

# **CATTLE MARKETING AND LENDING**

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## CATTLE MARKETING AND LENDING

The cattle business is big business. The Texas Department of Agriculture says that Texas is “first” in the United States in the number of cattle and calves. (www.gotexan.org). The Texas Cattle Feeders Association estimates that cattle feeding in Texas, Oklahoma, and New Mexico is a \$7 billion industry, with an economic impact of \$19 billion. (www.tcfa.org).

For an industry of this size, custom and practice plays a surprisingly important role. It underlies and forms a part of many cattle transactions. In Texas this practice and custom developed in the “open range” era, when cattle roamed free on public lands. As a result, these cattle could be claimed simply by taking possession. The commercial production of beef cattle at that time involved simply driving the cattle north to a railhead.

The modern beef production industry has now segmented into three distinct production cycles: 1) cow/calf operations, with the object of producing a calf, 2) stocker operations, with the object of producing an animal to go into a feedyard, and 3) feedyard operations, with the object of producing an animal for slaughter. In many respects, the law has changed with the industry. Custom, however, has not changed as fast, and many difficult problems in “livestock law” result from this conflict.

The sources of law in Texas can be broadly characterized as follows:

Commercial Law: This body of law refers to marketing and to liens.

\* \* \*

Agriculture Code: This body of law refers primarily to production issues such as agistment liens, branding laws, and fencing laws.

\* \* \*

Custom: This source of law, which primarily involves the often unexpressed agreements of the parties, underlies many cattle transactions, and often is critical in determining disputes.

This paper identifies legal principles and problems that often arise in cattle transactions and disputes. Because these sources of law are so intertwined as a practical matter all must be considered in creating or in unwinding any particular transaction.

### I. CATTLE MARKETING AND THE UCC

#### A. Transfers of Ownership.

##### 1. Industry Practices.

Common industry practices often create situations of great legal ambiguity. For example:

Contracts for the purchase and sale of cattle are routinely made over the telephone with little or no written documentation.

Even though cattle are not fungible, they are sometimes bought and sold as if they were.

Cattle often are sold several times during their production cycle. The “Code of the West” is that a buyer does not ask his seller from whom he bought the cattle. Industry custom also is that a “man’s word is his bond.” As a result, cattle may be bought and sold with marginal, if any, proof of ownership other than the seller’s (often unstated) assertions.

Arrangements for grazing cattle “on the gain,” and the wide varieties of arrangements for providing capital, sharing in profits and losses, and division of responsibilities for caretaking are often the subject of simple oral agreements. These arrangements may create a wide variety of legal relationships. Although cattlemen routinely refer to practically all of these relationships as “partnering,” almost none of them actually result in a legal partnership.

Cattle identification markings, such as brands and eartags, are used for many purposes, and are not limited to designations of ownership.

Individuals in the cattle marketing business may participate in many different types of transactions which involve different legal relationships. For example, a cattle trader may buy and sell on a commission basis; may purchase and sell outright, taking a position which subjects him to market risk; or may buy and sell under strict price guidelines from an ultimate user. In many cases the parties involved are not aware of the legal results created by these relationships.

The industry is capital intensive but many parties involved operate on fairly thin margins. As a result, crises of insolvency occur with some frequency and may have considerable ripple effects.

##### 2. Uniform Commercial Code Principles

a. Passage of “Title” (Statutory references will be to the Texas Uniform Commercial Code, TEX. BUS. & COM. CODE ANN. §§ 1.101-11.108, unless otherwise stated.)

Section 2.401 is the first statute to keep in mind 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 perfects a retained 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).
- (5) After delivery, if the seller has not obtained a security agreement that complies with Article 9, the seller’s interest in the cattle terminates, despite any attempt to “retain title.” 8A Anderson, Uniform Commercial Code, § 9-113:7, p. 668.
- (6) 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).

b. Shelter Rules.

Section 2.403 contains many of the UCC’s “shelter” rules that protect down stream parties. It is often involved in cattle insolvency situations

§ 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.

Under § 2.403(c): 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.

Section 2.403 is thus a priority-ranking statute. 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.

c. Applying The Safe-Harbor Provisions Of § 2.403.

Courts apply the safe-harbor provisions of § 2.403, based on specific distinctions made in the Code. For example:

A lender to an insolvent middleman may be a “good-faith purchaser for value” and thus protected by § 2.403(1). *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 cattle buyer who pays with a bad check, or who fails to render payment at all, can pass to its buyer rights which are unassailable by the original seller. Classical 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).

