

The “Buyer in Ordinary Course of Business” as to Farm Products

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The “buyer in ordinary course of business” (“BOCB”) concept is critical to understanding of the rights of both purchasers of farm products and secured creditors with perfected interests in farm products under the Uniform Commercial Code (“UCC”). Prior to enactment of the Food Security Act of 1985 (“FSA”), the law was highly protective of secured parties over BOCB. Under the old rule, a BOCB from a seller engaged in farming operations did *not* take free of a perfected security interest without consent from the secured party. Purchasers of farm products—such as grain elevators—were assumed to be sophisticated enough to check for filed financing agreements prior to purchase. This was difficult for some purchasers,ⁱ and, since a secured creditor could maintain actions against both the seller and the BOCB, sometimes a BOCB paid twice for the same farm products.

Under the FSA, a BOCB takes free of a security interest in farm products purchased from a seller engaged in farming *unless*—as discussed herein—the secured creditor takes certain additional measures. The FSA gave individual states the option to either (1) adopt a central filing system or (2) follow an actual notice rule. Idaho opted to adopt a central filing system.

Since the enactment of the FSA,ⁱⁱ Idaho’s UCC provisions regarding perfection of a security interest in (a) farm products; and (b) any other collateral, have been split into two distinct parts, both of which require filing of different UCC-1 financing statements with the Idaho secretary of state. One system is called the UCC-1F system and is related solely to perfection of a security interest in farm products; the other system is called the UCC-1B system and is related solely to perfection of security agreements other than farm commodities.

Farm products and a farming operation are defined by Idaho Code Section 28-9-102(34 and 35):

Idaho Code Section 28-1-102(34). GENERAL DEFINITIONS.

(34) "Farm products" means goods, other than standing timber, with respect to which the debtor is engaged in a farming operation and which are:

(A) crops grown, growing, or to be grown, including:

(i) crops produced on trees, vines and bushes; and

(ii) aquatic goods produced in aquacultural operations;

(B) livestock, born or unborn, including aquatic goods produced in aquacultural operations;

(C) supplies used or produced in a farming operation; or

(D) products of crops or livestock in their unmanufactured states.

(35) "Farming operation" means raising, cultivating, propagating, fattening, grazing, or any other farming, livestock, or aquacultural operation.

Idaho Code Section 28-1-201 (9) defines buyer in ordinary course of business as follows:

Idaho Code Section 28-1-201(9). GENERAL DEFINITIONS.

(a) Unless the context otherwise requires, words or phrases defined in this section, or in the additional definitions contained in other chapters of the uniform commercial code that apply -----

(b) Subject to definitions contained in other articles of the uniform commercial code that apply to particular articles or parts thereof:

(9) "Buyer in ordinary course of business" means a person that buys goods [a] in good faith, [b]without knowledge that the sale violates the rights of another person in the goods, and [c] in the ordinary course from [d] a person, other than a pawnbroker, [5] in the business of selling goods of that kind. A person buys goods in the ordinary course if the sale to the person comports with the usual or customary practices in the kind of business in which the seller is engaged or with the seller's own usual or customary practices. . . . A buyer in ordinary course of business may buy for cash, by exchange of other property, or on secured or unsecured credit, and may acquire goods or documents of title under a preexisting contract for sale. . . ."Buyer in ordinary course of business" does not include a person that acquires goods in a transfer in bulk or as security for or in total or partial satisfaction of a money debt.ⁱⁱⁱ

Idaho Code Section 28-9-320(a) states the rule as to buyers in ordinary course of business (emphasis added):

Idaho Code Section 28-9-320. BUYER OF GOODS.

(a) Except as otherwise provided in subsection (e) of this section, a buyer in ordinary course of business, **other than a person buying farm products from a person engaged in farming operations**, takes free of a security interest created by the buyer's seller, even if the security interest is perfected and the buyer knows of its existence. **A buyer who, in the ordinary course of business, buys farm products from a person engaged in farming operations or a commission merchant or selling agent who in the ordinary course of business sells farm products for a person engaged in farming operations shall take and sell free of a security interest created by his seller, even though the security interest is perfected and the buyer or commission merchant or selling agent knows of the existence of such interest, if he has registered with the secretary of state pursuant to section [28-9-523\(h\)](#) and the security interest is not listed on the most recent master list or cumulative supplement distributed by the secretary of state pursuant to section [28-9-523\(i\)](#), unless he has received written notification, as that term is used in applicable federal law and regulation, of the security interest from the secretary of state, his seller or the secured party.**^{iv}

The "applicable federal law and regulations" referenced in the statute refers to the Farm Security Act of 1985 codified at 7 U.S.C. § 1631.

A. The UCC-1B System

An analysis of a buyer in ordinary course of business under the UCC-1B system, related to collateral other than farm products, is relatively simple. For example, if Buyer purchases a new vehicle from Dealer B, and Dealer B's inventory of vehicles is subject to a perfected

security interest in favor of Bank C, and if Buyer otherwise qualifies as a BOCB, Buyer takes the vehicle free and clear of Bank C's security interest. This happens millions of times a day.

