (Supp. 1984); OKLA. STAT. ANN. tit. 12A, § 9-307 (West Supp. 1987).

South Dakota makes it a crime for a livestock or grain producer to sell the product without notifying the buyer of a security interest in the product. The Code's farm product exception, however, remains intact whether or not the producer provides the notice. S.D. CODIFIED LAWS ANN. § 57A-9-503.2 (Supp. 1987).

North Dakota had a notification system similar to that of Oklahoma and Nebraska from 1983 to 1985. N.D. CENT. CODE § 41-09-28(4)-(8) (1983 Supp. 1987).

138. OKLA. STAT. ANN. tit. 12A, § 9-307(3) (West Supp. 1987) provides as follows:

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 such security interests exist, the certificate 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 penitentiary 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).

139. Under the North Dakota law as it existed from 1983 to 1985, if the seller disclosed no security interests, buyers were required to inquire further to verify that such disclosure was accurate. N.D. CENT. CODE § 41-09-28(7)(b) (1983).

tioneers from liability for selling farm products subject to a security interest.¹⁴⁰ This modification is relatively limited in scope and attempts to accomplish legislatively what several courts have attempted to do in judicial decisions¹⁴¹—redefine the elements of conversion with respect to farm products sales by the farmer-debtor's agents. This modification does not, however, remove buyers' liability under section 9-307(1) for conversion and replevin when the farmer-debtor fails to pay off the loan.

5. Central Filing Systems

Oregon, Kansas, Iowa, Washington, South Dakota, and Nebraska all have adopted some form of central filing system to record security interests in farm products.¹⁴² These systems keep the farm products exception in place, but offer buyers a more realistic opportunity to discover the existence of a secured interest and the secured party's identity. Central filing systems are a direct replacement for the local filing systems these six states had previously employed under their respective Codes. As a consequence, these systems' primary impact, from a lender's perspective, is to change the location in which the lender must file a financing statement in order to perfect its interest. Once a lender has made the proper filing, it has fulfilled its obligation. Farm products buyers are then held to have constructive notice of the security interest and bear the burden of checking the filings to learn about that security interest.

Nebraska, for example, requires the lender to file the financing statement locally with the county clerk. The county clerk then forwards the financing statement to the Secretary of State, who places the information in a central, computerized filing system. Buyers then have constructive notice of a perfected security interest under the Code. But they also have 24-hour per day, seven day per week access to the system via computer-telephone links. Buyers can also gain information from the central system in person, by written request, or via telephone. Under the Nebraska system, buyers know that they have only one filing location to check and that the state can handle their queries promptly at any time of day or night via computer.¹⁴³

140. GA. CODE ANN. § 11-9-307(3) (1982); LA. REV. STAT. ANN. §§ 3:561(5), 3:568 (West Supp. 1984); MD. COM. LAW CODE ANN. § 9-307(1)(b) (Supp. 1986); NEB. REV. STAT. § 69-109.01 (1981); *see supra* note 133 (how Michigan has provided protection to commission merchants and selling agents).

141. *See supra* text accompanying notes 122-28.

142. IOWA CODE ANN. § 554.9407(2) (West 1967); KAN. STAT. ANN. §§ 84-9-401-410 (Supp. 1984); NEB. REV. STAT. §§ 9-413-415 (Supp. 1984); 1983 Or. Laws 626; S.D. CODIFIED LAWS ANN. § 57A-9-401(1) (Supp. 1987); WASH. REV. CODE ANN. § 62A.9-307(4)(b) (Supp. 1987) (livestock sales only).

143. The Nebraska central filing system is set forth in NEB. REV. STAT. §§ 9-307(6), -411(4),

6. Centralized Notification Systems

In 1985, North Dakota also adopted a type of central filing system for crops and livestock.¹⁴⁴ The North Dakota system, however, has a significant difference from the systems discussed in the previous section. In North Dakota, the central filing system does not constitute constructive notice to farm products buyers. Instead, notice requirements are met only when the system's operator, the Secretary of State, sends the buyer a list of farmer-debtors who have granted security interests in their crops and/or livestock and the lenders who have taken those security interests.¹⁴⁵ If the buyer receives a list that does not indicate a security interest against the farm products he wishes to purchase, he takes free of any security interest that does in fact exist.¹⁴⁶

To distinguish the North Dakota system from the systems of Oregon, Kansas, Iowa, Washington, South Dakota, and Nebraska, the North Dakota system is called a "centralized notification" system (as opposed to a "central filing" system). A centralized notification system, which requires actual notice to buyers from the system's operator, as opposed to giving constructive notice to buyers, is the second notification alternative adopted by section 1324.¹⁴⁷ Since 1981, Montana has had a more limited centralized notification system applicable only to livestock sold through public auctions. Secured parties are required to file notices of security interests with the Montana Department of Livestock which in turn is required to send the notices to central livestock markets. If the notice is not filed or sent, central livestock markets cannot be held liable for the security interest through the tort of conversion.¹⁴⁸

7. Procedural Limitations

Some states have adopted procedural protections for buyers such as (1) a requirement to make a good faith effort to recover from the farmer-debtor before filing a suit against the buyer;¹⁴⁹ or (2) short statutes of limitation.¹⁵⁰

-413-415 (Supp. 1984). South Dakota also allows direct computer access and toll-free telephone requests to the central filing system. S.D. CODIFIED LAWS ANN. §§ 57A-9-403(9), -407.1 (Supp. 1987).

144. N.D. CENT. CODE §§ 41-09-28(9)-(13), -46 (Supp. 1987).

145. *Id.* § 41-09-28(9).

146. *Id.* § 41-09-28(13)(b), (c).

147. Food Security Act of 1985, *supra* note 4, at § 1324(e)(2)-(3), (g)(2)(C)-(D).

148. MONT. CODE ANN. § 81-8-301 (1985).

149. Compare N.D. CENT. CODE § 41-09-28(6) (1983) with *id.* § 41-09-28(12) (Supp. 1987).

150. S.D. CODIFIED LAWS ANN. § 57A-9-503.1 (Supp. 1987) (two-year limitation from the purchase date).

E. Problems with Nonuniform Responses to Farm Products Financing

Courts and state legislatures have responded to the Code's farm products exception in a myriad of ways. Courts have reached diametrically opposed decisions on identical fact patterns. Because they frequently have rendered decisions that turn on unique facts rather than general principles, many decisions provide little guidance in predicting whether the lender or the buyer is likely to prevail in any lawsuit arising from a farmer-debtor's failure to repay a loan with sale proceeds.

Although the authors have not discovered any published data on the economic consequences of this uncertainty, they believe that lenders have responded to it by raising interest rates and/or collateral requirements on farm product loans or by denying loans to farmers to whom the lender might otherwise, in a less risky situation, make a loan. At the same time, the authors suspect that farm products buyers pay farmers less for farm products than they otherwise would because they perceive a greater risk of double payment. If these observations are correct, the uncertainty created by unpredictable court decisions has caught farmers in a double squeeze—lenders offer less financing at higher prices while buyers offer lower prices for the farmers' products.

State legislative responses also have generated nonuniformity in farm product financing. While the various state enactments amending the Code's farm products provisions have consistently favored buyers and commission merchants, the various state responses have not been consistent in the manner of providing protection. Thus, lenders, farmers, and farm products buyers, when considered from a nation-wide perspective, have a myriad of rules to follow in order to protect their own interests.

Many farm transactions today involve multi-state contacts. Conflicts of laws problems may arise when, as is inevitable, the various laws impose different requirements on the same aspect of a farm product loan. Complying with the different laws of the various states and uncertainty about which state's law governs imposes additional transaction costs upon both the lender and the buyer.¹⁵¹ Again, the authors suggest that uncertainty about legal requirements translates into less available credit at a more expensive rate and lower prices.

151. For example, an Oklahoma farm lender who desires to make a loan to a farmer using as collateral livestock located in Kansas and crops to be grown in Oklahoma must know to file centrally in Kansas but locally in Oklahoma. Compare KAN. STAT. ANN. §§ 89-9-401(1), -410(1)(b) (Supp. 1987) with OKLA. STAT. ANN. tit. 12A, § 9-401(1)(a) (West Supp. 1987). If the debtor is likely to move the livestock to Oklahoma or the crops, once harvested, to Kansas, the lender must also be concerned about these multistate contacts. U.C.C. §§ 1-105, 9-103, and 9-401(3) & (4) are relevant when considering multistate contacts.

for farm products. Just as uncertainty about judicial outcomes puts farmers in a double squeeze, so too does nonuniformity in state laws. When everyone (farmers, lenders, buyers, commission merchants, etc.) involved in agriculture is already under great financial stress, the "costs" of uncertainty seem particularly wasteful and socially undesirable.

As a consequence, many commentators recommended that the Code's Permanent Editorial Board act to produce a uniform change in the farm products exception.¹⁵² The other alternative was for Congress to preempt the area by enacting uniform legislation. Most commentators preferred state, rather than Congressional action, for numerous reasons, including the following: (1) traditionally, commercial law has been enacted at the state level;¹⁵³ (2) other Code sections have nonuniform provisions and interpretations;¹⁵⁴ (3) action by Congress on the farm products exception might lead to other attempts to persuade Congress to enact a federal Uniform Commercial Code; and (4) even if Congress changed section 9-307, farm products buyers would remain subject to double liability in certain instances.¹⁵⁵

Notwithstanding these arguments, members of Congress began introducing bills to repeal or modify the farm products exception in 1983.¹⁵⁶ By adopting section 1324, Congress ended the debate.

II. SECTION 1324 OF THE 1985 FARM BILL

A. Introduction

Before reviewing and analyzing section 1324 in detail, it is again important to note certain things that section 1324 does not do. Section 1324 does not govern disputes that are based on sales that oc-

152. See, e.g., Meyer, *supra* note 3 at 439-43; Uchtmann, *supra* note 3, at 1348.

153. See Uchtmann, *supra* note 3, at 1351.

154. See, e.g., U.C.C. § 9-401 (providing for three filing alternatives). Numerous states have amended section 2-315 which deals with implied warranties. Also, section 2-318 provides three alternative sets of warranty provisions.

155. Buyers would still be subject to the risk of double liability with respect to landlord liens, which section 9-104(b) excludes from Article Nine coverage, and with respect to statutory liens, which section 9-104(c) excludes from Article Nine coverage. Each individual state, with its own peculiar lien priority structure, determines who wins in a lawsuit between a buyer and a landlord, or between a buyer and a statutory lien claimant. *Id.* § 9-104 comments 2-3. Under the Code, buyers also are subject to double liability if they ignore a lender's actual notice of payment obligations set forth in the security agreement. See *supra* note 130.

156. H.R. 1591, 99th Cong., 1st Sess. (1985); H.R. 3297, 3296, 98th Cong., 1st Sess., 129 CONG. REC. 10,583 (1983). The Farm Products Buyers' Protection Act of 1983 simply provided as follows:

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.

curred prior to December 24, 1986. Nor does it replace any Code provision dealing with the creation, attachment, or perfection of a security interest. Finally, Code rules (state law) still govern priority disputes not involving ordinary course buyers, commission merchants, or selling agents.¹⁵⁷

Section 1324's core is found in subsection 1324(d) (applying to buyers in the ordinary course of business) and subsection 1324(g)(1) (applying to commission merchants and selling agents who sell in the ordinary course of business). These two subsections provide:

Except as provided in subsection [1324(e)] and notwithstanding any other provision of Federal, State, or local law, a buyer who in the ordinary course of business buys a farm product from a seller engaged in farming operations shall take free of a security interest created by the seller, even though the security interest is perfected; and the buyer knows of the existence of such interest.

Except as provided in paragraph [1324(g)(2)] and notwithstanding any other provision of Federal, State, or local law, a commission merchant or selling agent who sells, in the ordinary course of business, a farm product for others, shall not be subject to a security interest created by the seller in such farm product even though the security interest is perfected and even though the commission merchant or selling agent knows of the existence of such interest.¹⁵⁸

Subsections 1324(e) and 1324(g)(2), referenced in subsections 1324(d) and 1324(g)(1), are Congress's exceptions to section 1324's general rule. Each provides two separate methods of notification to buyers, commission merchants, and selling agents which, if correctly followed, allow lenders to retain their preferred, protected status as security interest holders. These two notification methods are "pre-sale notification"¹⁵⁹ and "centralized notification."¹⁶⁰ The two methods differ dramatically. Under the pre-sale notification system, the lender or seller must take affirmative action to preserve the lender's priority. The lender must give buyers, commission merchants, and selling agents a written notice (which must meet numerous requirements) of the security interest. Although similar in concept to the prior notice systems which some states adopted in response to problems with the farm products exception, section 1324's pre-sale notification system is cumbersome and subject to numerous questions and criticisms.

The centralized notification system requires that states create a cen-

157. See *supra* note 26; see also H.R. REP. NO. 271, 99th Cong., 1st Sess., pt. 1, at 110 (1985) ("[T]he bill would not preempt basic state-law rules on the creation, perfection, or priority of security interests.").

158. Food Security Act of 1985, *supra* note 4, at § 1324(d), (g)(1).

159. *Id.* § 1324(e)(1), (g)(2)(A)-(B).

160. *Id.* § 1324(e)(2)-(3), (g)(2)(C)-(D).

tral filing system that complies with both section 1324 and the regulations promulgated by the Administrator of the Packers and Stockyards Administration on the Secretary of Agriculture's behalf. Once a state creates the system, lenders must file notices resembling Article 9 financing statements but designated as "effective financing statements" under section 1324. When a lender files an "effective financing statement," the central filing system's operator (the states' Secretaries of State or their designees) must provide actual notice on a regular schedule to buyers, commission merchants, and selling agents who have registered to receive the notice. Compliance with the section 1324 requirements and the accompanying USDA regulations for a centralized notification system is also cumbersome and subject to numerous questions and criticisms.

After section 1324's effective date of December 24, 1986, those engaged in agricultural financing and marketing have three alternatives. Alternative one is for lenders and states to take no action to comply with section 1324. To do so would mean that buyers, commission merchants, and selling agents always take free of any security interest in farm products. Alternative two is for states to do nothing, but for lenders to attempt to comply with the pre-sale notification system. Alternative three is for states to attempt to comply with the centralized notification system. Under the last two alternatives, if the lender is able to successfully utilize either of section 1324's notification systems, it will retain claims for conversion and replevin against farm products buyers, commission merchants, and selling agents.

As one observer predicted,¹⁶¹ the Comptroller of the Currency has taken the position that if lenders and/or states fail to take any action to comply with section 1324's notification methods, farm product loans will be considered "unsecured" loans.¹⁶² Because regulators have not taken a similar attitude toward inventory lenders, such a result may seem unduly harsh. Yet, because section 1324 places farm products lenders in a unique situation, different from Code inventory lenders, it may justify such an attitude by regulators. At the same time, the Comptroller stated that farm product loans are secured if "reasonable efforts" are made to comply with section 1324's requirements.¹⁶³ Of course, if regulators do classify farm products loans as unsecured when lenders cannot assure compliance with section 1324, there will be serious ramifications for already financially troubled lenders¹⁶⁴ and for their farm product borrowers. By adopting this

161. See *supra* note 28.

162. Comptroller of the Currency, Banking Circular #BC-221 (Dec. 22, 1986).

163. *Id.*

164. Nationally, 116 banks failed in 1987. In Oklahoma alone, sixty-two banks have failed since July 1982. Twenty-four of these failed from January 1, 1987, through August 20, 1987.

position, regulators will force lenders to act more conservatively in making agricultural sector loans. Ultimately, farmers and ranchers will bear the consequences of a restricted flow of adequate capital for agriculture.

