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SECTION 9-307(1): THE U.C.C.'S OBSTACLE TO AGRICULTURAL COMMERCE IN THE OPEN MARKET

*John F. Dolan**

INTRODUCTION

The Uniform Commercial Code¹ provides a general open market rule in the Secured Transactions article which permits certain good faith purchasers to take goods free of perfected security interests. That general rule, however, excepts from its application sales of farm products by persons engaged in farming operations. Defenders of the exception proffer two justifications. Some feel that farm producers would not find ample credit if farm lenders faced the possibility of losing collateral to buyers. Others argue that the exception enjoys widespread support among state legislatures and among the federal agencies which account for a significant share of agricultural credit. Thus, this second argument continues, adoption of a rule in the Code which treats farm sales in the same fashion as it treats nonfarm sales would invite deviation from the Code rule by both state and federal systems with a resulting loss of uniformity.

This article holds first, that the farm exception grows out of archaic notions of agriculture and agricultural finance; second, that the exception is basically unfair in that it penalizes unwary buyers who reasonably expect they will buy free of security interests; third, that the exception creates uncertainty and thereby increases transaction costs to the detriment of farm producer and farm lender; and fourth, that the farm exception itself has so contributed to a lack of uniformity that its abrogation could hardly cause more.

DEFINING THE ISSUE

Article 9 of the Uniform Commercial Code takes pains to differentiate four classes of goods:² consumer goods, equipment, farm prod-

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¹ The Uniform Commercial Code is hereinafter cited as "Code." Unless otherwise noted, all section references are to the 1972 official version of the U.C.C., and references to the comments are to those prepared by the sponsoring agencies to the 1972 version.

² U.C.C. § 9-105(1)(h) sets forth the general definition of "goods". Hereinafter all U.C.C. section numbers will be referred to by section number only.

ucts, and inventory.³ This differentiation facilitates disparate treatment of each of the four categories. Consumer goods,⁴ for example, are free from certain filing requirements which attend other classes of goods⁵ and are subject to different foreclosure rules.⁶ These rules arise out of the notion that the nature of consumer transactions justifies treatment different from that afforded transactions in a commercial setting.⁷

Similarly, the Code makes allowance for the inherent dissimilarities between "equipment," which the Code defines to include assets used by a business,⁸ and "inventory," which it defines to include assets the business holds for sale or lease or otherwise consumes.⁹ The methods of financing these two classes of goods and, more importantly, the probability of selling one and the improbability of selling the other¹⁰ justify their different treatment in connection with the relative priorities of lenders¹¹ and the protection of persons who buy such goods.¹²

THE FARM PRODUCTS CATEGORY

Equipment and inventory are similar to the extent that both are owned for profit or commercial purposes as opposed to the domestic purposes of personal, family, and household uses. There remains, however, a category of goods and which comprises a significant element of commerce but which Code drafters could reconcile with neither the fish of commerciality nor the fowl of domesticity. That specially treated class consists of farm products.

³ Section 9-109(1) to (4).

⁴ Consumer goods include those goods "used or bought for use primarily for personal, family, or household purposes." Section 9-109(1).

⁵ Section 9-302(1)(d).

⁶ See §§ 9-504(3), 9-505(1) to (2), 9-507(1).

⁷ Cf. § 2-104, Comment 1 (special rules for merchants).

⁸ Section 9-109(2). The definition also serves as a catchall. See § 9-109(2), Comment 5.

⁹ Section 9-109(4). The important distinction between inventory and equipment appears to be one of duration. Materials used by the business and consumed by it are inventory, whereas machines used or consumed by it are equipment. Compare § 9-109(4) with § 9-109(2).

¹⁰ Courts have concluded that the term "inventory" in a security agreement includes after-acquired inventory because "inventory by its nature and definition changes from day to day." *In re Fibre Glass Boat Corp.*, 324 F. Supp. 1054, 1056 (S.D. Fla.), *aff'd per curiam*, 448 F.2d 781 (5th Cir. 1971).

¹¹ Compare § 9-312(3) with § 9-312(4). See generally § 9-312, Comment 3.

¹² Although the buyer protection rule of § 9-307(1) does not use the term "inventory," it is clear that this class of goods is the kind to which the section is directed. See §§ 9-307(1), 1-201(9), and 9-102, Comment 5. Cases have tended to hold, true to academic consistency but perhaps contrary to the expectations of the parties, that buyers of "equipment" do not benefit from buyer protection rules. See, e.g., *Bruce v. Martin-Marietta Corp.*, 544 F.2d 442 (10th Cir. 1976) (sale of used aircraft by airline not subject to products liability rule); *Hempstead Bank v. Andy's Car Rental Sys.*, 35 App. Div. 2d 35, 312 N.Y.S.2d 317 (1970) (sales of vehicles held for lease, though technically inventory, not subject to the § 9-307(1) rule).

Farm products, by definition, must be in the possession of a farmer,¹³ yet the rules which apply to them affect all who deal in agricultural commodities. Clearly, farm products include what would otherwise be inventory: crops, livestock, and the raw materials of farm production, as well as the products both of crops and livestock in their "unmanufactured states."¹⁴ This definition leaves by implication those products which are in their manufactured states (*e.g.*, leather or corn flakes) and which are not his "equipment" as the farmer's only "inventory."¹⁵ In short, with that sole exception for manufactured state inventory, farmers can hold no inventory in the Code sense. They can only hold "farm products."

SPECIAL TREATMENT FOR FARM PRODUCTS

Having constructed this farm products (inventory-which-is-not-inventory) category, the Code drafters fashioned special rules for it. The first concerns the filing requirements, and the second concerns the relative priorities of a secured inventory lender and a purchaser in a subsequent inventory sale.

The first difference is in filing requirements. Section 9-401 poses three filing options for lenders secured by farm products. The first requires central filing; the others require local filing. The Code drafters did not choose among the three options, but an overwhelming majority of the jurisdictions have opted for either the second or the third. Because only five states¹⁶ require central filing for farm products, in nearly all jurisdictions the filing of financing statements covering farm products will be local, with buyers or lenders searching for such financing statements at the county or town level.

The filing options, however, must rank as a relatively minor consideration and are not the reason for the creation of the separate farm products class of goods. Code drafters could have effected the local filing option for farm products in the fashion they effected it for farm equipment. Such equipment is not by definition a separate class of goods but

¹³ Section 9-109(3). The Code wisely eschews the term "farmer" for the terms "debtor engaged in raising, fattening, grazing or other farming operations." It thereby avoids the problem of determining whether, for example, a stock broker can be a farmer.

¹⁴ *Id.*

¹⁵ A farmer's equipment (assuming of course that livestock are not equipment) falls into the "equipment" category of goods. *See* § 9-109(2).

¹⁶ CONN. GEN. STAT. ANN. § 42a-9-401(1) (West Cum. Supp. 1977); DEL. CODE tit. 6, § 9-401(1) (1975); HAW. REV. STAT. § 490:9-401(1) (1968); IOWA CODE ANN. § 554.9401(1) (West Cum. Supp. 1977-78); UTAH CODE ANN. § 70A-9-401(1) (1968). California, Maine, and Oregon require central filing for livestock, though not for other farm commodities. CAL. COM. CODE § 9401(1) (West Cum. Supp. 1977); ME. REV. STAT. tit. 11, § 9-401(1)(a) (West Cum. Supp. 1976-77); OR. REV. STAT. § 79.4010(1) (Oregon Digest 1977). A Montana pre-Code statute requires the secured party to notify the Montana Department of Livestock. MONT. REV. CODES ANN. § 52-319 (Smith 1977). *See generally* Batey Land & Livestock Co. v. Nixon, — Mont. —, 560 P.2d 1334 (1977).

falls into the section 9-109 definition of "equipment." However, the Code provides two options for local filing of "equipment used in farming operations,"¹⁷ even though generally a financing statement covering equipment would be filed centrally.¹⁸

The second area of different treatment concerns the rights of the lender and the subsequent purchaser of inventory. Where either farm or nonfarm inventory is involved, section 9-306(2) often in practice operates to terminate the creditor's interest in inventory after that transfer. That section provides:

[A] security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise

Because lenders recognize that the purpose of inventory is sales, that a need to perform a filing search inhibits sales, and that sales free and clear of the lender's interest serve the purposes of lender and borrower alike, almost all lenders customarily authorize inventory sales. In effect, then, lenders and their borrowers fashion a private open-market rule through their security agreement which authorizes sales free of the lender's security interest.¹⁹

This willingness by lenders to authorize sales of secured inventory stems only in part from the protection afforded the lender by the proceeds which arise from that sale.²⁰ Inventory lenders often do not make inventory loans with the expectation that they will receive proceeds from each sale. Such expectations, while inherent in any discrete, short-term loan, are inconsistent with the indispensable notion of working capital loans of intermediate term secured by inventory. Rather, inventory lenders often make such loans on the assumption that borrowers will utilize proceeds of sale to acquire new inventory and will reduce the working capital loan not as a result of discrete sales but as a consequence of capital needs and cash flow.²¹

In those infrequent situations where the inventory lender does not authorize sale, section 9-307(1) fulfills the expectations of the buyer in

¹⁷ Section 9-401(1). The second and third alternative subsections lump "equipment used in farming operations" with "farm products" for the purpose of determining the proper place to file.

¹⁸ *Id.*

¹⁹ See, e.g., *Lisbon Bank & Trust Co. v. Murray*, 206 N.W.2d 96 (Iowa 1973).

²⁰ Section 9-306(1) defines proceeds as "whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds."

²¹ The discrete lien approach stemmed from the commercial loan theory of banking, popular before the 1930's, that all loans must be self-liquidating. The modern banking doctrine, developed in the 1940's and 1950's, of measuring a bank's liquidity in terms of all loans, not just discrete loans, permits commercial lenders to justify the revolving loan so indispensable to inventory finance. See generally L. RITTER & W. SILBER, *PRINCIPLES OF MONEY, BANKING, AND FINANCIAL MARKETS* 102-03 (2d ed. 1977).

ordinary course by imposing the open-market rule by operation of law. That section provides that a buyer in ordinary course of business other than a person buying farm products from a farmer "takes free of a security interest created by his seller even though the security interest is perfected" By carving out the exception for farm sales, the Code exempts those sales from the open-market rule of section 9-307(1). Significantly, however, the Code does not exempt them from the practical open-market effect of section 9-306(2), which operates only in the event the secured party authorizes the sale in the security agreement "or otherwise."

Most farm lenders do not authorize such sales in the security agreement, and most courts, though not all, have read the "or otherwise" language of section 9-306(2) narrowly. Accordingly, the effect of the farm products exception is to impose a strict security of property rule and to refuse the benefit of open-market precepts to sales comprising a significant measure of commercial activity—agricultural sales.

In brief, local filing is not the only impetus for the separate classification of "farm products." That impetus also derives from a far more significant policy choice favoring security of title over commercial celerity. Since the law of sales as manifested in the "buyer in ordinary course" rules has traditionally struck this balance on the side of commercial celerity, it is necessary to examine the history of, and evaluate the rationale for, this departure in sales involving farm products.

UNIQUE FEATURES OF AGRICULTURAL LENDING

The history of agricultural financing parallels that of the commercial sector with three notable exceptions. First, the mechanization of agriculture tended to occur later than that of other industries.²² While requirements for credit are no less pressing in agricultural enterprises than in other businesses,²³ these requirements did not develop contemporane-

²² Commentators seem to agree that it has been only in the last 40 or 50 years that the agricultural industry has demonstrated a marked need for other than real estate financing. See Bunn, *Financing Farmers: Existing Kansas Law and the Uniform Commercial Code*, 2 KAN. L. REV. 225 (1954); Bunn, *Financing Farmers: Existing Wisconsin Law, The Green Giant Case and the Uniform Commercial Code*, 1954 WIS. L. REV. 357; Hawkland, *The Proposed Amendment to Article 9 of the U.C.C.—Part I: Financing the Farmer*, 76 COM. L.J. 416 (1971). See generally A. NELSON, W. LEE, & W. MURRAY, *AGRICULTURAL FINANCE* 308-11 (6th ed. 1973).

