Cattle Deals Gone Bad

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David was honored in 2016 with the Excellence in Agricultural Law Award by the American Agricultural Law Association.

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All errors and omissions in this paper are those of the author alone.

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INTRODUCTION

This article is intended to provide an overview of the legal principles which often are involved when cattle deals go bad. Although the focus of the article is on cattle, the core concepts involving transfer of title, creation and enforcement of agricultural liens, and equitable concepts that may come into play when these different interests rise to the level of conflict, are common throughout the agricultural production industry.

The article is divided into three sections. The first section discusses Uniform Commercial Code rules involving buying and selling and some pre-UCC concepts that retain vitality despite the existence of the UCC. The second section discusses security interests under the UCC, how these are affected by the federal Food Security Act, and the existence and effect of statutory liens. The third discusses the Packers and Stockyards Act. All of these issues are likely to become involved in major crisis of insolvency.

I. BUYING AND SELLING FARM PRODUCTS

A. Uniform Commercial Code

1. Forming a contract of sale

Section 2.201(a) requires that contracts for sales of goods with a price of more than $500 be in writing, but because so much of the cattle business is conditioned without much or any paperwork, the statute of frauds is sometimes involved in disputes. There are many exceptions to this. 2.201(c)(2) provides: "A contract which does not satisfy the requirements of Subsection (a) but which is valid in other respects is enforceable if the party against whom enforcement is sought admits in his pleading, testimony or otherwise in court that a contract for sale was made...." Further, § 2.204 says:

> (a) A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract.
>
> (b) An agreement sufficient to constitute a contract for sale may be found even though the moment of its making is undetermined.
>
> (c) Even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.

The Official Comments to 2.204 say that "if the parties intend to enter into a binding agreement, this subsection recognizes that agreement as valid in law, despite missing terms, if there is any reasonably certain basis for granting a remedy. The test is not certainty as to what the parties were to do not as to the exact amount of damages to the plaintiff. Nor is the fact that one or more terms are left to be agreed upon enough of itself to defeat an otherwise adequate agreement. Rather, commercial standards on the point of 'indefiniteness' are intended to be applied, this Act making provision elsewhere for missing terms needed for performance, open price, remedies and the like."

2. Identifying goods to a contract of sale

The Code requirement (§ 2.401(a)) that goods be "identified" to a contract before title can pass is sometimes involved in cattle disputes. As applicable here, § 2.501(a) provides that unless the buyer and seller agree otherwise, goods are identified "when the contract is made if it is for the sale of goods already existing and identified" or, if the contract is for the sale of "future goods" [goods to be delivered in the future], identification occurs "when the goods are shipped, marked, or otherwise designated by the seller as goods to which the contract refers." § 2.501(a)(2).

Arguments can arise that cattle are not identified to a contract under fact patterns common in the cattle business, such as: (1) commingling of cattle that are not segregated, branded, tagged or otherwise dedicated to a specific contract; or (2) delivery of cattle under buy-back agreements.

A commingling issue could arise if cattle in the possession of the seller that are described in purchase invoices sent to a buyer do not match the cattle acquisition records of the seller. This could support an argument that the cattle were not in existence at the time of the contract, and consequently became "future" goods which could not be identified until the cattle were acquired by the seller and "designated" to a particular contract.

Kit Car World, Inc. v. Skolnick, 616 So.2d 1051 (Fla. App. 1993), illustrates the "identification" concept. The contest in that case was between a secured creditor who seized component parts and inventory used to assemble replica car kits and the debtor's customers who had paid the full price for the car kits but to whom delivery was rendered impossible by the seizure. The court held that the buyers did not have an interest in the items because they were commingled and not identified at the time of seizure to any particular contract. The court noted that the identity of the customers who eventually would have received the available kits had the debtor remained in business was a matter of "pure speculation" and as a result held that the interest of the purchasers was inferior to the interest of the secured creditor.

There is an exception to the "future goods" rule if the goods are part of an "identified fungible bulk." Fungible goods are goods in which "any unit is, by nature or usage of trade, the equivalent of any other like unit." § 1.201(17).

Official Comment 5 to Section 2.501 says:

> Undivided shares in an identified fungible bulk, such as grain in an elevator or oil in a storage tank, can be sold. The mere making of the contract with reference to an undivided share in an identified fungible bulk is enough under subsection (a) to effect identification if there is no explicit agreement otherwise.

Producers sometimes make "buyback" agreements. These have been attacked under the theory that they constitute disguised financing arrangements rather than actual purchase agreements. An example is *In re Porter (Michigan Livestock Credit Corp. v. Porter)*, 202 B.R. 109 (N.D. Ind. 1996). In this case the Porters, who were hog farmers, filed a bankruptcy and in this bankruptcy challenged the interest of Michigan Livestock Credit Corporation. The Porters claimed that the agreements between them and Michigan Livestock were disguised financing arrangements and not bailment contracts. Michigan Livestock argued that it retained ownership of the hogs under an agreement by which the Porters fed and bred the hogs which were supplied by a firm designated by Michigan Livestock. Michigan Livestock always paid for the animals and credited the purchase price to the Porters' account and after the hogs reached slaughter weight, they were sold in Michigan Livestock's name. The bankruptcy court found that the arrangement was a disguised financing agreement but on appeal the district court found that the arrangement was actually a bailment under which Michigan Livestock retained ownership.

3. Passage of "Title"

Section 2.401 is often the starting point in sales disputes. It establishes the following general principles:

> (1) The rights and remedies of purchasers, sellers, and third parties established in Article 2 apply "irrespective of title to the goods, except where the provision refers to such title." § 2.401.
>
> (2) Title to goods cannot pass under a contract for sale before they are "identified" to the contract. § 2.401(a). "Identification" is described in § 2.501.
>
> (3) Unless explicitly agreed identification of goods to a contract gives the buyer only the "special property" interest created at various points in Article 2. § 2.401(a); § 2.507.
>
> (4) Any retention or reservation by the seller of the "title" in goods shipped or delivered to the buyer is limited by the Code to the reservation of a security interest. In cases of insolvency, sellers often assert that "title" did not pass until the buyer's check cleared. This argument is of little value in a contest with a third-party creditor of the insolvent buyer, however unless the seller has perfected a prior security interest. *See In re Samuels*, 526 F.2d 1238, 1246 (5th Cir.), *cert. denied sub nom*, 429 U.S. 834, 97 S. Ct. 98, 50 L. Ed. 2d 99 (1976). If the seller has not obtained a security agreement that complies with Article 9, the seller's interest in the goods terminates on delivery. 8A Anderson, Uniform Commercial Code, § 9-113:7, p. 668.
>
> (5) Unless otherwise explicitly agreed, title passes to the buyer at the time and place at which the seller completes his performance with reference of the physical delivery of the goods, despite any reservation of a security interest, and even though a document of title is to be delivered at a different time or place. § 2.401(b). For examples in the cattle business, *see Miles v. Starks*, 590 S.W.2d 223 (Tex. Civ. App.— Fort Worth 1979, writ ref'd n.r.e.), *cert. denied*, 449 U.S. 875 (1980); *Brumley Estate v. Iowa Beef Processors, Inc.*, 704 F.2d 1351 (5th Cir. 1983).

4. Shelter Rules

Section 2.403 contains many of the UCC's "shelter" rules that protect downstream parties. It protects parties according to their status under the Code classifications. Persons who qualify as "good faith purchasers" are permitted to take good title from one with "voidable" title. Persons who meet the more strict requirements to qualify as "buyers in ordinary course" may be permitted to take good title even from one with no title.

§ 2.403(a) provides:

> A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the rights purchased. A person with voidable title has power to transfer a good title to a good-faith purchaser for value. When goods have been delivered under a transaction of purchase, the purchaser has such power even though
>
> (1) The transferor was deceived as to the identity of the purchaser, or
> (2) The delivery was in exchange for a check which is later dishonored, or
> (3) It was agreed that the transaction was to be a 'cash sale,' or
> (4) The delivery was procured through fraud punishable as larcenous under the criminal law.

§ 2.403 (c) contains the "entrustment" rule:

> Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business.

5. The Shelter Rules and the Cattle Industry

Courts have applied the shelter rules in common facts patterns that arise in cattle marketing disputes. For example:

A lender to an insolvent middleman may be a "good-faith purchaser for value" and enforce its security interest against an unpaid seller. *Rufenacht v. Iowa Beef Processors, Inc.*, 656 F.2d 198 (5th Cir. 1981), *cert. denied*, 455 U.S. 921, 102 S. Ct. 1279, 71 L. Ed. 2d 462 (1982); *Continental Grain Co. v. Heritage Bank*, 548 N.W.2d 507 (S.D. 1996). However, a lender does not qualify as a "buyer" under the statutory definitions and so cannot be protected by the entrustment provisions. *MBank Waco, N.A. v. L & J, Inc.*, 754 S.W.2d 245 (Tex. App.—Waco 1988, writ denied).

A buyer who pays with a bad check, or who fails to render payment at all, can pass to its buyer rights that defeat the original seller. Classic examples are *In re Samuels*, 526 F.2d 1238, 1242 (5th Cir.), *cert. denied sub nom*, 429 U.S. 834, 97 S. Ct. 98, 50 L. Ed. 2d 99 (1976); *Brumley Estate v. Iowa Beef Processors, Inc.*, 704 F.2d 1351 (5th Cir. 1983); *Rufenacht v. Iowa Beef Processors, Inc.*, 656 F.2d 198 (5th Cir. 1981), *cert. denied*, 455 U.S. 921, 102 S. Ct. 1279, 71 L. Ed. 2d 462 (1982).

The entrustment rule permits a "merchant" who has no ownership interest at all to pass good title to a buyer in ordinary course. Entrustment occurs with "any delivery and any acquiescence in retention of possession, regardless of any condition expressed between the parties to the delivery or acquiescence and regardless of whether the procurement of the entrusting or the possessor's disposition of the goods have been such as to be larcenous under the criminal law." § 2.403(c). Many grazing and caretaking situations could involve an entrustment. The case of *MBank Waco, N.A. v. L & J, Inc.*, 754 S.W.2d 245 (Tex. App.—Waco 1988, writ denied), presents this situation.

The ability of a merchant to transfer good title to a buyer in ordinary course is not unlimited. If the entrusting party has void title, as in the case of stolen goods, and then transfers possession of those goods to a merchant seller, the merchant cannot pass good title to a buyer in the ordinary course because § 2.403 allows a "transfer of all rights of the entruster" to a BOC, and in this instance the entruster has no rights. *See Olin Corp. v. Cargo Carriers, Inc.*, 673 S.W.2d 211

(Tex. App.—Houston [14th Dist.] 1984, no writ). *See* cases collected in *Anderson on UCC,* §2.403.122-129.