Even if states and lenders are able to comply with section 1324's notification methods, the federal law still raises many questions. The language of subsections 1324(d) and 1324(g)(1) is preemptive, stating that the provisions govern "notwithstanding any other provision of Federal, State, or local law."¹⁶⁵ Clearly, Congress has exercised its power under the supremacy clause of the United States Constitution to preempt conflicting state or local laws and has repealed¹⁶⁶ or overridden prior conflicting federal law. Subsections 1324(d) and 1324(g)(1) also use terms whose definitions are crucial in applying section 1324 to particular disputes and to understanding its impact upon farm products financing and marketing in the American economy. Section 1324 defines some of the terms but not others.¹⁶⁷ Consequently, courts will have to define some terms as they address specific cases. Additionally, although section 1324 uses much Code terminology, in some instances Congress chose to give the same terms different meanings. This dichotomy of meanings is likely to create further confusion and interpretational problems.

Part II of this article examines subsections 1324(d) and 1324(g)(1) and analyzes their impact upon the legal doctrines which have governed and which will now govern the financing, buying, and selling of farm products. Part II also discusses questions of retroactivity and preemption, as well as examining section 1324's definitional problems. This article does not address questions concerning the implementation and interpretation of section 1324's notification alternatives. These "implementation" questions are reserved for a second article to be published in the *Kansas Law Review*.¹⁶⁸

Of the 116 failed banks in 1987, thirty-five were agricultural banks. The Oklahoma Daily, Aug. 21, 1987, at 1, col. 4; The Daily Oklahoman, Mar. 27, 1987, at 17, col. 2.

165. Food Security Act of 1985, *supra* note 4, at § 1324(d), (g)(1).

166. Section 1324 does not expressly list other federal laws which subsections (d) and (g)(1) repeal. Hence, courts must determine whether the language "notwithstanding any other provision of Federal . . . law" repeals other federal laws by implication on a case-by-case basis. *Id.*

167. Section 1324 defines the terms "buyer in the ordinary course of business," "commission merchant," "farm product," "knows," "security interest," and "selling agent" in subsections (c)(1), (c)(3), (c)(5), (c)(6), (c)(7), and (c)(8) respectively. Section 1324 does not define the terms "farming operations," "buys," and "sells." This article will later discuss the implications of these definitions and "non-definitions."

168. As of August 15, 1987, eleven states (Arkansas, Idaho, Louisiana, Maine, Mississippi, Montana, Nebraska, North Dakota, Oregon, Utah, and Vermont) had sought to obtain the required certification from the United States Department of Agriculture for centralized notification systems. All other states, therefore, are covered by section 1324's presale notifica-

B. *Retroactivity of Section 1324*

Perhaps the first practical question lenders face is determining what transactions section 1324 covers. Subsection 1324(j) states that the section will become effective twelve months after its enactment December 23, 1985. Therefore, section 1324 does not cover sales of farm products *prior* to December 24, 1986. Similarly, section 1324 clearly covers sales of farm products that occur *after* the effective date if the farmer-debtor also created the security interest *after* the effective date. It is not clear, however, whether section 1324 applies to farm products sales that occur *after* December 24, 1986, when the security interest in those farm products attached *prior* to that date. By failing to include complete transition rules in the statutory language, Congress has forced courts to resolve the retroactivity issues for these latter transactions. Courts can only look to section 1324's legislative history to ascertain congressional intent and then give effect to that intent within constitutional bounds of the retroactive application of laws.

The 1985 version of the legislation which ultimately became section 1324 provided that the section applied to all security interests created on or after its effective date (which was to be thirty days after enactment), plus all security interests already in existence after a one-year grace period.¹⁶⁹ A Senate amendment to the original legislation delayed the effective date for one year and further exempted security interests that had attached prior to the effective date for an additional year.¹⁷⁰ Both the original language and the Senate amendment covered prior security interests after a one-year grace period, measured from the effective date. The two proposals differed, however, on the legislation's effective date.

tion provisions. Many state legislatures are likely to direct activity during 1987 toward section 1324 issues. For example, the Oklahoma legislature passed a bill to create a state centralized notification system. Okla. H.B. No. 1052, 41st Leg., 1st Sess. (1987) (signed into law on May 6, 1987).

The United States Department of Agriculture has issued regulations under section 1324. Clear Title—Protection for Purchasers of Farm Products, 9 C.F.R. § 205 (1987). These regulations are only for centralized notification because section 1324(i) gave the Secretary of Agriculture authority to prescribe regulations limited to the "implementation and management of a central filing system." 51 Fed. Reg. 10,795 (1986) (quoting Food Security Act of 1985, *supra* note 4, at § 1324(i)). Thus, these regulations provide no authoritative interpretation or binding law for presale notification. However, when similar or analogous problems arise in both notification systems, these regulations are possibly useful guides for the resolution of the problems. Uchtmann, *Federal Clear Title Rules Preempt State Law on Dec. 23, 1986*, 4 AGRIC. L. UPDATE 1-2 (Nov. 1986).

169. H.R. REP. NO. 271, *supra* note 157, at 110; S. REP. NO. 147, 99th Cong., 1st Sess. 4 (1985).

170. H.R. CONF. REP. NO. 447, 99th Cong., 1st Sess. 486 (1985).

The final language of subsection 1324(j) demonstrates that the House and Senate compromised by delaying the effective date for one year from the date of enactment. Congress deleted language specifically addressing retroactivity to prior security interests. Yet, the compromise implies that section 1324 covers all security interests, including those created prior to its effective date. The House and Senate apparently agreed that a one-year grace period sufficiently protected persons already holding security interests by allowing them time to act to make the necessary adjustments.

Moreover, the precise language of subsections 1324(d) and 1324(g)(1) support an interpretation that section 1324 covers prior security interests. These subsections allow buyers, commission merchants, and selling agents, after the effective date, to deal in farm products free from the risk of double payment. Therefore, subsections 1324(d) and 1324(g)(1) refer to "buying" and "selling" as section 1324's focal point. Section 1324 does not focus on the events surrounding the creation, attachment, or perfection of security interests between lenders and farmers.¹⁷¹

If some farm products sales still carry a double payment risk (because they involve collateral for security interests created prior to the effective date), farm products transactions will be risky for buyers for a number of years to come. Buyers would have no easy means to ascertain which farm products section 1324 covered and which the Code still covered. Unless section 1324 covers all farm products sales occurring after its effective date, the freedom to buy and sell farm products without double payment risk, section 1324's purpose, will be seriously undermined.

Thus, after December 24, 1986, lenders must give notification of all security interests *whenever created*, in accordance with the alternative set forth in section 1324, to buyers, commission merchants, and selling agents, or lose the security interest as against them. Furthermore, the conclusion that section 1324 is retroactive is the safe conclusion for lenders to adopt. If a lender complies with section 1324, the issue becomes moot.

171. Although these financing events may be relevant for other reasons under section 1324, they are not the purpose behind the adoption of section 1324. Section 1324(a) sets forth congressional findings that buyers, commission merchants, and selling agents are presently subject to the risk of "double payment" and that such risk inhibits and obstructs interstate commerce in farm products. Farm Security Act of 1985, *supra* note 4, at § 1324(a)(2)-(4). Section 1324(b) then states that the legislation's purpose "is to remove such burden on and obstruction to interstate commerce in farm products." *Id.* § 1324(b). These two subsections make clear that Congress was primarily concerned with the marketing of farm products. It was concerned with the farm products financing only in so far as financing affects marketing. Section 1324's direct object is marketing; its indirect object is financing.

1. Constitutional Challenge to Retroactivity

If courts construe section 1324 to apply to security interests created prior to its enactment, lenders may challenge section 1324 as a violation of their constitutional property rights.¹⁷² Courts are receptive to such claims when the person affected is deprived of substantive property rights, but generally are unreceptive when new laws relating to property rights only require compliance with new procedures or remedies.¹⁷³

Section 1324 does not deprive lenders of any substantive property right in their farm products security interests. It does, however, mandate that the security interest holders take new and additional actions to protect their security interests. Otherwise, they may lose them at the time the collateral is bought and sold. Section 1324 changes only the *manner* in which lenders holding security interests must give notice—already required by the Code—to buyers, commission merchants, and selling agents to maintain their preferred status. As a consequence, courts are likely to decide that section 1324's changes are procedural and remedial rather than substantive. If so, they will conclude that section 1324 does not violate any constitutional rights of persons holding prior security interests.¹⁷⁴

172. Section 1324 is a federal statute. Thus, constitutional arguments about its retroactivity cannot rely upon Article I, section 10 (impairing the obligation of contracts) because that clause applies solely to the states and is inapplicable to the federal government. J. NOWAK, R. ROTUNDA & J. YOUNG, *CONSTITUTIONAL LAW* § 11.8, at 372 n.1, 382 (3d. ed. 1986). However, fifth amendment due process and "taking" considerations place some limitations, analogous to those imposed on states through the impairment of contracts clause, upon the retroactivity of federal legislation. *Id.* § 11.9.

173. *Id.* § 11.9, at 388-91. Indeed, the treatise authors write: "[W]hen there is a substantial impairment of contract by federal legislation, and the law is reviewed under the fifth amendment due process clause rather than the contracts clause which applies to state legislation, a court will be more lenient in upholding the legislative impairment of contracts." *Id.* at 390.

174. On the issue of section 1324's retroactivity, it seems instructive to compare how the Code's drafters treated the adoption of the Code itself as compared to how they treated the adoption of the 1972 amendments to the Code. With respect to the adoption of the Code itself, the drafters felt that the change was so substantial that they drafted Article Ten with a position of non-retroactivity. 9 HAWKLAND, U.C.C. SERIES (Callaghan) §§ 10-101, 101:01 (1986). But with respect to the adoption of the 1972 amendments, they took the opposite stance and opted for maximum retroactivity in Article Eleven because the "changes are not nearly as great." *Id.* § 11-102. The 1972 changes did involve a requirement that the security interest holders refile in different locations than previously required under the Code. *See id.* §§ 11-103:01, -105:01, -106:01. Thus, the 1972 amendments changed the place, though not the manner, at which security interest holders gave notice of their interests. *See id.* Although the 1972 amendments concerning refiling are less burdensome on security interest holders than section 1324's notice methods, the basic thrust of both is to preserve the prior substantive property right while imposing different notice requirements for protection of that property right.

C. Preemption

1. Achieving a Limited Purpose with Minimal Disruption

Without question, section 1324's legislative history indicates that Congress intended to preempt the Code's farm products exception.¹⁷⁵ Yet, for several reasons, section 1324 does not preempt just the Code's farm products exemption.

First, although section 1324 specifically preempts the farm products exception, its legislative history also indicates that it preempts other state law "to the extent necessary to achieve the goals of this legislation."¹⁷⁶ In practical terms, this broader preemptive effect will force courts to determine which other state laws, particularly other provisions in the Code, conflict with section 1324's goals.

Second, section 9-307's farm products exception by its terms applies only to Code buyers in the ordinary course of business; it does not apply directly to commission merchants and selling agents. Section 1324, on the other hand, also provides protection to commission merchants and selling agents who sell farm products in the ordinary course of business. Thus, when section 1324 preempts "any other provision of Federal, State, or local law," it may preempt other laws protecting commission merchants and selling agents, even though those laws are more closely related to tort doctrines defining conversion than to commercial law doctrines, such as the Code's farm products exception.

Third, any commercial or tort laws that section 1324 preempts will be *state* laws because states are the traditional source of such laws. For example, there is no "federal" Uniform Commercial Code. Thus, when Congress declares that the protections of subsections 1324(d) and 1324(g)(1) apply "notwithstanding any other provision of Federal" law, it assuredly is referring to more than a non-existent federal farm products exception.

Section 1324's language and its legislative history, however, indicate that Congress did not intend to broadly preempt state commercial laws and tort doctrines. Subsection 1324(b) makes clear that the law's purpose is to remove the burden that the risk of double payment previously placed on interstate commerce.¹⁷⁷ The core subsections, 1324(d) and 1324(g)(1), accomplish this purpose. The legislative history, moreover, also indicates that section 1324 serves a limited

175. H.R. REP. NO. 271, *supra* note 157, at 110; S. REP. NO. 147, *supra* note 169, at 4.

176. H.R. REP. NO. 271, *supra* note 157, at 110.

177. Section 1324(a) sets forth congressional findings about the existence of the risk of double payment which causes a burden on interstate commerce. Food Security Act of 1985, *supra* note 4, at § 1324(a). Section 1324(b) then sets forth the legislation's purpose as removing this burden. *Id.* § 1324(b).

purpose. Section 1324 does not “preempt basic state-law rules on the creation, perfection, or priority of security interests.”¹⁷⁸ Because state law rules on the creation, perfection, and priority of security interests do not directly relate to the risk of double payment, Congress had no need to preempt them. Or, to use the legislative history’s language, Congress did not need to preempt such state-law rules because doing so was not “necessary to achieve the goals of [section 1324].”¹⁷⁹

Although section 1324’s statutory language and legislative history indicate that it does more than simply preempt the farm products exception, courts should not interpret it to preempt more broadly than its limited purpose requires. Section 1324 preempts only when necessary to protect buyers, commission merchants, and selling agents from the risk of double payment arising from the marketing of farm products by a person engaged in farming operations. Beyond this limited purpose, section 1324 is inapplicable.

Federalism principles also support interpreting section 1324 to achieve focused, but limited, preemption. Because section 1324 is federal law, it presents federal questions over which federal courts have jurisdiction.¹⁸⁰ If section 1324’s preemption provision is interpreted broadly, beyond its limited purpose, federal courts will be asked to decide commercial and tort law questions, areas that our constitution presumptively leaves to state authority. Federal courts’ jurisdiction will not be based on diversity, but on federal questions arising from a Congressional mandate. A broad preemption interpretation would make federal courts the primary source of commercial and tort law for the marketing of farm products—a major segment of

178. H.R. REP. NO. 271, *supra* note 157, at 110.

179. *Id.* In contrast, the House Report does set forth several laws necessarily preempted, such as laws “that the buyer check public records, obtain no-lien certificates from the farm product sellers, or otherwise seek out the lender and account to that lender for the sale proceeds.” *Id.*; see also *id.* at 430 (Volkmer amendment to substitute “no-lien certificates” for the buyer notification provisions of the bill, defeated).

180. The authors believe that section 1324 creates a “substantial claim” for buyers, commission merchants, and selling agents that they take free of security interests “directly” under a federal law (section 1324) unless the interest holder has followed section 1324’s notification methods. Similarly, lenders have a substantial claim that if section 1324’s notification methods are properly used, the security interests can be enforced, in appropriate circumstances, against buyers, commission merchants, and selling agents. Thus, the authors conclude that federal question jurisdiction really is not open to challenge. See C. WRIGHT, *LAW OF FEDERAL COURTS* § 17, at 90-91 (4th ed. 1983). State courts, however, have concurrent jurisdiction because Congress did not make the federal jurisdiction exclusive. See *id.* § 45. Of course, defendants in a state action could ask for removal to the federal courts. See *id.* § 38. But cf., Meyer, *Congress’s Amendment to the UCC: The Farm Products Rule Change*, 8 J. AGRIC. TAX’N & L. 3 (1986) (Professor Meyer suggests that cases relating to section 1324 should be brought in federal court).

the American economy. Although it may be assumed that Congress knew that section 1324 created federal questions, Congress gave no indication that it intended federal courts to replace state courts as the primary source for commercial and tort law relating to farm products.¹⁸¹

Section 1324 and its legislative history indicate, instead, that Congress intended section 1324 to cause "minimal disruption" of other federal, state, and local laws. Because of this intent, however, courts sometimes may have to choose between protecting buyers, commission merchants, and selling agents and achieving minimal disruption. This conflict of goals has led the authors to conclude that section 1324 does not protect buyers from statutory liens, landlord liens, or unperfected consensual security interests when the holders have complied with section 1324's notification systems. The next section considers achieving "minimal disruption" in defining section 1324's relationship to the Code and the tort of conversion.¹⁸²

181. Section 1324's legislative history contains only two direct references to federalism principles. Secretary of Agriculture John Block, writing to support section 1324's passage, made the first reference to federalism. His concerns, however, were solely with the farm products exception of section 9-307 itself. To his mind, these reasons for preempting the farm products exception outweighed his usual reticence to preempt the states authority in commercial law matters. See S. REP. NO. 147, *supra* note 169, at 9. The clear implication of his letter is that he perceived section 1324 to maintain state authority in all commercial law areas except the farm products rule.