²³ Statistics indicate that credit requirements are real indeed and are increasing at a rapid rate. One authority estimates that in a ten-year period capital requirements for the "typical" cash grain farm in the corn belt increased from \$97,000 to \$203,000 and for the "typical" southwest cattle ranch from \$141,000 to \$205,000. See *Hearings on the Effect of Corporate Farming on Small Business Before the Subcomm. on Monopoly of the Senate Select Comm. on Small Business*, 90th Cong., 2d Sess. 93 (1968).

ously with those of other businesses.²⁴ More importantly, the primary source of farm collateral prior to and during the initial stages of agricultural mechanization was land, which then was the farmer's single most valuable asset.²⁵ Finally, the nation's romantic preoccupation with the "yeoman farmer"²⁶ fostered a paternalistic attitude on the part of courts and lawmakers toward farmers.²⁷

All three of these exceptions resulted in treatment of agricultural credit needs disparate from that of the rest of the economy. Generally, the factor's lien acts and the Uniform Trusts Receipt Act, both of which were passed to facilitate secured inventory lending in other sectors of the economy,²⁸ did not cover agricultural transactions.²⁹ Rather, agricultural lenders were forced to resort to the chattel mortgage statutes³⁰ with their kinship to the familiar real estate mortgage.³¹

Pre-Code rules of inventory financing reflect these historic differences. Pressure had exerted itself in nonagricultural settings to foster inventory financing which permitted buyers to take free and clear of the lender's encumbrance.³² Pre-Code buyers from farmers, however, did not enjoy that protection, because the chattel mortgage statutes did not extend it.³³ Buyers of farm commodities from persons other than farmers, how-

²⁴ The technological revolution in agriculture began in earnest when in 1917 the use of the horse reached its zenith. See generally E. HIGBEE, *FARM AND FARMERS IN AN URBAN AGE* 7-44 (1963); Brake, *A Perspective On Federal Involvement In Agricultural Credit Programs*, 19 S.D.L. REV. 567 (1974); Doll, *Farm Debt as Related to Value of Sales*, 49 Fed. Res. Bull. 140 (1963); Leavitt, *A Bank Examiner Looks at Agricultural Lending*, 49 Fed. Res. Bull. 922 (1963).

²⁵ Real estate, of course, continues to serve as collateral for farm loans, but its predominance as that type of collateral has diminished. See Brake, *supra* note 24, at 589, 591-92.

²⁶ See generally R. HOFSTADTER, *THE AGE OF REFORM*, ch. 1 (1955).

²⁷ For example, until 1972, the Uniform Commercial Code, out of fear that a farmer could become a "peon" if he were able to encumber his crops for years to come, would not permit a farmer to mortgage future crops. See Hawkland, *supra* note 22, at 421. See also § 9-204(4)(a) (1962 version); § 9-312(2).

²⁸ Factor's lien acts were adopted by a majority of states and grew primarily out of the textile industry but were utilized in other industries as well. See generally Skilton, *The Factor's Lien on Merchandise—Part I*, 1955 WIS. L. REV. 356. Trust receipts, on the other hand, were originally a common law device and were later broadened by the Uniform Trust Receipts Act. See generally 1 G. GILMORE, *SECURITY INTERESTS IN PERSONAL PROPERTY*, ch. 4 (1965).

²⁹ Professor Skilton argues that the factor's lien acts might apply depending on the language of the particular act, but he cites no evidence that farm lenders resorted to them. See Skilton, *supra* note 28, at 389.

³⁰ See generally 1 L. JONES, *THE LAW OF CHATTEL MORTGAGES AND CONDITIONAL SALES* §§ 54a & c (6th ed. 1933).

³¹ See generally Gilmore & Axelrod, *Chattel Security: I*, 57 YALE L. J. 517, 529 (1948).

³² See generally Skilton, *supra* note 28, at 363.

³³ It was the general rule of chattel mortgage law that a sale by the mortgagor does not defeat the interest of the mortgagee in the property. See *Hathaway v. Brayman*, 42 N.Y. 322 (1870); *contra*, Uniform Conditional Sales Act § 9; Uniform Trust Receipts Act § 9(2). There

ever, frequently did enjoy that protection. Under the early factor's acts,³⁴ for example, those who purchased farm commodities from a factor defeated the rights of a true owner if the owner had authorized the factor to sell or had entrusted the factor with a document of title.³⁵ It mattered not, however, whether the seller had limited the factor's authority. If the factor could sell, the true owner's conditions or limitations did not prevent the good faith purchaser from taking free of these conditions.³⁶ The Supreme Court held, furthermore, that the Uniform Warehouse Receipts Act yielded a similar result if the true owner entrusted a warehouse receipt to an agent.³⁷ These rules applied against not only the true owner but also against his creditors.³⁸ Thus, pre-Code rules favored security of property if the farmer marketed his goods himself, but favored commercial celerity if he marketed them by using documents of title or through a factor with authority to sell.

The drafting of the Code provided an appropriate occasion to re-examine these differences. Although these disparate rules seem to result from the historic forces that fashioned them and not from any conscious policy election, the Code accepted them almost intact.

CRITICISM OF THE RULE

Not surprisingly, commentators, who have traditionally championed the open market, accept the farm products exception with reluctance. While some of these commentators acknowledge the initial premise that farm financing is *sui generis*,³⁹ they are unable to articulate persuasive reasons for the separate classification, and they generally disapprove of the farm products exception.⁴⁰ Although various criticisms have been

were exceptions, however, for cases of implied authority to sell, including sales by "traders" in the ordinary course of business. 2 L. JONES, *supra* note 30, §§ 457a-458.

³⁴ The early factor's acts related to sales by factors of goods that were entrusted to them by the true owner. See 6 Geo. 4, ch. 94 (1825). These acts differed from the more recent factor's lien acts which related to factors who acted as inventory lenders. See N.Y. PERS. PROP. LAW § 45 (McKinney) (repealed 1964).

³⁵ See, e.g., N.Y. PERS. PROP. LAW § 43 (McKinney) (repealed 1964).

³⁶ See *Gazzola v. Kimball*, 156 Tenn. 229, 299 S.W. 1039 (1927).

³⁷ *Commercial Nat'l Bank v. Canal-Louisiana Bank & Trust Co.*, 239 U.S. 520 (1916).

³⁸ *Id.*

³⁹ "Buyers of farm products are presumed to be professionals, and as such they are likely to know that security interests in what they buy are common." Coogan, *Public Notice Under the Uniform Commercial Code and Other Recent Chattel Security Laws, Including "Notice Filing,"* 47 IOWA L. REV. 289, 302 (1962). See Hawkland, *supra* note 22, at 418; Hunt & Coates, *The Impact of the Secured Transactions Article on Commercial Practices with Respect to Agricultural Financing*, 16 LAW & CONTEMP. PROB. 165, 170-71 (1951).

⁴⁰ Professor Skilton, in discussing the official comment to § 9-307(1), expresses dismay that the comment offers little comfort "[t]o one who sees little or no justification in the first place" for the farm products exclusion. Skilton, *Some Comments on the Comments to the Uniform Commercial Code*, 1966 WIS. L. REV. 597, 625. See also Coates, *Financing the Farmer*, 20 PRAC. LAW. 45 (1974); Dugan, *Buyer-Secured Party Conflicts Under Section 9-*

forwarded against the farm products exception, two persuasively argue against this exception. The first concerns the unfairness and economic impact of holding that sales are subject to the inventory lender's security interest. The second stems from the fact that a party granted a purchase money security interest in after-acquired inventory need not give notice to the prior farm inventory lender.

Surprise and the "His Seller" Trap

The first criticism of the farm products exception usually centers on the unfairness that attends the fact that purchasers of farm products from farmers are often unaware that the vegetables they buy at the roadside stand are encumbered.⁴¹ Critics are especially concerned about the application of the section to subsequent purchasers after the initial inventory sale by the farmer. The buyer-in-ordinary-course doctrine, under the language of section 9-307, applies only to security interests "created by his seller";⁴² that is, the security interest is discharged only if it was one created by the person selling to the buyer in ordinary course. Therefore, the subsequent purchaser takes subject to the security interest created by the farmer, since the farmer is not "his seller." For example, if a farmer grants a security interest in his grain to a production credit association and then sells the grain to an elevator which, in turn, sells it to a broker, neither the elevator nor the broker take free of the association's security interest. The elevator, while it may fit the definition of a buyer in ordinary course, cannot avail itself of the buyer-in-ordinary-course rule of section 9-307(1), because it buys from a person engaged in farming operations. The broker also cannot avail himself of the section because, even though he may rise to the status of a buyer in ordinary course, he only takes free of security interests created by his seller: the elevator. The farmer created the security interest in question, and the broker, therefore, takes subject to it. Accordingly, commentators speculate in mock horror that a Palm Beach at the haberdasher's,⁴³ a box of cereal at the grocer's,⁴⁴ and a sizzling ribeye on the platter⁴⁵ may be subject to the lien of a farmer's lender.⁴⁶

307(1) of the Uniform Commercial Code, 46 U. COLO. L. REV. 333 (1975); Hawkland, note 22 *supra*.

⁴¹ The simile is Professor Henson's. R. HENSON, HANDBOOK ON SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE 86 (1973). See also Coogan, *supra* note 39, at 301.

⁴² Section 9-307(1) (emphasis supplied).

⁴³ See § 9-315. If goods, such as cotton, become part of a product, such as cloth, a perfected security interest in the cotton continues in the cloth. The rule applies to "cases where flour, sugar and eggs are commingled into cake mix . . ." Section 9-315, Comment 3.

⁴⁴ Coates, *supra* note 40, at 49.

⁴⁵ Garden City Prod. Credit Ass'n v. Lannan, 186 Neb. 668, 677, 186 N.W.2d 99, 104 (1971) (Newton, J., dissenting).

⁴⁶ "Security interests in farm products survive, regardless of perfection, well into the consumer's digestive tract." Dugan, *supra* note 40, at 362. *But cf.* First Nat'l Bank v.

The criticism implicit in these examples loses most of its bite, however, in light of the practical obstacles confronting the lender who chooses to pursue distant collateral.⁴⁷ Needless to say, a wheat crop financier will derive little economic benefit from chasing his debtor's wheat in grocery stores or kitchen cupboards. The criticism gains respectability, on the other hand, in situations where a slaughterhouse, grain elevator, cotton gin, or broker buys the farmer's products. In these instances the farm financier enjoys targets far less elusive and diffuse than products held by grocers and consumers. In fact, the cases indicate that financiers are not reluctant to sue such defendants as brokers and slaughterhouses on conversion theories.⁴⁸

The basis of the objection, then, is sound. Because of the "his seller" requisite of the buyer-in-ordinary-course rule, farm lenders can follow the collateral to purchasers who do not buy from the farmer. On the other hand, in the nonfarm situation, because the original buyer in ordinary course from a nonfarmer takes free and clear of the security interest, the buyer may pass the goods on to his buyers free of any such encumbrance.⁴⁹ Gauging the fairness of these differences depends in part on whether the purchaser losing the protection is a slaughterhouse or grain elevator rather than a consumer motoring through the countryside on a fine summer evening, and the justification for accepting or rejecting this criticism may well turn upon the way one perceives the farm purchaser.⁵⁰

Boston, — Colo. App. —, 564 P.2d 964 (1977) (security interest in crops does not extend to cattle that ate them).