B. Rights of the Unpaid Seller

1. Arguments Based On Buyers' Relationships With (Solvent) Third Parties

a. Agency Relationships

The practitioner should never overlook principles of agency in an insolvency situation in an effort to reach a solvent party. In the context of the cattle business, several instructive cases resulted from the bankruptcy of Louis Heller, a cattle buyer who operated in the Texas and Oklahoma panhandles and southern Kansas in the early 1970's. *Brumley Estate v. Iowa Beef Processors, Inc.*, 704 F.2d 1351 (5th Cir. 1983), *Rufenacht v. Iowa Beef Processors, Inc.*, 656 F.2d 198 (5th Cir. 1981), *cert. denied*, 455 U.S. 921, 102 S. Ct. 1279, 71 L. Ed. 2d 462 (1982); *Lubbock Feedlots, Inc. v. Iowa Beef Processors, Inc.*, 630 F.2d 250 (5th Cir. 1980); *Valleyview Cattle Company v. Iowa Beef Processors, Inc.*, 548 F.2d 1219 (5th Cir.), *cert. denied*, 434 U.S. 855, 98 S. Ct. 174, 54 L. Ed. 2d 126 (1977).

b. Joint Venture or Partnership Arrangements

Alleged, or actual, joint ventures or partnerships are sometimes involved in disputes created by insolvency. These legal relationships may be used by an unpaid seller to an insolvent middleman to bypass the Code provisions on title or ownership transfer. Thus, an unpaid supplier may argue that his buyer was a "partner" of the now insolvent buyer in an attempt to impose liability. These arguments are sometimes successful. *Heinrich v. Wharton County Livestock, Inc.*, 557 S.W.2d 830 (Tex. Civ. App.—Corpus Christi 1977, writ ref'd n.r.e (joint venturer not a "buyer in ordinary course"), and *W. H. Hodges & Co. v. Donley County State Bank*, 399 S.W.2d 193 (Tex. Civ. App.—Amarillo), *rev'd*, 407 S.W.2d 221 (Tex. 1966) (agreement between cattle owner and pasture provider to split profits did not create a "joint venture" so as to permit caretaker's lender to acquire lien rights).

The *Hodges* opinion is particularly instructive because the case involved the classic elements of a "true owner," a "broke middleman," and a lender. The owner, Hodges, placed cattle on pasture with Sherrod under a profit sharing agreement. Sherrod then mortgaged the cattle to the bank. The bank claimed Hodges was a joint venturer of Sherrod and was therefore estopped to contest its lien. Although the court of civil appeals agreed, the Supreme Court reversed on the ground the alleged joint venture did not exist because the necessary "community of interest" between Hodges and Sherrod did not exist.

c. Common Law Trust

Another potential source of recovery for unpaid sellers is presented by a case involving the demise of a feedyard in Donley County, Texas. *South Cent. Livestock Dealers, Inc. v. Security State Bank*, 551 F.2d 1346 (5th Cir. 1977), involved a complaint by unpaid cattle sellers that the lender to the feedyard which had sold their cattle wrongfully converted sales proceeds by offsetting them to pay debts owed to the lender by the feedyard, and tortiously interfered with their contract with the feedyard. The Court said:

> Texas has long held that if a bank knows that deposits by a debtor in his own name are in fact held by him in a fiduciary capacity, then the bank may not

> apply such funds to the individual indebtedness of the debtor. In *Steere v. Stockyards National Bank*, 113 Tex. 387, 256 S.W. 586, 589-92 (Tex. Com. App.1923, opinion adopted), a livestock commission dealer accepted consignments of cattle from shippers for sale. The dealer's normal practice was to deposit the proceeds of sale in his personal account, then remit the net proceeds to the shippers. The Stockyards National Bank, recipient of the dealer's deposits, knew of the dealer's business procedure. When the dealer created indebtedness by over-drafting, the bank reduced the overdraft by applying deposited proceeds for the sale of cattle. The Court ruled that since the bank knew or had reason to know that the funds deposited were those of third parties it could not apply them to the debtor's indebtedness. In *National Indemnity Co. v. Spring Branch State Bank*, 162 Tex. 521, 348 S.W.2d 528, 529 (1961), the bank offset the account of an insurance agent indebted to it. The insurance agent's account included insurance premiums held by the agent pursuant to an express trust provided in the contract between the agent and the insurance company. The Supreme Court of Texas reiterated the *Steere* rule and went on to hold that even if a bank is unaware that funds in an account are subject to a trust, it may not offset trust funds. *See also Security Bank & Trust Co. v. Geren*, 288 F. 317 (5th Cir. 1923).
>
> The evidence of Security State's involvement in adjusting the feedlot's financial affairs - including the chiding administered when the feedlot overdrew the cattle account, admonishing the feedlot that it was dealing with other people's money - suggests that Security State was aware of the fiduciary nature of the funds the feedlot held in the cattle account. If the line of cases we note remains Texas law, the evidence here makes a jury case.
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> * * *
>
> Under Texas law, a tortious interference with a contract entails intentional and willful acts calculated to cause damage and with the unlawful purpose of causing damage to the contracting parties without just cause or lawful right. The evidence, viewed most favorably to plaintiffs, can support the view that Security State employed a number of devices to protect its interests with full knowledge that its action would interfere with the feedlot's contractual relations with its customers and employed the devices without just cause or legal right. (citations omitted)

Also see discussion of this topic in Part IV below.

2. Sellers' Remedies Under the UCC

a. Demand For Adequate Assurance

§ 2.609 give a seller (or a buyer) a right to demand adequate assurance of due performance. The demand is to be made in writing and can be made when "reasonable grounds for insecurity arise." The party seeking assurance is permitted to suspend its own performance until assurance is received.

b. Action For The Price

Under § 2.709 and common law principles of contract, the seller may pursue against the buyer the often hollow victory provided by an action for the unpaid purchase price.

c. Cover Sale Of Undelivered Goods

If the seller still has possession of the goods which are the subject of the contract, the seller may resell the goods to another and seek a recovery from the defaulting purchaser of the price differential under § 2.706.

d. Termination Of Future Deliveries

If the goods are still in the seller's possession, or are in transit, the seller may seek to halt delivery of the goods under § 2.703 or § 2.705.

3. Reclamation

Cattle are often delivered for sale without the requirement of immediate payment. Often payment is made when the buyer sends a check on the truck or by mail. In cases of the buyer's insolvency, the sellers should invoke "reclamation" under § 2.702. The statute provides:

> (2) Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten (10) days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three (3) months before delivery the ten-day limitation does not apply . . . .
>
> (3) The seller's right to reclaim under subsection (2) is subject to the rights of a buyer in ordinary course or other good-faith purchaser under this article (§ 2.403). Successful reclamation of goods excludes all other remedies with respect to them.

a. Demand Reclamation

A credit seller must exercise the reclamation right within ten days after the buyer received the goods. *Ranchers & Farmers Livestock Auction of Clovis v. First State Bank of Tulia, 531 S.W.2d 167 (Tex. Civ. App.—Amarillo 1975, writ ref'd n.r.e)*; *O'Brien v. Chandler*, 7 U.C.C. 2d 1450, 765 P.2d 1165 (N.M. 1988). There is "no specific time limit for a cash seller to exercise the right of reclamation. However, the right [of reclamation] will be defeated by delay causing prejudice to the buyer, waiver, estoppel, or ratification of the buyer's right to possession." §2.507, Official Comment 3.

b. Extension Of Time to Reclaim By Representation Of Insolvency

The time for a credit seller to reclaim may be extended if the seller has received a written misrepresentation of solvency within three months before delivery. If such writing is received, the ten-day limitation does not apply. Presumably, therefore, if such a misrepresentation is received the seller may reclaim goods from the buyer as long as the buyer has them. The written misrepresentation may be found not only in conventional financial statements, but also in the form of other writings which implicitly represent an ability to pay. In *Liles Brothers & Son v.*

Wright, 34 U.C.C. 1174, 638 S.W.2d 383 (Tenn. 1982), a post-dated check was held to be a written representation of solvency.

c. Distinction Between Credit and Cash Sales

A major impediment to a seller seeking reclamation may be proof that the sale was a "credit" sale because of the short time deadlines for credit sales. This question may arise in the common situation in which a seller accepts as payment a check that is later dishonored.

A Texas case holds that accepting a check which is later dishonored does not change a cash sale into a credit sale under the reclamation statute. *Ranchers & Farmers Livestock Auction of Clovis v. First State Bank of Tulia*, 531 S.W.2d 167 (Tex. Civ. App.—Amarillo 1975, writ ref'd n.r.e). This case adopted the view that as between the buyer and seller, the delivery of cattle is conditioned on payment, and reclamation is available if the check fails to clear. *See also Ranchers & Farmers Livestock Auction Company v. Honey,* 552 P.2d 313, 19 U.C.C. 1337 (Colo. Ct. App. 1976).

An Oklahoma court has held that a "credit sale" occurred when payment for orders made by telephone was made by "sight" drafts submitted by the seller to the purchaser's bank, which were then paid by the purchaser with a check to the bank. *Kennett-Murray & Company v. Pawnee National Bank,* 598 P.2d 274, 26 U.C.C. 686 (Okla. App.1979)

Note that § 2.511 provides that "payment by check is conditional and is defeated as between the parties by dishonor of the check" and, that the right of the buyer "as against the seller" to retain or dispose of goods is conditional upon payment. § 2.507.

d. Reclaiming Seller Versus Purchaser's Secured Creditor

A perfected secured party will prevail over a reclaiming seller. *In re Samuels*, 526 F.2d 1238, 1242 (5th Cir.), *cert. denied sub nom*, 429 U.S. 834, 97 S. Ct. 98, 50 L. Ed. 2d 99 (1976).

The *Samuels* analysis relies upon the fact that the Code expressly makes the right to reclaim subject to the rights of a buyer in ordinary course or a good-faith purchaser, and that a lender may be a "good-faith purchaser" within the meaning of § 2.702 and § 2.403.

The fact situation in *Samuels*, which involved livestock producers who had sold cattle to an insolvent packer, has been addressed by statute. 7 U.S.C. § 196 (1980), provides that a packer's inventory of cattle, carcasses, meat products, and its accounts receivables are held in trust for the benefit of any unpaid sellers of livestock. Tex. Agric. Code § 148.026 provides a similar remedy.

What happens if the lender has not perfected its interest? *In re Tucker*, 329 B.R. 291, 301 (Bkrtcy. D. Ariz. 2005), involved a contest between a wholesale credit seller of vehicles (Par) and a floor plan secured creditor (DAVCO). Both of these parties had dealings with a used car dealer (Tucker, whose d/b/a was Harvest Car Company) that filed Chapter 7. The wholesaler exercised its reclamation remedy. The secured creditor claimed this action was subject to its security interest. The court ruled against the lender based on its conclusion that "an unperfected secured creditor does not qualify as an "other good faith purchaser."

The Court ruled for Par, the unpaid seller, rather than DAVCO, the unperfected secured lender. The Court's reasoning on the priority issue was:

> "To prevail under *Talcott*, *GECC* and *Samuels,* the secured creditor must qualify as a "good faith purchaser." As *Samuels* correctly notes, a secured creditor expressly satisfies the U.C.C.'s definition of purchaser.[FN21] To qualify as a "good faith" purchaser, the secured creditor must observe "reasonable commercial standards of fair dealing in the trade." [FN22] This Court concludes that an inventory financier such as DAVCO fails to observe reasonable commercial standards of fair dealing when it fails to file a financing statement so that credit sellers can become aware of the risk to their reclamation rights and protect themselves by perfecting an inventory purchase money security interest, which requires notification to the conflicting inventory financier.[FN23] An inventory financier who had an opportunity to perfect and failed to do so therefore fails to qualify as an "other good faith purchaser," and therefore is subordinate to the rights of a reclaiming seller.
>
> FN21. *Samuels*, 526 F.2d at 1242, citing U.C.C. § 1-201(32)(" 'purchase' is broad and includes ... taking by ... voluntary mortgage, pledge, or lien").
>
> FN22. *Id.* at 1243, citing U.C.C. §§ 1-201(19) & 2-103(a)(2) [now 2-103(1)(b)].
>
> FN23. U.C.C. § 9-324(b)."