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). Thus, 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.

Entrustment permits one with no claim to title to pass good title to a buyer in ordinary course. However, if an "entrustment" has not occurred, the buyer, under the common-law rule, takes subject to the interest of the true owner. See *Olin Corp. v. Cargo Carriers, Inc.*, 673 S.W.2d 211 (Tex. App.--Houston [14th Dist.] 1984, no writ).

The ability of a dealer to transfer to 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 cases collected in *Anderson on UCC § 2.403.122-129*.

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).

## **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 cattle 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.

## **2. Sellers' Remedies Under the Code**

### **a. Action For The Price.**

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

### **b. 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 of the Code.

### **c. 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.

### **d. Reclamation.**

Cattle are typically 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 seller's best remedy may be "reclamation," as permitted by § 2.702, discussed in detail below. The statute provides:

(b) 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 . . . .

(c) 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.

### 3. Reclamation.

#### a. Demand for Reclamation.

The credit seller must exercise the reclamation right within ten days after the buyer received the goods. *Ranchers & Farmers, supra; O'Brien v. Chandler*, 7 U.C.C. 2d 1450, 765 P.2d 1165 (N.M. 1988). There is "no specific 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 in which to reclaim may be extended if the seller has received a written misrepresentation of solvency within three months before delivery. If such a 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. In the cattle business this question may arise in the common situation in which a seller accepts as payment a check that is later dishonored. In this situation often the parties did not intend to create a credit sale, but in fact treated the check as cash.

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. Reclamation for Cash Sellers.

As originally promulgated the UCC appeared to require a cash seller to exercise its rights of reclamation within the 10 day rule of §2.702. This language appeared in former Official Comment 3 to §2.507, which said: "the provision of this Article for a ten day limit within which the small seller may claim goods delivered on credit to an insolvent buyer is also applicable here." However, this Comment was modified as a result of a Permanent Editorial Board commentary (PEB Commentary No. 1 dated March 1, 1990) which recommended deletion of this limitation Official Comment 3 §2.507 now says: "There is no specific 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." The Texas UCC has adopted this change. Unfortunately, cases have not uniformly recognized this modification. It does not appear that any Texas cases have addressed this revision, although older Texas cases have recognized the ten day limitation to a cash seller. *See Chapman Parts Warehouse, Inc. v. Guderian*, 609 S.W. 2d 317 (Tex. App.--Austin 1980); *C.F. Burk v. Emmick*, 637 F. 2d 1172 (1980)(rejecting holdings that the 10 day limitation applies to a cash seller); *see cases collected at 1 White and Summers, Uniform Commercial Code §3-7, at note 18-20 (Practitioners Edition 2006).*

#### e. Reclaiming Seller Versus Purchaser's Secured Creditor.

The perfected secured party will prevail over the 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.

(f) 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 trustee the rights of 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. Health Warranties.**

There are at least three sources of implied warranties under the Code. First, the Code implies into all contracts for the sale of goods the warranties of merchantability (§ 2.314), and, that 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 a fair or average quality within the description; and (3) are fit for the ordinary purposes for which such goods are used. . . .” Section 2.314(b). In its entirety, § 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, in 1979, the Legislature added new § 2.316(f):

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

Acts 1979, 66th Leg. R.S. p. 190, ch. 99 § 1, eff. May 2, 1979.

We have found two Texas cases that 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 war-

ranty 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 create 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.

The author has 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).

## 3. Attorney Fees for Breach of Warranty

Last month the Texas Supreme Court held that a claim for breach on an express warranty could support an award of attorney’s fees. *Medical City of Dallas, Ltd. v. Carlisle Corp.*, \_\_\_ S. W. 3rd \_\_\_, (Tex., No. 06-0660, April 11, 2008)

## II. PRE-UCC CONCEPTS

### A. The Code Rejects the “Cash Sale” Doctrine.

Before the Uniform Commercial Code, 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).

### B. 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.” Cases in other states have addressed whether local livestock statutes are dispositive under this category. An example *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. Agriculture Code Ann. §146.01, discussed below] was not impliedly repealed by the enactment of the Texas U.C.C.”). No Texas cases have 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.

### C. The “Bill of Sale” Statute.

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.

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 it held that the statute also 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 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).