B. The UCC-1F System

The concept of a buyer in ordinary course of business under the UCC-1F system (related solely to farm products) is exceedingly more complex. Idaho has established the USDA certified Idaho Central Filing System to implement the requirements of the FSA. *See* IDAPA 34.05.01 (Rules Governing Farm Products Central Filing System).

While the language of this statute can be difficult to ponder, its analysis can be split into discrete parts to simplify the picture. **From the position of a secured lender whose loan is collateralized by farm products, the secured lender must take at least the following steps to assure that its security interest will not be cut off by its farmer's/borrower's sale of the secured lender's farm products collateral.**

First, the secured creditor must take all steps necessary to perfect its security interest in the farm products. This is done through the filing of an appropriate UCC-1F financing statement with the Idaho Secretary of State. This can be easier said than done, since the UCC-1F financing statement requires different and more extensive information (for example, a farm product code for the farm product, and a county code for the Idaho County in which the farm product is located). Failure to assure such compliance can render the lender unsecured.

Second, the secured creditor must comply with Idaho Code Section 28-9-523(h) and (i) as identified in footnote iv below. The secured creditor must take these steps to achieve protection from its farmer/borrower selling the farm product to a third party who is a BOCB. Otherwise the BOCB takes free of the secured creditor's security interest. And a "belt and suspenders" approach is recommended: the secured creditor should both (a) comply fully with Idaho Code Section 28-9-523(h) by including its identifying information on the necessary list; and (c) confirm that the information on the list is correct, by obtaining a report under Idaho Code Section 28-9-523(i).

Third, the consequences of the secured creditor's failure to comply with all of these requirements can be severe. Under that situation the purchaser of the farm products from the farmer/borrower may be considered to be a BOCB, such that the purchaser and any subsequent parties take free and clear of the secured creditor's security interest.

Fourth, the positive consequences to the secured creditor if he fully complies with the UCC cannot be over emphasized. If the secured creditor follows all of the necessary requirements, case law establishes that the secured creditor may have an action against both the farmer/borrower and his purchaser, based upon conversion liability, or Section 28-9-320 liability. So if the farm product disappears through sale or otherwise, the security interest of the secured creditor generally continues in the farm products, and the secured creditor has legal recourse against both the farmer/borrower and his purchaser.

Fifth, the Secretary of State has promulgated rules and regulations regarding the specifics of a UCC-1F filing. Those are identified above, and should be followed closely.

Sixth, most secured lenders who make loans collateralized by farm products, conduct periodic crop or farm product inspections of their collateral. Inspections confirm that "all is well" with the lender's collateral.

Seventh, the secured creditor must be aware that there are certain agricultural liens which, by statute, automatically take precedence over and prime the secured creditor's perfected security interest in farm products. Those "automatic priming agricultural liens" include the seed lien (Idaho Code § 45-304), the farm labor lien (Idaho Code § 45-303), and the farm commodity lien (Idaho Code § 45-1801 *et seq.*). Those statutes should be reviewed.

Conclusion

Compliance with relatively complex UCC provisions is absolutely necessary for a secured creditor to assure itself that its farmer/borrower transfer of farm products to a third party purchaser, does not cut off the secured creditor's security interest, because that purchaser is a buyer in ordinary course of business.

ⁱ For example, meat packers are subject to the Packers and Stockyards Act that requires prompt payment within 24 hours. Since packers often purchase livestock for slaughter from many sellers in multiple states it was impractical for them to check UCC records for filed financing statements in every relevant state. The old rule also presented challenges to purchasers who forward contracted for future delivery of farm products, which had security interests attached *after* the contract was formed. And marketing agencies, such as sale barns, risked liability for conversion for selling livestock subject to perfected security interests without consent from the secured creditor.

ⁱⁱ In very limited situations the FSA, as a federal statute, may actually pre-empt the state law as indicated in the UCC. Instances of this occurring are rare indeed.

ⁱⁱⁱ The UCC concept of a buyer in ordinary course of business is the personal property corollary of a bona fide purchaser under real estate law.

^{iv} Idaho Code Section 28-9-523(h) and (i) state:

Idaho Code Section 28-9-523

(h) The secretary of state shall maintain a list of all buyers of farm products, commission merchants, and selling agents who register with the secretary of state indicating an interest in receiving the lists described in subsection (i) of this section.

(i) The secretary of state shall distribute complete master lists for each farm product category at least quarterly to each buyer, commission merchant and selling agent registered under subsection (h) of this section and distribute either complete lists or cumulative supplements, which supplements shall be issued not less frequently than semimonthly, of financing statements covering farm products filed subsequent to the last date of filing for financing statements on the last preceding quarterly master list, which the buyer, commission merchant or selling agent has requested. The date of receipt for lists and supplements shall be the third calendar day following the date of mailing by the secretary of state, or in the event the mail is not delivered on that day, the first day thereafter on which mail is delivered.