

OFFICIAL OPINION NO. 89-02, Food Security Act of 1985

January 3, 1989

Honorable Joyce Hazeltine
Secretary of State
State Capitol
Pierre, South Dakota 57501

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Dear Secretary Hazeltine:

You have requested my opinion concerning the following factual situation:

FACTS:

The Secretary of State's Office is the designated central filing system under the Food Security Act of 1985 for effective financing statements which describe security interests in farm products. This is a federal system which is intended to make it easier for buyers of farm products to discover whether those products are subject to a security interest, so those buyers can avoid the risk of double payment for the same products. A question has arisen as to whether the federal statute, 7 U.S.C. 1631(d), applies to liens other than security interests in farm products under the Uniform Commercial Code.

Based upon these facts, you have asked the following question:

QUESTION:

Does 7 U.S.C. 1631(d) allow a buyer to purchase farm products covered by statutory liens such as landlord, agister, seed, or threshers' liens free from any lienholder interest or title unless the buyer receives notification in accordance with 7 U.S.C. 1631?

The crux of your question is whether 7 U.S.C. 1631 preempts state law on statutory liens. In my opinion the answer to that question is No.

When Congress enacted the Food Security Act of 1985, it included a provision which was intended to afford protection to purchasers of farm products and to commission merchants and selling agents who sell farm products for others. The problem which Congress sought to address is described at 7 U.S.C. 1631(a):

(1) certain State laws permit a secured lender to enforce liens against a purchaser of farm products even if the purchaser does not know that the sale of the products violates the lender's security interest in the products, lacks any practical method for discovering the existence of the security interest, and has no reasonable means to ensure that the seller uses the sales proceeds to repay the lender;

(2) these laws subject the purchaser of farm products to double payment for the products, once at the time of purchase, and again when the seller fails to repay the lender;

(3) the exposure of purchasers of farm products to double payment inhibits free competition in the market for farm products; and

(4) this exposure constitutes a burden on and an obstruction to interstate commerce in farm products.

The mechanism Congress chose to address that problem is codified at 7 U.S.C. 1631(d):

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

A similar provision was included to protect commission merchants and selling agents dealing with farm products. 7 U.S.C. 1631(g)(1).

At the same time Congress realized that it was necessary to allow secured parties to protect their liens on farm products. Therefore, Congress provided alternate mechanisms by which secured parties could give notice of their liens to buyers and commission merchants and avoid the impact of the new rule; South Dakota opted to form a central filing system where a secured party could file a financing statement in order to perfect its security interest. If the "effective financing statement" is properly filed, buyers and commission merchants then

have constructive notice of the lien, with the burden of checking the Secretary of State's Office regarding whether there are liens covering particular sellers and types of farm products. 7 U.S.C. 1631(e)(2)-(3).

The problem which Congress addressed arose primarily from the "farm products exception" to the Uniform Commercial Code. South Dakota's farm products exception is found at SDCL 57A-9-307(1):

(1) A buyer in ordinary course of business (subsection (9) of 57A-1-201) other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence. (Emphasis added.)

Under this exception, a purchaser of farm products faced a risk of having to pay twice for the same product, once to the seller, and once to the secured party, if the seller did not pay off the lien, or if the secured party had not consented to the disposition. SDCL 57A-9-306(2). The buyer could be forced to do so, even if the buyer did not know a lien existed. See e.g., *Aberdeen Production Credit Association v. Redfield Livestock Auction, Inc.*, 379 N.W.2d 829 (S.D. 1985).

Congress found that risk to be not only inequitable, but also a burden on interstate commerce. "A single Federal rule is needed to restore consistency to this area of the law, and remove that burden." H.R. Rep. No. 99-271, p. 108, 1985 U.S. Code Cong. and Admin. News, p. 1212. Your question seeks to define the impact of 7 U.S.C. 1631(d) and (g)(1) on state law.

There is little question that Congress intended those statutes to preempt SDCL 57A-9-307(1) to the extent of the farm products exception.