Senator Heflin, in the minority report he filed with the Senate, made the second plea for federalism. He opposed passing section 1324 because "[t]he problems arising in the area of agricultural secured lending, no less than in other areas of commercial transactions, are best handled at the state level through traditional means of state regulation." *Id.* at 12.

When Senator Cochran responded to Heflin's concerns, he argued the need for a uniform federal rule, but a uniform rule limited to the farm products exception. *Id.* at 5. In fact, whenever anyone expressed the need for uniformity as a reason for supporting section 1324, they sought uniformity limited to the farm products exception. See *id.* at 3-4; H.R. REP. NO. 271, *supra* note 157, at 109, 430-31.

This interchange between Heflin and Cochran and the uniformity discussion also implies that Congress intended any increase in federal authority with regard to the marketing of farm products to be limited, not broad. Therefore, federal courts should not interpret section 1324 as a mandate to become modern-day Justinians of agricultural commodity financing, buying, and selling.

182. Although section 1324 preempts any provision of federal, state, or local law with which it is in conflict, the authors have limited this article to preemption issues arising from the interplay between section 1324 and the Uniform Commercial Code and between section 1324 and the tort of conversion. In the author's minds, these two relationships give rise to the most obvious and immediately pressing questions concerning preemption. But by focusing on preemption issues related to these Code and tort law areas, the authors do not mean to imply that other preemption issues do not exist or that they are not important. See Meyer, *Another Look at Section 1324*, 8 J. AGRIC. TAX'N & L. 153 (1986) (discussion of recent Iowa legislation which section 1324 may preempt); Sanford, *The Reborn Farm Products Exception Under the Food Security Act of 1985*, 20 U.C.C. L.J. 3, 24, n.76 (1987) (discussion of interplay between section 1324 and state mortgage and federal bankruptcy laws).

2. Section 1324 and the Uniform Commercial Code

a. Buyer in the ordinary course of business

In the original 1985 House version, section 1324 defined the term "buyer in the ordinary course of business" as a person who:

(1) in the ordinary course of business buys farm products from a person engaged in farming operations who is in the business of selling farm products; *and (2) buys the products in good faith without knowledge of [sic] the sale is in violation of the ownership rights of [sic] security interest of a third party.*¹⁸³

This original definition closely tracks Code section 1-201(9)'s¹⁸⁴ definition of buyer in the ordinary course. But the Senate's 1985 version of section 1324 did not include the second component (italicized above) of the House's definition.¹⁸⁵ The Conference Committee adopted, and Congress enacted, the Senate definition. Subsection 1324(c)(1) defines a buyer in the ordinary course of business as:

[A] person who, in the ordinary course of business, buys farm products from a person engaged in farming operations who is in the business of selling farm products.¹⁸⁶

Although no legislative history indicates why Congress preferred the Senate version, the "buyer in the ordinary course" definitional difference between section 1324 and the Code has two significant preemption implications.

(1) Preemption of presale notification under the Code

As previously noted, under the Code, a holder of a security interest has always had the option to give an inventory buyer actual notice of payment obligations imposed by the security agreement. If the buyer ignored those payment obligations, he took subject to the security interest even though he otherwise would have qualified under section 9-307 as a "buyer in the ordinary course."¹⁸⁷

Subsection 1324(d) provides that a section 1324 buyer in the ordinary course takes free of a security interest unless the holder of the security interest properly utilizes one of the methods of actual

183. H.R. CONF. REP. NO. 447, *supra* note 170, at 486. (emphasis added).

184. U.C.C. § 1-201(9), in relevant part, reads as follows:

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

185. H.R. CONF. REP. NO. 447, *supra* note 170, at 486.

186. *Id.* at 487.

187. See *supra* note 130.

notice set forth in subsection 1324(e). Thus, even if a lender gives a section 1324 buyer in the ordinary course actual notice of payment obligations under the Code, such notice alone will not remove the buyer from subsection 1324(c)(1)'s definition of buyer in the ordinary course. Actual notice under the Code is effective only if it conforms to the notification systems specifically authorized in subsection 1324(e). In other words, the change in definition forces holders of security interests to conform to subsection 1324(e)'s notification systems. Therefore, subsection 1324(e) is not an alternative to actual notice under the Code, but a replacement.

Comparing the presale notification requirements under the Code to subsection 1324(e)'s notification requirements explains why section 1324 is a replacement and not an alternative. Subsection 1324(e) mandates that lenders provide more information to the buyer than do the Code's actual notice requirements.¹⁸⁸ Congress probably required this additional information because it presumed that buyers need the additional information to further reduce the risk of double payment. Congress considered subsection 1324(e)'s notification methods necessary to achieve the legislation's goals. Thus, subsection 1324(e) should preempt presale notification under the Uniform Commercial Code.¹⁸⁹

(2) Preemption of state laws repealing the farm products exception

If section 1324 preempts presale notification under the Code, it immediately follows that section 1324 preempts all state laws repealing the Code's farm products exception. States, such as California, Tennessee, Virginia, Minnesota, and Michigan,¹⁹⁰ may assume (in-

188. Professor Clark in his memo to the American Bankers Association provides an excellent contrast between presale notification information that satisfies the U.C.C. and the information necessary to satisfy the presale notification of subsections 1324(e)(1) and 1324(g)(1)(A) and (B). Professor Clark phrases the contrast as that between "simple" and "great complexity." Clark Memorandum, *supra* note 13, at 37-44.

189. The House and Senate conferees apparently realized that if section 1324 and the Code defined buyer in the ordinary course identically, security interest holders would provide actual notice in the manner that was least burdensome. As long as the buyer had actual notice of payment obligations, the buyer could not qualify as a "buyer in the ordinary course of business" and, therefore, could not qualify for the law's protection. Because actual notice under the Code is significantly less burdensome than section 1324's notification methods, the conferees must have realized that subsection 1324(e)'s notification methods would become dead letters. In effect, if they had not changed the definition, section 1324, as a practical matter, would have accomplished nothing more than the repeal of the farm products exception, as had already been proposed in 1983. See *supra* note 156. Section 1324 goes much further than the attempted repeal in 1983.

190. See *supra* text accompanying notes 130-33.

correctly) that their repeal laws have achieved the same goal as section 1324, putting farm products buyers in their states in the same position as farm products buyers under section 1324.¹⁹¹ Such an assumption may be true or false.

The assumption is true if repealer states meant to let buyers buy completely free of security interests, unless holders of security interests complied with subsection 1324(e)'s presale notification system. States intending that result simply removed "dead wood" from their statutes because section 1324 had already preempted the farm products exception. If these states had not repealed the farm products exception, section 1324 would have caused the same result as of December 24, 1986.

The assumption is false, however, in states like California where, for ten years, security interest holders have treated repeal of the farm products exception as simply an invitation to protect their secured interests through presale notification under the Code. In states like California, security interest holders now must realize that section 1324 forces them to change from Code presale notification to substantially different subsection 1324(e) presale notification. For example, after December 24, 1986, California farm products buyers who receive only a Code presale notification will not receive as much protection as Congress meant for section 1324 buyers to receive. They will not get all the information that subsection 1324(e)'s notification methods require. Although California security interest holders are likely to be surprised that section 1324 has preempted the repeal of the California farm products exception, that result is necessary in order to achieve section 1324's purpose—to allow section 1324 buyers in the ordinary course to take free unless a lender follows section 1324's notification methods.¹⁹²

191. In states that have repealed the farm products exception, the effect is to put farm products buyers in the same position under the Code as inventory buyers. In his letter supporting section 1324, Secretary of Agriculture John Block states: "The effect of the bill is only to treat farm products in the same manner as any other inventory under the Uniform Commercial Code." S. REP. NO. 147, *supra* note 169, at 9. A state that has repealed the farm products exception could point to this statement by Secretary Block to argue that its action achieves the goals of the legislation. Unfortunately, Secretary Block's statement is true only in the sense that section 1324 farm products buyers, like Code inventory buyers, must receive actual notice of payment obligations before they are bound by security interests. But as previously noted, the contents of the actual notice that subsection 1324(e) mandates differ substantially from the contents of actual notice under the Code. Thus, section 1324 treats farm products buyers similarly to Code inventory buyers, but not identically. Indeed, it is precisely section 1324's stringent notification methods that may justify bank regulators in treating farm products lenders differently from inventory lenders. See *supra* text accompanying notes 161-64.

192. Professor Clark agrees that section 1324 has preempted state repealer laws. Clark Memorandum, *supra* note 13, at 42.

b. Security interest defined and interpreted

Subsection 1324(c)(7) defines security interest as “an interest in farm products that secures payment or performance of an obligation.”¹⁹³ Section 1-201(37) of the Code defines security interest as “an interest in personal property . . . which secures payment or performance of an obligation.”¹⁹⁴ The two definitions are identical except that section 1324 applies to only one type of personal property—farm products. The fact that subsection 1324(c)(7) parallels the Code’s definition of security interest will be important in resolving several preemption issues likely to arise in section 1324 cases.

(1) Preemption and statutory or landlord liens

Farm products buyers and agent sellers have run a risk of double payment not only from consensual lenders, such as private banks and federal credit agencies, but also from statutory lienholders who have provided services or goods to farmers.¹⁹⁵ Landlord liens are another source of double payment risk. Statutes and case law in agricultural states strongly protect landlords by giving their liens priority over most other claimants.¹⁹⁶ Statutory lienholders and landlords, in effect, provide “credit” to the farmer until he has paid for their goods and services or the use of their land. If the farmer fails to pay a statutory lienholder or landlord from the proceeds of a farm products sale, the lienholder may claim that its lien covered the farm products and that the buyer or agent seller is liable in conversion. If a court agrees with the statutory or landlord lienholder, the buyer or agent seller faces the same double payment risk imposed by the Code’s farm product exception.

Farm products buyers and agent sellers could argue that subsection 1324(c)(7)’s definition of “security interest” is sufficiently broad to include such liens because statutory and landlord liens secure payment of farmer obligations. Moreover, buyers and agent sellers could argue that a broad “security interest” definition serves section 1324’s

193. Food Security Act of 1985, *supra* note 4, at § 1324(c)(7).

194. U.C.C. § 1-201(37). Section 1-201(37) then continues by comparing a security interest to the retention of title under Code Article Two, to the special property interest of a section 2-401 buyer, and to a lease and consignment arrangement. Aside from section 1-201(37)’s first sentence, the section is irrelevant to the questions this article addresses.

195. Numerous statutory liens exist with considerable variation between the several states. Without citing to particular state laws, common examples of statutory liens would include agister liens, thresher liens, agricultural in-put supplier liens, and warehouse liens.

196. See, e.g., *Cleveland v. McNabb*, 312 F. Supp. 155 (W.D. Tenn. 1970); *Holmes v. Riceland Foods, Inc.*, 261 Ark. 27, 526 S.W.2d 414 (1977); *Prior v. Rathjen*, 199 N.W.2d 327 (Iowa 1972); KAN. STAT. ANN. § 58-2526 (1983). See generally 2 R. POWELL & P. ROHAN, *POWELL ON REAL PROPERTY* ¶ 230[2] (1986).

purpose of removing the burden the risk of double payment puts on interstate commerce. Thus, buyers and agent sellers could contend that unless they receive proper notification in accordance with subsection 1324(e) or 1324(g)(2), they take free of statutory and landlord liens.¹⁹⁷ Although the preceding argument is sensible and understandable, courts should reject it because section 1324's language, its legislative history, and other policy reasons do not support it.

Section 1324's definition of security interest is identical to the Code's definition of security interest. The Code, however, does not treat statutory liens as security interests; indeed, except for a limited issue discussed below, the Code completely excludes statutory liens from its coverage.¹⁹⁸ Similarly, Code section 9-104(b) explicitly states that the Code excludes landlord liens from its coverage. Section 9-104(j) reiterates that exclusion. Comment 3 to section 9-104 explains that the Code applies only to "security interests in personal property" and not landlord liens because they are considered to be in or on real estate.

Moreover, the core subsections, 1324(d) and 1324(g)(1), protect buyers and agent sellers from security interests "*created by the seller, even though the security interest is perfected.*"¹⁹⁹ The words "created by the seller" seem to imply that the seller must have contracted voluntarily for the security interest. The language would include a bank loan, but not necessarily a lien imposed by law, such as a statutory lien. The words "even though the security interest is perfected" are a clear reference to those security interests that the Code covers. Thus, section 1324's language easily permits an interpretation of the term "security interest" which limits its coverage to those security interests contractually entered into by farmers and which holders can perfect under the Code.²⁰⁰ Because statutory and landlord liens are not contractual arrangements and a holder cannot perfect them under the

197. The argument presented in the text was suggested by S. Turner, Memorandum to Am. Bar Ass'n Comm. on Commercial Fin. Servs., Sub-Comm. on Agri. and Agri-Business Fin. § 3.04 (Apr. 4, 1986).

198. Section 9-102(2) reads in part: "This Article does not apply to statutory liens except as provided in Section 9-310." Section 9-104(c) reaffirms section 9-102(2): "This Article does not apply . . . to a lien given by statute or other rule of law for services or materials except as provided in Section 9-310 on priority of such liens." See *infra* text accompanying notes 201-03 (section 9-310's relevance to the issue this part of the article discusses).

199. Food Security Act of 1985, *supra* note 4, at § 1324(d) (emphasis added).

200. The Code also makes the distinction made in the text. The introductory paragraph of the official comments to section 9-102 makes clear that Article Nine applies to all "consensual security interests in personal property." U.C.C. § 9-102 comment 1. Comment One then explains that statutory liens are excluded from Article Nine precisely because they arise "by reason of status and not by consent of the parties." *Id.* comment 1. Sections 9-104(c) and 9-310 then carry this distinction forward by using language which makes clear that statutory

Code, subsections 1324(d)'s and 1324(g)(1)'s protections are simply inapplicable to statutory and landlord liens.

Section 1324's legislative history makes numerous references to the double payment risk arising from the "farm products" exception, but does not make a single reference to the double payment risk created by statutory or landlord liens.²⁰¹ It does indicate that Congress did not intend section 1324 to preempt state laws with respect to "priority of security interests."²⁰² The only Code section that covers statutory liens, section 9-310, deals with them as a *priority* matter between Code security interests and liens arising by *operation of law*.²⁰³ Also, Code sections 9-104(b) and 9-104(c) expressly exclude landlord liens from Code coverage. Thus, the legislative history supports excluding statutory and landlord liens from section 1324's definition of "security interest."

Policy reasons corroborate the conclusion that statutory and landlord liens are not "security interests" under section 1324. Traditional lenders, such as banks, expect to protect their security interests through notification systems such as the Code or that now provided by section 1324. They have personnel to prepare and handle loans in accordance with such notification systems. Statutory and landlord lienholders, however, generally have not had to comply with these notification systems.²⁰⁴ Because statutory and landlord lienholders are not in the business of providing credit, but extend "credit" to farmers only incidentally to providing other services or goods, they lack the personnel trained to prepare and handle loans. As a policy

liens are "given by statute or other rule of law." *Id.* §§ 9-104(c), -310. Therefore, under the Code, security interests and statutory liens are mutually exclusive categories. *But see* Meyer, *supra* note 180, at 17. Professor Meyer, however, may now agree with the analysis set forth in the text with respect to both landlord liens and statutory liens. *See* Meyer, *supra* note 182.