Tucker referred to the only case it could find that addressed this issue, *Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank*, 184 Colo. 166, 519 P.2d 354 (1974)(en banc), but refused to follow it.

e. Reclaiming Seller Versus Purchaser's Trustee In Bankruptcy

11 U.S.C. § 546(c) of the Bankruptcy Code recognizes a limited right for a reclaiming seller to prevail over the bankruptcy trustee. Under § 546(c), the trustee's "avoiding powers" granted under § 544(a) ["the strong-arm clause," giving the trustee the rights of a hypothetical judicial lien creditor, or a hypothetical judicial lien creditor, or a hypothetical executing creditor, or a hypothetical BFP]; § 545 [power of the trustee to avoid certain "statutory liens"]; § 547 [preferential transfers] and § 549 [power of the trustee to avoid post-petition transfers] have been made subject to any statutory or common law right of the seller in the ordinary course of the seller's business to reclaim goods from a debtor who has received the goods while insolvent. However, § 546(c) requires the seller to make written demand for reclamation within ten days after the buyer receives possession and provides that the court may deny reclamation and give the seller a priority claim or a lien to secure the claim. If the bankruptcy is filed within ten days of the receipt, the notice period is twenty days.

Section 546(c) of the Bankruptcy Code is helpful to reclaiming sellers in that it gives a reclaiming seller a chance to gain secured status in the bankruptcy and helpful in that it implicitly authorizes the seller to make a notice of reclamation, even after the filing of a bankruptcy. Note, however, that the Bankruptcy Code establishes its own requirements for reclamation, and does not recognize the extended time to make reclamation if a written representation of solvency has occurred.

C. Warranties

There are at least three sources of implied warranties under the Code. The Code implies into all contracts for the sale of goods the warranties of merchantability (§ 2.314) and of fitness for a particular purpose (§ 2.315). A third source of implied warranty is trade usage and course of dealing (§ 2.314(c)).

1. Warranties of Merchantability and Fitness for Livestock Excluded by Statute

The warranty of merchantability requires goods to be of such quality as to "(1) pass without objection in the trade under the contract description; and (2) in the case of fungible goods, are of fair or average quality within the description; and (3) are fit for the ordinary purposes for which such goods are used. . . ." § 2.314(b). § 2.315, creating the implied warranty of fitness for a particular purpose, states:

> Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section [permitting exclusion or modification] an implied warranty that the goods shall be fit for such purpose.

Thus, it would seem that a "health" warranty could either be implied as a warranty of merchantability, or, perhaps, a warranty of fitness. However, this has been modified in several states.

In Oklahoma, §2.316(d) provides:

> (d) the implied warranties of merchantability and fitness do not apply to the sale or barter of livestock or its unborn young, provided that seller offers sufficient evidence that all state and federal regulations pertaining to the health of such animals were complied with; provided, however, that the implied warranties of merchantability and fitness shall apply to the sale or barter of horses.

In Texas, § 2.316(f), provides:

> The implied warranties of merchantability and fitness do not apply to the sale or barter of livestock or its unborn young.

We have found two Texas cases which have considered § 2.316(f). Both have held the statute did not apply. In *Teague v. Bandy*, 793 S.W.2d 50 (Tex. App.—Austin 1990, writ denied, the court reasoned that the case did not involve the "sale or barter of livestock or its unborn young" because the dispute concerned the purchase of an interest in "future" embryos, not existing unborn young.

In *Kincheloe v. Geldmeier*, 619 S.W.2d 272 (Tex. Civ. App.—Tyler 1981, no writ), a cattle buyer sued a sale barn for breach of an implied warranty of merchantability. The allegation was that the seller breached this warranty by delivering cattle which were infected with brucellosis. The court noted that § 2.316(f) "now precludes application of the implied warranty of merchantability to the sale of livestock," but held that the statute did not apply because the operative facts occurred before it became effective. The court held that the evidence was sufficient to support the trial court's finding that the implied warranty of merchantability was excluded or modified by usage of trade under § 1.205(b). The evidence was that a buyer of cattle from an auction purchases the cattle "as is," and the court held this was sufficient to support a finding that this was a "trade usage" disclaimer of the implied warranty of merchantability.

2. Warranties Implied by Course of Dealing or Usage of Trade.

This leaves for consideration whether a health warranty may be implied by course of dealing or trade usage. § 2.314(c) says:

Unless excluded or modified (Sec. 2.316) other implied warranties may arise from course of dealing or usage of trade.

Thus, if course of dealing or usage of trade creates implied warranties, they become a part of the contract unless they are excluded or modified, or unless they contradict the contract itself. § 1.205(d).

The two concepts of course of dealing and usage of trade must be considered separately. Both are defined in § 1.205:

> (a) A course of dealing is a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct.
>
> (b) A usage of trade is any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such usage are to be proved as facts. If it is established that such a usage is embodied in the written trade code or similar writing the interpretation of the writing is for the court.

A "course of dealing," if proved, would thus be of limited application because it would be proved only between the parties based upon a "sequence of previous conduct." The more general "usage of trade," however, does not depend on the existence of prior dealings between the parties. Thus, if a usage of trade were that cattle were to be delivered in a healthy condition, that would become a part of the agreement between the parties, unless it differed from the express agreement made. An example of this is described in 3 Anderson, Uniform Commercial Code, § 2.314:126, which states:

> When it is shown that the trade custom is that an order of "steel" without any specification being added means steel of "commercial quality," which in turn means steel with a carbon content ranging from 1010 to 1020, a contract for the sale of "steel" by a merchant seller gives rise to a warranty that it is steel of "commercial quality" and has such carbon content.

This author found no cases that discuss whether course of dealing or usage of trade could override the statutory disclaimer of implied warranties of Section 2.316(f) but cautions that this question needs to be addressed if disputes arise. *Kincheloe v. Geldmeier*, 619 S.W.2d 272 (Tex. Civ. App.—Tyler 1981, no writ) (testimony that purchases of cattle at a sale barn are "as is" established a trade usage).

D. Buying and Selling Cattle Outside of the UCC

1. The Code Rejects the "Cash Sale" Doctrine

Before the Uniform Commercial Code was enacted, unpaid suppliers could impose liability on downstream buyers from insolvent buyers by using the "cash sale doctrine." The theory was that the supplier's "title" did not transfer until the supplier was paid, and therefore the middleman had no title to pass to third parties. A typical case was *Valley Stockyards Co. v. Kinsel*, 369 S.W.2d 19 (Tex. 1963). Kinsel sold cattle to a "cattle trader" named Wiley, who gave him a check that failed to clear. In the meantime, Wiley resold the cattle through the Valley Stockyards. Kinsel sued Valley under the "cash sale doctrine," alleging that Valley converted his retained ownership interest when it resold the cattle. The Court held that a fact issue was presented under the cash sale doctrine and remanded the cause for further proceedings.

The UCC rejected the cash sale doctrine. Section 2.401 "specifically limits the seller's ability to reserve title once he has voluntarily surrendered possession to the buyer. . . ." *In re Samuels*, 526 F.2d 1238, 1246 (5th Cir.), *cert. denied sub nom*, 429 U.S. 834, 97 S. Ct. 98, 50 L. Ed. 2d 99 (1976).

2. The Effect of "Local Statutes"

UCC § 2.102 says that "this chapter … [does not] impair or repeal any statute regulating sales to consumers, farmers, or other specified classes of buyers." Some cattle cases have addressed whether local livestock statutes are dispositive under this category. An example is *Farmers Livestock Exchange of Bismark, Inc. v. Ulmer*, 2 U.C.C. 2d 1194, 393 N.W.2d 65 (N.D. 1986), (local statute which provided that a livestock auction market was liable to the "rightful or lawful owner" of livestock was superior to UCC provisions on title passage), cited with approval in *Southwestern Elec. Power Co. v. Grant*, S.W.3d 211, 218 (Tex. 2002). This issue was mentioned in *Brumley Estate v. Iowa Beef Processors, Inc.*, 704 F.2d 1351, 1359 (5th Cir. 1983), where the court assumed "at least for purposes of argument that article 6903 [now Tex. Agric. Code §146.01, discussed below] was not impliedly repealed by the enactment of the Texas U.C.C."). No Texas cases appear to have been resolved on this issue, although as noted below, brand laws and the "bill of sale statute" have been addressed in Texas cases.

3. "Bills of Sale" and Brands

Tex. Agric. Code Ann. § 146.001 contains language that originated in a statute dating from the 1860's purporting to render "prima facie illegal" the possession of cattle without a written bill of sale from the seller. Oklahoma has a similar provision for brands. 2 Okla. St. 34-8

The statute was last the subject of construction by a Texas case in *Valley Stockyards Co. v. Kinsel*, 369 S.W.2d 19 (Tex. 1963). There, the statute, then article 6903, was held not to be applicable because the sale in question was contemplated to occur outside the state of Texas. *Brumley Estate v. Iowa Beef Processors, Inc.*, 704 F.2d 1351 (5th Cir. 1983), characterized *Kinsel* as holding that the statute applied only in counties that were on a list of counties found in then Article 7005 (now Tex. Agric. Code § 146.052). Under the facts of the case before the Court also held that the statute did not apply.

For more than a century the statute has been held not to render a consummated sale void. *Wells v. Littlefield*, 59 Tex. 556 (1883).

It has been suggested that the statute has broader application, based on arguments analogizing section 146.001 to certificated goods, such as motor vehicles. Although no Texas or Oklahoma cases have specifically addressed this situation, one Colorado case has rejected this argument expressly. *Cugnini v. Reynolds Cattle Co.*, 687 P.2d 962, 39 U.C.C. 112, 119 (Colo. 1984).

4. Equitable Concepts

If the Code does not apply, courts will often turn to concepts drawn from equity. For example, in *MBank Waco, N.A. v. L & J, Inc.*, 754 S.W.2d 245 (Tex. App.—Waco 1988, writ denied), the court applied the equitable concept that "the one who created the loss should bear the burden of the loss" after analyzing the Code and determining that it did not apply. *See also Farmers Livestock Exchange of Bismark, Inc. v. Ulmer*, 393 N.W.2d 65 (N.D. 1986).

II. LIEN DISPUTES IN BAD CATTLE DEALS

When cattle deals go bad and secured lending is involved, the mechanics of creating and perfecting security interests are always scrutinized. These inquiries, which involve questions such as whether security agreements have been signed, whether the language covers the collateral or whether UCC-1s were properly filed, are not unique to bad cattle deals. This article will not discuss these but will instead focus attention on the special rules for "farm products" created by the UCC.