⁴⁷ These comments apply only in the context of agricultural sales. For a discussion of the "his seller" feature in other contexts, see Knapp, *Protecting the Buyer of Previously Encumbered Goods: Another Plea for Revision of UCC Section 9-307(1)*, 15 ARIZ. L. REV. 861 (1973).

⁴⁸ See, e.g., *United States v. Topeka Livestock Auction, Inc.*, 392 F. Supp. 944 (N.D. Ind. 1975); *United States v. E.W. Savage & Son, Inc.*, 343 F. Supp. 123 (D.S.D. 1972), *aff'd*, 475 F.2d 305 (8th Cir. 1973); *United States v. Hughes*, 340 F. Supp. 539 (N.D. Miss. 1972); *Farmers State Bank v. Stewart*, 454 S.W.2d 908 (Mo. 1970); *Farmers State Bank v. Edison Non-Stock Coop. Ass'n*, 190 Neb. 789, 212 N.W.2d 625 (1973). Some of the conversion cases, by explaining marketing practices, demonstrate the full implication and adverse impact of imposing conversion liability on defendant brokers and slaughterhouses. For this reason some courts are reluctant to invoke a conversion rule. See, e.g., *United States v. Hext*, 444 F.2d 804 (5th Cir. 1971).

⁴⁹ See § 9-307(1). That is not to say, however, that the "his seller" feature poses no problems outside the realm of agricultural commodities. It does, as Professor Knapp explains. See Knapp, note 47 *supra*.

⁵⁰ Whether it should so turn is another matter. "Perhaps a small country bank holding a small country mortgage makes a more appealing plaintiff than a national finance company doing a multi-million dollar business in inventory financing—but in fact these days the mortgagee is apt to be one of the many agencies of the United States which dabble in the farm credit business." 2 G. GILMORE, *SECURITY INTERESTS IN PERSONAL PROPERTY* § 26.10, at 707 (1965). In one case it was not a buyer but a buyer's bank with a security interest in

Regardless of the fairness or unfairness of this subordination of the interests of subsequent purchasers of farm products, the farm products exception is subject to criticism on the basis of economic consequences. In theory many buyers of farm products are well aware of the exception and either go to the expense of a filing search or buy at their peril. As a result, such buyers must determine either the cost of the search or of the risk. The buyer then has three alternatives for accommodating these costs: he may increase the price to his customers, decrease the offering price to the farm seller, or accept the costs himself. Whatever alternative he selects, agricultural commerce ultimately bears the costs and the corresponding consequences in both domestic and international markets.

The Purchase Money Priority Problem

Even without the "unfair surprise" problem, the farm products rule confronts a second and more subtle criticism arising out of the inventory priority rules. Article 9 provides that a purchase-money secured party's rights to inventory will not take priority over a person having an earlier perfected security interest in the same inventory unless the purchase-money party gives notice.⁵¹ Thus, for example, if a debtor grants a bank a floating security interest in inventory, that is, a security interest in all of its inventory whether then owned or thereafter acquired, and if the debtor subsequently grants a security interest to a supplier whose credit permits the debtor to acquire additional inventory, the supplier can defeat the bank only if it gives notice to the bank of the purchase money transaction.⁵² The notice requirement protects the revolving inventory financier by virtue of the fact that it prevents the dilution of the collateral without his knowledge.⁵³ At the same time, it grants priority to a creditor who merits it: a creditor who provided the financial resources to purchase the after-acquired property. In short, the rule provides flexibility for inventory financing by facilitating a new source of credit to the debtor and protecting the original lender from surprise.

At the same time, as Professor Hawkland points out,⁵⁴ because farm products are not "inventory,"⁵⁵ financing of farm "inventory" (that is, farm products) does not qualify for such flexible treatment. Since farm products are not "inventory," a purchase-money sale of such goods falls within section 9-312(4), which contains no notice provision—and the

after-acquired property which sustained the loss. *Baker Prod. Credit Ass'n v. Long Creek Meat Co.*, 266 Or. 643, 513 P.2d 1129 (1973).

⁵¹ Section 9-312(3).

⁵² See, e.g., *Redisco, Inc. v. United Thrift Stores, Inc.* (*In re United Thrift Stores, Inc.*), 363 F.2d 11 (3d Cir. 1966).

⁵³ Section 9-312, Comment 3.

⁵⁴ Hawkland, *supra* note 22, at 418.

⁵⁵ See text accompanying notes 8-15 *supra*.

revolving agricultural lender loses the benefit of the notice.⁵⁶ Thus, the lender may unknowingly be put in the position of being unable to satisfy his debt from the farmer and be forced to pursue the inventory collateral in the hands of subsequent purchasers. As we have seen, this inventory may be sufficiently dispersed to make this remedy impractical. This danger may deter the extension of revolving credit to farmers despite the fact that, as several authorities suggest, agricultural businesses need revolving credit⁵⁷ as a result of growing capital requirements. Similarly, because farm products are not inventory, proceeds from their sale elude the revolving lien farm lender, although such proceeds continue as collateral for the revolving inventory financier of other industries.⁵⁸ In short, the farm products exceptions from the inventory definition and from the open market rule, both of which ostensibly protect farmers and farm lenders, create an obstacle to one type of credit farmers need, even though both of these exceptions are ostensibly designed to protect farmers and farm lenders.⁵⁹

Traditional Rationale for the Farm Products Exception

Notwithstanding these criticisms of the exception, courts and commentators advance two arguments in support of the exception. The first of these, that agricultural enterprises will not be able to secure credit without this "favorable" agricultural lending rule,⁶⁰ rings hollow against the arguments set out in the preceding portion of this article. It is difficult to see how a rule which hinders agricultural business, as the farm products exception does, can help the creditors of that business. Presumably, agricultural lenders, whether government-funded or not,⁶¹ are just

⁵⁶ See *United States v. Mid-States Sales Co.*, 336 F. Supp. 1099, 1102 (D. Neb. 1971); *Burlington Nat'l Bank v. Strauss*, 50 Wis. 2d 270, 184 N.W.2d 122 (1971).

⁵⁷ See, e.g., Bunn, note 22 *supra*; Clark, *Some Problems in Agricultural Lending Under the UCC*, 39 U. COLO. L. REV. 352 (1967); Hunt & Coates, *supra* note 39, at 180.

⁵⁸ This distinction is evident in the language of § 9-312(3) which limits the purchase money inventory priority to "identifiable cash proceeds received on or before delivery of the inventory" to the debtor's buyer. Section 9-312(4) extends the purchase money priority to all proceeds. Thus, § 9-312(3) tends to protect revolving "inventory" lenders' claims to proceeds. Because the intermediate revolving farm lender is not an "inventory" lender, he loses that additional protection. See § 9-312, Comment 3.

⁵⁹ This discussion does not necessarily apply in jurisdictions which have not adopted the 1972 amendments to article 9. See generally R. HENSON, *supra* note 41, § 6-5, at 137-38.

⁶⁰ While no one appears enthusiastic about this rationale for the rule, those who support the rule usually resort to it. See Note, *Agricultural Financing under the U.C.C.*, 12 ARIZ. L. REV. 391 (1970). Cf. 2 N.Y. LAW REVISION COMM'N, HEARINGS ON THE UNIFORM COMMERCIAL CODE 1285 (1954) (bank lawyer objecting to the general rule of § 9-307(1) on the theory that it imperils the lender's security).

⁶¹ Although the article 9 review committee emphasizes the role of the federal government in agricultural lending, the government is not the only source of such credit. Commercial banks make more than 50% of the total non-real estate loans to farmers. Brake, *supra* note 24, at 592. Sellers of farm equipment and supplies, to the extent that they sell on credit, also comprise a significant, though difficult to measure, component of the overall credit

as interested in promoting the sale of agricultural commodities and healthy prices as their borrowers are. Similarly, it is difficult to understand how intermediate term agricultural lending is enhanced by a rule which deprives it of the notice and proceeds protection the Code affords the rest of the commercial sector.

A second subtle and rarely articulated justification for the farm products rule stems from the idea that most agricultural sales differ fundamentally from most nonagricultural sales. This theory assumes the farm sale paradigm to consist of a small yeoman farmer selling his annual crop to a large, sophisticated grain company. Accordingly, the theory is premised on the belief that the sophisticated farm products purchaser, unlike the less sophisticated buyers of other goods, will be aware of the exception to the free market rule and will therefore take steps to protect himself.

Certainly not all farm transactions fit the model: the dairy industry and some livestock operations are notable exceptions.⁶² Nevertheless, it is reasonable to assume that many, and perhaps most, do fit this model. The farm paradigm survives in part from the nation's historic image of subsistence farming and crafty brokers.⁶³ It may be inconsistent with modern realities of agricultural commerce⁶⁴ to picture all agricultural sales in such fashion, yet it may be consistent with many of those modern realities, and legislatures may design rules based on reasonable presumptions of what the realities of the situations are. It is an acknowledged fact that the drafters of the Code assumed the converse situation of strong sellers and relatively weak buyers as generally the case, and therefore fashioned some of the Code to serve that assumption, even though that assumption is also not always true.⁶⁵ Regardless of the reasonableness of

picture. See generally ECON. RESEARCH SERVICE, U.S. DEP'T OF AGRICULTURE, *AFS-3 Agricultural Finance Statistics* (July 1976). [hereinafter cited as *AFS-3*].

⁶² See generally Comment, *Proposed Anticorporate Farm Legislation*, 1972 WIS. L. REV. 1189, 1194, 1197-98.

⁶³ One court put the image in the following terms:

I pay no compliment to that enterprising and intelligent class of men, the dealers in cotton, when I remark, that from personal observation I am persuaded, they are better judges of the quality and value of cotton, and will sooner detect its imperfections, and its intermixture with foreign materials, than even the grower himself, when they have equal opportunities. The grower has no other standard of quality than his own or his neighbor's crop.

Carnochan v. Gould, 17 S.C.L. (1 Bail.) 179, 182 (1829).

⁶⁴ "While family farms still exist in this country, farms operating on a subsistence basis rather than operating as businesses must now be a small part of the total occupation of farming." PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, REVIEW COMMITTEE FOR ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE, *Preliminary Draft No. 2*, at 15 (1970) [hereinafter cited as *Preliminary Draft No. 2*].

⁶⁵ "[T]he drafting assumes that the seller is the big fellow and the buyer the little fellow." Kripke, *The Principles Underlying the Drafting of the Uniform Commercial Code*, 1962 U. ILL. L.F. 321, 324.

these assumptions, however, the Code's widely adopted local filing option frustrates the purpose of the distinction.

If, in fact, purchasers from agricultural businesses are large and sophisticated business enterprises, it is reasonable to assume that they are or ought to be aware of the farm products rule. The local filing option reduces to futility, however, any effort on their part to discover the existence of a security interest.⁶⁶ A grain transaction illustrates the dilemma.

It is not enough for a Kansas City broker to know that the grain he acquires comes from Texas, Nebraska, or Kansas. He must determine the county where the owner of the grain resides or, if the owner does not reside in the state from which the grain originates, the county where the grain was grown.⁶⁷ Such an inquiry requires that the buyer discover the identity of the producer—an investigation which is complicated by the fact that the buyer may not be dealing with the producer but with the producer's buyer or another intermediate party. Thus, a broker may be dealing with an elevator which has acquired its grain from a number of growers. A broker may be dealing with a cattle-feeding operation, which fattens cattle and acts as selling agent for dozens of investors,⁶⁸ any of which may have granted a security interest in his own cattle. Finally, the "his seller" characteristic confounds the inquiry not only for the first buyer but for each subsequent buyer down the chain of buyers until the goods are sufficiently dispersed to render the secured party's attempts to locate them inefficient. If the buyer decides not to search, he cannot be sure that title is good.⁶⁹

⁶⁶ Professor Dugan goes a step further: "[I]t is fatuous to expect buyers in ordinary course to check the Article 9 filings." Dugan, *supra* note 40, at 344 n.39.