201. H.R. REP. NO. 271, *supra* note 157, at 420, 425, 430-31 *passim*; S. REP. NO. 147, *supra* note 169, at 1 *passim*; H.R. CONF. REP. 447, *supra* note 170, at 485-92 *passim*.

202. H.R. REP. NO. 271, *supra* note 157, at 110.

203. U.C.C. § 9-310 reads as follows:

When a person in the ordinary course of his business furnishes services or materials with respect to goods subject to a security interest, a lien upon goods in the possession of such person given by statute or rule of law for such materials or services takes priority over a perfected security interest unless the lien is statutory and the statute expressly provides otherwise.

204. *But see* MINN. STAT. §§ 514.950-.959 (Supp. 1987); N.D. CENT. CODE § 41-09-28(9) (Supp. 1987). The two citations are to state laws which require statutory lienholders to comply with notification systems in order to protect their statutory liens. These state statutes predate section 1324 and, therefore, could have served as models of how to include statutory liens within the notification system Congress created. However, section 1324's legislative history makes no reference to state statutes requiring statutory lienholders to give notice. Thus, we cannot ascertain whether or what Congress thought about these two state statutes.

matter, it makes sense to treat traditional lenders and statutory and landlord lienholders differently.

Finally, if federal courts interpret the term "security interest" to include statutory and landlord liens, they will become deeply enmeshed in rearranging the "lien law" of every state. Except for section 9-310 which governs *possessory* statutory liens, the Code does not address the "lien law" of the several states. It purposefully lets the individual states decide the priorities between Article 9 security interests and nonpossessory statutory and landlord liens. "Lien law," in other words, is not Code law. The Code's drafters have not attempted to impose any uniform "superpriority" upon the states with respect to their "lien law." If federal courts interpret section 1324 to cover statutory and landlord liens, they will be treading where "wise persons" have previously feared to tread.²⁰⁵

At this point, the interpretive principle of "minimal disruption" becomes relevant. Section 1324's language and legislative history are quite compatible with a limited definition of security interest. A limited definition still allows the legislation to achieve the express goal upon which Congress most clearly focused—protection of buyers and agent sellers from the risk of double payment arising from the traditional financing of agricultural production. A broader interpretation will thrust federal courts into lawmaking roles that the Code traditionally has left to the states. Before federal courts intrude upon federalism principles and become the source of "lien law" for the states, Congress should express such an intent much more clearly and loudly. Until that occurs, the interpretive principle of "minimal disruption" supports excluding statutory and landlord liens from section 1324's definition of "security interest."²⁰⁶

So that the preceding conclusion does not mislead statutory lienholders or landlords and their lawyers, the authors set forth one caveat. Section 1324 applies to any consensual, perfectible security

205. For what the Code's "wise persons" [drafters] thought about "lien law," compare U.C.C. § 9-104, comment 3 with *id.* § 9-310, comment 2.

206. The conclusion that section 1324 does not preempt landlord lien law means only that state law governing the priority between landlord liens and buyers or agent sellers of farm products is the controlling law. Although it is true that most states give preference to landlord liens over buyers and agent sellers of farm products, if a particular state law protects buyers or agent sellers, for whatever reasons, that state law would govern.

The preceding conclusion is particularly important for statutory lienholders because, in contrast to landlords, state statutes and decisions have not protected them consistently. Just because statutory liens are not within section 1324's coverage does not mean that statutory lienholders win in a lawsuit against buyers and agent sellers. No preemption only means that state law, with its preferences and results, controls whomever those preferences and results favor in specific fact situations.

interest in farm products—even those taken by persons who do not ordinarily consider themselves credit lenders. Thus, if a statutory lienholder or landlord decides that the nonconsensual, nonperfectible statutory or common law lien is insufficient to protect his interests²⁰⁷ and decides to take an Article 9 security interest, his Article 9 security interest is within section 1324's coverage. As a result, if the statutory lienholder or landlord fails to provide buyers and agent sellers the required section 1324 notice, his Article 9 security interest will be unprotected. Of course, he could still rely upon the statutory or common law landlord lien which section 1324 has not preempted.

(2) Preemption and perfected vs. unperfected security interests

Subsection 1324(d) refers to taking free of a security interest even though perfected. The term "perfected" certainly refers to a "perfected" security interest under the Code. In contrast, subsection 1324(e) states that if a secured party gives proper notice, the buyer takes subject to a security interest. It does not use any qualifying adjective to indicate whether the security interest must be perfected or not. This language difference raises the following interpretive question: if a secured party provides the subsection 1324(e) notice to a buyer, but has not perfected under the Code, who prevails under section 1324, the secured party or the buyer?²⁰⁸

Section 1324 farm products buyers in the ordinary course may argue that subsection 1324(e) is an exception to subsection 1324(d)'s general rule. Arguably, then, the language of subsection 1324(d) that refers to taking free of a security interest "even though perfected" must be read into subsection 1324(e). The result is that buyers, including those who have received section 1324 notification, only take subject to security interests that are perfected under the Code.

Section 1324's statutory language, its legislative history and policy considerations, however, do not support this argument. The proper interpretation of section 1324 is that a buyer who has received the actual notice subsection 1324(e) requires takes subject to a security interest, whether perfected or not. Subsection 1324(d) states that unless a secured party gives a buyer the appropriate notice, the buyer takes

207. For a good discussion of why statutory lienholders or landlords might want to take an Article Nine security interest, see Meyer, *Should Farm Leases Include an Article 9 Security Interest?*, 5 J. AGRIC. TAX'N & L. 60 (1983).

208. The identical question arises with respect to commission merchants and selling agents under subsections 1324(g)(1) and 1324(g)(2). Because the analysis is similar for both buyers and seller's agents, the textual discussion deals with buyers, but the conclusion applies to commission merchants and selling agents.

free of a security interest “even though the security interest is perfected; and the buyer knows of the existence of such interest.”²⁰⁹ In other words, perfection alone does not protect a secured party. Section 1324 protects him only if he gives subsection 1324(e) notification to the buyer. Subsection 1324(d)’s language tracks very closely the language of Code section 9-307 which embodies the same result: perfection alone does not protect secured parties as against inventory buyers in the ordinary course. The Code protects a secured party against inventory buyers in the ordinary course only if the secured party gives actual notice to the buyers that the sale will violate the debtor’s payment obligations contained in the security agreement.²¹⁰ Because the language of subsection 1324(d) and Code section 9-307(1) is very similar, courts should interpret subsection 1324(d) as putting farm products buyers in the same position the Code places inventory buyers in the ordinary course of business: actual notice provides protection when perfection does not.

The preceding discussion, although useful, is not directly responsive to the interpretive question under consideration: who prevails between a notified buyer and an *unperfected* secured party? To answer this interpretive question directly, an examination of how the Code handles such a conflict is relevant.

Code section 9-201 sets forth the following general rule:

Except as otherwise provided by this Act a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors.²¹¹

A search of the Code for provisions that “otherwise” provide reveals only section 9-301(1)(c):

[A]n unperfected security interest is subordinate to the rights of . . . a transferee in bulk or other buyer not in ordinary course of business or . . . a buyer of farm products in ordinary course of business, to the extent that he gives value and receives delivery of the collateral *without knowledge of the security interest* and before it is perfected.²¹²

Reading these two Code sections together yields the result that an unperfected secured party prevails over a notified inventory buyer, who section 9-307(1) ordinarily would protect from constructive notice, and over a notified farm products buyer, who section 9-307(1) ordinarily binds by constructive notice. This result occurs provided the

209. Food Security Act of 1985, *supra* note 4, at § 1324(d).

210. *See supra* note 130.

211. U.C.C. § 9-201; *see also id.* § 9-306(2) (reiterating the general rule set forth in section 9-201).

212. *Id.* § 9-301(1)(c) (emphasis added).

buyer has received actual knowledge of the security agreement's payment obligations.²¹³ In other words, if courts interpret subsection 1324(d) as equivalent to Code section 9-307(1), by putting farm products buyers in the same basic position as Code inventory buyers in the ordinary course, they should interpret subsection 1324(e) as equivalent to Code section 9-301(1)(c) and give protection to secured parties who give actual notice to farm products buyers, even if a secured party's interest is unperfected.

Section 1324's legislative history strengthens the argument for equivalence between subsection 1324(e) and section 9-301(1)(c). If courts interpret subsection 1324(e) to require both notification and perfection, subsection 1324(e) would change section 9-301(1)(c)'s perfection rule and reorder its priority.²¹⁴ The House Report explicitly states that section 1324 does not preempt "basic state-law rules on . . . perfection, or priority of security interests."²¹⁵ Thus, the only interpretation of subsection 1324(e) that complies with the legislative history is an interpretation that subsection 1324(e) and Code section 9-301(1)(c) are equivalent.

Section 1324 reflects Congress's decision that constructive notice under the Code is unfair to farm products buyers and burdens interstate commerce.²¹⁶ Section 1324 removes this unfairness and burden by requiring secured parties to provide actual notice of payment obligations to farm products buyers. But once secured parties give actual notice (in the form section 1324 requires), it seems reasonable to require buyers to comply with the knowledge they have about the security interest. It seems unreasonable to allow them to ignore this knowledge and still claim subsection 1324(e)'s protection on the ground that the secured party has failed to perfect its interest.²¹⁷ Perfection (a form

213. 8 W. HAWKLAND, R. LORD & C. LEWIS, U.C.C. SERIES (Callaghan) § 9-301 (1986); J. WHITE & R. SUMMERS, *supra* note 61, §§ 25-2, -12, -13. Several commentators on section 1324 seem confused about section 9-301(1)(c)'s meaning and conclude, incorrectly, that under section 9-301(1)(c) unperfected security interest holders lose to notified buyers. These commentators then worry that subsection 1324(e) changes this incorrect interpretation of section 9-301(1)(c)'s priority to provide greater protection to *secured parties* than the Code would give. Meyer, *supra* note 180, at 7; Turner, *supra* note 197, at § 3.05.

The argument made in this article's text is that courts should interpret subsection 1324(e) to maintain the perfection and priority rule of section 9-301(1)(c) rather than accept an argument that subsection 1324(e) provides *buyers* greater protection than the Code would give.

214. See 8 W. HAWKLAND, R. LORD & C. LEWIS, *supra* note 213, at § 9-301:02 (commentators call section 9-301(1) a priority section between unperfected secured parties and other classes of claimants under the Code).

215. H.R. REP. NO. 271, *supra* note 157, at 110.

216. See Food Security Act of 1985, *supra* note 4, at § 1324(a).

217. Cf. U.C.C. § 9-307 comment 2 (the Code makes a similar policy judgment that buyers ought not be allowed to ignore actual knowledge of payment obligations contained in the security agreement).

of constructive notice) is redundant when the secured party has given the buyer actual notice. Thus, an interpretation of subsection 1324(e) that does not require perfection before the actual notice is effective achieves section 1324's purpose and minimally disrupts Code law through preemption.²¹⁸

c. Farm products

The initial House bill defined the term "farm products" in language almost identical to that used by Code section 9-109(3).²¹⁹ Senate amendments changed the term to "farm product" (singular) and rewrote its definition in language that does not track the Code's language. Because Congress ultimately adopted the Senate amendments, section 1324's definition of "farm product" is substantially dissimilar from its Code counterpart.²²⁰

Although section 1324's definition of "farm product" is substantially dissimilar from the Code's definition, there is no indication that section 1324 classifies commodities as farm products any differently than the Code does. Thus, whatever is a farm product under the Code will also be a farm product under section 1324. As a consequence, cases construing what is a crop, livestock, or a product thereof in an unmanufactured state under the Code should be authoritative in construing the same terms under section 1324.²²¹ Courts should define the terms "crop," "livestock," and "products . . . in their

218. See Sanford, *supra* note 182, at 19.

The conclusion that subsection 1324(e) provides protection to an unperfected security interest, as long as the secured party has given the notice that subsection mandates, does not mean that a secured party can ignore Code perfection rules. Although subsection 1324(e) would protect an unperfected secured party against a buyer with actual notice, it does not in any way change the priority between an unperfected secured party and those potential claimants listed in Code section 9-301(1)(a) and (b). To be fully protected against all claimants, a secured party needs to comply with both section 1324 and the Code. Section 1324 and the Code provide two similar, but distinct and independent systems for handling security interests. *Cf. Note, Clear Title: A Buyer's Bonus, A Lender's Loss—Repeal of UCC § 9-307(1) Farm Products Exception by Food Security Act § 1324 [7 U.S.C. § 1632]*, 26 WASHBURN L.J. 71, 93-94 (1986).

219. H.R. 2100, 99th Cong., 1st Sess. § 1314(c)(2) (1985).

220. H.R. CONF. REP. NO. 447, *supra* note 170, at 486, 489.

221. *E.g.*, *United States v. Newcomb*, 682 F.2d 758 (8th Cir. 1982); *Bornstein v. Somerson*, 341 So.2d 1043 (Fla. Dist. Ct. App.), *cert. denied*, 348 So.2d 944 (Fla. 1977); *Barron v. Edwards*, 45 Mich. App. 210, 206 N.W.2d 508 (1973); *Jessen v. Ashland Recreation Ass'n*, 204 Neb. 19, 281 N.W.2d 210 (1979). See generally *Schneider, The Ownership of Growing Crops: The Continuing Struggle Between Property Law and the Uniform Commercial Code*, 8 J. AGRIC. TAX'n & L. 99 (1986). The difference between the singular definition "farm product" in section 1324 and the plural definition "farm products" in section 9-109(3) does have a significant impact in terms of implementing the notice provisions under the federal law in comparison to the Code's notice requirements. The authors reserve this issue, however, for the following article discussing the implementation of section 1324's notification methods.

unmanufactured states" the same under section 1324 as they have under the Code.

The preceding conclusion does mean, however, that section 1324 has preempted any state *nonuniform* farm products definitions. Section 1324 farm products buyers and selling agents are entitled to the information subsections 1324(e) and 1324(g)(2) require, regardless of the fact that any particular state has narrowed the category of items included within the Code's "farm products" definition.

For example, in Kansas, the state legislature opted to continue section 9-307(1)'s farm products exception, but excluded from its farm products definition, for that section only, milk, cream, and eggs.²²² In effect, the Kansas legislature repealed the farm products exception for those three items. Kansas buyers of milk, cream, and eggs are, therefore, in the same position with respect to these three items as California buyers are with respect to all farm products.²²³ Because section 1324 preempts state repeal of the farm products exception,²²⁴ after December 24, 1986, Kansas buyers of milk, cream, and eggs will take completely free of any security interest unless secured parties properly follow subsection 1324(e)'s notification methods. After December 24, 1986, Kansas lenders with security interests in milk, cream, and/or eggs must do more than give the Code's pre-sale notification to buyers. Thus, section 1324 has changed the relationship between Kansas lenders and milk, cream, and egg buyers.

d. Other section 1324 defined terms

Subsection 1324(c) defines eleven terms.²²⁵ Only four of them, however, have preemption implications for the Code. Five defined terms ("central filing system," "effective finance statement," "State," "person," and "Secretary of State") are important to subsections

222. KAN. STAT. ANN. § 84-9-307(1) (1983).

223. See *supra* note 130. Once the Kansas legislature excluded milk, eggs, and cream from the definition of farm products, it left Kansas lenders who relied on these commodities for collateral with only two choices. First, Kansas lenders could do nothing, meaning that these commodities would be sold as inventory free and clear of the lender's security interest in accord with section 9-307(1)'s general rule. Second, Kansas lenders could give Code presale notification. That had become the standard operating procedure among California lenders. Particularly with respect to milk, some Kansas lenders may have adopted the "California" approach because it was fairly easy to gain an "assignment" of the "milk proceeds" from a dairy cooperative by giving the appropriate actual notice to the cooperative. If Kansas lenders were unaware of, or did not utilize, the Code presale notification method, section 1324 will act as an expansion of lender protection. If, however, Kansas lenders were using Code presale notification, section 1324 is a contraction of lender protection because its notification methods are more difficult to satisfy than the Code presale notification method. Cf. Meyer, *supra* note 180, at 7.