A. Security Interests Under the Uniform Commercial Code

1. Lien Continuation

The UCC creates a general rule that after a lien attaches it continues to exist even after the collateral is sold by the debtor. § 9.315(a) The major exception to this rule protects a "buyer in ordinary course" (a "BOC"). A purchase by a BOC cuts off the lien created by the BOC's seller. UCC § 9.320. A buyer is a BOC if it acts in good faith and without knowledge that the purchase violates a security agreement.

To encourage lenders to make loans to farmers, the UCC created an exception to this exception. Under the "farm products exception" a person who otherwise qualified as a "buyer in ordinary course" could not take free of a security interest created by its seller if the goods were "farm products."

The "farm products exception" made possible what is commonly known as the "double payment" problem. This situation occurred when a buyer paid its seller for farm products, but the seller did not pay its lender. The lender, using the farm products exception, could enforce its lien against the buyer, and in effect force the buyer to pay for the farm products twice.

California may have eliminated this problem with a non-uniform amendment to the UCC. Its version of UCC § 9.320, says:

> Except as otherwise provided in subdivision (e) (referring to statutory liens), a buyer in ordinary course of business takes free of a security interested created by the buyer's seller, even if the security interest is perfected and the buyer knows of its existence.

Compare this to § 9.320 in other states, including Texas:

> Except as otherwise provided in Subsection (e) (referring to statutory liens), 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.

2. Definition of Farm Products

Article 9 creates six (6) categories of "goods-related definitions." As explained in Official Comment 4 to § 9.102, these categories are "goods"; "consumer goods"; "equipment"; "farm products"; "farming operation"; and "inventory." The same source notes that these classes of goods are "mutually exclusive. For example, the same property cannot simultaneously be both equipment and inventory."

The UCC defines "farm products" in § 3.102(a) as follows:

"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 or corps or livestock in their unmanufactured states.

(E) "Farming Operations" means raising, cultivating, propagating, gathering, grazing or any other farming, livestock, or aquacultural operation.

Although these categories of goods are mutually exclusive, goods can change their classification.

The Official Comments also seek to provide some guidance as to how long goods are "farm products." The comments say that crops, livestock and their products "cease to be 'farm products' when the debtor ceases to be engaged in farming operations with respect to them." The Comments provide, as an example, that goods cease to be "farm products" when they "come into the possession of a marketing agency for sale or distribution or of a manufacturer or processor as raw materials," at which point they become "inventory." § 9.102 comment 4(a).

3. Attachment – "Rights in the Collateral"

In the cattle business the issue of "rights in the collateral" can be very important. Lenders and others sometimes tend to equate possession coupled with the representation of the possessor as unimpeachable evidence of ownership. Brands and ear tags can support such claims' apparent validity. However, in pasture and feedyard situations, cattle often are not in the physical possession of their owners. Mere possession by the debtor will not establish sufficient "rights in the collateral" to permit a lien to attach. *MBank Waco, N.A. v. L & J, Inc.*, 754 S.W.2d 245 (Tex.

App.—Waco 1988, writ denied). To the extent the debtor holds any additional rights, however, those "rights" may be subject to claims of the possessor's lender, either by contractual lien, *see Continental Grain Co. v. Heritage Bank*, 548 N.W. 2d 507 (S.D. 1996), *InterFirst Bank of Abilene v. Lull*, 778 F.2d 228 (5th Cir. 1985), or by estoppel. *MBank, supra*; *Pleasantview Farms, Inc. v. Ness*, 455 N.W.2d 602 (S.D. 1990).

For example, *see MBank N.A. v. L. & J. Inc.*, 754 S.W. 245 (Tex. App.—Waco 1993, writ denied). In that case the alleged true owners of cattle, the Mamot family, allowed Mr. Young to pasture cattle they claimed as their own in Texas, and to place his brands on the cattle. Young borrowed money from MBank and purported to grant a lien on the cattle. The court held that Mamots were estopped from claiming that the bank did not have an enforceable interest because they knowingly gave possession of the cattle to Young and allowed him to place his brands on the cattle and said: "A recorded brand, such as Young's, is evidence of ownership of the cattle on which it is placed. *See DeGarca v. Galvan*, 55 Tex. 53, 57 (1881)."

Although "naked possession" by a debtor is not sufficient to permit a security interest to attach, the necessary rights in the collateral to permit attachment may be created by estoppel. For example, if a cattle owner allows another to appear to have complete ownership, he may be estopped to deny the security interest claimed by a lender to the apparent owner. *Pleasantview Farms, Inc. v. Ness*, 455 N.W.2d 602 (S.D. 1990).

4. Purchase Money Liens

Under § 9.324, a lender seeking a prior purchase money security interest secured by livestock must take the following steps: (i) The lender must advance funds to enable the debtor to acquire the collateral; (ii) The security interest must be perfected when the debtor receives possession of the livestock; (iii) The purchase money lender must send an "authenticated notification" to the conflicting security interest holder; (iv) The holder of the conflicting security interest must receive the notice within six months before the debtor receives possession of the livestock; and (v) The notice must state that the purchase money lender has or expects to acquire purchase money security interest in the debtor's livestock and describes the livestock. This poses great difficulty because buyers may not be known in advance.

An argument can be made that if the debtor never receives possession of the goods, the notice provisions of § 9.324, which require advance notice to a previous lender, are not required to be followed. The argument is that the notice is required to be given only before the debtor "receives possession," and because the debtor never receives possession, the notices are not required.

Citizens Nat'l Bank of Denton v. Cockrell, 850 S.W.2d 462, 465 (Tex. 1993), adopted the rule that the possession contemplated by the statute (at that time numbered 9.312) was physical control of the collateral, and said: "One who controls the collateral possesses it, and leads others to believe it is his." *Kunkel v. Sprague Nat'l Bank*, 128 F.3d 636 (8th Cir. 1997), involved cattle that had been classified by the court as "inventory" and under the version of the UCC that applied, a PMSI lender was required to give advance notice of its intent to take a security interest to conflicting security interest holders, similar to the notice now required for livestock lenders. *Kunkel* held that the feedyard was not required to provide that notice in a custom feeding situation because the owner never had "possession" of the cattle.

First National Bank v. Lubbock Feeders, L.P., 183 S.W.3d 875 (Tex. App.—Eastland 2006, rev. denied), adopted the reasoning of *Kunkel v. Sprague* and held that a feedyard that perfected an interest in its customer's cattle was not required to give advanced notice to obtain purchase money priority because the customer never received possession of the cattle.

5. Secured Party's Notice to Bailee

Although creditors will always want to perfect by filing, § 9.313 may supply a useful tool to employ in an emergency. In the livestock context, if a lender finds cattle shortages occurring, it may find some of the missing cattle in the possession of the feedyard, pasture lessor, or livestock sale barn. These parties may in some instances be characterized as bailees. If collateral is in the hands of a bailee, perfection may occur by notice to the bailee. The secured party is deemed to have possession from the time the bailee receives notice of the secured party's interest. § 9.313.

6. Owner's Notice to Bailee

Section 9.505 permits an owner of goods (a "bailor") that are in the possession of another (a "bailee") to file a financing statement that will serve as notice to others, including lenders, that the bailee is not the owner. Presumably, the bailee's lender will check the UCC filings before making a loan based on a false representation of ownership and avoid a dispute. *In American Bank & Trust v. Schaull*, 2004 S.D. 40, 678 N.W.2d 779, 53 UCC Rep. Serv. 2d 367 (2004), the South Dakota Supreme Court affirmed a finding that the bailee/caretaker's lender would have been put on notice by a bailee filing, which would have defeated the lender's claim. Unfortunately for the owner, it did not file the bailee UCC-1.

The current UCC-1 form financing statement contains, at the bottom as item 5, the box labeled "bailee/bailor." Checking this box should allow a bailor to give notice that he has goods in the possession of the bailee that the bailee does not own.

B. The Food Security Act

Bad cattle deals often involve efforts by lenders to collect debts caused by their borrowers' failure to repay their loans from persons with whom their borrowers did business. Buyers of farm products have been playing a continuous game of whack-a-mole to fend off claims by lenders to their suppliers since at least the time the UCC was adopted. The stated purpose of the Food Security Act of 1985 was to eliminate this "double payment" problem. This problem plagued buyers of farm products who paid their suppliers and were forced to pay again if their suppliers did not pay their lenders.

The double payment problem has survived this Congressional effort to eradicate it. Much of the blame can be assigned to the UCC concept known as "lien continuation," the "created by the seller" rule, and the "farm products exception" the FSA inherited from the UCC. Other problems arise from the movement of farm products from state to state, from the inconsistent adoption of the notice provision of the FSA by the states, and from the traditional "handshake" method of doing business in agricultural marketing.

1. The Food Security Act (7 U.S.C. § 1631)

The Federal Food Security Act became law in December 1986. The FSA expressly stated that its purpose was to eliminate the "double payment" problem because it created an impediment to the free transaction of commerce in farm products.

The FSA concerns transactions in "farm products." The definition of "farm products" in the FSA is generally the same as that in the UCC. The FSA protects two general classes of persons: "buyers" of farm products, and "marketing agents," which generally includes livestock sale barns and commission agents.

2. How to Perfect Under the FSA

The FSA generally requires a lender to provide actual notice of its interest but allows states to choose a central filing system. Texas and Kansas are "actual notice" states; Oklahoma and Colorado are "central filing" states.

In direct notice states, buyers who receive a notice in in proper form purchase farm products subject to that lender's security interest.

In states that have adopted a central filing system, (www.gipsa.usda.gov/GIPSA contains a list), a secured party files a specialized notice with the state designated authority that gives specific information about the extent of the lien. A buyer of farm products which have been "produced" (see discussion below) in that state take subject to the lender's security interest if the documentation is in order or if it has received direct notice. Otherwise, the buyer takes free of that security interest. Buyers are also authorized to register in central filing states. If a buyer registers, and the lender does not, then the buyer takes free of the interest. 7 U.S.C. § 1631

3. Cases Involving Direct Notice

In "direct notice" states such as Texas and Kansas actual notice is required. In these states, the lender must contact the potential seller and give notice of its security interest. The burden is thus on the lender to contact the buyers.

In *Farm Credit Midsouth, PCA v. Farm Fresh Catfish Co.*, 371 F.3d 450 (2004), the court adopted a "strict compliance" view of the Food Security Act's direct notice provisions. The court held that the lender's letter to its debtor's customer advising of the loan, but failing to state the debtor's social security number or tax identification number and failing to state where the farm products covered by the interest were located did not comply with the Act, and held that the purchaser bought the products free from the security interest even though the purchaser knew of the existence of the interest. There are other cases that have addressed this issue: *Lisco State Bank v. McCombs Ranches, Inc.* 752 F.Supp. 329, n.6 (D. Neb. 1990) (actual notice insufficient, and noting "that the "direct notice" provision of the FSA does not contain the "substantial compliance" language included in the definition of "effective financing statement"") *First Nat'l Bank & Trust v. Miami County Coop. Assoc.*, 897 P.2d 144 (Kan. 1995) (adopting a substantial compliance rule)(discussed and rejected in *Farm Fresh Catfish*); *Farm Credit Services of Mid America, ACA v. Rudy, Inc.*, 680 N.E.2d 637, 644 (Ohio Ct. App. 1996) (holding that a direct notice was not "seriously misleading"); *State Bank of Cherry v. CGB Enters.*, 984 N.W.2d 449 (Ill. 2013), (rejecting "substantial compliance" argument in a direct notice state).