### D. Brands As a “Title Predicate.”

Some states are viewed in the industry as “strong” brand law states. New Mexico is one. There, a cattle owner who does not register and brand his cattle cannot move them out of the county without the permission of the “brand inspector,” a state employee.

The industry views Texas as a “weak” brand law state, that is, a state whose laws do not mandate proof of brands as proof of ownership. In the writer’s opinion, this view corresponds with the current status brand laws in Texas. The statutes provide a mechanism for a brand owner to register that brand with the county clerk. TEX. AGRIC. CODE ANN. §§ 144.001-128. They do not, however, purport to make a sale or transfer of livestock unlawful or unenforceable without compliance with the statute.

This was not always true. The legislation that created what is now Chapter 144 was enacted in 1848. Law of March 20, 1848, ch. 124, 1848 Tex. Gen. Laws 156, 3 H. Gammel, Laws of Texas 156 (1848). The statute, then designated as art. 4561, was in issue in *Rankin v. Bell*, 85 Tex. 28, 19 S.W. 874 (1892). The court there held that it was error to permit the alleged owner to testify that her brand was on the cattle in the absence of proof or evidence that the brand was recorded. The court held that under the statute “an unrecorded brand is no evidence of ownership and the record of the brand cannot be proved by parol.” *Id.*

The statute was amended in 1913 to exclude it from application in criminal cases. 1913 Tex. Gen. Laws 129. The statute was thereafter renumbered as article 6899. TEX. REV. CIV. STAT. art. 6899 (Vernon 1925). In 1929, the 41st Legislature repealed the statute. Law of March 20, 1848, *supra*, repealed by Act of Feb. 11, 1929, ch. 22, 1929 Tex. Gen. Laws 55, 55-56 (The “Repealing Act”). The Repealing Act, titled “Repealing Law Making Stock Brands Exclusive Evidence of Ownership,” stated:

SECTION 1. That Article 6899, Title 121, Chapter 1 of the Revised Civil Statutes of 1925, which read as follows: “No brands except such as are recorded, as provided in this chapter shall be recognized in laws as any evidence of the ownership of cattle, horses [sic] or mules upon which the same may be used; provided that this shall not apply in criminal cases,” be and the same is hereby repealed.

SECTION 2. The fact that the repeal of this Article will simplify (sic) the procedure in the trial of the rights of property where the ownership of livestock is in dispute, and whereas, this Article was originally adopted in 1848, at a time when all cattle were

moved overland; and whereas, now a great majority of the cattle men in Texas own cattle in more than one brand, creates an emergency and an imperative public necessity that the constitutional rule, requiring bills to be read on three several days be suspended, and said rule is hereby suspended, and that this Act take effect and be in force from and after its passage and it is so enacted.

The history of the Texas brand legislation is thus a good example of the way that changes in industry forced changes in the law. When the brand law was enacted, no fences obstructed the range, and “all cattle were moved overland.” The only practical way to show ownership was to place a brand on the animal. After the open range was closed by fences and physical control over livestock became easier, the old law became a hindrance on commerce and was repealed.

#### E. 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).

### III. CONTRACTUAL LIENS

#### A. Lien Creation.

A security interest is not enforceable against either the debtor or any third party with respect to the collateral, and it does not attach until (1) the collateral is in the possession of the secured party pursuant to agreement, or the debtor has signed a security agreement which contains a description of the collateral; (2) value has been given; and (3) the debtor has “rights in the collateral.” UCC § 9.203(1) & (2).<sup>1</sup>

A related issue that is very important to most agricultural lenders is the “lien continuation” status provided to agricultural liens. Section 9.320(a) (former § 9.307(a)) provides that a buyer in ordinary course of business takes free of a security interest created by its seller, notwithstanding knowledge of the security interest, but excepts out of this protection “a person buying farm products from a person engaged in

farming operations.” *See also* discussion of lien continuation at Part II(C) below.

#### B. Perfection Rules.

##### 1. How to Perfect under the Uniform Commercial Code.

Perfection of a security interest in goods can be accomplished either (a) by filing a financing statement (UCC § 9.310), (b) by taking possession pursuant to a valid security agreement (§ 9.313), and, as noted below, by special rules covering goods in the possession of third parties.

Note: Perfection of liens under the UCC is not compliance with the Food Security Act.

##### a. General Rule.

The general rule under Revised Article 9 is that there is only one place to file: the debtor’s “location.” § 9.301; 9.501.