224. See *supra* text accompanying notes 183-92.

225. See Food Security Act of 1985, *supra* note 4, at § 1324(c).

1324(e)'s and (g)(2)'s notification methods, but because these notification methods are separate from and independent of the Code, these defined terms do not preempt the Code.²²⁶ Two of these five terms ("State" and "person") are completely non-controversial and are unlikely to create any interpretive problems. The remaining three terms, however, are relevant to a proper understanding of section 1324's implementation. The authors will address those three terms in a forthcoming article on notification methods. Two defined terms ("commission merchant" and "selling agent") have no counterpart in the Code and are more relevant to preemption issues relating to conversion. This article will discuss them in a subsequent section.²²⁷ Of the remaining four defined terms, this article already has discussed the preemption implications of three ("buyer in the ordinary course," "security interest," and "farm product"). Thus, only one defined term ("knows" or "knowledge") is left.

Subsection 1324(c)(6) defines "knows" or "knowledge" to mean actual knowledge. Code section 9-201(25) gives the same meaning to "knows" or "knowledge." Nothing in section 1324's statutory language, its legislative history, or the policy reasons behind its adoption gives any indication that courts should interpret "knows" or "knowledge" differently under section 1324 than under the Code. Thus, Code cases addressing what constitutes actual knowledge in a particular fact situation should be authoritative in resolving analogous section 1324 cases. Section 1324's definition of "knows" and "knowledge" should not have any preemptive effect.

e. Undefined section 1324 terms also found in the Code

Section 1324 also uses terms that it does not define, but which are identical to terms found in the Code. This article will now address the preemption implications raised by some of these other terms.

(1) Farming operations (including the "second buyer problem")

"Farming operations" is a crucially important term in section 1324. By subsection 1324(c)(5)'s definition, an item cannot be a "farm product" unless it was "used or produced in *farm operations*" and is "in the possession of a person engaged in *farming operations*."²²⁸

226. We cannot overemphasize our earlier point: the Code and section 1324 operate simultaneously on parallel but completely separate tracks. Professors Clark and Meyer also stress the importance of recognizing that the notification systems of section 1324 and the Code are independent and distinct from one another. Meyer, *supra* note 180, at 160; Clark Memorandum, *supra* note 13, at 25, 45-47, 53.

227. See *infra* notes 268-69 and accompanying text.

228. Food Security Act of 1985, *supra* note 4, at § 1324(c)(5) (emphasis added).

Additionally, under subsections 1324(c)(1)(3) and (8), a “buyer in the ordinary course,” “commission merchant,” and “selling agent” must buy or sell a *farm product* or the section 1324 definitions will not cover them. Indeed, the definitions of “buyer in the ordinary course” and “selling agent” reinforce the importance of farming operations by further stating that the buying or selling of the farm product must be with a “person engaged in farming operations.”

When attention shifts from subsection 1324(c)’s definition to section 1324’s core subsections that state the protections the law provides, the term “farming operations” is again crucial. Under subsection 1324(d), a section 1324 buyer takes free of a security interest when he buys a *farm product* from a seller engaged in *farming operations*. Moreover, under subsection 1324(g)(1), a commission merchant or selling agent is not subject to a security interest in a *farm product* sold for another.

The repetitive use of the term “farming operations” in subsections 1324(c), 1324(d), and 1324(g)(1) indicates that Congress intended section 1324 to apply solely to the American economy’s agricultural sector. Congress meant to legislate solely with respect to the buying and selling of farm products by and from farming operations. Although these statements about Congressional intent may seem rather obvious, Congress’s intent is very significant and has important consequences.

Although section 1324’s language and legislative history indicate indisputably that section 1324 only applies to marketing of farm products by farming operations, nothing in the statutory language or legislative history addresses whether Congress intended section 1324’s use of the term “farming operations” to be identical to the Code’s use of that term. Yet, the fact that Congress used the term in the same context as the Code does provide a powerful argument for an identical interpretation. If courts interpret “farming operations” differently under section 1324 than under the Code, they will increase confusion in agricultural commercial transactions. Moreover, courts can achieve section 1324’s goal by interpreting “farming operations” as equivalent to Code “farming operations.” The interpretive principle of minimal disruption points, therefore, towards simplification by defining “farming operations” identically under section 1324 and the Code. If courts accept this conclusion as correct, then section 1324 does not preempt the Code on this issue. Code case law²²⁹ which defines “farming operations” will remain authoritative for section 1324 cases.

229. The Code contains no definition of farming operations. Thus, courts have developed the definition on a case-by-case basis. For cases deciding what is or is not farming operations, see *supra* notes 53-58 and accompanying text.

By concluding that section 1324 uses the term "farming operations" as the Code uses it, two propositions immediately follow. First, because Congress intended section 1324 only to apply to farming operations and their farm products, section 1324 simply does not cover a sale of an item that is not a farm product. Section 1324 has nothing to say about "double payment" risks outside farm products marketing by farming operations. Thus, section 1324 leaves "double payment" risks with respect to nonfarm products (*i.e.*, consumer goods, inventory, and equipment) for Code resolution. Second, section 1324 does not cover an agricultural product sold by a seller who is not engaged in farming operations. For example, the business of a slaughterhouse, even though handling livestock, is not the business of farming operations.²³⁰

On the other hand, the conclusion that the section 1324 term "farm operations" is equivalent to the Code's does not settle the question of how section 1324 resolves what is known as the "second buyer problem." For example, suppose a slaughterhouse purchases a pony from a horse rancher engaged in the business of breeding, raising, and selling ponies. The slaughterhouse intends to slaughter the pony with other horses for dog food, specialty butcher shops, glue, and other products. Suppose also that an agricultural lender had financed the rancher and had fully complied with subsection 1324(e) by giving the slaughterhouse buyer proper notification. For reasons unknown, the slaughterhouse ignores the notification and does not comply with the security agreement's payment obligations. Now suppose a compassionate food-chain buyer takes pity on the pony and buys it to save it from slaughter. Shortly thereafter, the farmer and the slaughterhouse both become insolvent and the farmer defaults on his obligations to the agricultural lender. The agricultural lender then turns to the compassionate food-chain buyer for a "second expression of compassion." Who prevails between the agricultural lender and the food-chain buyer?

The preceding situation is an example of the "second buyer problem." In such a situation, the second buyer purchases an item, originally classified as farm products under the Code, which, at the time of the second sale, the Code would classify as the second seller's inventory. Code section 9-307(1) clearly establishes that the second buyer has bought subject to the agricultural lender's security interest and can be made to pay a second time.²³¹ This result occurs because

230. *E.g.*, *In re Samuels & Co., Inc.*, 526 F.2d 1238 (5th Cir.), *cert. denied*, 429 U.S. 834 (1976); *First Nat'l Bank v. Smoker*, 153 Ind. App. 71, 286 N.E.2d 203 (1972) (cattle are inventory to packers).

231. *E.g.*, *Garden City Prod. Credit Ass'n v. Lannan*, 186 Neb. 668, 186 N.W.2d 99 (1971).

section 9-307(1) states that an inventory buyer takes free only from security interests "created by *his* seller."²³² The food-chain buyer as inventory buyer would take free of any security interest created by his inventory seller (the slaughterhouse), but not free from any pre-existing security interest (the agricultural lien) which "his" seller did not create and which still exists.²³³ If section 1324 uses "farming operations" in the same way as the Code, then second or remote farm products buyers should remain liable to agricultural lenders because section 1324's provisions do not cover the second sale.

Yet, if section 1324 permits a lender to saddle a second buyer who buys inventory with an agricultural lien created when the item was a farm product, it fails to eliminate a double payment risk that will burden interstate commerce. Because Congress passed section 1324 to remove the double payment burden from agricultural interstate commerce, one could argue that section 1324 should resolve the second buyer problem by always protecting the second buyer. This argument, however, sweeps too broadly.

Section 1324 does not remove all double payment risk from agricultural marketing transactions. For example, if a section 1324 buyer ignores a security agreement's payment obligations (such as joint-payee check) after proper notification and pays a farmer who dissipates the money, the section 1324 buyer will be liable to the secured party who gave the proper notification. If at this point a second buyer makes an inventory purchase from the section 1324 buyer, the section 1324 buyer is selling inventory that it has not obtained free of the agricultural security interest. The second buyer cannot directly claim section 1324's protections because the second sale is outside the section's coverage. Thus, he can prevail only if section 1324 somehow preempts the continuation of the agricultural security interest from the section 1324 buyer to the second buyer. Congress, however, gave no indication that it meant for section 1324 to preempt the normal rule that a buyer only receives as good a title as his seller had.²³⁴ Furthermore, the interpretive principle of minimal disruption supports the result that courts should not interpret section 1324 to preempt such a basic personal property law rule. Consequently, courts should not interpret section 1324 to protect a second buyer from double payment risk when his seller (a section 1324 buyer) has ignored the lender's proper notification of the farmer's payment obligations.

There is one final variation on the "second buyer problem" worth

232. U.C.C. § 9-307(1) (emphasis added).

233. See generally J. WHITE & R. SUMMERS, *supra* note 61, § 25-13, at 1070.

234. See D. BURKE, *PERSONAL PROPERTY IN A NUTSHELL* 186-201 (1983) (discussion of the usual personal property rule).

addressing. Assume that the section 1324 buyer, instead of ignoring the payment obligations, complies fully. Unfortunately, his check is then returned for lack of sufficient funds. In the meantime, however, he has sold the item (as inventory) to a second buyer.

Subsection 1324(e) states that a section 1324 buyer takes subject to a security interest if he ignores payment obligations. By implication, he should take free if he obeys payment obligations.²³⁵ Thus, if a section 1324 buyer follows the payment obligations, no security interest encumbers inventory sold to a second buyer. On this factual pattern, the second buyer should take free of any double payment risk.

Protecting a second buyer when a section 1324 buyer (his seller) has complied with payment obligations achieves section 1324's goal of unburdening interstate commerce. Moreover, to so interpret section 1324 does not conflict with the Code. Code section 2-403 protects a buyer who buys from a person who paid with a check that is later dishonored, if no outstanding security interest exists.²³⁶ Because subsection 1324(e) states that no outstanding security interest exists if a section 1324 buyer follows payment obligations, the conclusion that section 1324 protects a second buyer in the preceding returned-check situation is consistent with the Code. Such a conclusion does not require section 1324 to preempt any additional Code provisions, nor does it violate the interpretive principle of minimal disruption.

(2) "Buys"

Although subsection 1324(d) protects a section 1324 farm products buyer who *buys* in the ordinary course of business, its statutory language does not make clear whether the word "buys" should be given the same meaning as Code section 1-201(9) gives it. The Code defines the term "buys" to exclude the following three categories of takers of goods: those who obtain goods (1) by a bulk purchase;

235. At this point, some might object that if the check is returned unpaid, a section 1324 buyer has not fulfilled the payment obligations of a joint-payee check. They might argue that the obligation is met only if the implied condition that the check is good turns out to be true. However, if the lender wants a greater payment obligation than just a joint-payee check to protect against a bad check, then he must specify additional payment obligations in the subsection 1324(e) notice. If the lender and the farmer do not want to extend credit to the check-writing buyer, they must insist on a certified or cashier's check which guarantees that the funds exist to cover the check. By failing to insist on a guaranteed funds check, the lender and the farmer are trusting the section 1324 buyer to be honest. Subsection 1324(c)(1) does not include any requirement of good faith or honesty in its definition of buyer in the ordinary course. In fact, Congress specifically deleted the requirement of good faith from the definition. H.R. CONF. REP. 447, *supra* note 170, at 486. Thus, buyers who buy a farm product with a check that is returned unpaid still qualify for subsection 1324(e)'s protection.

236. See D. BURKE, *supra* note 234, at 206-20.

(2) as payment for a pre-existing debt (in contrast with giving new value for the goods); or (3) as collateral for subsequent loans.²³⁷ The uncertainty of what "buys" means in section 1324 is heightened because section 1324 expressly redefines "buyer in the ordinary course of business," which Code section 1-201(9) also defines.²³⁸

If courts interpret subsection 1324(d)'s use of the word "buys" to encompass the three groups the Code excludes from its definition, they will require secured parties to give the potential members of these groups actual notice in accordance with section 1324's notification methods. If secured parties do not comply, they risk allowing members of these three groups to take free of their security interests. On the other hand, if courts interpret "buys" the same as under the Code, secured parties need not notify the members of these three groups because they are not *buyers* covered by section 1324. Therefore, members of those three groups will remain subject to a double payment risk.

Although section 1324's purpose is to remove the burden on interstate commerce that the risk of double payment creates, the section's legislative history indicates that Congress was concerned only about the double payment risk existing for agricultural buyers in the ordinary course of business. Congress did not evidence an intent to eliminate double payment risk for those whose acquisition of agricultural goods occurs in transactions which are *not* considered *in the ordinary course* of business. The Code excludes three groups (bulk sale purchasers, those who receive goods for antecedent debts, and those who take goods as collateral for subsequent loans) from its definition of "buys" precisely because their transactions are not the normal, usual transactions of buyers in the ordinary course.²³⁹ Thus, legislative history supports an interpretation that "buys" means the same in section 1324 as it does in the Code.

Moreover, if courts interpreted the word "buys" in section 1324 more broadly than its Code definition, they would violate the principle of minimal disruption. A broad interpretation of "buys" is not needed to achieve section 1324's goals, would preempt a Code definition when legislative history suggests that such preemption is unnecessary, and would involve the federal courts as lawmakers in areas of commercial law traditionally left to state authority. Defining the word "buys" the same as in the Code, however, removes the double

237. See U.C.C. § 1-201(9); B. CLARK, *supra* note 12, § 3.4[1]; J. WHITE & R. SUMMERS, *supra* note 61, § 25-13.

238. The first sentence of Code section 1-201(9) defines "buyer in the ordinary course" while the third sentence defines "buying." U.C.C. § 1-201(9); see *supra* notes 183-92 and accompanying text (discussion of the great importance of section 1324's redefinition of "buyer in the ordinary course").

239. See U.C.C. § 1-201(9).

payment burden without unnecessary preemption.²⁴⁰ Furthermore, an identical interpretation means that Code cases applying the Code definition of "buys" are authoritative for interpreting section 1324.²⁴¹

There is one additional reason for defining the word "buys" in section 1324 in accordance with the Code definition. If courts interpreted "buys" differently, section 1324 would also preempt Code section 9-301(1)(c), which determines the priority between unperfected security interest holders and non-ordinary course buyers. This article argued earlier that courts should not interpret section 1324 to preempt Code section 9-301(1)(c) because the legislative history indicates that Congress did not intend to preempt basic state Code priority.²⁴² Thus, different interpretations of "buys" would create an internal inconsistency between various subsections of section 1324. Courts can provide a consistent interpretation of section 1324's various subsections only if they interpret "buys" identically under section 1324 and the Code.²⁴³

f. Effect of section 1324 on state nonuniform amendments to the Code

As we indicated earlier,²⁴⁴ many states had passed nonuniform amendments to the Code's farm products exception prior to December 1986. A logical question, then, is what preemption impact does section 1324 have upon these nonuniform amendments? The easiest answer would be to say that section 1324 preempted all these non-uniform state amendments. But, as is often the case, the easy answer is not always the correct one.