⁶⁷ This example assumes that the local filing rules of the second and third alternatives to subsection (1) of § 9-401 or analogous nonconforming provisions are in force, as indeed they are in all but five jurisdictions. See note 16 *supra*. Those alternative subsections provide that the place to file for farm products is the local filing office in the county of the debtor's residence or, if the debtor is not a resident of the state, then in the county where the goods are kept. When the collateral is growing crops there must be a filing in the county where the land is located.

⁶⁸ See, e.g., *Swift & Co. v. Jamestown Nat'l Bank*, 426 F.2d 1099 (8th Cir. 1970); *In re Charolais Breeding Ranches, Ltd.*, 20 U.C.C. Rep. Serv. 193 (W.D. Wis. 1976). See also *In re Cadwell, Martin Meat Co.*, 10 U.C.C. Rep. Serv. 710 (E.D. Cal. 1970); *Bank of Madison v. Tri-County Livestock Auction Co.*, 123 Ga. App. 768, 182 S.E.2d 687, *rev'd*, 228 Ga. 325, 185 S.E.2d 393 (1971); Clark, note 57 *supra*.

⁶⁹ He can rely, of course, on his cause of action for breach of warranty of title under § 2-312. Any suggestion, however, that this cause of action provides buyers with sufficient protection misunderstands the basic presupposition of the open market rule: a cause of action by itself is insufficient. See generally Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 YALE L.J. 1057 (1954). Several states have anticipated the problem and made provision for central filing of financing statements for livestock. See, e.g., California, Maine, and Oregon versions of § 9-401(1)(c). CAL. COM. CODE § 9401(1)(c) (West Cum. Supp. 1977); ME. REV. STAT. tit. 11, § 9-401(1)(c) (West Cum. Supp. 1976-77); OR. REV.

In sum, the notion that agricultural commodity buyers are sufficiently sophisticated to protect themselves by searching and therefore do not need the protection of an open market rule rests on insecure footing. Practically speaking, such buyers cannot protect themselves, and the consequences are uncertainty and economic loss for the agricultural commodity markets.

THE PERMANENT EDITORIAL BOARD AND THE EXCEPTION: A CRITIQUE
OF THE UNIFORMITY RATIONALE

Early drafts of the Code characterized its farm exception to the open market rule as nothing more than the acceptance of a historic rule.⁷⁰ The 1950 Proposed Final Draft fostered market freedom in all but farm sales, and achieved the exception in much the same fashion as the present Code by excluding "farm products" from the definition of inventory⁷¹ and by limiting market freedom to sales of inventory.⁷² In addition, the 1950 Proposed Final Draft's definition of inventory recognized that the processing of farm products alters the character of those products so that they become the farmer's inventory.⁷³ In short, Code drafters provided early that a farmer can hold and sell inventory, making him subject to both the open market rule and the inventory rules, but only in the infrequent situation where the farmer has processed his farm products.⁷⁴ Subsequent drafts of the Code, while varying the language of the operative sections, maintained and even strengthened this dichotomy between inventory and farm products.⁷⁵

This twenty-year commitment to the farm products exception

STAT. § 79.4010(1) (Oregon Digest 1977). See also MONT. REV. CODES ANN. § 52-319 (Smith Cum. Supp. 1975). In Montana a notice of livestock lien must be listed in the office of state stock inspectors stationed at the several "central livestock markets" for an auctioneer to be liable in conversion.

⁷⁰ See § 9-307, Comment 2 (1950 version). Professor Gilmore described it as an instance of article 9 "bowing before the weight of case law authority." 2 G. GILMORE, *supra* note 50, at 714.

⁷¹ Section 9-109(5) (1950 version).

⁷² Section 9-307(1) (1950 version).

⁷³ "Goods" are farm products, the 1950 version said, only if they are in their "unmanufactured state." Section 9-109(4) (1950 version).

⁷⁴ The present official version lists "ginned cotton, wool-clip, maple syrup, milk and eggs" as being sufficiently "unmanufactured" to fit the farm products definition. Section 9-109(3).

⁷⁵ The 1951 *Proposed Final Draft No. 2* removed all purchases of agricultural goods, whether farm products or inventory, from the open market rule. See §§ 1-201(9), 9-307(1) (1951 version). The official text of 1952, the first of the drafts adopted by the sponsoring agencies, continued this broad exemption of sales by farmers. See §§ 1-201(9), 9-307(1) (1952 version). It was not until the 1957 official version that the Code retrenched from the broad farm exception by limiting it to farm products alone as opposed to farm goods, thereby reinstating processed farm products as inventory. See § 9-307(1) (1957 version). With minor changes, the balance struck in the 1957 Code prevails today. See §§ 9-109(3), 9-307(1).

confronted the review committee appointed by the permanent editorial board to consider changes in article 9.⁷⁶ That committee proposed to treat farm sales as any other business sale. The board, however, rejected the change.⁷⁷

The review committee's recommendation assumed that the farm products exception was rooted in pre-Code rules,⁷⁸ questioned the advisability of retaining it, and noted: "Feelings run strong on this issue"⁷⁹ It suggested that the federal government "insists on the preservation of its security interest on farm products as against buyers or auctioneers"⁸⁰

In short, the committee, even though it supported the change, expressed reluctance based on two assumptions: first, the strength of historic forces and local feeling fosters unwillingness among the states to accept such a change; and second, the federal government would resist such a change. Both of these assumptions entail the danger of lack of uniformity,⁸¹ and they may have prompted the board's ultimate decision not to change the rule. The following discussion of the proffered justifications for the farm products rule includes an analysis of these assumptions. That analysis suggests that the assumption that the federal government would resist the change is incorrect, and that lack of uniformity endures even though the states may be hostile to the change.

Role of the Federal Government

In the early 1930's, the federal government's role in agricultural financing broadened from real estate lending to comprehensive agricultural credit.⁸² Today, crops, livestock, and equipment serve directly or indirectly as collateral for government loans through a complex network of government agencies⁸³ which provide credit for a significant percent-

⁷⁶ See PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, FINAL REPORT at vii-ix (1971) [hereinafter cited as FINAL REPORT].

⁷⁷ See *Preliminary Draft No. 2*, *supra* note 64, at 15-16; FINAL REPORT, *supra* note 76, at 209. The committee suggested the change as an "optional" amendment. *Id.*

⁷⁸ *Preliminary Draft No. 2*, *supra* note 64, at 15.

⁷⁹ FINAL REPORT, *supra* note 76, at 209.

⁸⁰ *Id.*

⁸¹ The Code commands that its provisions be construed liberally and applied to promote its underlying purposes, one of which is "to make uniform the law among the various jurisdictions." Section 1-102(2)(c). The review committee affirmed the importance of uniformity in article 9. "[I]t would be a great mistake to introduce serious nonuniformity into any fundamental aspect of operations under Article 9." *Preliminary Draft No. 2*, *supra* note 64, at 1. See also FINAL REPORT, *supra* note 76, at vii.

⁸² See 2 G. GILMORE, *supra* note 50, § 32.3.

⁸³ The federal government's role in agricultural lending includes both direct loans through the Farmers Home Administration and indirect loans through the farm credit system, which includes federal land bank associations, farm cooperatives, and production credit associations. See generally Brake, note 24 *supra*.

age of all agricultural financing.⁸⁴ In the past, the government has not hesitated to use the attractiveness of its credit as a lever to direct change in state law to make its position more secure.⁸⁵

Commercial lawyers, including those instrumental in drafting the Code, are ever conscious that the Code is peculiarly state law.⁸⁶ Most federal courts hold that federal, not state, law applies to suits in which the federal government is itself a party.⁸⁷ If the assumptions of the editorial review committee are correct that the farm products exception benefits farm lenders (to whom the federal government has made substantial commitments), and that federal courts and Congress fashion federal law to protect federal agencies, then a change in the Code's farm products exception might prompt federal courts or Congress to reject the Code rule. Accordingly, these two assumptions merit examination.

Economic Benefit of Farm Product Exception to Farm Lenders.—The previously discussed economic objections to the farm products rule support the argument that the rule does not benefit agricultural lenders. The whole purpose of the open market concept is to foster sales. Except for the unwary buyer, buyers of farm products from the farming enterprise must either inquire as to the state of the title or take it at their peril. Both the inquiry and risk of clouded title clearly impede the free flow of agricultural commodities and thereby may have a depressing effect on farm prices and sales. This economic impact would not benefit agricultural lenders.

The unwary buyer, of course, will fail to compute that peril into his price. He is the most likely prey of the agricultural lender under the present rule. An argument justifying the exception from such a state of facts is hardly persuasive. No supporter of the exception has mustered the temerity to make it expressly. One wonders, however, whether it is not implicit in much of the pressure of the federal agency lobby.

In brief, it is difficult to bottom the farm exception rule on the plight of the unwary buyer and more difficult to defend the rule's harmful consequences for agriculture itself, which, one would assume, Congress

⁸⁴ The most recent data indicate that the federal government's role in farm real estate debt approximates 36% of the amount loaned and in non-real estate farm debt approximates 41% of the amount loaned. See *AFS-3*, *supra* note 61, Tables 2, 19.

⁸⁵ In order to enjoy the full benefit of the farm credit program, many states modified their crop mortgage statutes in the 1930's. See *Gilmore & Axelrod*, *supra* note 31, at 536.

⁸⁶ Congress has adopted the Code for the District of Columbia. See D.C. CODE § 28:1-101 (1967).

⁸⁷ See, e.g., *Clearfield Trust Co. v. United States*, 318 U.S. 363 (1943); *United States v. Hext*, 444 F.2d 804 (5th Cir. 1971); *Cassidy Comm'n Co. v. United States*, 387 F.2d 875 (10th Cir. 1967); *United States v. Carson*, 372 F.2d 429 (6th Cir. 1967); *United States v. Wegematic Corp.*, 360 F.2d 674 (2d Cir. 1966); *United States v. Sommerville*, 324 F.2d 712 (3d Cir. 1963), *cert. denied*, 376 U.S. 909 (1964); *Cargill, Inc. v. Commodity Credit Corp.*, 275 F.2d 745 (2d Cir. 1960); *United States v. Matthews*, 244 F.2d 626 (9th Cir. 1957).

intended to benefit from the agricultural lending program.⁸⁸ Accordingly, there is little to commend the position that the rule's justification lies in its benefit to agricultural lenders or that Congress should so view it.

Judicial Alteration of Federal Law to Protect Federal Agencies.—

The second assumption which underlies the board's adherence to the farm products exception is the assumption that federal courts fashion rules which are most favorable to federal agencies. The foregoing analysis questioned whether the exception would in fact be beneficial to federal interests. However, even assuming that the exception benefits farm lenders and the federal agencies committed to them, it is questionable that this benefit would motivate federal courts to retain the farm exception rule notwithstanding its elimination from the Code. A close look at the rule of federal cases reveals that uniformity of result is the principal reason for judicial adoption of federal commercial law which differs from state commercial law; and, accordingly, that the uniformity of a Code rejection of the farm products exception would prompt federal adherence to that result regardless of any putative federal benefit of retaining the rule.