There are two exceptions to this rule. Local filing is required to perfect a security interest if the collateral is minerals to be extracted, or timber, and if the collateral is goods that are, or are to become, fixtures.

##### b. Kinds of Collateral Subject to Filing.

Before the 1995 revisions to Article 8, security interests in many assets could be perfected only by possession. The 1995 revisions to Article 8 and Section 9.115 introduced the concept of perfection by filing with respect to many classes of “investment property.” Revised Article 9 continued the trend by expanding the categories of collateral for which filing is a permissible method of perfection.

The availability of perfection by filing does not preclude perfection by other available means, such as possession or control. In some instances, the secured party will need to choose the manner of perfection because some methods of perfection create a better priority position than others.

##### c. Location of the Debtor.

Generally, the law of the jurisdiction where the debtor is “located” will govern how to perfect an interest. This means that lenders must first determine where the debtor is located before searching for other competing liens or attempting to perfect an interest.

For example, if the borrower is a Delaware corporation and the interest must be perfected by filing, the filing must be made in the place designated in the Delaware version of Article 9. § 9.307(e) & § 9.301 & § 9.102(a)(71).

Section 9.307 is the key provision for determining the “location” of a debtor. This statute divides debtors into the categories of individuals, “registered organizations,” and “organizations.”

<sup>1</sup> References to “Revised” Article 9 will refer for emphasis to the changes that became effective in 2001, but unless noted otherwise, all references are to the current law, which includes the 2001 changes.

An individual's "location" is his or her principal residence. § 9.307(b)(1). A "registered organization" is a business entity created under the law of a state or the United States. Examples are corporations, limited partnerships, limited liability corporations, limited liability partnerships, professional corporations, professional associations, cooperatives, and non-profit corporations. A "registered organization" that is organized under state law is located in that state. Special rules apply for federally created organizations. Business entities which are not created by registration under state law are defined as "organizations." Examples are partnerships, joint ownership situations, estates and trusts. The location of an "organization" is its place of business if it has only one place of business. If it has more than one place of business, it is located at its chief executive office." (One can imagine a number of difficulties which may arise as to location of filing in the loose partnerships and joint ventures common in the agriculture business).

An issue that arises sometimes in the cattle business concerns a debtor that is a resident of another country. §9.307(c) says that the rule requiring filing in the debtor's location does not apply unless the debtor is "located in a jurisdiction whose law generally requires information concerning the existence of a non possessory security interest to be made generally available in a filing, recording, or registration system. If subsection (b) does not apply, the debtor is located in the District of Colombia." Unfortunately, this means that a creditor wishing to perfect a security interest in property of a foreign national may be required to obtain an opinion from local counsel about the filing rules of a particular foreign jurisdiction before making a decision about whether filing in the United States would provide protection.

d. The Debtor's Name.

Section 9.503 says how the debtor's name must be stated on a financing statement. The underlying principle is that the name must be specific. For example, with respect to a corporation or other "registered organization," the financing statement must provide the name of the debtor as shown on the public record of the debtor's jurisdiction of organization. Decedent's estates which are debtors must also be identified clearly, as must be trusts. Section 9.503(c) disapproves of "trade names." Section 9.503(a)(4) deals with "organizations." If the "organization" is two persons having a joint or common interest, or a simple partnership, "if the debtor has a name," then the financing statement must provide that name, but "if the debtor does not have a name," then the financing statement must provide the names of the partners, members, associates, or other persons comprising the debtors.

Informal relationships of co-producers in agricultural situations may create filing confusion.

Section 9.506 says that a financing statement is effective "even if it has minor errors or omissions, unless the errors or omissions make the financing statement "seriously misleading." Section 9.506 also says that a financing statement that fails to satisfy the 9.503 requirements (see above) is misleading, and therefore ineffective to perfect an interest, unless a computer search run under the debtor's correct name reveals the financing statement with the incorrect name. Thus, the outcome in a perfection dispute may depend on the type of search logic used in the relevant jurisdiction. (Under current practice in Texas, the search system will pick up similar business names, but not necessarily on a statewide basis, because the search service generally requires designation of a city of business location.)

Effective June 16, 2007 the Texas Legislature adopted changes to the "naming" rules. As to individuals, the change provides that a name in a UCC-1 is sufficient if it is the name shown on the individual's drivers license or identification certificate issued by the individual's state of residence. For registered organizations the rules provide that the financing statement should provide "the name of the debtor indicated on the debtor's formation documents that are filed of public record in the debtor's jurisdiction of organization." §9.503 *supra*.

e. Identification of the Collateral.