(1) Notice of security interest by sellers to buyers

Section 1324 specifically adopts notification methods that put the burden of protecting agricultural security interests first and foremost

240. Professor Clark, in his memorandum to the American Bankers Association, has argued that Congress should amend section 1324 to clarify that the word "buys" tracks the Code definition. Clark Memorandum, *supra* note 13, at 24. Professor Clark's suggestion probably is the best resolution of the issue, but the authors' conclusion that section 1324 does not preempt the Code definition of "buys" provides an alternative resolution that reaches the same conclusion as Professor Clark.

241. See cases cited in J. WHITE & R. SUMMERS, *supra* note 61, § 25-13 nn. 82-83.

242. See *supra* notes 208-18 and accompanying text.

243. By concluding that section 1324 does not provide protection to those who acquire agricultural products through transactions *not* in the ordinary course of business, and further concluding that section 1324 does not preempt Code section 9-301(1)(c), the authors thus agree with other commentators that an unperfected security interest holder has priority, under section 9-301(1)(c), over a person who acquires farm products as a buyer *not* in the ordinary course of business. This is the result courts normally reach under the Code. See B. CLARK, *supra* note 12, § 3.2[4]; 8 W. HAWKLAND, R. LORD & C. LEWIS, *supra* note 213, § 9-301:07.

244. See *supra* notes 129-50 and accompanying text.

on those who hold those interests. These security interest holders must take the initiative under both notification methods to provide the actual notice that will prevent their security interest from becoming ineffective as against buyers, commission merchants, and selling agents.²⁴⁵ Moreover, section 1324's legislative history reiterates that security interest holders bear the risk and that section 1324 does not require farm products buyers, commission merchants, and selling agents to check public records for constructive notice or to demand "no-lien certificates" from the farm product seller.²⁴⁶ Thus, Congress clearly intended to preempt Oklahoma and Nebraska non-uniform amendments imposing such requirements.

Several states with this type of nonuniform amendment also imposed criminal penalties on sellers who provided false information to buyers who inquired about outstanding security interests.²⁴⁷ Because section 1324 preempts states from putting the burden of inquiry on buyers, it has also preempted these criminal penalties. States can no longer penalize farmers under a preempted system. On the other hand, section 1324 should not preempt state laws that make it a criminal offense to sell mortgaged property.²⁴⁸ States do retain an independent sovereign interest in punishing those who "defraud" by selling collateral. Punishing the selling of mortgaged property does not in any way conflict with section 1324 by impermissibly burdening farm products buyers.

(2) Central filing

No central filing system adopted by states prior to section 1324's effective date, not even North Dakota's centralized notification system which most closely resembles section 1324's centralized notification, can satisfy, by itself, section 1324's requirements. This is true for the simple reason that the United States Department of Agriculture must certify all state centralized notification systems under section 1324.²⁴⁹ However, it is again important to remember that section 1324 and the Code are parallel, but completely separate laws. Thus, a state

245. In section 1324's prenotification system, the security interest holder has the affirmative obligation to provide actual notice directly to potential section 1324 buyers, commission merchants, and selling agents. In section 1324's centralized notification system, the security interest holder has the affirmative obligation to provide an effective financing statement to the Secretary of State. The Secretary of State then in turn provides the actual notice directly to registered section 1324 buyers, commission merchants, and selling agents.

246. H.R. REP. NO. 271, *supra* note 157, at 110.

247. *E.g.*, OKLA. STAT. tit. 12A, § 9-307(a) (Supp. 1987) (false statement by seller is a felony).

248. *E.g.*, *id.* tit. 21, § 1834 (1983) (sale of chattels encumbered by security agreement is a felony).

249. Food Security Act of 1985, *supra* note 4, at § 1324(c)(2), (i).

can have a Code central filing system for agricultural products which section 1324 would not repeal. That same state can then submit a centralized notification system to the USDA for certification as in compliance with section 1324. This centralized notification system might or might not be identical to the state's Code central filing system. When properly understood, section 1324 does not preempt any of the nonuniform state central filing systems *as Code systems*.²⁵⁰ Security interest holders in agricultural products, however, can enjoy section 1324's benefits only if they satisfy one of section 1324's two alternative notification methods.

In concrete terms, a security interest holder must comply with a state's Code central filing system to gain the Code's protections. The same holder must also comply with section 1324 to protect his security interest from becoming ineffective as against section 1324 buyers, commission merchants, and selling agents. If the state in which the holder resides has a section 1324 certified centralized notification system, he can satisfy section 1324 by complying with the state centralized notification system's requirements. From the holder's perspective, complying with the Code and with section 1324 are separate and distinct legal compliance actions.

(3) Prior notice of security interest by lenders to buyers

Subsections 1324(e)(1) and (g)(2)(A) have detailed provisions setting forth a presale notification method. These provisions put the burden on security interest holders to provide actual notice to section 1324 buyers, commission merchants, and selling agents or lose the continuation of their security interest through the sale. The section 1324 presale notification method is not identical to, nor should it be confused with, the nonuniform state Code amendments which adopt analogous actual notice systems. Thus, where the section 1324 presale notification alternative applies, security interest holders must comply with section 1324's notice provision or their security interests will become ineffective against section 1324 buyers, commission merchants, and selling agents. Compliance with the state nonuniform Code amendments, even if the holder could prove as a factual matter

250. In the succeeding companion article focusing on implementation of section 1324 notification methods, the authors will discuss the reasons for and against states trying to create a central filing system that both serves the Code and satisfies section 1324. We will also discuss what individual states who have received certification have done in this regard.

As of August 15, 1987, four states (Montana, Nebraska, North Dakota, and Oregon) that had adopted a central filing or centralized notification system prior to December 24, 1986, also had received certification for a section 1324 centralized notification system from the USDA. Four states (Kansas, Washington, South Dakota, and Iowa) with central filing systems had not applied for certification. *See also supra* note 168.

that the buyer had received actual notice, simply fails to meet section 1324's requirements and would be legally meaningless. After December 24, 1986, section 1324 buyers, commission merchants, and selling agents are entitled to receive a section 1324 notification. In this limited sense, section 1324 preempts these state nonuniform Code amendments.²⁵¹

Because the Code and section 1324 are parallel but distinct laws, farm products buyers might argue, however, that section 1324 does not preempt these state nonuniform amendments to the extent of repealing them. Buyers could argue further that security interest holders must, therefore, comply with both the relevant federal notification method (either presale notification or certified centralized notification) and state presale notification requirements before their security interests would bind farm products buyers. If courts embraced this argument, holders would have to give actual notice twice—once under state law and once under section 1324.

Nowhere in section 1324's legislative history is there a direct reference to preemption (in the sense of repeal) of state nonuniform presale notification systems.²⁵² Yet, when one considers section 1324 as a whole, the better interpretation appears to be that section 1324 does not allow imposition of a double burden of actual notice upon security interest holders. For actual notice to be effective, section 1324 provides detailed requirements for either a presale notification method, subsections 1324(e)(1) and (g)(2)(A), or a certified centralized notification method, subsections 1324(e)(2) and (3), and (g)(2)(C) and (D). Detailed requirements in a federal law indicate a pervasiveness that courts often interpret as congressional intent that the federal law occupy the field to the exclusion of state laws.

Moreover, to interpret section 1324 in such a way that security interest holders must twice provide actual notice to farm products buyers does not accomplish any worthwhile purpose. Such an interpretation simply increases the holder's burden and allows buyers an additional "escape hatch," even though it does not directly conflict

251. With regard to the point raised in the text, section 1324 preempts state lender-notice-to-buyer systems in the same way that it preempts state laws that repealed the farm products exception of section 9-307(1). See *supra* notes 187-92 and accompanying text.

252. The Senate report does discuss allowing states and lenders "maximum flexibility" in designing and implementing a presale notification system. S. REP. No. 147, *supra* note 169, at 4. But this reference to "maximum flexibility" seems ambiguous as to whether Congress meant to allow states to impose a second burden of actual notice upon security interest holders. Moreover, the Senate report was written before the Conference Committee proposed centralized notification as the state-controlled method of providing actual notice to buyers. H.R. CONF. REP. No. 447, *supra* note 170, at 485. Congress may well have meant the centralized notification system to limit the maximum flexibility of states to design and implement presale notification systems.

with the federal statutory scheme.²⁵³ What section 1324 demands is that buyers receive actual notice of security interests in farm products. Once buyers receive that actual notice in accordance with section 1324's notification methods, they do not need a second notification. To require security interest holders to give a second actual notice under state law actual notice systems undermines section 1324's protections for holders of security interests and conflicts with its goals.

In states requiring lenders to provide notice to buyers, nonuniform amendments often have the following two provisions: (1) an obligation that farmers provide their lenders a list of potential buyers; and (2) a criminal penalty for farmers who sell to buyers not on the furnished list.²⁵⁴ Subsection 1324(h) contains similar provisions. Because section 1324 preempts state nonuniform presale notification systems, there is a question whether it also preempts these two additional provisions, most particularly the criminal penalty for farmers. The best answer is that section 1324 does not preempt such provisions.

States that have statutes requiring farmers to provide lists of potential buyers and imposing penalties against farmers who sell "off-list" have an independent sovereign interest in prohibiting such "fraudulent" conduct. States may decide to prosecute such offenses even when the federal government, for whatever reason, is uninterested in pursuing the penalties provided in subsection 1324(h).²⁵⁵ Moreover, these two additional provisions do not conflict with subsection 1324(h); rather, they reinforce the comparable federal provisions. Courts might well interpret section 1324 as welcoming this reinforcement to provide better protections to both security interest holders and section 1324 buyers, commission merchants, and selling agents. As a consequence, although section 1324 preempts state nonuniform presale notification systems because they impose unwarranted burdens on security interest holders, it does not preempt the two additional provisions because they impose burdens on defrauding farmers. That result is desirable from the sovereign perspective of both the federal and state governments.²⁵⁶

253. See J. NOWAK, R. ROTUNDA, & J. YOUNG, *supra* note 172, § 9.1-.4 (general discussion of the legal standards relevant to preemption issues). The authors purposefully do not use the argument that the legislative history and statutory language evidence a need for national uniformity which would prohibit state alternatives. The need for national uniformity is not set forth as a finding of Congress in subsection 1324(a), nor as a purpose of the legislation in subsection 1324(b). Indeed, Congress chose nonuniformity in several section 1324 provisions. For a fuller discussion of nonuniformity, see *infra* notes 294-97 and accompanying text.

254. E.g., ILL. ANN. STAT. ch. 26, paras. 9-205.1, -306.02 (Smith-Hurd Supp. 1987).

255. The authors save issues of implementation of subsection 1324(h) for the succeeding companion article.

256. The text discusses whether section 1324 preempts the obligation to provide a list of potential buyers and criminal penalties for selling "off-list." The authors have concluded,

(4) Procedural limitations

Several states have addressed the farm products exception problem through procedural rules that provide additional protection to farm products buyers. Specifically, several states have adopted shorter statutes of limitation within which a secured party must sue a farm products buyer and a requirement that a secured party first attempt recovery against the farmer-debtor before suing the buyer.²⁵⁷ Section 1324 does not set forth any comparable procedural protections for buyers. Nor does its legislative history discuss nonuniform state amendments to the Code. Do these nonuniform state amendments have any surviving validity?

In answering this question, it is important to remember that section 1324 is a federal law that creates substantive federal rights enforceable in federal courts. Thus, as federal courts enforce section 1324's substantive rights, they will be addressing federal questions, which means that federal, and not state law, governs. If a federal statute sets forth the rule of decision on a particular issue, it governs regardless of state law. But if a federal statute does not provide the rule of decision on a particular issue, federal courts decide that issue by generating federal common law. In developing federal common law, federal courts can set its content either through the creation of an independent federal rule or through the adoption of the state law where the federal court sits. As a consequence, if these procedural nonuniform state amendments are to have any continuing validity, federal courts must choose them as the content of federal common law.²⁵⁸

Recent Supreme Court decisions have stated that the decision to fashion an independent federal rule or to adopt the forum state's law as the federal common law is a matter of judicial policy guided primarily by the following three factors: (1) the need for a nationally uniform rule; (2) the necessity for protecting federal interests from being undermined by state law rules; and (3) the disruptive impact an independent federal rule would have on existing relationships under state law. Moreover, while these three factors are the guiding factors, the Supreme Court has warned that the outcome in any individual case depends upon the particular federal governmental interests involved and the impact state law would have upon those interests.²⁵⁹

however, that section 1324 also preempts other portions of state lender-notice-to-buyer systems. Whether state law, as opposed to preemption, would allow preemption of one section of an act while allowing another section to remain valid may well depend upon whether the state enactment contains a severability clause.

257. See *supra* notes 149-50 and accompanying text.

258. See generally C. WRIGHT, *supra* note 180, § 60.

259. See, e.g., *Wilson v. Omaha Indian Tribe*, 442 U.S. 653 (1979); *United States v. Kimbell Foods, Inc.*, 440 U.S. 715 (1979).

Applying the preceding three factors to section 1324 and its relationship to procedural nonuniform state amendments, the authors conclude that federal courts are likely to adopt both the shortened statute of limitation and the requirement that secured parties first seek recovery from farmer-debtors as the federal common law. Under subsections 1324(e) and (g)(2), a secured party has a federal substantive right to sue a buyer, commission merchant, or selling agent to whom proper notice has been given and who fails to obtain a waiver or release of the security interest by performing the payment obligations. This is the federal substantive right created by section 1324 for security interest holders.²⁶⁰ But Congress has not even hinted that the federal government has an overriding interest in statutes of limitation or exhaustion of remedies type requirements once a holder properly establishes the right to compensation under section 1324. Provided the holder gives actual notice in conformity with section 1324's requirements, Congress evidenced no concern with statutes of limitation or exhaustion requirements. Because Congress did not authorize the federal courts to ignore such procedural nonuniform state amendments, federal courts should adopt such state laws as the content of federal common law.²⁶¹

Holders of security interests in farm products might argue that to adopt these nonuniform state procedural amendments as federal common law impermissibly burdens the substantive rights granted by section 1324. They could argue that if they are bound by short statutes of limitation and the requirement to seek recompense first from farmer-debtors, they are subjected to different rules in different states and to greater costs in ultimately recovering against buyers, commission merchants, and selling agents as allowed by section 1324. This argument might be especially appealing to federal courts when the secured party bringing the section 1324 claim is a federal entity involved in agricultural lending.

Although the preceding argument is understandable, recent case

260. Congress clearly has created a substantive federal right for security interest holders to sue buyers who received actual notice and then ignored the payment obligations set forth in that notice. Thus, the authors conclude that if a state passed a law that always allowed buyers to take free of a security interest in farm products, even though the secured party had given actual notice under section 1324 and the payment obligations had been ignored, section 1324 would preempt such a law. *Accord* Cohen, *Clear Title to Purchasers of Secured Farm Products: Federal Preemption of Uniform Commercial Code Section 9-307(1)*, Cong. Res. Serv., Libr. of Cong. (Jan. 28, 1986).

261. C. WRIGHT, *supra* note 180, § 60. Aside from cases in which the United States interests are directly involved, or cases of interstate and international relations, Professor Wright indicates that the Supreme Court recently has "taken a cautious course toward the recognition of federal common law" unless congressional authorization to formulate substantive rules of decision exists. *Id.* at 393-94. No such congressional authorization exists with regard to the two issues discussed in the text.

law undercuts its persuasiveness. With respect to statutes of limitation, Congress so rarely includes a limitations rule in federal legislation that courts have simply grown accustomed to adopting state statutes of limitation. Typically, they adopt limitations from state statutes granting substantive rights analogous to the federal rights at issue.²⁶² Nothing in section 1324's legislative history or statutory purposes indicates that federal courts should abandon their customary response and create an independent federal statute of limitation under section 1324.