In the Texas Panhandle there is a "newspaper notice" which attempts to provide actual notice to buyers. Lenders subscribe to the newspaper and give the statutory information about their borrowers, and the newspaper is delivered to potential buyers. To our knowledge, the effect of this "newspaper notice" has not been decided by any court.

4. Where Are Farm Products "Produced" Under the Food Security Act?

The Food Security Act provides that buyers of farm products that have been "produced in" a state take subject to a security interest created by its seller if the seller's lender has filed an Effective Financing Statement (an "EFS") in that state (a) and the buyer has failed to register, or (b) the buyer has received written notice of the interest from the Secretary of State where the goods were produced. 7 U.S.C. § 1631(e).

The "direct notice" section of the statute does not restrict the effects of a notice to goods "produced in" any particular state. Thus, lenders in both direct notice and in central filing states may give direct notice to buyers to perfect its interest.

The FSA does not define the term "produced in." This can be a problem for cattle because cattle could be "produced in" several states, such as where they are born, pastured or fed. The terms would seem to involve a husbandry function, [1] but there is room to argue that the term has a greater scope, and could extend to the area of marketing as well as husbandry, making the number of states in which cattle are "produced" even larger.

A case involving Oklahoma discussed this issue. In *Great Plains National Bank v. Mount*, 280 P.3d 670 (Colo. App. 2012), the Court decided a contest between a cattle buyer from Colorado and a secured lender in Oklahoma. The problems in the *Mount* case started after Fred Smith, an Oklahoma cattleman, bought 231 cattle from a cattle broker in Missouri. Smith received the cattle in Oklahoma. His buyer, Mount, sorted off 206 head in Oklahoma after he inspected the cattle at Smith's facility, and then shipped them to Colorado. Mount paid Smith but Smith did not pay his lender. Smith's check to the broker was later returned NSF.

Smith's lender, Great Plains National Bank, covered the NSF check, and then sued Mount, and Mount's lender, Cattle Consultants, to enforce its security interest in the 206 head. Great Plains claimed that the cattle were "produced in" Oklahoma. Because it had complied with the central notice provisions of Oklahoma by filing an EFS there, Great Plains argued that Mount could not take free of Great Plains' security interest unless he paid the lien. Mount claimed that the cattle were "produced in" Missouri, a "direct notice" state and as a result, Great Plains could not prevail because it had not given him the direct notice required under Missouri law.

The Court held that the cattle were "produced in" Oklahoma, and therefore Mount took the cattle subject to the Great Plains' lien:

> The FSA does not define "produced in." We are unaware of, and the parties have not directed us to, any case law defining the phrase as used in the FSA. Consequently, we give the phrase its plain and ordinary meaning, which may include consideration of dictionary definitions…[and] the legislative purpose of the FSA, legislative history, and the consequences of particular constructions to discern the meaning of the phrase.

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[1] *See Ag Services of America, Inc. v. United Grain, Inc.*, 75 F. Supp. 2d 1037 (D. Neb. 1999). That case involved a purchase of corn by United Grain, a commercial buyer, from a seller, the Kollings, who grew the corn in a central filing state (Nebraska). United Grain paid the Kollings, but the Kollings did not pay the proceeds to their lender. The court held that United Grain should have registered in Nebraska and that its failure to do this made it liable to the Kollings' secured lender. There was no discussion in the opinion about what "produced" meant, but in the context of the opinion it appears that the court equated it with the place where the corn was grown, because it was delivered to facilities in Kansas and in Nebraska.

> *…*…*
>
> Because the FSA is focused on ensuring buyers can obtain adequate notice of potential security interests in farm products, the meaning of "produced in" should be interpreted to reflect that focus. Accordingly, we conclude that "produced in," as used in this context, means the location where farm products are furnished or made available for commerce. Such an interpretation allows lenders to discern where they must file notice of their security interests and ensures a practical means for buyers to discover otherwise unknown security interests in farm products, as Congress intended. 7 U.S.C. § 1631(a)-(b); *see also* H.R. Rep. No. 99-271, at 109-10 (1985) (the FSA was intended to create a "universal rule" preempting state laws forcing "innocent buyers of farm products to become unwilling loan guarantors").

Careful buyers will therefore check lien filings in states where their sellers are located and where their cattle originate.

5. The FSA Does Not Apply to Purchase Transactions

The FSA does not protect a buyer from claims by any party other than a lienholder. Therefore, the FSA offers no protection to a buyer who has purchased cattle from a seller under circumstances which will create lack of "title" or "ownership" in the seller. Instead, other bodies of law, such as agency, estoppel and the Code "title" provisions (§§ 2.401-2.403) must be examined. *See First State Bank of Athens v. Purina Ag Capital Corp.*, 113 S.W.3d 1 (Tex. App.—Tyler 1999, no writ) (FSA not applicable because no sale occurred).

6. Do Privacy Laws Preclude Proper Notice Under the Food Security Act?

The Food Security Act may have a privacy law problem. When it became law in December 1986 the statute required lenders to give notice to buyers of farm products that identified their borrowers by "the social security number of the individual debtors, or, in the case of debtors doing business other than as an individual, the Internal Revenue Service taxpayer identification number of such debtors …" See Pub. L. 99-198, title XIII § 1324, Dec. 23, 1985, 99 Stat. 1558, 7 U.S.C. § 1631).

This language applied both to direct notice and to constructive notice given by the filing of an Effective Financing Statement (an "EFS").

In 2004, the Privacy Protection of Certain Sellers of Farm Products Act was adopted to attempt to protect social security and tax identification numbers. [2] See Pub. L. 108-447, 118 Stat. 2809, Section 776, which provided:

> Section 1324(c) of the Food Security Act of 1985 (7 U.S.C. 1631(c)) is amended
>
> (1) in subsection (c)--
>
> (A) in paragraph (2)(C)(ii)(II), by inserting "or other approved unique identifier," after both "social security number" and "identification number";

[2] The publication of social security numbers by financial institutions is restricted by Gramm-Leach-Bliley Act of 1999, 15 U.S.C. §§ 6801 – 6809. TEX. BUS. & COM. CODE §501.001, says: "A person, other than a government or a governmental subdivision or agency, may not: (1) intentionally communicates or otherwise makes available to the public an individual's social security number …."

(B) in paragraph (4)(C)(iii), by inserting ", or other approved unique identifier," after both "social security number" and "identification number"; and

(C) by adding the following at the end:

> "(5) The term "approved unique identifier" means a number, or numbers and letters, or other identifier selected by the Secretary of State using a selection system or method approved by the Secretary of Agriculture";

(2) in subsection (e)(1)(A)(ii)(III), by inserting ", or other approved unique identifier," after both "social security number" and "identification number"; and

(3) in subsection (g)(2)(A)(ii)(III), by inserting ", or other approved unique identifier," after both "social security number" and "identification number".

Note that the definition of an "Approved Unique Identifier" was added to definition of "Effective Financing Statement in §1631(c), the central filing section, and did not appear in the language relating to direct notice, which is in §1631(e).

It is not clear to the writer of this article that the definition of "Approved Unique Identifier" which was added in 2004 applies to the direct notice provisions. The Explanatory Notes for the commercially published version of the statute says that the definition was added as new "bracketed paragraph (12) to 1631(c), making it a general definition, in order to "maintain numerical continuity," but this is not in the enabling language of the statute itself. There is a regulation on this subject, which says: "Approved Unique Identifier means a combination of numbers selected by the Secretary of State using a selection system or method approved by the Secretary of Agriculture." 9 CFR 205.1 This regulation does not appear on its face to be restricted to central filing EFS notice.

This differential quirk may pose difficulties for lenders who wish to notify buyers of their interests in farm products produced in non-central filing states: they must provide a notice that includes the following information, among other items:

> The social security number, or other approved unique identifier, of the debtor, or in the case of a debtor doing business other than as an individual, the Internal Revenue Service taxpayer identification number, or other approved unique identifier, of each debtor….

1631(e) (i) (iii) If, as in Texas, the Texas Secretary of State has not selected a "combination of numbers … using an "Approved Unique Identifier" that is a selection system or method approved the Secretary of Agriculture," met a lender who provided a notice with the borrower's social security number, and clearly violate privacy laws?

Some lenders and their counsel have adopted the convention that the following form of "approved unique identifier" is satisfactory: "000-00-1234" where "1234" is the last four digits of the borrower's social security number. The writer of this article is not aware of any cases that have addressed this question.

But this approach may not be in "strict compliance" with the FSA. There are cases that discuss whether the direct notice is required to be in strict or in substantial compliance with the FSA. The definition of "Effective Financing Statement" contains a list of information to be included in the filing to be made in central filing states, but it allows the notice to qualify if it "substantially complies with the requirements of this subparagraph even though it contains minor errors that are not seriously misleading." 7 U.S.C. § 1631(c)(4)(H). There is no similar language in the statute for lenders which provide direct notice.

In *Farm Credit Midsouth, PCA v. Farm Fresh Catfish Co.*, 371 F.3d 450 (Tenth Cir. 2004), the court adopted the view that strict compliance was required for a lender providing direct notice. The court held that the lender's letter to its debtor's customer advising of the loan, but which failed to state the debtor's social security number or tax identification number and failed to state where the farm products covered by the interest were located, did not comply with the FSA. As a result, the purchaser bought the products free from the security interest even though the purchaser knew of the existence of the interest. This view was adopted by the Illinois Supreme Court in *State Bank of Cherry v. CGB Enters.*, 984 N.W.2d 449 (Ill. 2013), which held that a notice which did not identify the county where the farm products were located did not comply with the statute. *See also Lisco State Bank v. McCombs Ranches, Inc.* 752 F.Supp. 329, n.6 (D. Neb. 1990) (actual notice insufficient, and noting "that the "direct notice" provision of the FSA does not contain the "substantial compliance" language included in the definition of "effective financing statement"").

First Nat'l Bank & Trust v. Miami County Coop. Assoc., 897 P.2d 144 (Kan. 1995), adopted the view of substantial compliance rule for a lender to provide direct notice, and allowed a notice that did not describe the location of the collateral to qualify. This case was discussed and rejected by *Farm Fresh Catfish* and by *State Bank of Cherry*. *Farm Credit Services of Mid America, ACA v. Rudy, Inc.*, 680 N.E.2d 637, 644 (Ohio Ct. App. 1996), applied the UCC standard to a direct notice and held that it was not "seriously misleading" because it did not accurately describe the crop year.