Article 9 contains specific provisions to outline at least the broad parameters of requirements for collateral description.

The broadest possible description is allowed in a UCC financing statement. To qualify as a sufficient financing statement, a UCC-1 must, among other things, "indicate the collateral covered by the financing statement." § 9.502(a)(3). Section 9.504(2) provides that the financing statement may indicate that it covers "all assets," or "all personal property."

A general description of this nature is not allowed in a security agreement. A security agreement that grants a security interest in "all the debtor's personal property," without other statements of the collateral description, is not effective because § 9.108(c) provides that such a description does not reasonably identify the collateral. However, Section 9.108(b) provides that a general description by Article 9 category is permissible.

f. The Debtor's Signature.

Revised Article 9 eliminated the requirement that the debtor sign the financing statement. The purpose is to facilitate electronic filing and electronic searches. However, the debtor must authorize the filing in an "authenticated record." § 9.509(a)(2). Section 9.509(b) provides that the signing or authentication of a security agreement automatically authorizes the filing of an initial financing statement and certain amendments.

g. Movement of Debtor's Residence.

Former law (§ 9.103(1)(d)) allowed a filing which was properly perfected in another state to continue four months after a change in the state in which collateral is located. If the creditor fails to re-perfect within the four months, an intervening creditor could achieve priority.

Revised Article 9 adopted the "four month" rule, but applies to changes in the location of the debtor, not changes in the location of the collateral.

Thus, under Revised Article 9, a security interest perfected by filing in the state where the debtor is located at the time the lien is created could become unperfected four months after the debtor moves to a new "location." (§ 9.316).

**C. Special Rules for Livestock.****1. Definition of Farm Products.**

Article 9 describes four mutually exclusive "types" of collateral within the broader concept of "goods." Section 9.109 lists these four subsets of "goods" as "consumer goods," "equipment," "farm products," and "inventory."

The former formulation for "farm products," included the requirement of "possession" by a "debtor engaged in raising, fattening, grazing or other farming operations." The 2001 definition does not require the debtor to be a "farmer":

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

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

- (i) Crops produced on trees, vines and bushes; and
- (ii) aquatic goods produced in aquaculture operations;

(B) Livestock, born or unborn, including aquatic goods produced in aquaculture operations;

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

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

§ 9.102(34) (emphasis added). The new Code also added a definition of "farming operation," as follows:

"Farming operation" means raising, cultivating, propagating, fattening, grazing, or any other farming, livestock or aquaculture operation. § 9.102(35).

The comments to the new provisions say that the addition of the definition of "farming operations" is for clarification purposes only. § 9.102, comment 4(a).

The comments also seek to provide some guidance as to when farm products lose their character as such. 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 go on to 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).

**2. 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).

**3. Ownership Transfers.**

As noted above, UCC § 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). Lender-debtor-supplier contests, however, continue to

arise. 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).”

#### 4. Purchase Money Liens.

Section 9.324 can be a very important provision. The effect of this statute can best be understood in the context of the pre-2001 rules. Former § 9.312(c) and (d) gave PMSI lenders the chance to achieve priority over preexisting perfected lenders. If the collateral were inventory, the PMSI lender had to give advance notice to the prior lender, but for other collateral, including farm products (if they were not inventory), no such advance notice was required. In both situations, the PMSI lender had to provide funds to enable the debtor to acquire the collateral and the lien had to be perfected within twenty days after the debtor received possession of the collateral.

Section 9.324 placed livestock under the advance notice rule. Under revised § 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. A subordination agreement is preferable.

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 in Mundy v. Lubbock Feeders, L.P.*, 183 S.W.3d 875 (Tex. App. Eastland 2006, review denied), adopted the reasoning in the *Kunkel v. Sprague National Bank* case, 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. 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 hands of the feedyard, pasture lessor, or livestock commission company. 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. Bailment Financing Statements.

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. Schaul*, 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, the owner 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. The bailor needs written permission from the bailee to file the form.

This procedure may be appropriate for a cattle owner who pastures cattle with others. The appropriate language can be inserted in a grazing agreement, or even in a sales contract. The bailee will need to decide whether to accept this because it could create inquiries from its lenders. Lenders may want to require their borrowers to obtain such authorization from their pasture providers, and require these statements to be filed.