The leading case dealing with judicial formulation of federal commercial law different from applicable state law is *Clearfield Trust Co. v. United States*.⁸⁹ In *Clearfield Trust* a check issued by the federal government was cashed with a forged indorsement. The payee was not given notice of the forged indorsement until more than fifteen months later, at which time the federal government instituted suit to recover the amounts paid. Rather than apply state negotiable instruments rules, which require prompt notice, and therefore would have yielded a result adverse to the government, the Supreme Court resorted to the "federal law merchant."⁹⁰ The Court held that delay in notice was a defense only if actual damage to the payee was shown and, in effect, fashioned a rule to accommodate the bureaucratic vastness of the national government.⁹¹

While the factual holding in *Clearfield* supports the board's fear that the federal courts would favor the federal government, the language and rationale of *Clearfield* are far more reassuring: "The application of state law . . . would subject the rights and duties of the United States to exceptional uncertainty. It would lead to great diversity in results by making identical transactions subject to the vagaries of the laws of the several states. The desirability of a uniform rule is plain."⁹² A proper

⁸⁸ See generally Brake, note 24 *supra*. See also 12 U.S.C. § 2001 (1976).

⁸⁹ 318 U.S. 363 (1942).

⁹⁰ *Id.* at 367.

⁹¹ *Id.* at 369-70.

⁹² *Id.* at 367. See also *D'Oench, Duhme & Co. v. F.D.I.C.*, 315 U.S. 447, 472 (1942) (Jackson, J., concurring) ("Federal law is no juridical chameleon changing complexion to match that of each state wherein lawsuits happen to be commenced because of the accidents of service of process and of the application of the venue statutes.").

reading of *Clearfield*, then, reveals two concerns: first, that the government cannot be subject to rules fashioned for private litigants and therefore unrealistic in their application to the government; and second, that the government should not be subject to the vagaries and uncertainties that obtain in the absence of uniformity.

Lower federal court decisions have carefully observed *Clearfield's* uniformity rationale and therefore should dispel the concern that federal courts will accede to a federal insistence on the farm products exception. These decisions have held that the federal court prerogative of choosing federal common law over state law arises in those situations where a "genuine federal interest would be subjected to uncertainty by application of disparate state rules."⁹³ That federal interest prevails especially in instances involving the federal fisc.⁹⁴ This is not to say, however, that federal courts must fashion a rule to favor the government in all instances. "Rather, the thrust of this consideration is that federal rights should not be at the mercy of the power of any particular state court or legislature to change the applicable law."⁹⁵ While a majority of the circuits favor application of the federal rule in farm sale cases,⁹⁶ that majority emphasizes the uniformity rationale of the *Clearfield* line of authority,⁹⁷ and those which eschew the federal rule do so on the grounds that the need for uniformity is not compelling.⁹⁸ In accord with the uniformity rationale, federal courts reflect a ready willingness, furthermore, to incorporate the

⁹³ *United States v. Sommerville*, 324 F.2d 712, 714-15 (3d Cir. 1963), *cert. denied*, 376 U.S. 909 (1964). Significantly, the *Sommerville* court rejected Pennsylvania's Code, which it saw as peculiarly state law, as it largely was in 1963. *See also* *New York, N.H.&H. R. Co. v. Reconstruction Fin. Corp.*, 180 F.2d 241, 244 (2d Cir. 1950): "[S]uch agencies, being national in their scope and aim, shall not be forced to shape their transactions to conform to the varying laws of the places where they occur, or are to be carried out."

⁹⁴ *United States v. Hext*, 444 F.2d 804, 810 n.18 (5th Cir. 1971); *Cassidy Comm'n Co. v. United States*, 387 F.2d 875, 878 (10th Cir. 1967); *United States v. Sommerville*, 324 F.2d 712, 716 (3d Cir. 1963), *cert. denied*, 376 U.S. 909 (1964).

⁹⁵ *United States v. Hext*, 444 F.2d 804 (5th Cir. 1971). Significantly, the *Hext* court, whose opinion reflects strong support for a uniform federal rule, held against the Farmers Home Administration.

⁹⁶ *Compare* *United States v. Hext*, 444 F.2d 804 (5th Cir. 1971); *Duvall-Wheeler Livestock Barn v. United States*, 415 F.2d 226 (5th Cir. 1969); *Cassidy Comm'n Co. v. United States*, 387 F.2d 875 (10th Cir. 1967); *United States v. Carson*, 372 F.2d 429 (6th Cir. 1967); *United States v. Sommerville*, 324 F.2d 712 (3d Cir. 1963), *cert. denied*, 376 U.S. 909 (1964); *United States v. Hughes*, 340 F. Supp. 539 (N.D. Miss. 1972), *with* *United States v. Union Livestock Sales Co.*, 298 F.2d 755 (4th Cir. 1962); *United States v. Kramel*, 234 F.2d 577 (8th Cir. 1956).

⁹⁷ *United States v. Sommerville*, 324 F.2d 712, 715 n.8 (3d Cir. 1963), *cert. denied*, 376 U.S. 909 (1964) ("The necessity of uniformity must decide whether state law should be rejected as the source for the applicable federal rule."). *See* *United States v. Union Livestock Sales Co.*, 298 F.2d 755 (4th Cir. 1962); *United States v. Kramel*, 234 F.2d 577 (8th Cir. 1956); *United States v. Topeka Livestock Auction, Inc.*, 392 F. Supp. 944 (N.D. Ind. 1975).

⁹⁸ *See* *United States v. Kramel*, 234 F.2d 577, 581 (8th Cir. 1956).

provisions of uniform state laws into the federal common law rules. For example, provisions of the Uniform Sales Act⁹⁹ and of the Negotiable Instruments Law¹⁰⁰ found their way into federal common law as have the provisions of article 2.¹⁰¹ Similarly, the federal bench recognizes that the Code is truly "national law"¹⁰² and accepts it enthusiastically as an indication of what general law should be.¹⁰³ One federal opinion refers to article 9 as the "principal fount of general commercial law governing secured transactions."¹⁰⁴

Not surprisingly, the Code's role as a source of federal law stems not only from its reputation as a work of scholarship,¹⁰⁵ but above all from the uniformity it has achieved.

When the states have gone so far in achieving the desirable goal of a uniform law governing commercial transactions, it would be a distinct disservice to insist on a different one for the segment of commerce, important but still small in relation to the total, consisting of transactions with the United States.¹⁰⁶

Accordingly, federal courts carefully avoid peculiarly local variations of the Code and refer instead to the official version.¹⁰⁷ The Second Circuit, which wholeheartedly endorses the Code as a source of federal common law,¹⁰⁸ earlier rejected the Uniform Warehouse Receipts Act as a source upon one question, because state courts divided sharply on the meaning of that statute.¹⁰⁹ It is, therefore, in its role as a restatement that the Code serves as the source of the federal law.¹¹⁰

⁹⁹ *Whitin Mach. Works v. United States*, 175 F.2d 504, 509 (1st Cir. 1949).

¹⁰⁰ *New York, N.H.&H. R. Co. v. Reconstruction Fin. Corp.*, 180 F.2d 241, 244-45 (2d Cir. 1950).

¹⁰¹ *Lea Tai Textile Co. v. Manning Fabrics, Inc.*, 411 F. Supp. 1404, 1405 (S.D.N.Y. 1975).

¹⁰² *United States v. First Nat'l Bank*, 470 F.2d 944, 946 n.3 (8th Cir. 1973); *Fruehauf Corp. v. Yale Express Sys., Inc. (In re Yale Express Sys., Inc.)*, 370 F.2d 433, 437 (2d Cir. 1966).

¹⁰³ See *Duvall-Wheeler Livestock Barn v. United States*, 415 F.2d 226 (5th Cir. 1969); *Cassidy Comm'n Co. v. United States*, 387 F.2d 875 (10th Cir. 1967); *United States v. Carson*, 372 F.2d 429 (6th Cir. 1967); *Fruehauf Corp. v. Yale Express Sys., Inc. (In re Yale Express Sys., Inc.)*, 370 F.2d 433 (2d Cir. 1966); *United States v. Wegematic Corp.*, 360 F.2d 674 (2d Cir. 1966). *Cf.*, *Mahon v. Stowers*, 416 U.S. 100 (1974) (per curiam) (the Court concluded that the applicable federal law (Packers and Stockyard Act) did not override the U.C.C. (TEX. BUS. & COM. CODE)).

¹⁰⁴ *United States v. Hext*, 444 F.2d 804, 809-10 (5th Cir. 1971).

¹⁰⁵ Traynor, *Statutes Revolving In Common-Law Orbits*, 17 CATH. U.L. REV. 401, 424 (1968).

¹⁰⁶ *United States v. Wegematic Corp.*, 360 F.2d 674, 676 (2d Cir. 1966).

¹⁰⁷ See *United States v. First Nat'l Bank*, 470 F.2d 944, 946 n.3 (8th Cir. 1973).

¹⁰⁸ See *Fruehauf Corp. v. Yale Express Sys., Inc. (In re Yale Express Sys., Inc.)*, 370 F.2d 433 (2d Cir. 1966); *United States v. Wegematic Corp.*, 360 F.2d 674, 676 (2d Cir. 1966).

¹⁰⁹ *Cargill, Inc. v. Commodity Credit Corp.*, 275 F.2d 745 (2d Cir. 1960).

¹¹⁰ Traynor, *supra* note 105, at 422; *Fairbanks, Morse & Co. v. Consol. Fisheries Co.*, 190 F.2d 817, 822 n.9 (3d Cir. 1951).

Admittedly, nothing in these decisions commands the application of the Code to federal questions. Some courts defer to it in the absence of federal authority,¹¹¹ and one respected jurist recently urged Congress to adopt the Code in order to avoid the “disturbing prospect” of disparity between federal commerce law and the Code.¹¹² Nevertheless, an analysis of the federal cases does not support the eventuality, implicit in the review committee’s concern, that the federal courts will insist upon the farm products exception. The federal agencies which are lobbying for the rule do not make federal common law, and federal courts do not fashion that common law in order to favor those federal agencies. Instead, federal courts fashion law to achieve certainty and uniformity and to effectuate the purpose of federal programs.¹¹³ The excision of the farm products exception from section 9-307(1) would not endanger those objectives, making it likely that the federal courts will follow such an amendment and not retain the old exception.

Actual Disuniformity in Farm Products Cases

The permanent editorial board does not appear to have been any more concerned with rationalizing the farm products exception than were the original drafters of the free market rule when they engrafted the farm products exception onto it. Rather, the concern of both the original drafters and the board in this area was with uniformity. The answer to this concern for uniformity is a historical fact which the board apparently overlooked: state courts and legislatures have already deviated from the exception, so that there is in fact no uniformity. In addition, courts have often done violence to useful principles of commercial law, thereby giving rise to harmful precedent and jeopardizing other achievements of the Code in the area of commercial lending. The remainder of this article will discuss the theories under which courts and legislatures have sought to avoid the effect of the farm products exception.

Waiver.—The 1950 Proposed Final Draft of the Code stipulated in section 9-306 that by taking a security interest in proceeds, an inventory lender gave his debtor authority to sell and waived the lender’s security interest when the sale was effected.¹¹⁴ The rationale for this proposed “rule of construction”¹¹⁵ presumed that the security interest in proceeds reflects a financing arrangement wherein the lender expects the debtor to

¹¹¹ United States v. Humboldt Fir, Inc., 426 F. Supp. 292, 296-97 (N.D. Cal. 1977).

¹¹² Bank of America v. United States, 552 F.2d 302, 303 n.1 (9th Cir. 1977) (opinion of Clark, J.).

¹¹³ United States v. Carson, 372 F.2d 429, 432 (6th Cir. 1967) (“Where a decision is likely to have a substantial effect on the implementation of a federal program, then a federal court should declare a rule consistent with the program’s demands.”).