With respect to the requirement that secured parties first seek recovery from farmer-debtors, federal courts have been quite reluctant to ignore nondiscriminatory state law which affects the enforcement of a federal substantive right even though adopting state law does subject the holder of the federal substantive right to different rules in different states and does increase the costs of asserting the federal substantive right. Moreover, courts have shown this reluctant attitude in cases where federal entities such as the Farmers Home Administration and the Small Business Administration have asserted substantive federal rights.²⁶³ For federal courts to ignore these precedents in section 1324 cases, Congress apparently would need to express some overriding federal interest. Yet, neither section 1324's legislative history nor any peculiarities in the substantive rights section 1324 creates for secured parties indicate that federal entities, much less private commercial secured parties asserting their section 1324 rights, should receive more favorable treatment against these procedural nonuniform state amendments relating to farm products than they did against state laws governing priority between secured parties and foreclosure. As a consequence, in states which have the requirement that secured parties first seek recompense against farmer-debtors, federal courts are likely to adopt this requirement as the federal common law interpretation of section 1324. Furthermore, the adoption of such procedural nonuniform state amendments as federal common law accords with the interpretive principle of minimal disruption.

262. *Id.* at 394-95.

263. See *United States v. Kimbell Foods, Inc.*, 440 U.S. 715 (1979) (Supreme Court adopts nondiscriminatory state commercial law setting priorities between conflicting secured parties as content of federal common law even though one of the secured parties is SBA or FmHA); *United States v. Ellis*, 714 F.2d 953 (9th Cir. 1983) (FmHA must abide by nondiscriminatory state foreclosure laws which court adopted as the content of federal common law); see also *United States v. S.K.A. Assocs., Inc.*, 600 F.2d 513 (5th Cir. 1979).

3. Section 1324 and Conversion

a. The general impact of section 1324

Conversion is an ancient tort doctrine that applies to any factual situation in which one person wrongfully exercises dominion over another's personal property. Moreover, conversion is a strict liability tort in which the offender's knowledge of the unlawfulness of his acts of dominion is irrelevant. When these conversion rules are applied in the farm products context, they mean that not only is the farmer who sells mortgaged farm products *without authority* liable for conversion, but so is the auctioneer who sells as the farmer's agent and also the farm products buyer, whether buying from the farmer or the farmer's agent.²⁶⁴

As the need for free and unhindered flow of commerce expanded, courts began to develop the commercial law doctrine of the "good faith purchaser" who takes free and clear of liability for conversion despite the fact that the seller had in fact sold without authority.²⁶⁵ Under this doctrine, buyers who lack knowledge that the sale is unauthorized gain an affirmative defense to what previously had been strict liability under conversion doctrine. The Code endorses and strengthens the protections provided to good faith purchasers.²⁶⁶ While these commercial law developments protect buyers, they do not change the basic tort doctrine of conversion. Agents, such as auctioneers, continue to be liable in conversion even though those to whom they sell (good faith purchasers) are no longer subject to conversion liability. With respect to agents, the tort law doctrine of conversion continued to apply.²⁶⁷

Section 1324 changes the conversion doctrine as it applies to agents

264. D. BURKE, *supra* note 234, at ch. II *passim*.

265. *Id.* ch. VI *passim*.

266. The Code's basic adoption of the "good faith purchaser" rule is found in section 2-403. Through transformation into a "buyer in ordinary course of business," the Code provides additional protection for the "good faith purchaser;" *see also* U.C.C. § 7-205 (warehouse receipts); *id.* § 9-307(1) (buyer of inventory, but buyer of farm products specifically excluded); *id.* § 9-301(1)(c) (in limited circumstances, buyer of farm products). By providing protection to farm products buyers who buy without having received actual notice of a security interest against the farm products, subsection 1324(d) is a further commercial law extension of the concept of "good faith purchaser."

267. *See* First Nat'l Bank v. Southwestern Livestock, Inc., 616 F. Supp. 1515 (D. Kan. 1985); Garden City Prod. Credit Ass'n v. International Cattle Sys., 32 U.C.C. Rep. Serv. (Callaghan) 1207 (D. Kan. 1981); Commercial Bank v. Hales, 281 Ark. 439, 665 S.W.2d 857 (1984). These three cases clearly illustrate that the commercial law doctrine of "good faith purchaser," which protects purchasers from liability for conversion, does not extend to agents of the person who sells without authority. These agents remain liable for the tort of conversion.

selling farm products. It provides agents with the same legal protection the commercial law already had provided to buyers. Under subsection 1324(g)(1), commission merchants and selling agents are no longer strictly liable in conversion. They, like section 1324 buyers, are now liable for conversion only if they receive actual notice of the security interest in accordance with the notification methods set forth in section 1324 and then ignore the notice. In this regard, section 1324 has made a major change in tort law. It has provided commission merchants and selling agents with an affirmative defense to conversion. The next section will discuss precisely how great a preemptive impact section 1324 has had upon the tort law doctrine of conversion.

b. Section 1324 defined and undefined terms

(1) "Commission merchants" and "selling agents"

Subsection 1324(g)(1) protects commission merchants and selling agents who sell farm products on another's behalf. Subsections 1324(c)(3) and (8) define "commission merchant" and "selling agent" to identify precisely who subsection 1324(g)(1) protects. Both definitions make clear that Congress intended section 1324 to provide protection to any person acting as a sales agent for farmers. The only apparent restriction is the requirement that the commission merchants or selling agents themselves be "engaged in the business" of acting as a selling agent for farmers. Congress apparently decided that it should remove the risk of double payment only from those who are actively and consistently involved in the interstate commerce of agricultural products. In contrast, Congress decided not to protect persons who act only occasionally as agent sellers because they are not sufficiently involved in interstate commerce. For those who do not qualify as being "engaged in the business" of acting as an agent seller, Congress has retained state law liability for conversion even after section 1324's effective date.²⁶⁸

Subsections 1324(c)(3) and (8) and 1324(g)(1) have no counterparts in the Code because the Code does not address the tort liability of agents selling on behalf of others. Obviously, section 1324 can have no preemptive impact on the Code when the two laws simply do not overlap. On the other hand, almost all states recognize the tort of conversion for agent sellers of farm products.²⁶⁹ Section 1324 has

268. The exclusion of casual agents from subsection 1324(g)(1)'s protection parallels the exclusion of nonordinary course buyers from subsection 1324(d)'s protection. Buyers, too, are protected only if they are engaged in the buying of farm products in their ordinary business. See *supra* notes 237-43 and accompanying text.

269. *E.g.*, *United States v. Topeka Livestock Auction, Inc.*, 392 F. Supp. 944 (N.D. Ind. 1975); *Commercial Bank v. Hales*, 281 Ark. 439, 665 S.W.2d 857 (1984).

preempted these state tort doctrines after its effective date. After that date, holders of security interests in farm products are able to sue commission merchants and selling agents in conversion only if they have satisfied section 1324's actual notification methods. If a security interest holder fails to give notice in accord with section 1324's requirements, a commission merchant or selling agent takes free of conversion liability, regardless of state law.

(2) The terms "sells" and "seller"

Although subsection 1324(g)(1) uses the words "sells" and "seller," nowhere does section 1324 define these two terms. However, Code sections 2-106(1)²⁷⁰ and 2-103(d)²⁷¹ do define them. Section 1324's legislative history gives no indication that Congress meant to preempt the Code definitions of these two terms. Nor is there any indication that Congress meant for the federal courts to create federal common law definitions for these two terms. In accord with the principle of minimal disruption, then, federal courts should interpret "sells" and "seller" under section 1324 to mean the same as the relevant Code sections define them. If interpreted identically, Code cases deciding when a sale has occurred and who is a seller are precedent for interpreting section 1324.²⁷²

c. Nonuniform state statutes on conversion

While the common law rule is that agents of persons selling without authority can be held liable for conversion, four states (Georgia, Maryland, Louisiana, and Nebraska) have adopted statutes that change this common law liability rule. Georgia protects commission merchants who sell livestock or agricultural products provided the sale is "made in the ordinary course of business and without knowledge of the perfected security interest." Maryland removes conversion liability from auctioneers who sell farm products for another without acquiring an interest in the farm products. Louisiana exempts market agencies from conversion liability when selling livestock unless the agency has received a notice meeting the requirements set forth in the Louisiana statute. Finally, Nebraska shields auctioneers who sell personal property if the principal's identity is disclosed and if the sale is in good faith and without notice of the security interest.²⁷³ The Loui-

270. "A 'sale' consists in the passing of title from the seller to the buyer for a price (Section 2-401)." U.C.C. § 2-106(1).

271. "'Seller' means a person who sells or contracts to sell goods." *Id.* § 2-103(1)(d).

272. See B. CLARK, *supra* note 12, ¶ 3.4[2] (discussion of Code cases defining the word "sale").

273. See *supra* notes 140-41 and accompanying text (statutory citations and brief discussion of these three statutes); see also Uchtmann, *supra* note 3, at 1330-32.

siana statute is the most narrow in that it protects only agent sellers of livestock, while the Nebraska statute is the broadest because it protects auctioneers selling any type of personal property.

Insofar as these statutes apply to the sale of farm products, section 1324 has preempted all four. These four state statutes are now legally irrelevant to marketing transactions involving farm products. After the effective date of section 1324, security interest holders will be able to bring conversion actions against commission merchants and selling agents only if they have satisfied section 1324's notification methods. On the other hand, the Nebraska statute applies to the sale of many goods in addition to farm products. With regard to these non-farm products goods, section 1324 has not preempted the Nebraska statute because section 1324 deals solely with marketing transactions in farm products.

Courts should reject any argument by commission merchants and selling agents that they can avoid section 1324 liability by demonstrating that security interest holders did not comply with any additional requirements imposed by these four state statutes. Congress has adopted two detailed methods through which security interest holders can give notice. The statutory scheme's clear implication is that if a security interest holder complies with these notification methods, he has a federal right to pursue conversion against commission merchants and selling agents who ignore the actual notice he gave.²⁷⁴ In other words, section 1324 occupies the entire field of conversion liability between secured parties and commission merchants/selling agents. No room exists for additional or different state statutory requirements.²⁷⁵

d. Authorized disposition under tort law and Code section 9-306(2)

At common law, conversion is a strict liability tort; if the exercise of dominion was wrongful, the offender is liable for conversion notwithstanding that he acted in good faith and with the best intentions. The only defense to conversion is to prove that one's actions were in fact a lawful exercise of dominion. Similarly, Code sections 9-201 and 9-306(2) set forth the general rule that a security interest stays

274. The Committee Reports on section 1324 do not make a single reference to commission merchants' and selling agents' conversion liability in tort, aside from restating the relevant provision in the "section-by-section analysis" portion of the Report. S. REP. No. 147, *supra* note 169, at 6. This is true despite the fact that the earliest House bill introduced on the farm products exception during the 99th Congress provided protection for commission merchants and selling agents. H.R. 2100, *supra* note 219.

275. See *supra* notes 251-56 and accompanying text (similar preemption issues raised by the interrelationship between state nonuniform Code amendments requiring prior notice of a security interest by lenders to buyers and section 1324).

attached to collateral, despite its sale, exchange or other disposition "unless the disposition was authorized by the secured party in the security agreement or otherwise." The "unless" clause allows the person charged with conversion under the Code to defend by showing that his actions on another's behalf were authorized. Thus, both for tort and commercial law, the liability of commission merchants, selling agents, and buyers depends on whether the farmer who sold the farm products was acting with authorization (no conversion) or without authorization (conversion).

Subsection 1324(e) states that a farm products buyer "takes subject to" a security interest if he has been properly notified and if he "has failed to perform"²⁷⁶ or "does not secure a waiver or release"²⁷⁷ by performing payment obligations between the secured party and the indebted farmer. Correspondingly, subsection 1324(g)(1) provides that a commission merchant or selling agent "shall be subject to" a security interest if he has been properly notified and if he "has failed to perform"²⁷⁸ or "does not secure a waiver or release"²⁷⁹ by performing payment obligations. It is possible to read these provisions as imposing absolute liability upon buyers, commission merchants, and selling agents any time they fail to perform payment obligations of which they had notice, even though they could present evidence of authorization, either express, implied, or by estoppel.²⁸⁰ Such a reading of section 1324 would change both tort and commercial law conversion from a cause of action based on proof of "wrongful dominion" or "without authorization" to a cause of action based on failure to fulfill payment obligations, regardless of whether the sale was authorized or not. Reading section 1324 to impose absolute liability based only on receipt of notice would mean that section 1324 preempts both common law conversion and Code section 9-306(2).

To illustrate the preceding discussion, consider the following two factual patterns:

Pattern One. A lender provides the appropriate section 1324 notice to a buyer that livestock is subject to a security interest which the lender will release only if the buyer pays through a certified joint payee check. The buyer buys livestock on five different occasions from the farmer-debtor

276. Food Security Act of 1985, *supra* note 4, at § 1324(e)(1)(B).

277. *Id.* § 1324(e)(3)(B).

278. *Id.* § 1324(g)(2)(B).

279. *Id.* § 1324(g)(2)(D)(ii).

280. The argument that section 1324 creates absolute liability for buyers, commission merchants, and selling agents whenever they have been properly notified and then fail to fulfill the payment obligations between the lender and the farmer-debtor is suggested in S. Turner, *supra* note 197, § 3.09.

and each time he fails to perform the payment obligations.²⁸¹ On four of those occasions, the farmer-debtor immediately remits the proceeds of the check to the lender. On the fifth occasion, however, the farmer spends the money on other debts and does not repay the lender. The lender now sues the buyer for conversion because he did not fulfill the payment obligations. If courts read section 1324 to impose absolute liability, the buyer cannot argue that the course of dealing or course of performance between the lender and the farmer-debtor constituted implied authorization for the sale under Code section 9-306(2)'s "or otherwise" language.²⁸²

Pattern Two. Imagine the same basic facts as in Pattern One except that the buyer discovers the section 1324 notice prior to the fifth purchase and anxiously calls the lender to learn if the security agreement is still in effect because the buyer has not heard any complaints about the four previous purchases. The lender mistakenly says that the farmer has repaid the debt. The buyer completes the fifth sale only to be sued later (when the lender does not receive the money on the fifth sale) on the claim that he did not perform the payment obligations. If courts read section 1324 to impose absolute liability, the buyer cannot argue that the lender's mistaken authorization constitutes either an express authorization or an authorization by estoppel under tort law or Code section 9-306(2).²⁸³

Section 1324's legislative history is filled with references to the problems that buyers face in trying to learn if the farm products they are buying are subject to a security interest.²⁸⁴ In response to perceived problems, the legislative history is replete with arguments about the need for buyers to receive actual notice of security interests before being held responsible. But the legislative history does not contain a single comment on the elements of "wrongful dominion" in tort conversion or "without authority" in commercial law conversion. What the legislative history does intimate is that those promoting the passage of section 1324 thought that by addressing the good faith (*i.e.*, lack of actual knowledge) of the buyer, commission merchant, or selling agent they were solving the perceived problems.²⁸⁵ As the

281. For purposes of the questions discussed in the text, the reason the buyer fails to perform the payment obligations is irrelevant. Whether the buyer's noncompliance is due to purposeful choice or inadvertence is not the correct question. The correct question is whether the buyer (once he has failed to comply with payment obligations for whatever reason) can present evidence that his acts do not constitute conversion because the lender, in some way, authorized the sales.

282. See *supra* notes 66-113 and accompanying text (discussion of the case law relating to implied authorization under section 9-306(2)).