### 7. The “Created by the Seller” Rule.

Section 9.320 permits a buyer in ordinary course to take free of a security interest “created by the buyer’s seller,” but security interests are sometimes created by upstream suppliers. This means that 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*, 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 33-8, note 12-14 (Practitioner’s Ed. 2006). Also see discussion at part IV (c) (4) below.

## D. “Agricultural Liens” Under Revised Article 9

### 1. The New “Agricultural Lien.”

#### a. Definition.

§9.102 (a) (5) defines an agricultural lien as an interest, other than a security 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 his 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 operations; 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.

#### b. Key Points.

Under this definition the key features of an “agricultural lien” are the following:

- (1) The lien concerns “farming operations;”
- (2) The lien arises by operation of law as opposed to the agreement of the parties;
- (3) The effectiveness of the statutory lien does not depend on the debtor’s possession of the property.

#### c. Texas Liens Which May Be “Agricultural Liens.”

Texas recognizes a number of involuntary statutory liens which arise in connection with agricultural operations. Some examples are:

- (1) The agister’s lien on livestock. (TEX. PROP. CODE § 70.003).
- (2) The cotton ginner’s lien on ginned cotton. (TEX. PROP. CODE § 70.003).
- (3) The chemical and seed supplier’s lien on crop proceeds. (TEX. AG. CODE CHAP. 128).
- (4) The feed supplier’s lien on proceeds. (TEX. AG. CODE CHAP. 188).
- (5) The lien on livestock, carcasses and products with respect to livestock sold for slaughter. (TEX. AG. CODE §§ 148.021-.030).
- (6) The stock breeder’s lien on offspring. (TEX. PROP. CODE § 70.201).
- (7) The agricultural lien on crops of a contract grower. (TEX. PROP. CODE §§ 70.401-410).

#### d. How to Perfect an “Agricultural Lien.”

The holder of an “agricultural lien” must comply with the Article 9 requirements for perfection of a security interest, and the lien is subject to the general priority rules of Article 9. The local law of the jurisdiction where the farm products are located governs the perfection and priority of an agricultural lien on farm products. § 9.302.

#### e. Significance of an “Agricultural Lien.”

The classification of a lien as an “agricultural lien” has important consequences. Revised § 9.333 continues the prior rule of section 9.310 which gives priority to statutory liens which are dependent on possession. Thus, if a lien is created by statute in farm products, and the effectiveness of that lien depends on the debtor’s possession of the goods, the lien has priority over an Article 9 lien and an agricultural lien. Although there are no cases in Texas that discuss this precise issue, the author believes that a good example of this involves the statutory agister’s lien contained at Property Code Section 70.003. The effectiveness of the liens created by that statute is dependent on possession and as a result it should not qualify as an “agricultural lien” and, if the statutory provisions are satisfied, have priority over competing contractual liens. The lien on livestock, carcasses and products for livestock sold for slaughter is probably not an

“agricultural lien” because it does not secure a supplier’s inputs. The remainder of the listed liens, however, appear to be “agricultural liens” because they do provide a lien for input costs and do not depend upon possession.

A quick review of the menu of statutory liens created in Texas suggests the likely existence of similar liens in other states. Statutory liens tend to be “customized” depending upon the whims of the legislature which enacted them. The prospect for confusion abounds because there may be many different ways to perfect the liens and enforce them. In every case, in every state, there is the possible need to determine whether the provisions of Article 9 will trump any more explicit provisions in the relevant statutory involuntary lien.

The author invites practitioners’ interest to the Texas Agricultural Landlord’s Lien, TEX. PROP. CODE § 54.001, *et seq.* The Landlord’s Lien is intended to secure the landlord’s debt for furnishing real estate or other inputs. However, by virtue of TEX. PROP. CODE § 54.004, the lien persists for 30 days following harvest. Hence, it is not dependent on possession. Therefore, the lien would seemingly be an “agricultural lien” and the landlord would be required to perfect the lien by filing.

Since the involuntary statutory liens involving agricultural operations differ from state to state, lenders seeking priority of their interest in the collateral of out of state borrowers will need to exercise great caution.

f. Superpriority

§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 has located one case that discussed this issue. *Stockman Bank of Montana v. Mon-kota, Inc*, 2008 Mont. 74 (March 4, 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.

## E. JOINT CREDITOR PROBLEMS

### 1. Need for Agreements.

Producers often have more than one lender. For example, there may be a loan for cattle produced in a cow-calf operation, a separate loan for a stocker operation, and a third loan for a feedyard operation.