¹¹⁴ Section 9-306(2) (1950 version).

¹¹⁵ *Id.*, Comment 2(b).

sell the goods and expects the buyer, having given value, to take free and clear. Bank spokesmen criticized what they saw as unrelieved market freedom in this and other purchaser provisions of the 1950 and subsequent drafts.¹¹⁶ Professor Gilmore, one of the chief draftsmen of article 9, defended the notion that the secured party should be satisfied with proceeds.¹¹⁷ The bankers prevailed, however, when the 1957 Official Draft retreated somewhat by excising any reference in the text of the statute to the notion that taking a security interest in proceeds amounts to a waiver and constitutes authorization for sale. The notion survived, however, in the comments,¹¹⁸ and Professor Gilmore maintained his original position.¹¹⁹ It was not until the 1972 revisions that the drafters entirely eliminated from even the comments the idea that the taking of proceeds is an indication of waiver of the security interest on sale.¹²⁰

Nonetheless, section 9-306 stands as strong support for the waiver argument by providing that an authorization to sell the secured collateral destroys the security interest. Such an authorization may be found in the security agreement itself or may arise "otherwise." The term "otherwise" invites courts to construe actions of the creditor as waivers amounting to sale authorization, and the rule of section 1-103, which directs that the law of equity and the principle of estoppel "shall supplement" the provisions of the Code, underscores that invitation. Courts accept the concept of waiver as intrinsic to that section.¹²¹

As this paper noted earlier, in most industries inventory lenders traditionally recognized the need for intermediate term, working capital loans with inventory as collateral, as opposed to discrete inventory loans. They have authorized the sale of inventory without the bother of prior approval. By virtue of such authority, those sales become free of the lender's lien under section 9-306(2). However, in the agriculture industry farm lenders traditionally have refused to grant such authorization in the security agreement.¹²² As this article also suggests, historic features of

¹¹⁶ 2 N.Y. LAW REVISION COMM'N, HEARINGS ON THE UNIFORM COMMERCIAL CODE 1123, 1321-22 (1954).

¹¹⁷ *Id.* at 1184.

¹¹⁸ Section 9-306, Comment 3 (1962 version).

¹¹⁹ 2 G. GILMORE, *supra* note 50, § 26.11.

¹²⁰ In fact, the 1972 drafters were not satisfied with merely deleting the language from the comment. They specifically rejected the notion that the taking of proceeds is any implication of waiver. "The right to proceeds, either under the rules of this section or under specific mention thereof in a security agreement or financing statement does not in itself constitute an authorization of sale." Section 9-306, Comment 3. This change may reflect the fact that the 1972 Code also stipulates, contrary to earlier drafts, that unless the security agreement otherwise provides, the secured party has a security interest in proceeds. Section 9-203(3).

¹²¹ *Multiplastics, Inc. v. Arch Indus., Inc.*, 166 Conn. 280, 348 A.2d 618 (1974). See 1 ANDERSON'S UNIFORM COMMERCIAL CODE § 1-103:51, at 36 (2d ed. 1970).

¹²² Even though farm lenders have not authorized sale in the security agreement itself, these lenders in practice have not insisted on notice by the farm debtor prior to an inventory

agricultural lending, rather than logic, explain that refusal. In any event, coupled with the farm products exception of section 9-307(1) (itself a product of those same historic features), that refusal confronts courts with a formidable obstacle to any open market result. A few courts, however, have proved equal to the task.

The leading case reaching an open market result is *Clovis National Bank v. Thomas*.¹²³ There the lender conducted itself in the fashion often repeated throughout many of these cases and throughout much of agricultural finance. The bank forbade the sale of collateral without its prior written consent. At the same time, true to the reality of intermediate term financing, the bank permitted the borrowing rancher to sell his cattle without that consent. Instead, the bank relied on his honesty to account for the proceeds either by paying the bank or by acquiring new cattle inventory. This "course of conduct," the court ruled, amounted to a waiver of the condition that sale must be consented to in writing. The waiver of the condition left the sale authorized, and, pursuant to the rule of section 9-306(2), such an authorized sale operated to place the collateral in the hands of the purchaser free of the bank's lien.¹²⁴

Some critics promptly attacked the *Clovis* reasoning.¹²⁵ They noted the Code's command that express terms control over course of dealing when the two cannot be construed together reasonably.¹²⁶ Since the course of dealing in *Clovis* suggests no requirement for written authority

sale. In *Colorado Bank & Trust Co. v. Western Slope Inv., Inc.*, 36 Colo. App. 149, 539 P.2d 501 (1975), the security agreement forbade sales without the written consent of the bank. The bank's loan officer testified that he never required his borrowers to obtain that consent. He said that he relied on their honesty alone. See generally *Hawkland*, *supra* note 22, at 419; *Hunt & Coates*, *supra* note 39, at 170-71. Other cases indicate that with marked consistency farm lenders, including government agencies, do not insist on such notice as evidenced through their course of dealing or usage of trade. See, e.g., *United States v. Hext*, 444 F.2d 804 (5th Cir. 1971); *Cassidy Comm'n Co. v. United States*, 387 F.2d 875 (10th Cir. 1967); *United States v. Sommerville*, 324 F.2d 712 (3d Cir. 1963), *cert. denied*, 376 U.S. 909 (1964); *United States v. Central Livestock Ass'n*, 349 F. Supp. 1033 (D.N.D. 1972); *United States v. E.W. Savage & Sons, Inc.*, 343 F. Supp. 123 (D.S.D. 1972), *aff'd*, 475 F.2d 305 (8th Cir. 1973); *United States v. Pirnie*, 339 F. Supp. 702 (D. Neb. 1972), *aff'd per curiam*, 472 F.2d 712 (8th Cir. 1973); *In re Cadwell, Martin Meat Co.*, 10 U.C.C. Rep. Serv. 710 (E.D. Cal. 1970); *Planters Prod. Credit Ass'n v. Bowles*, 256 Ark. 1063, 511 S.W.2d 645 (1974); *Lisbon Bank & Trust Co. v. Murray*, 206 N.W.2d 96 (Iowa 1973); *Farmers State Bank v. Edison Non-Stock Coop. Ass'n*, 190 Neb. 789, 212 N.W.2d 625 (1973); *Garden City Prod. Credit Ass'n v. Lannan*, 186 Neb. 668, 186 N.W.2d 99 (1971); *Clovis Nat'l Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726 (1967); *Blubaugh v. Ponca City Prod. Credit Ass'n*, 9 U.C.C. Rep. Serv. 786 (Okla. Ct. App. 1971); *Burlington Nat'l Bank v. Strauss*, 50 Wis. 2d 270, 184 N.W.2d 122 (1971). See generally §§ 1-205(1) & (2). But see *Fort Collins Prod. Credit Ass'n v. Carroll Dairy*, 553 P.2d 95, 97 (Colo. App. 1976).

¹²³ 77 N.M. 554, 425 P.2d 726 (1967).

¹²⁴ The tension underlying the *Clovis* situation is not new to agricultural commerce. See, e.g., *Patridge v. Minnesota & D. Elev. Co.*, 75 Minn. 496, 78 N.W. 85 (1899).

¹²⁵ See, e.g., 20 BAYLOR L. REV. 136 (1967); 8 NAT. RESOURCES J. 183 (1968).

¹²⁶ Section 1-205(4).

and since the express terms do require it, reasonable construction of the two does not obtain, and the Code's preference for express terms applies.

Professor Dugan¹²⁷ contends that in situations similar to *Clovis* the course of dealing section is inapposite and that the course of performance section controls.¹²⁸ Course of dealing comprises 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"¹²⁹ The term "previous" means "previous to the agreement," according to the comments.¹³⁰ Course of performance involves conduct *after* the agreement.¹³¹ Although in *Clovis* it appears that the conduct was pre-agreement,¹³² certainly many, if not most, cases will involve post-agreement conduct.

In any event, the same problem is posed for the *Clovis* defenders by the course of performance section—it designates express terms controlling when those terms and course of performance cannot reasonably be construed together.¹³³ Professor Dugan argues,¹³⁴ however, that subsection 3 of the course of performance section renders course of performance "relevant to show a waiver or modification" of any term inconsistent with the course of performance.¹³⁵ If this argument is correct, the waiver issue may turn in part on the question whether the conduct occurred before or after the agreement. This position suffers, however, from the fact that the course of performance provision is located in the sales article and by its terms applies only to a "contract for sale." These factors suggest that application of the course of performance provision to a security agreement is inappropriate.¹³⁶

There remains, however, a second criticism of the *Clovis* court's reliance on course of dealing. That criticism stems from the fact that the party benefiting from the course of dealing in *Clovis* was not a party to it, and, so far as the opinion discloses, did not even know about it. The Code

¹²⁷ Dugan, *supra* note 40, at 340-41.

¹²⁸ Section 2-208.

¹²⁹ Section 1-205(1).

¹³⁰ Section 1-205, Comment 2.

¹³¹ Section 1-205, Comment 2; § 2-208(1).

¹³² 77 N.M. at 557-58, 425 P.2d at 727-28. There had been more than one security agreement. The court found that the bank knew of sales without prior written consent under earlier security agreements but had no actual knowledge of sales during the term of the security agreement under which the bank was claiming.

¹³³ Section 2-208(2). See § 1-205(4).

¹³⁴ Dugan, *supra* note 40, at 340-41.

¹³⁵ "[T]he preference is in favor of 'waiver' whenever such construction . . . is needed to preserve the flexible character of commercial contracts and to prevent surprise or other hardship." Section 2-208, comment 3.

¹³⁶ Professor Dugan, however, rejects the notion that the course of performance section applies only to sales contracts. He contends that §§ 9-105(4) and 1-201(3) support extension of the course of performance rule to security agreements. Dugan, *supra* note 40, at 340.

expressly defines course of dealing as dealing "between the parties to a particular transaction."¹³⁷ The reason for this limitation is to respond to the reasonable expectations and reliance of the parties and not of some stranger.¹³⁸ The course of performance section may be given the same construction.¹³⁹ The comments to that section note that the reason for the rule is to "prevent surprise or other hardship."¹⁴⁰ Further support for this construction is found in the fact that the section makes it clear that a course of performance arises out of conduct by one party only when the other party has had an opportunity to object to that conduct.¹⁴¹

The *Clovis* decision, by allowing a third party to take advantage of the course of dealing between other parties, does not use the course of dealing provision in this restricted manner. This broader construction, however, is more correct. It does not matter that the effect of this reasoning is to benefit a stranger to the course of dealing, because section 9-306(2) itself operates to carry the effect beyond the immediate parties to that conduct. If the secured party had authorized the sale expressly, a cattle auctioneer ignorant of that authorization would, nonetheless, escape that liability because section 9-306(2) directs that an authorization to sell renders the sale free of the security interest. By the same token, if the course of dealing between the secured party and the debtor results in an authorization to sell, it does not matter that the auctioneer is a stranger to it. The reason behind the course of dealing section does not justify its extension to strangers, but the reason behind section 9-306(2) does.

In addition, some cases criticize the *Clovis* court's use of the waiver doctrine on the grounds that the bank did not intend to waive its security interest. Traditionally, the argument goes, the doctrine of waiver includes a requirement of knowledge.¹⁴² It is only the *knowing* waiver which the law considers. Courts have rejected waiver arguments based on inadvertent conduct or conduct which the actor does not reasonably know will cost him a contract right.¹⁴³ In *Clovis*, however, the bank must be charged with the knowledge that since it had not insisted upon prior written approval on previous occasions, the court might conclude that such conduct amounted to a waiver of the prior written approval requirement. It is also fair to infer that waiver of the requirement for prior written consent amounts to an authorization to sell.