C. Lien Continuation Issues under the UCC and the FSA

1. Consent to Sell

Cases have generally recognized that if a lender has explicitly consented to the sale of farm products by agreement or implicitly consented by course of performance, it forfeits the right to pursue payment from third-party purchasers. *Weisbart & Co. v. First Nat'l Bank of Dalhart*, 568 F.2d 391 (5th Cir. 1978); (applying Texas law); *Fisher v. First Nat'l Bank of Memphis*, 584 S.W.2d 515, 519520 (Tex. Civ. App.—Amarillo 1979, no writ) (waiver must be explicit). In *Mercantile Bank of Springfield v. Joplin Regional Stockyards, Inc.*, 870 F. Supp. 278 (W.D. Mo. 1994), the court held that waiver was a viable defense even against a lender which properly gave notice under the Food Security Act. Cf., *Ag Services of America, Inc. v. United Grain Inc.*, 75 F. Supp.2d 1037 (D. Neb. 1999) (holding that waiver could not be a defense because of a special Nebraska statute stating that a security interest in farm products should not be considered waived as the result of any course of conduct between parties or any trade usage if the secured party had filed an EFS).

2. Buyer in the Ordinary Course

The term "buyer in ordinary course of business" under the Code (§ 1.201(9)) is defined more restrictively than the term "buyer in the ordinary course of business" under the Act. 7 U.S.C. § 1631 (c)(1). The Code definition requires a buyer to act in good faith and without knowledge that its purchase violates a security agreement. The Act requires only that the purchase be made in the ordinary course of business. A federal district court in Nebraska, relying on this difference, held that a person buying farm products is not required to act in "good faith and without knowledge" to take free of a security interest. *Lisco State Bank v. McCombs Ranches, Inc.*, 752 F. Supp. 329 (D. Neb. 1990).

A variation on this argument was addressed in *Consolidation Nutrition L.C. v. IBP, Inc.*, 669 N.W.2d 126 (S.D. 2003). In that case the court held that IBP, as a buyer of hogs, took free of an interest to the extent it acted as a purchaser, because it did not receive the required FSA notice, but held that it did not take free of the interest to the extent that "it acted as a creditor and setoff the sale proceeds to satisfy [the debtor's] preexisting debt under the hog procurement contract."

3. The "Created by the Seller" Rule

The Food Security Act carried forward the same "created by the seller" language as does the U.C.C. in §9.320. That is, the Food Security Act "provides no protection for a buyer of farm products from any valid security interest that was created by someone other than the immediate seller." *Fin Ag, Inc. v. Hufnagle, Inc.*, 700 N.W.2d 579, 582 (Minn. 2006).

The lien continuation rule has been combined with the language of § 9.320 to create hidden lien problems for buyers of farm products. The statute allows buyers to "take free of a security interest created by the buyer's seller." But what happens if the security interest is created by the seller's seller? In this situation, a party otherwise qualifying as a BOC may take subject to a security interest created by a supplier to its seller. *See Conseco Fin. Servicing Corp. v. Lee*, 2004 WL 1243417 54 U.C.C. Rep. Serv. 96 (Tex. App.—Houston [14th District] 2004, no pet.); cases collected at 4 White & Summers, Uniform Commercial Code, Section 338, note 1214 (Practitioner's Ed. 2006).

In *Hufnagle*, the parties involved were Fin Ag, a lender to Buck Farms, Buck's employee Tooker, and Meschke, a purchaser of corn from Tooker. Fin Ag claimed that Meschke took the corn subject to its security interest because that interest was created by Buck, not created by Tooker, under the theory that the "created by the seller" clause in 7 U.S.C. § 1631 required this result. The Court agreed.

Another case involving a similar situation reached the opposite result. *Fin-Ag, Inc. v. Cimpl's, Inc.*, 754 N.W.2d 1 (S.D. 2008). In that case, Fin-Ag, Inc. made a secured loan to the Berwalds. The Berwalds had a d/b/a called "C & M Dairy." Cimpl's, a packing plant, bought and paid for cattle from C & M. C & M did not pay Fin-Ag. Fin-Ag sued Cimpl's under the idea that its security interest was created by Berwarld, not by C & M, so it continued to be enforceable against Cimpl's even though it did not comply with the Food Security Act. Fin-Ag lost a summary judgment at trial and the Supreme Court affirmed. The court relied on the Congressional intent to protect buyers from unperfected liens, and on other cases, and said:

> "Ultimately, we agree with the Eighth Circuit Court of Appeals, and the Iowa, Arizona, and Oklahoma state courts. The courts either: (1) hold that the created by the seller limitation does not apply; or (2) treat the immediate seller as the entity that created the security interest when the immediate seller and the remote grantor of the security interest are closely related and the remote grantor was instrumental in creating the conflict."

To defend a claim of this nature, a buyer may rely on defenses such as consent to sell, waiver, or estoppel. In addition, there is authority to support the defense that this argument fails if the seller is closely related to the party that created the lien. In this situation, the seller and the supplier may be considered to be the same entity, with the result that the security interest is considered to have been created by seller, and thus subject to the lien clearing effect of 9.320. Finally, the buyer may argue that public policy should not allow this result. *See United States v. Continental Grain Co.*, 691 F.Supp. 1193 (W.D. Wis.1988).

4. Farm Products or Inventory

Many UCC cases addressed whether goods that appeared to be "farm products" were or became "inventory." The argument was usually advanced by the purchaser of the goods, in defense to a claim by a lender based on the "farm products" exception. If the goods were not "farm products" the lien continuation feature of § 9.320 did not apply.

A Texas cattle case on this issue is *Cox v. BancOklahoma AgriService Corp.*, 641 S.W.2d 400 (Tex. App.—Amarillo 1982, no writ). That case was brought by a lender against a buyer who bought cattle from its debtor. The lender relied on the farm products exception. The buyer, pointing to the debtor's affidavit stating that he was "a cattle trader, not a farmer, and that he held the cattle for inventory," argued that the debtor was not a "person engaged in farming operations," and therefore the cattle were not farm products under the Code definition. Although the court denied the defendant's claim on evidentiary grounds, it did not dispute the abstract proposition that a cattle trader or dealer may not be conveying "farm products" but may instead be conveying "inventory" so as to avoid application of the farm products exception.

Fin Ag, Inc. v. Hufnagle, Inc., 700 N.W.2d 579, 582 (Minn. 2006), rejected the farm product/inventory distinction in a FSA situation. The parties were Fin Ag, a lender to Buck Farms, Buck's employee Tooker, and Meschke, a purchaser of corn from Tooker. The court rejected Meschke's argument that he was protected because he bought inventory and not farm products. The Court said that this distinction did not protect Meschke because the Food Security Act applied to farm products, and an effort to distinguish between inventory and farm products "would require us to define seller two different ways in the same analysis without a significant indication that this was the Legislature's intent. No such indication exists here. Accordingly, if we examine the transactions under the UCC, we must conclude that Meschke took this claim subject to Fin Ag's security interest."

5. Auctioneer Liability under the FSA

Lien continuation problems can arise when farm products are sold through auctioneers. The pre-FSA common law rule was that an auctioneer was liable to a lender under an agency theory if it sold goods burdened with a lien. This theory, described as a rule of strict liability, imputed the sellers' failure to satisfy its lien to the auctioneer. *First Nat'l Bank of Amarillo v. Southwestern Livestock, Inc.*, 859 F.2d 847, 848 (10th Cir. 1988). Although no Texas cases under the Code consider this agency theory, a pre-Code cattle case appears to follow it. *Hagen v. Brzozowski*, 336 S.W.2d 213, 215 (Tex. Civ. App. — San Antonio 1960, no writ). Cases in other jurisdictions held that the farm products exception did not, in and of itself, defeat an auctioneer's agency liability. *See* cases collected in *First Nat'l Bank of Amarillo*, *supra*, 859 F.2d at 847.

One case, although in dicta, held that the FSA preempts this common law rule. *First Nat'l Bank of Amarillo*, *supra*, 859 F.2d 847, 850, n.2. However, some issues may remain. For example, the Act requires the auctioneer to sell "in the ordinary course of business." 7 U.S.C. § 1631(g)(1). If a sale is found not to be in the "ordinary course," the auctioneer may be faced with strict liability under the common law. Also, the distinction between farm products and inventory may continue to be an issue. Thus, if a "trader" sells, through an auctioneer, agricultural commodities that are not "farm products" because they were not in the possession of a "farmer," the Act may not protect the auctioneer. *Fin Ag, Inc. v. Hufnagle, Inc.*, 700 N.W.2d 579, 582 (Minn. 2006).

In addition, the auctioneer may face liability under the "created by the seller" rule if it purchases goods from a party that did not create the lien. See discussion above.

6. The FSA Does Not Apply to Proceeds

One potentially significant difference between the UCC and the FSA is their treatment of sales proceeds. Although a security in goods generally attaches automatically to "any identifiable proceeds of collateral," *see* UCC § 9.315(a)(2), courts have held that the FSA applies to the farm products only and not their proceeds. This means that the party which acts as a "buyer" is protected by the FSA, but if that party acts as a "lender," attempting to set off sales proceeds against pre-existing debt, it is not protected by the FSA. *State Bank of Cherry v. CGB Enterp.*, 984 N.E.2d 449 (Ill. 2013); *Consolidated Nutrition, L.C. v. IBP*, 669 N.W.2d 126 (SD 2003); *CNH Capital Am., LLC v. Trainer Grain & Supply Co.* (*In re Printz*), 478 B.R. 876 (Bankr. C.D. Ill. 2012).

III. FORECLOSURE SALES

A. UCC Rules

Part 6 of Article 9 contains the rules for foreclosure. We discuss below some of the rules involving cattle disputes.

The UCC Sale Provisions are very flexible. Sales can be public or private, and may be conducted with different degrees of advance notice. The overall requirement is that sales be "commercially reasonable." The burden to prove this is on the creditor.

Under §9.610 sales are allowed at a "public sale" or in limited situations, at a "private disposition." Although these terms are not defined in the statute, the Official Comments state that a public sale refers to a sale "at which the price is determined after the public has had a meaningful opportunity for competitive bidding." The term "meaningful opportunity" is "meant to imply that some form of advertisements or public notice must precede the sale and that the public must have access to the sale." Any disposition that is not a public disposition is a private disposition by negative implication.

The question of whether a sale is public or private is important in the cattle industry primarily because of the notice of sale requirements. Unless the collateral is "perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market (§9.611 (d)), then advance notice of the sale must be provided to interested parties. If the collateral does not fall into those categories then notice may be provided after the sale.

There are a few cases that discuss this issue. One court has held as a matter of law that cattle are not "customarily sold on a recognized market." *State Bank of Towner v. Hansen*, 30 U.C.C. 1493, 302 N.W.2d 760 (N.D. 1981). The court reasoned that even though futures contracts for live fat cattle and feeder cattle, and innumerable auction sales exist, there is the probability of variance between the cattle being sold on the "recognized" market and the cattle in question. A similar holding is *Wippert v. Blackfeet Tribe of the Blackfeet Indian Reservation*, 40 U.C.C. 1589, 695 P.2d 461 (1985. The South Dakota Supreme Court, however, has held that a herd of commercial cattle which the debtor intended to sell at a public livestock auction did qualify as property "customarily sold on a recognized market." *First National Bank of Minneapolis v. Kehn Ranch, Inc.*, 2 U.C.C. 2d 399; 394 N.W.2d 709 (S.D. 1986), *discussed in Arcoren v. Peters*, 829 F.2d 671, 677 n.7 (8th Cir. 1987 (en banc); *Cottam v. Heppner*, 777 P.2d 468, 9 U.C.C. 2d 805 (Utah 1989, held that the question was properly submitted to the jury in case involving cattle sold through a livestock auction. *United States v. Mid-States Sales Co.*, 336 F. Supp. 1099, 1103 (U.S. Dist. Neb. 1971), held that dairy cattle were not "perishable."