The bill is intended to preempt state law (specifically the so-called 'farm products exception' of Uniform Commercial Code section 9-307) to the extent necessary to achieve the goals of this legislation. Thus, this Act would preempt state laws that set as conditions for buyer protection of the type provided by the bill requirements that the buyer check public records, obtain no lien certificates from the farm products sellers, or otherwise seek out the lender and account to that lender for the sale proceeds. By contrast, the bill would not preempt basic state law rules on the creation, perfection or priority of security interests.

1985 U.S. Code Cong. and Admin. News, p. 1214. See also, at 1534. The plain language of the two subsections, viewed in light of the congressional findings (7 U.S.C. 1631(a)) and the legislative history, clearly indicate that the UCC's "farm products exception" was the driving force behind this portion of the Act. Congress did not, however, simply abrogate the exception, i.e., treating farm products like inventory. Instead, Congress mandated a new system to control the various relationships between secured parties and buyers, commission merchants, and selling agents dealing in farm products. The question is whether the system put in place by Congress has application beyond the UCC setting. For that question, there is no clear answer.

The language used in the Act itself contains many of the magic words which have become associated with the UCC. For example, the terms "buyer in the ordinary course of business," "security interest" and "farm products" are ones very familiar to UCC practitioners and the commercial world of agriculture. It is therefore easy to assume that Congress had only the UCC in mind. It is important to note, however, that those terms are defined in the Act, and the definitions are not entirely consistent with UCC definitions under State law. Other UCC terms are also used in the Act without federal definition, i.e., "security agreement," and "perfected."

Looking at the language used in 1631(d), it is certainly logical to argue for broad preemptive effect. The section states its applicability "notwithstanding any other provision of Federal, State or local law." That language is certainly broad enough to encompass state statutory liens such as agister's liens (SDCL 40-27-1); veterinarian liens (SDCL 40-27-13); landlord's liens (SDCL 38-17-1); seed liens (SDCL 38-17-3); threshers' liens (SDCL 38-17-14); or laborers (SDCL 44-11-1). Further, those liens pose a risk to buyers similar in nature to a perfected security interest. At the same time, however, the legislative history seems to indicate that Congress intended to minimally disrupt state law in this area.

Second, 1631(d) provides that a buyer can take free of even a perfected "security interest created by the seller." "Security interest" is defined in the Act at 7 U.S.C. 1631(c)(7) as "an interest in farm products that secures payment or performance of an obligation." As far as it goes, this definition is consistent with our UCC definition found at SDCL 57A-1-201(37). The definition is certainly broad enough to cover the state statutory liens mentioned above. Compare SDCL 44-1-1 which defines liens. The UCC handles that ambiguity by specifically exempting statutory and landlord liens from scope of Article Nine, except for determining lien priority. SDCL 57A-9-102(2); SDCL 57A-9-104(2), (3). The federal Act contains no such

clarifying language, and instead actually clouds the issue. For example, the congressional findings in 1631(a) make reference only to "lenders," "secured lenders," and "the lender's security interest in the products." Statutory lienholders are not commonly thought of as "lenders."

Furthermore, the phrase, "created by the seller" implies a consensual type of arrangement, like a security agreement, bank loan, or other contractual agreement. Such an interpretation is at least consistent with the "lender" language used in the federal act. Statutory liens, on the other hand, are not voluntarily "created" by the seller. "A statutory or other nonconsensual lien is 'incurred' and not 'created' by the debtor." S. Sanford, *The Reborn Farm Products Exception Under the Food Security Act of 1985*, 20 U.C.C.L.J. 3, 17 (1987). See also, Kershen & Hardin, *Congress Takes Exception to the Farm Products Exception of the UCC: Retroactivity and Preemption*, 36 Kan.L.Rev. 1, 45-46 (1987); K. Meyer, *UCC Issues*, 8 J. of Ag. Tax'n & Law 153 (1986).

Because Congress purported not to "preempt basic state law rules on the creation, perfection, or priority of security interests," it is permissible to assume that whether a security interest has been "created by the seller" will be a question of state law. 1985 U.S.Code Cong. and Admin. News, p. 1214. Under South Dakota law, liens are created either (1) by contract or (2) by operation of law. SDCL 44-1-1. The liens you inquire about fall in the second category, and a convincing argument can be made that such liens are not created by the seller. The contrary argument would be that the seller "creates" statutory liens by not paying his bills, or fulfilling his obligations. The state statute, however, seems clearly to indicate a consensual/non-consensual distinction in creating liens.