¹³⁷ Section 1-205(1).

¹³⁸ See *Weidinger Chevrolet, Inc. v. Universal C.I.T. Credit Corp.*, 501 F.2d 459, 463 (8th Cir.), *cert. denied*, 419 U.S. 1033 (1974).

¹³⁹ The term "other" in § 2-208(1) must be taken to mean the other *party*.

¹⁴⁰ Section 2-208, Comment 3.

¹⁴¹ Section 2-208(1).

¹⁴² See *Multiplastics, Inc. v. Arch Indus., Inc.*, 166 Conn. 280, 286, 348 A.2d 618, 621 (1974) ("Waiver is the intentional relinquishment of a known right.").

¹⁴³ See, e.g., *Kane v. American Nat'l Bank*, 21 Ill. App. 3d 1046, 316 N.E.2d 177 (1974).

Courts which eschew *Clovis* nonetheless refuse to accept this reasonable imputation of knowledge of waiver. They reason that while the lender knew it was waiving the *prior consent requirement*, and may reasonably be charged with knowledge it was waiving the prohibition against sale, it did not know it was waiving its *security interest* in the goods.¹⁴⁴

Those cases, however, require too much, because section 9-306(2) renders it unnecessary to show a waiver of the security interest. It is only necessary to show a waiver of the prohibition of sale. Section 9-306(2) does the rest. It provides that an authorization to sell operates as a rule of law to render the sale free of the security interest. There is nothing in section 9-306(2) which suggests that the rule applies only if the secured party intends to waive its security interest. The waiver by the Clovis Bank of the prohibition against sale clearly falls within the "or otherwise" language of the section, thereby terminating the security interest upon the event of the sale. The better reasoned cases so hold.¹⁴⁵

Some anti-*Clovis* courts advance the argument that lenders who waive the prior consent requirement do so on condition that the debtor will remit the proceeds to the lender.¹⁴⁶ That argument ignores the language of section 9-306(2), which charges a sale authorization with the legislative implication that the sale will be free of the security interest. Courts which infer such a condition are allowing the private agreement to frustrate not only the reason but also the letter of section 9-306(2). That provision, an open market rule, is designed to protect purchasers.¹⁴⁷ Permitting the lender and seller to modify it by a condition is as unjustified as permitting an entruster and bailee to modify the rule of section 2-403(2) by private agreement.

¹⁴⁴ Rather, these courts conclude that the secured party's knowledge was limited to the fact that it was waiving only the prior written consent requirement. *See, e.g.*, *United States v. Somerville*, 324 F.2d 712 (3d Cir. 1963), *cert. denied*, 376 U.S. 909 (1964); *Vermilion County Prod. Credit Ass'n v. Izzard*, 111 Ill. App. 2d 190, 249 N.E.2d 352 (1969); *Farmers State Bank v. Edison Non-Stock Coop. Ass'n*, 190 Neb. 789, 212 N.W.2d 625 (1973); *Garden City Prod. Credit Ass'n v. Lannan*, 186 Neb. 668, 186 N.W.2d 99 (1971).

¹⁴⁵ *E.g.*, *Farmers Nat'l Bank v. Ceres Land Co.*, 32 Colo. App. 290, 512 P.2d 1174 (1973); *Draper v. Minneapolis-Moline, Inc.*, 100 Ill. App. 2d 324, 241 N.E.2d 342 (1968); *Tanbro Fabrics Corp. v. Deering Milliken, Inc.*, 39 N.Y.2d 632, 350 N.E.2d 590, 385 N.Y.S.2d 260 (1976); *Credit Plan, Inc. v. Hall*, 9 U.C.C. Rep. Serv. 514 (Okla. Ct. App. 1971).

¹⁴⁶ *See, e.g.*, *United States v. Hughes*, 340 F. Supp. 539 (N.D. Miss. 1972); *United States v. Pirnie*, 339 F. Supp. 702 (D. Neb. 1972), *aff'd per curiam*, 472 F.2d 712 (8th Cir. 1973); *Baker Prod. Credit Ass'n v. Long Creek Meat Co.*, 266 Or. 643, 513 P.2d 1129 (1973). *Cf.* *South Omaha Prod. Credit Ass'n v. Tyson's, Inc.*, 189 Neb. 702, 204 N.W.2d 806 (1973) (express condition, known to buyer, prevents operation of § 9-307(1)).

¹⁴⁷ Section 9-306(2) is both a security of property provision to the extent that it allows the security interest to follow the collateral into the hands of the purchaser and an open market provision to the extent that it excepts from that rule collateral sold pursuant to a sale that is authorized by the security agreement or otherwise. It is in the second sense that the text of this article refers to § 9-306(2) as an open market provision.

In short, there is a colorable argument for invoking waiver in the frequently occurring *Clovis* situations. Although *Clovis* misconstrues the course of dealing provision, an argument for waiver can be made from the course of performance after the agreement—at least such an argument can be made if courts are willing to apply the course of performance provision to secured transactions under article 9. In any event, *Clovis* has spawned a vigorous line of authority.¹⁴⁸ It should be noted, however, that these cases represent the minority rule; a majority of courts have rejected the waiver theory either because *Clovis* misinterprets course of dealing, or, more spuriously, because courts hold the waiver to be conditioned on the prepayment of sale proceeds to the secured party.¹⁴⁹

Estoppel.—In addition to the *Clovis* waiver argument, one district court has adopted an estoppel theory which *Clovis* specifically rejected. In *United States v. Gleaners & Farmers Cooperative Elevator Co.*,¹⁵⁰ the defendant grain elevator purchased crops from a farmer that had obtained financing from the United States Department of Agriculture. When the defendant discovered the financing statement filed by the United States, which apparently contained a general description of the collateral, it asked the chief official of the local Farmers Home Administration (FHA) whether the security interest covered the farmer's crops. The official replied that the security interest covered only livestock and farm machinery, and, as a result, the defendant purchased the crops. The district court held that the government was estopped to bring an action for conversion on the basis of its actual lien on the crops because the grain

¹⁴⁸ See, e.g., *Swift & Co. v. Jamestown Nat'l Bank*, 426 F.2d 1099, 1104 (8th Cir. 1970); *United States v. Central Livestock Ass'n*, 349 F. Supp. 1033 (D.N.D. 1972); *In re Cadwell, Martin Meat Co.*, 10 U.C.C. Rep. Serv. 710 (E.D. Cal. 1970); *Planters Prod. Credit Ass'n v. Bowles*, 256 Ark. 1063, 511 S.W.2d 645 (1974); *Hedrick Savings Bank v. Meyers*, 229 N.W.2d 252 (Iowa 1975); *Lisbon Bank & Trust Co. v. Murray*, 206 N.W.2d 96 (Iowa 1973); *Central Washington Prod. Credit Ass'n v. Baker*, 11 Wash. App. 17, 521 P.2d 226 (1974).

¹⁴⁹ See *United States v. Sommerville*, 324 F.2d 712 (3d Cir. 1963), cert. denied, 376 U.S. 909 (1964); *United States v. Topeka Livestock Auction, Inc.*, 392 F. Supp. 944 (N.D. Ind. 1975); *United States v. E.W. Savage & Sons, Inc.*, 343 F. Supp. 123 (D.S.D. 1972), aff'd, 475 F.2d 305 (8th Cir. 1973); *United States v. Hughes*, 340 F. Supp. 539 (N.D. Miss. 1972); *United States v. Pirnie*, 339 F. Supp. 702 (D. Neb. 1972), aff'd per curiam, 472 F.2d 712 (8th Cir. 1975); *United States v. Big Z Warehouse*, 311 F. Supp. 283 (S.D. Ga. 1970); *United States v. Greenwich Mill & Elevator Co.*, 291 F. Supp. 609 (N.D. Ohio 1968); *Colorado Bank & Trust Co. v. Western Slope Inv., Inc.*, 36 Colo. App. 149, 539 P.2d 501 (1975); *Vermilion County Prod. Credit Ass'n v. Izzard*, 111 Ill. App. 2d 190, 249 N.E.2d 352 (1969); *Farmers State Bank v. Edison Non-Stock Coop. Ass'n*, 190 Neb. 789, 212 N.W.2d 625 (1973); *Garden City Prod. Credit Ass'n v. Lannan*, 186 Neb. 668, 186 N.W.2d 99 (1971); *First Nat'l Bank v. Calvin Pickle Co.*, 11 U.C.C. Rep. Serv. 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. 786 (Okla. Ct. App. 1971).

¹⁵⁰ 314 F. Supp. 1148 (N.D. Ind. 1970). Cf. *Muir v. Jefferson Credit Corp.*, 108 N.J. Super. 586, 262 A.2d 33 (1970) (nonfarm case).

elevator company was reasonably entitled to rely on the representations made by the highest local official of the FHA.¹⁵¹

Estoppel facts, of course, are less likely to arise than are waiver facts, and they probably yield results which are fair and which do not interfere seriously with the availability of farm credit. One difficulty, however, which confronts the estoppel argument is that some courts, unlike the court in *Gleaners*, refuse to apply estoppel against the government.¹⁵² Thus, any significant expansion of the estoppel doctrine would yield a lack of uniformity in the frequent cases where the federal government is the plaintiff. Most courts, however, have rejected estoppel arguments on one theory or another.¹⁵³

Limitations on Parties Subject to Conversion Liability.—In *United States v. Kramel*,¹⁵⁴ the Eighth Circuit applied pre-Code Missouri decisions which held that livestock commission merchants were not liable in conversion for dealing in cattle contrary to the lienholder's rights.¹⁵⁵ The Missouri cases¹⁵⁶ had construed the Federal Packers and Stockyards Act as imposing public utility status on the stockyard along with a duty to provide stockyard services without discrimination. That duty, the Missouri courts felt, relieved the stockyard from conversion liability.

The Missouri Supreme Court's decision to overrule the Missouri precedent on which *Kramel* relies renders *Kramel* suspect.¹⁵⁷ Yet, some states¹⁵⁸ through legislation of their own have effectively neutralized conversion claims against certain classes of defendants and thereby sub-

¹⁵¹ 314 F. Supp. at 1151.

¹⁵² See, e.g., *United States v. E.W. Savage & Sons, Inc.*, 343 F. Supp. 123 (D.S.D. 1972), *aff'd*, 475 F.2d 305 (8th Cir. 1973). Cf. *United States v. Hughes*, 340 F. Supp. 539 (N.D. Miss. 1972) (a waiver case).

¹⁵³ See, e.g., *United States v. Topeka Livestock Auction, Inc.*, 392 F. Supp. 944 (N.D. Ind. 1975); *United States v. E.W. Savage & Sons, Inc.*, 343 F. Supp. 123 (D.S.D. 1972), *aff'd*, 475 F.2d 305 (8th Cir. 1973); *Farmers State Bank v. Edison Non-Stock Coop. Ass'n*, 190 Neb. 789, 212 N.W.2d 625 (1973); *Clovis Nat'l Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726 (1967); *Blubaugh v. Ponca City Prod. Credit Ass'n*, 9 U.C.C. Rep. Serv. 786 (Okla. Ct. App. 1971); *Layng v. Stout*, 155 Wis. 553, 145 N.W. 227 (1914).

¹⁵⁴ 234 F.2d 577 (8th Cir. 1956).

¹⁵⁵ *Accord*, *United States v. Union Livestock Sales Co.*, 298 F.2d 755 (4th Cir. 1962); *United States v. Sommerville*, 211 F. Supp. 843 (W.D. Pa. 1962), *aff'd on other grounds*, 324 F.2d 712 (3d Cir. 1963), *cert. denied*, 376 U.S. 909 (1964); *States Securities Co. v. Norfolk Livestock Sales Co.*, 187 Neb. 446, 191 N.W.2d 614 (1971).