283. See *id.* (discussion of case law relating to express authorization under section 9-306(2)); see also *supra* notes 114-21 and accompanying text (discussion of case law relating to estoppel authorization). For a good discussion of authorization cases in farm products sales, see Richards, *supra* note 129, at 379-95.

284. The Committee Reports only discuss the farm product exception problems of buyers. See *supra* note 274.

285. The Senate Committee Report states: "The bill would extend the traditional protections contained in the Uniform Commercial Code, as adopted by the States, to the good-faith

two proceeding factual patterns indicate, however, addressing "lack of knowledge" is only one aspect of exposure to the risk of double payment in farm product transactions. Those promoting section 1324's passage apparently never sensed, and certainly never articulated, the "wrongful dominion" or "without authorization" aspect of conversion liability. Thus, the legislative history provides no direct assistance in resolving the preemption dilemma between section 1324 and common law or commercial law conversion. However, because the legislative history focuses exclusively on the "good faith, lack of knowledge" aspect, one could argue that courts should interpret section 1324 to change nothing beyond its legislative vision. Therefore, by Congress's "benign neglect," section 1324 has not changed the "wrongful dominion" or "without authorization" element of conversion.

Section 1324's language contains at best cryptic clues whether it has preempted the element of "wrongful dominion" or "without authorization" from conversion actions. Subsections 1324(e)(3)(B) and 1324(g)(2)(D)(iii) state that buyers, commission merchants, and selling agents take subject to or are subject to the security interest in a centralized notification system if they do not secure a waiver or release by performing payment obligations "*or otherwise.*" The "or otherwise" language in these subsections echoes Code section 9-306(2)'s "or otherwise" authorization language. Thus, one could argue that if section 9-306(2) allows an authorization defense through the "or otherwise" language, then so too does section 1324.²⁸⁶

On the other hand, subsections 1324(e)(1)(B) and 1324(g)(2)(B), relating to the presale notification system, state that buyers, commission merchants, and selling agents are subject to or take subject to a security interest of which they were properly notified by failing to perform the payment obligation. In the presale notification system

buyers of farm products in two ways. It would preempt the farm products exception language in the Uniform Commercial Code. It would also provide a simple mechanism under which lenders could choose to protect their security interests through actual notice to prospective buyers of the existence of the security interests." S. REP. NO. 147, *supra* note 169, at 4.

286. The difficulty with the textual discussion is that courts have reached diametrically opposed decisions about whether and, if so, under what factual circumstances to allow "or otherwise" authorization. *See supra* notes 66-122 and accompanying text. The legislative history does not provide a single clue as to which line of authority or which particular cases Congress meant the words "or otherwise" to echo.

Subsection 1324(b) lists the Act's sole purpose as the removal of the burden of double payment which hinders interstate commerce. Subsection 1324(a) sets forth findings of Congress which focus on the risk of double payment in farm product transactions. What is missing from both these subsections is any mention that section 1324 seeks uniformity. Indeed, the authors conclude that achieving uniformity is not a helpful guide in interpreting section 1324. *See infra* notes 294-95 and accompanying text.

statutory language, the "or otherwise" wording does not appear. Thus, section 1324's language is internally inconsistent between the two notification methods. Yet, no justification readily comes to mind for distinguishing between the centralized notification system and the pre-sale notification system with regard to allowing "or otherwise" authorization for one but not the other.

Subsection 1324(a) sets forth findings of Congress emphasizing that lack of actual knowledge creates a burden of double payment which obstructs interstate commerce. Subsection 1324(b) reiterates these findings by describing the legislation's purpose as the removal of this burden. In light of these fundamental objectives, interpreting subsections 1324(e) and (g)(2) to impose absolute liability upon buyers, commission merchants, and selling agents regardless of evidence of authorization, (thereby preempting tort law and Code section 9-306(2) law on "wrongful dominion" and "without authorization" respectively), is not necessary to fulfill section 1324's purpose. Section 1324 is solely designed to provide protection to buyers, commission merchants, and selling agents who lack actual knowledge of security interests and who, therefore, should not be made to pay twice.

Preempting tort law or Code section 9-306(2) on "wrongful dominion" or "without authorization" is not responsive to section 1324's requirements for actual notice to buyers, commission merchants, and selling agents. Indeed, if courts prohibit buyers, commission merchants, and selling agents from presenting authorization arguments, they expose such parties to the risk of double payment more often than if they allow them to defend against a conversion action on the basis that acts of "wrongful dominion" or "without authority" did not occur. Such a result undermines section 1324's purpose.

Considering section 1324's legislative history, language, and purpose, the authors conclude that courts should once again adopt the principle of minimal disruption. Before they interpret section 1324 to change the fundamental nature of conversion from a tort based on acts of "wrongful dominion" or "without authority" to a cause of action based solely on failure to comply with payment obligations, Congress should express such an intent more clearly.²⁸⁷ Until Con-

287. Congress easily could have expressed its intent to preempt the "wrongful dominion" or "without authority" element of conversion more clearly if it had desired to do so. For example, Congress could have distinguished between the two fact patterns presented earlier in the text. Congress could have provided that buyers take free of security interests when lenders have given either express authorization or authorization by estoppel (Pattern Two), but that courts should not permit implied authorization based on course of dealing or usage of trade (Pattern One). The nonuniform amendments to Code section 9-306(2) passed by the legislatures of New Mexico and Arkansas reflect this distinction between Pattern One and Pattern Two. See *supra* note 83. Therefore, Congress could have made such a distinction by using language adopted from the nonuniform amendments of New Mexico and Arkansas, but it did not do so.

gress does so, courts should not interpret section 1324 as preempting the common law nor the commercial law of conversion. Rather, courts should interpret section 1324 to allow buyers, commission merchants, and selling agents to present evidence that they are not guilty of either "wrongful dominion" or unauthorized sale. However, if courts adopt such a construction of section 1324, the consequence does follow that the apparently unending litigation over whether a secured lender has given express, implied, or estoppel authorization will continue with all the attendant conflicts between jurisdictions and confusing judgments peculiar to the specific facts of individual cases.²⁸⁸

D. *Receipt—Section 1324 Deference to State Law*

Subsections 1324(e) and (g)(2) state that farm products buyers and commission merchants or selling agents remain exposed to the risk of double payment if they *receive* actual notice in accordance with either of section 1324's notification methods and fail to comply with the payment obligations set forth in that actual notice. Subsections 1324(f) and (g)(3), in explicit contrast to the preemption language contained in the core subsections 1324(d) and (g)(1), command that "[w]hat constitutes receipt, as used in this section [1324], shall be determined by the law of the State in which the buyer resides."²⁸⁹

Subsections 1324(f) and (g)(3) did not appear in the legislative process until the Conference Committee substituted a rewritten bill for those originally introduced into the House and Senate.²⁹⁰ But the Conference Committee Report, in its discussion of proposed amendments, does not even mention these two new subsections.²⁹¹ Thus, the legislative history gives no direct evidence as to why Congress decided to defer to state law on this point.

The authors' propose two explanations for why Congress adopted subsections 1324(f) and (g)(3). First, Congress may have recognized the need for limiting section 1324's preemptive impact, especially with regard to a more "procedural" issue such as receipt. Indeed, one could interpret the fact that Congress deferred to state law on the definition of "receipt" as evidence that congressional intent supports the authors' suggested interpretive principle of minimal disruption for section 1324. These two subsections make clear that Congress did not command that section 1324 broadly preempt every legal term contained within its language.

288. One author already has taken the opposite position and concluded that section 1324 does preempt Code section 9-306(2) authorization. Sanford, *supra* note 182, at 9-10.

289. Food Security Act of 1985, *supra* note 4, at § 1324(f), (g)(3).

290. Compare S. 744, 99th Cong., 1st Sess. (1985) and H.R. 2100, *supra* note 219 with H.R. CONF. REP. NO. 447, *supra* note 170, at 487-92.

291. H.R. CONF. REP. NO. 447, *supra* note 170, at 485-87.

Second, the Conference Committee substitute for the original bills introduced the centralized notification method as an alternative that each state individually could create.²⁹² By authorizing this alternative notification method, Congress introduced nonuniformity into the legislation.²⁹³ Thus, deferring to state law on what constitutes receipt, although also introducing nonuniformity into the legislation, does not undermine a principle otherwise protected in the statutory language. Subsection 1324(b) lists removal of the double payment risk, which burdens and obstructs interstate commerce, as its sole purpose. Subsection 1324(b) does not list achieving a uniform federal rule (meaning a singular approach) for providing protection to farm products purchasers as one of section 1324's purposes.²⁹⁴ Congress must have decided, by adopting alternative methods of permissible notification and by deferring to state law determinations as to what constitutes receipt, that nonuniformity in these matters accomplishes a desirable result.

By deferring to state law for what constitutes receipt, section 1324 forces those giving actual notice to become familiar with the requirements of legal receipt in each of the fifty states and the United States territories. Those giving actual notice will have to know whether a particular state would allow actual notice, such as that section 1324 mandates, to be given by regular mail, or whether a particular state (for evidentiary reasons) has imposed additional mailing requirements such as certified mail return receipt requested or registered mail.²⁹⁵ Those giving the actual notice must know these requirements because if section 1324 buyers in the ordinary course or commission merchants and selling agents do not "receive" such actual notice, sec-

292. *Id.* at 485-86.

293. Congress's adoption of the centralized notification alternative introduced nonuniformity into section 1324 in two distinct ways. First, states could take no action to adopt a centralized notification system and therefore, would be covered by the Act's presale notification procedures. Other states, however, might adopt a centralized notification system. As a result, different states would handle the same problem—elimination of the double payment risk in farm product purchases—in very different ways. Second, even within the centralized notification method, Congress allowed each state to create its own system provided the system gains certification from the United States Department of Agriculture. Thus, different state centralized notification systems will vary, thereby creating another kind of nonuniformity.

294. Both the House and the Senate reports discuss the need for a "single Federal rule to restore consistency" to farm products marketing in light of the fact that many states had adopted nonuniform amendments to Code section 9-307(1). H.R. REP. NO. 271, *supra* note 157, at 109; S. REP. NO. 147, *supra* note 169, at 3. But this need for a "single Federal rule" is not listed in subsection 1324(a) in the findings of Congress. Moreover, after adopting the centralized notification alternative and deferring to state law on "receipt" (as the Conference Committee proposed), Congress had to know that it had abandoned a single federal rule as a goal. Thus, Congress intentionally introduced nonuniformity into section 1324. On certain issues that section 1324 raises, Congress chose nonuniformity as the appropriate response.

tion 1324 allows them to take free and clear of the creditor's security interest. Under section 1324, proving that buyers, commission merchants, and selling agents had actual notice of a security interest is irrelevant if that notice was not provided in accordance with the legal receipt requirements mandated by subsections 1324(f) and (g)(3).

Courts should also take careful note of the language in subsections 1324(f) and (g)(3) which states that the law that governs whether receipt has been legally accomplished is the law of the "*State in which the buyer resides.*"²⁹⁶ As the statutory language makes absolutely clear, those giving actual notice cannot fulfill the requirements of legal receipt by complying with the state law where the giver is located or with the state law where the debtor lives. Those giving actual notice, furthermore, must comply with *state* law because there is no relevant federal law governing the elements of legal receipt. Thus, a creditor trying to provide the actual notice on a single farmer through pre-sale notification may have to comply with the "receipt" laws of several different states depending upon the residences of the potential buyers, commission merchants, and selling agents.

In addition, subsections 1324(f) and (g)(3) also apply to centralized filing systems. Thus, as Secretaries of State send out the compiled lists of filed security interests, these lists then must be sent to each registered buyer, commission merchant, and selling agent in accordance with the requirements for legal receipt as set by the state where these registered parties reside. Assuredly, the registrants list for a particular state will include buyers, commission merchants, and selling agents from many different states. Therefore, Secretaries of State will need staffs trained to know the requirements of legal receipt for each of the fifty states and the United States territories. Whether private lenders and Secretaries of State can adequately train their staffs to be sufficiently knowledgeable and careful about the manner in which they give notice, so as to comply with the several states' requirements of legal receipt, is an important behavioral question raised by the adoption of subsections 1324(f) and (g)(3).

III. CONCLUSION

Two major conclusions follow from this article's discussion of section 1324. First, section 1324 presents many difficult and complex

295. Compare KY. REV. STAT. ANN. § 355.9-307 (Baldwin Supp. 1986) (written notice by certified mail, return receipt requested) with *id.* (Baldwin 1980) (written notice by certified mail, return receipt requested or by registered mail). The authors have not researched the requirements for legal receipt in all the jurisdictions subject to section 1324. However, Kentucky requirements, as they have changed since 1980, provide a glimpse of the complexity that subsections 1324(f) and (g)(3) created.

296. Food Security Act of 1985, *supra* note 4, at § 1324(f), (g)(3) (emphasis added).

questions relating to its retroactivity and preemption. These questions cannot be resolved until courts interpret section 1324, which means that a significant amount of section 1324 litigation in federal courts is inevitable. Until courts resolve the interpretive questions relating to retroactivity and preemption, lenders, farmers, buyers, commission merchants, and selling agents will be operating in an environment fraught with legal uncertainty. Thus, section 1324 has not reduced uncertainty about lending risks or farm products financing and marketing litigation. This uncertainty will result in lenders extending less credit at a higher price to farmers²⁹⁷ and in buyers paying lower prices to farmers for farm products.

Second, section 1324 does not introduce substantially greater uniformity into farm products financing and marketing. Congress specifically introduced nonuniformity into the law by allowing alternative notification methods, state variations in centralized notification systems, and by giving express deference to state law concerning what constitutes receipt of the required notices. Moreover, nonuniformity will continue in farm products financing and marketing because section 1324, understandably and justifiably, has not preempted many provisions of the Uniform Commercial Code that have produced litigation reaching disparate results. Nonuniformity means that lenders, farmers, and buyers must bear the time and expense to become familiar with several different modes of action and the obligation to know when to follow each mode of action. Lenders and buyers will undoubtedly pass these additional costs on to farmers either by charging higher prices for operating capital or by paying lower prices for farm products.

If Congress meant section 1324 to reduce uncertainty, reduce litigation, and encourage uniformity, it failed. Section 1324 will not achieve these goals. Indeed, Congress may have increased anxiety among farm lenders. At the same time, if Congress has created notification methods

297. Section 1324's impact on the flow of operating capital to farmers and ranchers is unclear. Anecdotal information provided to the authors by lawyers and bankers in Oklahoma indicates that possibly as many as 20% of Oklahoma banks that have made agricultural loans in the past intend to stop making loans collateralized by farm products. These informants report that bankers and their lawyer-advisors simply feel that section 1324 places too much additional risk of loss on lenders. This is especially true with regard to loans that are risky in the best of times and that are highly questionable in present economic times. Professor Meyer also reports similar anecdotal information. Meyer, *supra* note 182, at 161-62. Other informants, however, scoff that the bankers and their lawyers are all "sound and fury signifying nothing" and that lenders will make farm operating loans at the same volume and at the same costs now that section 1324 is in effect as prior to its passage. To these latter informants, section 1324 has changed the rules of the game, but the game of agricultural financing, itself, will continue relatively unaffected. Spring planting is near and during the spring, farmers and their lenders, like baseball teams in training, are filled with hope for a successful season to come.

that are easy to understand and apply, then, despite the retroactivity and preemption issues discussed in this article, section 1324 may lead to a system that will ultimately work efficiently and fairly for all concerned. Whether section 1324 accomplishes these latter goals is the subject of an article on implementing section 1324's notification methods that will be published in a later issue of the *Kansas Law Review*. Although this article has raised concerns about the impact section 1324 will have on agricultural financing, one cannot render a more fully informed judgment on section 1324 until after carefully examining the notification methods. In this regard, the authors request their audience to stay tuned to the same channel because this episode is "to be continued."