In *Havins v. First Nat'l Bank*, 919 S.W.2d 177 (Tex.App.—Amarillo, 1996, no writ) cows and stocker cattle were repossessed, then sold at a sale barn. The court discussed two lines of cases. One held that cattle were sold on a recognized market as a matter of law, and the other focused on the facts of the case. The court said: "To coin the old adage, if it looks, walks, and talks like a duck then why not consider it a duck. So, we conclude that cattle auctions may indeed be recognized markets if they satisfy the indicia of a recognized market." The court concluded that the evidence was not sufficient to support the trial court's conclusion that the auction in question did qualify, so it remanded the case.

Because the creditor has the burden to prove that sales are conducted in a "commercially reasonable" manner, and because of the uncertainty about whether a type of sale falls within the exception for the statute that excuses advance notice, the conservative view would be to assume that sales of cattle should be preceded by the notice required by the UCC.

Under § 9.611, a creditor that disposes of collateral must send a "reasonable authenticated notification of the disposition." The notice must be sent to the debtor (probably, the customer or person obligated to pay the feed bill), and the following persons are entitled to receive notice:

1. Other secured parties from whom the creditor has timely received written notice of a competing interest in the collateral;

2. Any person claiming an interest in the collateral is entitled to notice if the creditor has received an authenticated notification of the interest before the notification date;

3. Any other secured party is entitled to notice if it perfected an interest by a financing statement at least ten days prior to the notification date; and,

4. Any other secured party that has a security interest perfected prior to ten days before the notification date. (e.g. statutory lien).

The creditor is also obligated to send notice to any secondary obligor, a term that includes a guarantor.

Section § 9.613 provides that the notice of sale is sufficient if it: (i) describes the debtor and the secured party; (ii) describes the collateral to be disposed; (iii) states the method of disposition (e.g., sale, lease, license, etc.); (iv) states that the debtor is entitled to an accounting of the unpaid debt for a stated fee; and (v) states the time and place of any public sale of the collateral or the time after which the collateral will be disposed of if by another manner.

This notice is presumed to be timely under § 9.612 if it is sent at least ten days before the date of the disposition identified in the notice.

B. Sales Involving Local Statutes

Because the involuntary statutory liens involving agricultural operations differ from state to state, lenders seeking priority of their interest need to check local requirements.

Section 9.322(g) grants potential "superpriority" status if the statute that creates the agricultural lien provides that it has priority over a conflicting security interest in or agriculture lien on the same collateral. We are aware of two cases that discussed this issue. *Stockman Bank of Montana v. Mon-kota, Inc.*, 108 P.3d 1125 (Mont. 2008), concerned an agricultural lien that secured repayment of charges for fertilizer and pesticide. The statute provided for superpriority of that lien, and as a result the court held for the inputs provider over the bank lien. *See also Great Western Bank v. Willmar Poultry Company,* 780 N.W. 2d 437 (N.D. 2010).

IV. AGISTER'S LIENS

A. "Agricultural Liens" and "Possessory Liens" on Agricultural Products

Article 9 addresses "agricultural liens" that are not dependent upon possession as well as involuntary liens that are dependent upon possession. The definition of an agricultural lien is found in § 9.102:

> (5) "Agricultural lien" means an interest in farm products:
>
> (A) that secures payment or performance of an obligation for:
> (i) goods or services furnished in connection with a debtor's farming operation; or
> (ii) rent on real property leased by a debtor in connection with its farming operation;
>
> (B) that is created by statute in favor of a person that:
> (i) in the ordinary course of its business furnished goods or services to a debtor in connection with a debtor's farming operation; or
> (ii) leased real property to a debtor in connection with the debtor's farming operation; and
>
> (C) whose effectiveness does not depend on the person's possession of the personal property.

A possessory lien is defined in Section 9.333.

> (a) In this section, "possessory lien" means an interest, other than a security interest or an agricultural lien:
>
> (1) That secures payment or performance of an obligation for services or materials furnished with respect to goods by a person in the ordinary course of the person's business;
>
> (2) that is created by statute or rule of law in favor of the person; and
>
> (3) whose effectiveness depends on the person's possession of the goods.

(b) A possessory lien on goods has priority over a security interest in the goods unless the lien is created by a statute that expressly provides otherwise.

B. Priority

The perfection and priority provisions of Article 9 cover agricultural liens but not possessory liens. Under § 9.308(b), "[a]n agricultural lien is perfected if it has become effective and all of the applicable requirements for perfection in Section 9.310 have been satisfied. An agricultural lien is perfected when it becomes effective if the applicable requirements are satisfied before the agricultural lien becomes effective." Section 9.310 generally requires financing statements to be filed in order to perfect all security interests and agricultural liens. Consequently, the steps for perfection of an agricultural lien follow the rules for perfection of contractual security interests. Usually, the producer will lose this first battle because their filing will be late. Article 9 recognizes that state law "possessory" liens are excluded from its scope § 9.109(d)(2), and recognizes that such liens, if "possessory," have priority over competing Article 9 liens in the same collateral. Section 9.333(d) says that "a possessory lien on goods has priority over a security interest in the goods unless the lien is created by a statute that expressly provides otherwise."

The priority of an "agricultural lien" generally depends on the rules of Article 9, which generally favors the first to perfect. However, if the agricultural lien has been given "superpriority" status under Section 9.322(g), then the order of filing will not determine priority. Section 9.322(g) grants potential "superpriority" status if the statute that creates the agricultural lien provides that it has priority over a conflicting security interest in or agriculture lien on the same collateral. The author is aware of one case that discussed this issue. *Stockman Bank of Montana v. Mon-Kota, Inc.*, 180 P.3d 1125 (Mont. 2008), concerned an agricultural lien that secured repayment of charges for fertilizer and pesticide. The statute provided for superpriority of that lien, and as a result the court held for the inputs provider over the bank lien.

The lien continuation and "created by the seller" rules also affect UCC "agricultural liens." As noted above, the UCC allows a "buyer in ordinary course" to take free of a security interest created by its seller. Combined with the lien continuation rule of the UCC (section 9.315), downstream buyers from the BOC are at risk from contractual liens created by parties they did not deal with. However, an "agricultural lien" is not "created by the seller" because it is created by statute. Does this give the BOC's downstream buyers some protection from the holder of an agricultural lien even if that lien is perfected? Probably not. UCC section 9.317(b) provides that a buyer of goods "takes free of a security interest or agricultural lien if the buyer gives value and received delivery of the collateral without knowledge of the security interest or agricultural lien and before it is perfected."

C. Agister's Liens in Texas and Oklahoma

Both Texas and Oklahoma, and many other states, have adopted statutes which create liens on livestock as a matter of law in favor of the person who gives feed or care to the livestock. Because the liens arise by operation of law, no underlying contract or agreement is necessary to create the lien or to enforce it. There are significant differences between the liens in Texas and Oklahoma, and these differences are discussed below.

1. The Texas Agister's Lien

The Texas agister's lien is cited as TEX. PROP. CODE ANN. § 70.003. It grants a lien arising as a matter of law in favor of a party who provides care and feeding to animals left in its care by the owner. No documents need to be signed or filed to create this lien. The lien exists as long as the agister retains possession of the animals.

Although there do not appear to be any reported Texas cases on this point, the writer believes that the Texas agister's lien is superior to previously perfected contractual liens.

Practitioners should note that the lien is waived if the agister voluntarily releases possession. *Caprock Indus., Inc. v. Wood*, 549 S.W.2d 430 (Tex. Civ. App.—Amarillo 1977, no writ). This has very significant consequences. Agisters will often refuse to release possession of livestock until their bill is paid, and rightfully so – if they release possession, not only is the priority lost, but also the lien itself disappears in the absence of other arrangements.

2. The Oklahoma Agister's Lien

Oklahoma statutes create a "feedman's lien" and a "herdsman's lien." The former, at 4 O.S. 1981, § 191, creates a lien in favor of a person who is engaged in the "feeding, grazing, or herding" of domestic livestock, and the latter, at 4 O.S.1981, § 192, applies in favor of a person who has furnished or provided any "corn, feed, forage or hay" to the owner for the sustenance of domestic animals.

The Oklahoma courts hold that the rights of a UCC security interest holder have priority over those of a statutory lien holder unless the secured party has knowledge of the agister's lien and has consented to it.

Oklahoma courts have held for many years that the Oklahoma agister's liens were inferior to a previously perfected security interest. *See* Op. Atty. Gen. No. 85-171 (Jan. 9, 1986) However, the courts have also recognized a "consent" exception to this rule.

This exception was discussed in *Leger Mill Co., Inc. v. Kleen-Leen, Inc.*, 563 P.2d 132, 136 (Okla. 1977). *Leger Mill* involved a dispute between creditors regarding their priority in the proceeds from the sale of swine. *Id*. at 134. Leger Mill, the feed dealer, alleged that the secured creditors converted the sale proceeds upon which Leger Mill had a first and prior lien for feed furnished to the owner of the swine. *Id*. at 134. The feed dealer asserted its priority under § 192, the "feedman's lien." The lenders asserted priority under the UCC. After holding that the UCC lien was superior, unless the consent exception was satisfied, the Court discussed that exception.

The Court held that even though the lenders "had knowledge of the fact that Leger Mill was supplying feed" and "consented to or approved of the source from which mortgagor obtained the feed," the criteria of the exception were not met. *Id*. at 137. According to the Court, the implied consent exception is dependent upon two essentials: "First, upon mortgagee's knowledge that feed is being, or will be, supplied at the expense of the feeder, and second, upon mortgagee's promises or actions which induce feeder to supply feed to his detriment, based upon the belief that mortgagee has consented to the arrangement and will hold him harmless." *Id*. Applying the first criterion, the Court found that the lenders were not aware that Leger Mill was furnishing feed at its own expense. *Id*. at 138. Second, the Court held that the lenders did nothing to induce Leger

Mill to supply the feed. *Id*. Accordingly, the Court ruled that the facts of the case did not satisfy the implied consent exception. *Id*.

In *First National Bank of Mountain View v. Wilson*, 49 Okla. 370, 375 (Okla. 1915), the Court recited the rule that whether the lender has given implied consent is a question of fact, to be determined in light of the circumstances surrounding the transaction. In *Wilson*, the Court held that a bank waived its priority interest when, by its actions, it induced the feedman to purchase feed for cattle that were the security for the bank's loan to the owner of the livestock. *Wilson*, 49 Okla. at 375. In that case, the feedman held a lien for feed that she purchased after the owner of the livestock was unable to obtain further credit from the bank. *Id*. at 374. The bank agreed to lend funds to the feedman for the purpose of furnishing feed for the stock, which benefited the bank by preserving the property upon which it had its mortgage. *Id*. The Court held that "when by its action under the circumstances [the bank] induced [the feedman] to purchase feed and loaned her the money with which to make such purchase, we think it waived the right to assert the priority of its mortgage over her lien for the feed so furnished." *Id*. at 375

Thus, under Oklahoma law, if a feedyard were able to prove the elements of the "consent" exception, it could prevail in a contest with a secured lender. Unfortunately, this probably means a court trial of some nature. Written subordination agreements (both in Oklahoma and in Texas) are preferable.