¹⁵⁶ *Cresswell v. Leftridge*, 194 S.W.2d 48 (Mo. App. 1946); *Blackwell v. Laird*, 236 Mo. App. 1217, 163 S.W.2d 91 (1942), *overruled*, *Farmers State Bank v. Stewart*, 454 S.W.2d 908 (Mo. 1970).

¹⁵⁷ *Farmers State Bank v. Stewart*, 454 S.W.2d 908 (Mo. 1970).

¹⁵⁸ See, e.g., GA. CODE ANN. § 109A-9-307(3) to (4) (1973); MONT. REV. CODES ANN. § 52-319 (1975); NEB. REV. STAT. § 69-109.01 (1968). See also note 169 *infra*; *State Securities Co. v. Norfolk Livestock Sales Co.*, 187 Neb. 446, 191 N.W.2d 614 (1971).

stantially limited the effect of the farm products exception.¹⁵⁹ That exception loses its strength as the creditor loses his target defendants.¹⁶⁰ Accordingly, these statutes, to some degree at least, overcome the effect of the farm products rule, and add to the confusion and lack of uniformity the permanent editorial board feared.

A recent Wisconsin case, moreover, culls from section 9-311 support for a holding of no conversion. In *Production Credit Association of Chippewa Falls v. Equity Coop Livestock Sales Association*,¹⁶¹ the PCA's security agreement was silent on the issue of sales of collateral by the farmer. When the farmer sold through an auctioneer, the PCA sued the auctioneer in conversion. The Wisconsin Supreme Court reasoned that since section 9-311 gives the debtor the right to sell even though such sale may breach the security agreement, that right of the debtor saves the auctioneer from any conversion claim.

The Wisconsin court stretches section 9-311 out of shape. The announced purpose of the provision is to make clear that the debtor retains an interest in the goods (be it "title" or "equity of redemption") and that he *can* alienate that interest voluntarily or by judicial process.¹⁶² To expand the section beyond that limited purpose to support a change in the accepted law of conversion violates the Code's precepts of construction¹⁶³ and contradicts evidence elsewhere indicating that the Code leaves the rules of conversion undisturbed.¹⁶⁴ If the Wisconsin court chooses to alter conversion doctrine, it should not look to the Code for support. The *Chippewa Falls* case demonstrates again the strong resistance of some

¹⁵⁹ These conscious state decisions to depart from the course charted by the Code find a parallel in the Texas experience concerning sales of livestock. *Stowers v. Mahon (In re Samuels & Co.)*, 483 F.2d 557 (5th Cir. 1973), *rev'd per curiam*, 416 U.S. 100 (1974), had originally held, contrary to the clear import of the Code, that an unperfected seller of cattle could defeat the security interest of the stockyard's bank which had acquired a security interest in the cattle under an after-acquired property clause. The Supreme Court, however, reversed and remanded. The same Fifth Circuit panel on remand reasserted its original holding on somewhat different reasoning. *Stowers v. Mahon (In re Samuels & Co.)*, 510 F.2d 139 (5th Cir. 1975). But the Fifth Circuit sitting en banc reversed, adopting the dissenting opinion of Judge Godbold. *Stowers v. Mahon (In re Samuels & Co.)*, 526 F.2d 1238 (5th Cir. 1976). In a vigorous dissent by Judge Ainsworth, joined by four others, the majority of the original panel, however, persisted in its original position. The Texas legislature, moreover, had the last word when it created a cattleman's lien superior to any other Code security interest. *See* TEX. REV. CIV. STAT. ANN. art. 6910(b), §§ 4-7 (West Cum. Supp. 1978). Congress quickly followed suit by amending the Packers & Stockyards Act to achieve the same result. Packers & Stockyards Act, Pub. L. No. 94-410, 90 Stat. 1249 (amending 7 U.S.C. §§ 181-203 (1976)).

¹⁶⁰ Of course, the lienholder can trace the goods and replevy them, but that tracing can become problematical early in the process. *See* text accompanying notes 47-48 *supra*.

¹⁶¹ — Wis. 2d —, 261 N.W.2d 127 (1978).

¹⁶² Section 9-311, Comment 1.

¹⁶³ *See* § 1-102, Comment 1.

¹⁶⁴ *See* § 9-306, Comment 3.

courts to accept the consequences of the farm products exception—a resistance which, as here, may yield holdings that produce variation, not uniformity, in Code law.

Negotiable Documents of Title.—There remains a subtle challenge to the farm products exception with far reaching implications. An actual case illustrates it best. In *United States v. Hext*¹⁶⁵ the farmer delivered his cotton for marketing to a gin, which processed the cotton and warehoused it against negotiable warehouse receipts. The secured party, the government, knew of the delivery to the cotton gin and knew that the gin company was closely related to the warehouse company. When the warehouse sold the cotton, the government sued it on a conversion theory. The Fifth Circuit reversed the district court's judgment for the government, reasoning, in waiver or estoppel fashion, that the secured party's conduct prevented it from disputing the authority of the defendant warehouse.

More significantly, as an alternate theory for its holding, the court relied on section 7-503. That provision restricts the negotiability of documents of title by providing that the documents confer no right in goods against a person (such as the government in the *Hext* case) who had obtained a security interest in the goods prior to the issuance of the document by the bailee. In short, the section operates in the spirit of security of property principles. The provision, however, does not escape open market precepts altogether, for it stipulates that its security of property rule shall not apply if the secured party "acquiesced" in the procurement by the bailor of the document of title, or if the secured party "delivered or entrusted" the goods to the bailee with actual or apparent authority to "ship, store or sell" or otherwise deal with the products in a fashion that article 2 and article 9 would consider as calling for open market principles.¹⁶⁶ Applying this provision, the court held that the government had entrusted the cotton to the farmer with the apparent authority to store the cotton in the warehouse.¹⁶⁷ The court further held that the government had acquiesced in the procurement of warehouse receipts since it knew that it was the custom of the trade to market cotton in that manner and took no steps to prevent it.¹⁶⁸

The *Hext* opinion is significant for three reasons. First, the secured party in *Hext* was the Farmers Home Administration. Thus if *Hext* were to arise today in a state limiting the liability of commodity merchants, a court applying federal law would follow rules far different from those commanded by the state statute.¹⁶⁹ *Hext*, then, demonstrates how the

¹⁶⁵ 444 F.2d 804 (5th Cir. 1971).

¹⁶⁶ Section 7-503(1)(a)-(b).

¹⁶⁷ *United States v. Hext*, 444 F.2d 804, 814-15 n.34 (5th Cir. 1971).

¹⁶⁸ *Id.*

¹⁶⁹ As the *Hext* opinion noted, the Texas legislature modified the rule of conversion liability of cotton brokers in apparent response to the district court's decision against the

federal law–state law dichotomy can contribute to a lack of uniformity.

Second, because the defendant was a warehouseman, rather than an auctioneer, the court could have relied on section 7-404. That section provides that a warehouseman is not liable in conversion if he observes reasonable commercial standards and in good faith delivers the goods to the holder of negotiable receipts.¹⁷⁰ That specific provision of article 7, of course, contrasts sharply with the rule of liability which generally faces auctioneers and brokers under the Code and under the common law of conversion in most states. Section 7-404 parallels the state statutes, mentioned earlier, that limit conversion liability; it has the same effect of contributing to the diversity of result in these cases.

The *Hext* decision also furthers disuniformity in a much more fundamental and significant way. The “acquiesced” and “entrusted” language of section 7-503, taken with the reference in it to section 2-403, signals an invitation to use waiver and estoppel principles to achieve open market results. Professor Gilmore concludes that any time a lender leaves with the debtor goods which are inventory in nature, such as farm commodities, the lender has entrusted these goods for the purposes of section 7-503.¹⁷¹ Similarly, if a lender leaves farm goods with a farmer in an area or industry where farmers traditionally warehouse products, and the lender takes no steps to prevent this practice, then for purposes of section 7-503(1)(b) the lender will have acquiesced in the procurement of documents of title. Whether a secured party otherwise “delivered” or “entrusted” with apparent authority, or whether the secured party “acquiesced” in the procurement of the warehouse receipt, are factual issues similar to issues such as “negligence” or “reasonableness.” Such concepts lend themselves to characterization and are appropriately resolved by trial; they do not fix parameters or lead to uniformity. To the contrary, their vagueness fosters diversity. This disuniformity feature is likely to be substantial. A significant number of agricultural businesses effect the sale of farm products through negotiable warehouse receipts, and, to the extent that they do, courts may be able to reach results different from those that would obtain under the farm products exception.

CONCLUSION

Out of a desire for uniformity and a need to come to terms with strong local feelings, the Code perpetuates a historic rule excluding many

cotton broker. 444 F.2d at 809. *See* TEX. REV. CIV. STAT. ANN. art. 5571 (West Cum. Supp. 1978).

¹⁷⁰ In fact, the *Hext* court did refer to § 7-404 with respect to the warehouse defendant. 444 F.2d at 814-15 n.34. *Cf.* §§ 8-318, 3-419(3) (which attempt to create similar conversion immunity for agents dealing in investment securities and depository banks, respectively).

¹⁷¹ 2 G. GILMORE, *supra* note 50, § 25.4, at 666. The pre-Code cases, using waiver and estoppel theories, support Professor Gilmore. *See, e.g.,* *Commodity Credit Corp. v. Usrey*, 199 Ark. 406, 133 S.W.2d 887 (1939).

farm sales from open market principles. The exclusion stems first from the origins of agricultural finance, which developed under conditions different from that of other commercial finance; second, from archaic notions of agricultural commerce; and third, from the perception that agricultural sales are sufficiently different from other sales to merit different treatment.

The unique history of agricultural finance goes far in explaining the farm products exception. Agricultural lenders, enjoying protection from the open market, are reluctant to relinquish what they see as their preferred status. The nation's romance with the sturdy, yeoman farmer dies slowly, and even though thoughtful economists agree that agricultural credit needs parallel those of the rest of the economy, the myth persists, thereby impeding entry of agricultural commerce into the open market. The argument that agricultural sales may be unique in that most farm sellers are small and most farm buyers big, falls before the impossible search burdens imposed by the local filing rule and the "his seller" feature of section 9-307(1).

While some may argue that the rule is necessary as a course to achieve uniformity in the face of the insistence of the federal government and many state legislatures, close analysis renders the validity of the argument suspect. There is little in the federal cases to justify the charge that federal courts ignore good sense to fashion law favorable to government agencies. In fact, the cases support the contrary view. On the other hand, the insistence of state legislatures is very real, but no more real than the insistence of other state legislatures and state courts to the contrary.

The attempt to effect uniformity through the farm products exception has not succeeded. It is abundantly clear that in the face of results which strike courts and legislatures as unfair, the farm products rule falls. Furthermore, the Code itself through the "or otherwise" language of section 9-306(2), and the documents of title rules of sections 7-503 and 7-404, provides ample inroads against the rule for the imaginative and resourceful lawyer or judge, thereby further increasing disuniformity. What is more, the farm products exception has resulted in a strong line of cases which seriously misconstrue the Code's course of dealing provision and other Code sections.

The farm products exception has bred sprawling diversity through legislation, common law exceptions, and provisions within the Code itself. The review committee's recommendation that the exception be optional or be deleted altogether was a realistic alternative which, while not achieving the unobtainable uniformity, would have gone far in avoiding the baleful consequences the rule has fostered. In brief, such change would remove unnecessary fetters on farm financing and would permit commerce in agricultural commodities to assume its place in the open market.