The problem arises because after a lien attaches it generally continues even if the debtor places another lien on the same collateral. In the example given above, once the lien was placed by the production

lender, that lien continues absent agreement throughout the economic life of the cattle. This would deprive the debtor of available sources of credit, since the second or third lender will not issue credit without assurance of first lien position.

A common problem in multi-lender situations arises when “location-based” financing is in place. A security interest does not attach until a security agreement has been signed, the secured party has given value, and the debtor has acquired “rights in the collateral.” § 9.203(a). The arrival of livestock at a location may or may not coincide with the debtor’s acquisition of “rights” in the cattle. Other competing liens may have already “attached” by the time the cattle arrived at the designated location.

Purchase money security interests also present problems for lenders to livestock operations. The definition of a “purchase money security interest” limits it to a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.” § 9.103(b). Often, cattle are purchased using funds not provided directly by the lender, which instead “reimburses” the borrower. Another common situation involves “borrowing base” arrangements, in which the credit provided is based on the value, not the acquisition, of the cattle. Arguably, neither of these situations involves a PMSI. However, *see Kunkel v. Sprague Nat’l Bank*, 33 UCC Rep. Serv. 2d 943 (8th Cir. 1997).

Thus, to avoid the effect of lien continuation, or to avoid PMSI disputes, lenders must make agreements. The three most common are release, subordination, and assignment.

### 2. Release.

This involves a complete release of the security interest.

Most lenders do not want to do this, even if the release is specific as to location. Instead, most lenders want to retain a second lien even if they agreed to subordinate their otherwise first lien.

If a release is given, it typically will relate to specific locations, for example, cattle located in a specific feedyard.

### 3. Subordination.

Section 9.339 provides: “This chapter does not preclude subordination by agreement by a person entitled to priority.” The cases recognize validity of such agreements, even if verbal. *See AW-D v. Salkeld*, 372 N.E.2d 486 (Ind. Ct. App. 1978). The Comments note that “[o]nly the person entitled to priority may make such an agreement.” These agreements can be narrowly construed. *See Western Auto Supply Co. v.*

*Brazosport Bank of Texas*, 840 S.W.2d 157 (Tex. App.—Houston [1st Dist.] 1992, no writ).

The author recommends using written subordination agreements in every case in which conflicting interests may arise.

#### 4. Assignment.

An assignment is appropriate if one lender is buying out the lien position of another. Section 9.514 authorizes the assignment of the powers of the secured party of record.

This is sometimes used even if no buyout is involved. For example, if the first lender no longer maintains a lending relationship with the borrower, that lender may execute a UCC form assignment.

However, the assignment is only as good as the underlying debt obligation so a lender should not rely only on an assignment to obtain a prior lien position over other lenders. Instead, that lender should obtain subordination, releases, or assignments from every other lender conceivable involved in the debtor's operations.

#### 5. Solution.

All agreements of this nature should be in writing and signed by all parties. Otherwise, litigation may result. See, e.g., *In re Bishop*, 52 B.R. 470 (Bankr. N.D. Ala. 1985).

### F. Foreclosure Sales of Livestock.

#### 1. General Rules.

Revised Article 9 imposed heavier duties on lenders compared to former Article 9 with respect to notice and communication of plans for disposition.

Section 9.610 allows the creditor to dispose of the collateral by public or private sale, in its then condition or following any commercially reasonable preparation or processing, so long as every aspect of the sale is commercially reasonable. Commercial reasonableness is determined by the facts of every case. The duty to dispose of collateral in a commercially reasonable manner cannot be waived or varied. The parties may adopt standards that attempt to define commercially reasonable conduct, but those standards must not be manifestly unreasonable.

A secured creditor can purchase the collateral at a "public sale" and, in limited situations, at a "private disposition." Although these terms are not defined in Revised Article 9, 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." Since neither Revised § 9.610 nor the comments

discuss the meaning of private disposition, then any disposition that is not a public disposition must be a private disposition.

Under Revised Article 9 a creditor can purchase collateral at a private disposition if the collateral is customarily sold in a recognized market. An example of a recognized market is the New York Stock Exchange. Courts have reached inconsistent results in cases involving motor vehicles and livestock. Revised Article 9 may bring some consistency in future cases as it states:

"A market in which prices are individually negotiated or the items are not fungible is not a recognized market, even if the items are the subject of widely disseminated price guides or disposed of through dealer auctions."

