

What Farmers' Lenders Need to Know About the Food Security Act of 1985

Lenders to farmers should be aware of an additional tool that can be used to protect their security interests in farm products produced by their borrowers. Under state and federal law, a security interest created by a farmer in crops, livestock and other farm products is treated differently than other types of goods and inventory in terms of whether that security interest survives a sale to a buyer.

Generally, security interests in farm products, like other types of goods and inventory, are governed by Article 9 of the Uniform Commercial Code (the UCC). The UCC has been adopted, with some variation, in all 50 states. Section 9-320 of the UCC (Section 9-320) provides that buyers in the ordinary course of business, *other than buyers of farm products from a person engaged in farming operations*, will take the assets purchased free of a security interest created by their seller. The exception in Section 9-320 means that under state law, a lien created by a farmer in farm products will continue in those assets even after they have been sold to a buyer in the ordinary course of business.

Buyers of farm products persuaded Congress, as part of the Food Security Act of 1985 (the Food Security Act), to adopt a statute that imposes additional notice and/or registration requirements on farmers' lenders who wish to preserve their liens after sale of the farm products, which is codified in 7 U.S.C. § 1631. 7 U.S.C. §1631(d) and (e) provide that a buyer of farm products from a seller engaged in farming operations takes free of a security interest in the farm products, even if it knows of the security interest (and even if state law provides to the contrary) so long as it buys in the ordinary course of business, unless:

1. if the applicable state where the farm products are produced does not have a certified system for the registration of such security interests, within one year prior to the purchase the buyer has received notice of the security interest created by the seller; or
2. if the applicable state where the farm products are produced has a certified system for the registration of such security interests, the buyer has not registered with such system and the secured party has filed an effective financing statement with such system; or
3. if the applicable state where the farm products are produced has a certified

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system for the registration of such security interests, the buyer has registered and received notice of an effective financing statement but does not obtain the release of such security interest by the secured party as part of purchasing the farm products.

Therefore, under the Food Security Act, there are two types of states: those that have a certified system for the registration of security interests in farm products ("Clear Title States") and those without a certified system (Direct Notice States). Note that the certified system for registration of these types of farm products liens is a separate system from the regular recordation of UCC financing statements, and must be certified by the Secretary of Agriculture. There are 19 Clear Title States. Wisconsin is a Direct Notice State, but it is important to recognize that unlike the UCC, which provides for the recordation of security interests in a single state where the debtor is "located," under the Food Security Act, the law of the state where the farm products are produced governs this issue. Therefore, if a farmer produces farm products in both Direct Notice States and in Clear Title States, the farmer's lender may have to comply with both types of procedures, depending on which state the applicable farm products were produced.¹

If a farmer's lender wants its security interest to survive a sale of farm products, the steps it will need to take will depend on whether the farm products were produced in a Clear Title State or a Direct Notice State. In Direct Notice States, such as Wisconsin, the lender would need to send notice, on an annual basis, of its lien in the farm products to buyers and potential buyers of those farm products. The notice must include the following information, organized by type of farm product: the name and address of both the debtor secured party, the social security number or taxpayer identification number of the debtor, and a description of the farm products subject to the lien, including the amount of such products where applicable, the crop year, and the name of each county or parish in which such farm products are produced or located. When lending to a borrower producing farm products in Direct Notice States, the loan documents should require the borrower to provide a list of buyers and potential buyers of its farm products, and to update that list whenever new buyers are added. Even if a lender does not initially intend to give such notices, it should consider requiring the borrower to provide this list on a periodic basis so that if the credit quality of the borrower deteriorates, it could give such notices at a later date. The Food Security Act requires borrowers to cooperate with lenders in providing the list of buyers of their farm products.



In Clear Title States, a farmer's lender who wants its security interest in farm products to survive a sale of those assets will need to, in addition to filing a typical UCC financing statement, file an "effective financing statement" with the central filing system in such Clear Title State. The name of such form and specific content that is required varies by state, but the filing will generally include similar information to that covered by the notice required to be given in Direct Notice States.

Although they require complying with additional notice and/or filing procedures, the Food Security Act and Section 9-320 combine to give a farmer's lender a method unavailable to lenders in other industries to protect its interests and ensure that payments received by the farmer for farm products sold are used to repay the lender.

If you have any questions about this e-alert, farm product liens or lending in the agribusiness industry, please contact your Reinhart attorney or any member of the Reinhart [Banking and Finance Department](#).

¹ Note that the procedures required by Direct Notice States and Clear Title States under the Food Security Act affect only whether a buyer of farm products takes free of a security interest created by a person engaged in farming operations, and do not affect the validity of the underlying security interest; so a farmer's lender must still follow regular state procedures for creating and perfecting its security interest.

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