Further, the language of 1631(d) indicates that it applies "even though the security interest is perfected." Again, "perfection" is a concept most often associated with UCC transactions. Many of the statutory liens, however, provide a system for filing of those liens, usually with the local register of deeds. See e.g., SDCL 38-17-1; 38-17-5; 38-17-15; 40-27-13. While that process is usually not thought of as "perfection," giving public record notice of a lien obviously serves a similar function. See SDCL 44-2-3. Thus while the lien filing process is typically not referred to as "perfection," which has become somewhat a term of UCC art, the similarity of effect is difficult to ignore.

The legislative history of the section reinforces an interpretation that Congress had only the "farm products exception" to the UCC in mind for its preemptive treatment. For example, the statement of Rep. Steve Gunderson attached to House Report No. 99-217 indicates:

A growing problem in the marketing of agricultural products is the increasing inconsistency among states with respect to the so-called 'farm products exception' to the general buyer in the ordinary course rules of the Uniform Commercial Code. This exception permits a lender to seek payment from a purchaser of agricultural commodities for any unpaid security interest in those goods even if the buyer didn't know that the lien existed.

More and more states have come to recognize the restraint this exception places on the free-flow of commerce particularly as 24-hour final payment rules for some commodities have been established. Accordingly, 20 states have now eliminated the farm products exception in favor of various notice or central filing systems. This has, obviously, created a patchwork of rules and regulations across the country.

To restore uniformity to this area of the law, the credit title of H.R. 2100 includes 'clear title' language which my colleague from Texas, Mr. Stenholm, and I introduced earlier in the year in separate legislation (H.R. 1591). This language provides that a buyer of farm products takes those commodities free and clear of any security interest in those goods unless the buyer has received written notice of the lien from the lender together with instructions on how payment of the proceeds from the sale should be handled. Civil penalties are also created for a borrower who fails to apply the proceeds from such sales to his loan.

The adoption of this language will restore equity in the relationship between the buyer and the seller of farm products and the seller's lender. Simply stated, a buyer would not have to pay for the commodities he purchased a second time unless he knew of the lien on those products, had been told to include the lender in any payment for those goods, and failed to follow those instructions.

1985 U.S. Code Cong. & Admin. News, p. 1653-54.

The Committee Report also focuses exclusively on the UCC situation. *Id.* at 1212-1214. See also *id.* at 1529, 1534-35, where the discussion concerns only the effect on the UCC. While Representative De La Garza's statement on the conference report makes no specific references to the UCC, neither are there references to other lien laws. 131 Cong. Rec. H12499, Dec. 18, 1985, U.S. Code Cong. and Admin. News, p. 2544. Indeed, if Congress

had it in mind to affect other state lien laws, it certainly did not discuss that intent anywhere in specific fashion. The thrust of the legislative history is that congressional preemptive intent has aimed solely at the UCC.

It is important to remember, however, that it is a federal statute which is being interpreted, a statute which has yet to be subjected to judicial scrutiny. It is simply not possible to predict whether a court looking at the matter will concur with the foregoing analysis. It would be entirely plausible for a court to conclude that the statutory language is clear and unambiguous, and that the plain language, on its face, preempts statutory liens without the necessity of examining the Act's history. By the same token, a court could conclude that the language is ambiguous, compelling the court to examine the legislative history, and finding there only references to the Uniform Commercial Code, the court could easily conclude that Congress did not intend to impact other state lien laws.

Thus, the cautious statutory lienholder might wish to comply with the federal act until any uncertainty is resolved by court decision or further congressional clarification. Therefore, it is my opinion that the answer to your question is NO, but with the caveat that it might be prudent for a statutory lienholder to comply with the federal act until the language has been subjected to judicial review or clarifying legislation.

Respectfully submitted,

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ATTORNEY GENERAL

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