3. Oklahoma Buyer's Lien

In response to the demise of Eastern Livestock, in 2011, Oklahoma created the Livestock Owner's Lien Act of 2011 (Title 4, Oklahoma Statutes § 201.1 et seq.). Under this statute, "every livestock owner is granted a lien in all livestock sold by such livestock owner, for any unpaid portion of the sales price for such livestock" by operation of law. The owner's lien is perfected automatically and no financing statement is required to be filed. Okla. Stat. tit. 4, § 201.4. This lien also takes priority over other liens. *Id.* § 201.7.

The Owner's Lien attaches to all livestock and continues uninterrupted in the livestock or proceeds from the sale of livestock until the owner receives the full amount of the sales price. If a subsequent purchaser in good faith pays full price for the livestock, then the lien shall transfer to the proceeds paid by the good faith purchaser, who takes the livestock free of the owner's lien. *Id.* § 201.6.

V. THE PACKERS AND STOCKYARDS ACT

The Packers and Stockyards Act, 1921, 7 U.S.C. §§ 181-229c, (the "PSA"), often is involved when cattle deals go bad. It applies to transactions in livestock or poultry, in which a packer, dealer, market agency, swine contractor, or live poultry dealer is involved, and which are in interstate commerce. The PSA creates statutory trusts and requires bonds of market participants which may provide funds to reduce losses. In addition to this direct regulation, the industry structure created by the PSA may be used by private litigants who wish to seek or impose liability in the wake of insolvency of entities regulated by the PSA.

A. Classification of Market Participants by the Packers and Stockyard Act

As applicable to this article, the PSA applies to "packers," "market agents," "dealers" and parties providing "stockyard service" to register with the United States Department of Agriculture, Grain

Inspection Packers & Stockyards Administration ("GIPSA"), and maintain bonds, and custodial accounts to assure prompt payment and solvency for the protection of livestock sellers.

A "packer" is defined in 7 U.S.C. §191 as any person engaged in the business of (a) buying livestock in commerce for purposes of slaughter, or (b) of manufacturing or preparing meats or meat food products for sale or shipment in commerce, or (c) of marketing meats, meat food products, or livestock products in unmanufactured form acting as a wholesale broker, dealer, or distributor in commerce. A "market agency" is defined in 7 U.S.C. § 201(c)) as "any person engaged in the business of (1) buying or selling in commerce livestock on a commission basis or (2) furnishing stockyard services." A "dealer" is defined in 7 U.S.C. § 201 and means any person, not a market agency, engaged in the business of buying or selling in commerce livestock, either on his own account or as the employee or agent of the vendor or purchaser.

Cases of interest involving these definitions include *Solomon Valley Feedlot, Inc. v. Butz*, 557 F. 2d 71 (10th Cir. 1977) (Feedlot not subject to PSA and so not required to register); *St. Paul Fire and Marine Ins. Co., Inc. v. Idaho Bank & Trust*, 708 F. Supp. 285 (D. Idaho 1989) ("Dealer" was not a "packer" whose receivables are subject to the statutory trust); *Safeway Stores, Inc. v. Freeman*, 369 F.2d 952 (D.C. Cir. 1966) (Supermarket chain which prepared meat and meat food products was a "packer.")

B. The Custodial Trust Account

Section 207 of the Packers and Stockyards Act (7 U.S.C. § 196) requires certain market participants to create and maintain custodial accounts which are treated as trust funds for the benefit of unpaid cattle sellers. A regulation makes that obligation very clear:

> **§ 201.42 Custodial accounts for trust funds**
>
> (a) *Payments for livestock are trust funds.* Each payment that a livestock buyer makes to a market agency selling on commission is a trust fund. Funds deposited in custodial accounts are also trust funds.
>
> (b) *Custodial accounts for shipper's proceeds.* Every market agency engaged in selling livestock on a commission or agency basis shall establish and maintain a separate bank account designated as "Custodial Account for Shippers' Proceeds," or some similar identifying designation, to disclose that the depositor is acting as a fiduciary and that the funds in the account are trust funds.
>
> (c) *Deposits in custodial accounts*. The market agency shall deposit in its custodial account before the close of the next business day (the next day on which banks are customarily open for business whether or not the market agency does business on that day) after livestock is sold (1) the proceeds from the sale of livestock that have been collected, and (2) an amount equal to the proceeds receivable from the sale of livestock that are due from (i) the market agency, (ii) any owner, officer, or employee of the market agency, and (iii) any buyer to whom the market agency has extended credit. The market agency shall thereafter deposit in the custodial account all proceeds collected until the account has been reimbursed in full, and shall, before the close of the seventh day following the sale of livestock, deposit an amount equal to all the remaining proceeds receivable whether or not the proceeds have been collected by the market agency.

> (d) *Withdrawals from custodial accounts.* The custodial account for shippers' proceeds shall be drawn on only for payment of (1) the net proceeds to the consignor or shipper, or to any person that the market agency knows is entitled to payment, (2) to pay lawful charges against the consignment of livestock which the market agency shall, in its capacity as agent, be required to pay, and (3) to obtain any sums due the market agency as compensation for its services.

Lenders which ignore the nature of these accounts do so at their own risk. *See National Bank of Glenrock v. O'Neal*, 849 P.2d 711, 714 (Wyo. 1993) (depository bank liable for conversion or trust funds to cover deficits in operating account); *Central Bank of Mississippi v. Butler*, 517 S.2d 507 (Miss. 1987) (same); *South Central Livestock Dealers v. Sec. State Bank of Hedley*, 551 F.2d 1346 (5th Cir.1977)(see discussion above in part I).

C. P&S Bonds

7 U.S.C. § 204 requires market agencies, dealers, and packers to post bonds pursuant to regulations prescribed by the USDA to protect their suppliers. The procedure is set out in 7 C.F.R. § 201.33, titled "Persons damaged may maintain suit; filing and notification of claims; time limitations; legal expenses." Generally, the claimant must file a bond claim filed in writing within 60 days from the date of the transaction on which the claim is based. Suit must be commenced not less than 120 days nor more than 547 days from the date of the transaction on which the claim is based.

Perfected claimants are paid on a pro-rated basis. Unfortunately, in many cases the bonds are not sufficient to pay all claims.

D. The Packer Trust

In the early 1970's economic dislocation in the meat packing industry caused several packers to go bankrupt. The bankruptcies created massive problems and some important litigation. (*E.g. In re Samuels*, 526 F.2d 1238, 1243 (5th Cir.), *cert. denied sub nom*, 429 U.S. 834, 97 S. Ct. 98, 50 L. Ed. 2d 99 (1976). To attempt to protect livestock producers from serious financial loss, in 1976 Congress amended the Packers and Stockyards Act. One of the additions was 7 U.S.C. § 196 (1980). Because packer insolvency does not happen often, the statute may not be used often, but if needed is a powerful tool. It provides:

> (1) All livestock purchased by a packer in cash sales and all inventories of, or receivables or proceeds from meat, meat food products, or livestock products derived therefrom, shall be held by the packer in trust for the benefit of all unpaid cash sellers of such livestock until full payment has been received by such unpaid seller; and
>
> (2) The unpaid seller will lose the benefit of the trust if the seller does not preserve the trust by filing a claim with the Secretary of Agriculture. The claim must be filed promptly. For example, if the seller's loss occurs because of dishonor of a payment instrument, the seller must file the claim within <u>fifteen</u> business days after the seller received notice of dishonor.

In re Gotham Provision Co., 669 F.2d 1000 (5th Cir. 1982), is the base case. The contest in *Gotham* was between unpaid livestock producers and a secured lender to Gotham Provision Company, a packer. A secured lender held a security interest in Gotham's inventories, accounts receivable and proceeds. In *Gotham*, the court held (1) that § 196 gives a priority to the unpaid livestock producers over the secured creditor; and (2) that the trust created by the statute is a "floating trust" consisting of the commingled meat products, inventories, accounts receivables and proceeds from cash sales, and that the unpaid producers take priority in all such commingled assets until fully paid.

The trust will also take priority over payments made to the bankruptcy debtor's lawyers if payments to the lawyers came out of monies burdened with the trust. *In the Matter of Harmon*, 11 B.R. 162 (Bankr. N.D. Tex. 1980).

Producers are sometimes concerned about the "cash sale" requirement, because sales to packers rarely, if ever, are transacted in "cash." The statute and the regulations create presumptions that favor the seller on this point. The statute provides that a mere delay in payment will not create a credit sale because all sales are presumed to be cash sales unless the seller "expressly extends credit to the buyer." 7 U.S.C. § 196(c) (emphasis added). The regulations provide a form with language to satisfy this "express" agreement requirement. In effect, the regulation creates the means for a producer to opt out of trust protection. The form says:

> "On this date I am entering into a written agreement for the sale of livestock on credit to ________, a packer, and I understand that in doing so I will have no rights under the trust provisions of section 206 of the Packers and Stockyards Act, 1921, as amended (7 U.S.C. 196, Pub. L.94–410) with respect to any such credit sale."

9 C.F.R. § 201.200.

In addition to this language, the agreement must be for a single transaction, have a specified end date, and remain in effect until it is canceled in writing. *Id*.

When determining whether a sale is a "cash sale" each transaction must be reviewed separately. A course of conduct indicating credit sales should not be a factor when determining the status of a sale under the Act. *In Re Gotham* at 1007.

A similar regulation under the Packers and Stockyards Act creates a trust when a livestock buyer makes a payment to a market agency who is selling on a commission basis. 9 C.F.R. § 201.42 The regulation states that payments to the market agency are held in trust by the market only for the benefit of the Seller to the market agency. *Id*. A market agency is "any person engaged in the business of:

1. "Buying or selling in commerce livestock on a commission basis; or

2. "Furnishing stockyard services."

7 U.S.C. § 201(c). The regulation limits the application of the trust to market agencies selling on commission. 9 C.F.R. § 201.42(a).

Other cases interpreting the statute include *Fillippo v. S. Bonaccurso & Sons*, 466 F. Supp. 1008 (E.D. Pa. 1978) (application of act in determining what qualifies as "cash sale" and/or "packer"), and *Hedrick v. S. Bonaccurso & Sons*, 466 F. Supp. 1025 (E.D. Pa. 1978 (application of the act—determination of "cash sale," "packer" and what is included as "assets."

The Texas Act, TEX. AGRIC. CODE ANN. § 148.021-028, creates a lien in behalf of the seller of livestock which follows the carcass and its products and is expressly superior to any contractual security interest. For comparison, the Oklahoma Prompt Payment Act, 2 Okla. Stat. § 9.139, imposes no trust or continuing lien.

E. The Dealer Trust

There have been several attempts to amend the PSA to create a "Dealer Trust" that would create a statutory trust similar to the packer trust. As this article is submitted for publication, the "Securing All Livestock Equitably Act of 2017," or the "SALE Act of 2017," H.B. 4058, 115TH Cong. (1st Sess. October 12, 2017) is pending in committee.