#### 2. Are Cattle "Perishable"?

Under pre-Revised Article 9, several courts have found cattle to be non-perishable and some have determined that cattle are not customarily sold on a recognized market.

In *United States v. Mid-States Sales Company*, 10 U.C.C. 703, 336 F. Supp. 1099 (D. Neb. 1971) and, *State Bank of Towner v. Hansen*, 30 U.C.C. 1493, 302 N.W.2d 760 (N.D. 1981). The cattle in question had been repossessed and held for two weeks to eighteen days at other locations prior to the sale. Both courts emphasize these holding periods, which occurred because of the logistical difficulty of arranging the sale, in holding that the secured creditors had time to give notice and therefore should have been given notice. It appears that courts will not accept arguments that cattle become "perishable" simply because of interruption of ordinary feeding and marketing cycles. *Boatmen's Bank of Nevada v. Dahmer*, 2 U.C.C. 2d 754; 716 S.W.2d 876 (Mo. App. 1986) (court suggests that the fact that cattle "could have survived on adequate food and water" is sufficient to preclude perishability). Ultimately, an argument that no notice is required because condition of the cattle render them "perishable" at best may raise a fact question. *City Bank & Trust Co. v. Van Andel*, 41 U.C.C. 282, 220 Neb. 152, 368 N.W.2d 789 (1985). To avoid such an issue in litigation, it is submitted that the creditor should always give whatever notice is possible and carefully consider selling at a public sale as opposed to private treaty, especially where the creditor or its affiliates may be a purchaser.

#### 3. Are Cattle Customarily Sold On A Recognized Market?

In general, courts have viewed the "recognized market" exception narrowly. Most courts have held that the exception is limited to property sold on securities exchanges or commodity futures exchanges where there

are daily quotations of prices for items of uniform description. *FDIC v. Blanton*, 918 F.2d 524 (5th Cir. 1990) (applying Texas law) (NYSE is a “recognized market”); *Norton v. National Bank of Commerce of Pine Bluff*, 3 U.C.C. 119, 240 Ark. 143, 398 S.W.2d 538 (1966). The only Texas cattle case found is *Havins v. First National Bank of Paducah*, 919 S.W.2d 177, 181-184 (Tex. App.--Amarillo 1996, no writ). There, 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.

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.

#### **IV. SALES OUT OF TRUST: CONTESTS BETWEEN LENDERS AND PURCHASERS OR AUCTIONEERS**

##### **A. UCC Background and the Double Payment Problem.**

Most farm products are produced or maintained with at least some borrowed money and are theoretically subject to a lien at all steps of production.

The UCC adopted the general proposition that “a security interest continues in collateral, notwithstanding the sale, exchange or other disposition thereof, unless the disposition was authorized by the secured party in the security agreement or otherwise. . . .” UCC § 9.320(a). In order to

encourage the free flow of commerce, however, the Code adopted the general exception to this rule for a “buyer in ordinary course.” Such a buyer is permitted to take free of a security interest created by its seller. To encourage agricultural lending, however, the Code drafters created a window of exemption for “farm products” within the otherwise “lien clearing” effect of § 9.320:

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 buyer’s seller, even if the security interest is perfected and even though the buyer knows of its existence.

The “farm products exception” permitted a lender to pursue its lien in the hands of even a buyer who qualified as a “buyer in ordinary course” who had paid his supplier. This became known as the “double payment” aspect of the statute, because the buyer could be forced to pay twice - that is, once to its seller and once to its seller’s lender.

#### **B. The Food Security Act.**

##### **1. The Statute.**

Congress addressed the issue of lien continuation as a part of the Food Security Act of 1985. The Act became effective December 23, 1986, and is codified at 7 U.S.C. § 1631. Its stated purpose was to overturn the double payment problem created by the farm products exception. 7 U.S.C. § 1631(a), (b).

The Act created a limited safe harbor for three classes of persons who buy or deal in “farm products.” First, the Act protects a “buyer in the ordinary course of business,” defined as “a person who, in the ordinary course of business, buys farm products from a person engaged in farming operations who is in the business of selling farm products.” § 1631(c)(1). Second, the Act protects “commission merchants,” who are defined as persons “engaged in the business of receiving any farm product for sale, on commission, or for or on behalf of another person.” § 1631(c) (3). Third, the Act protects “selling agents,” who are defined to include “any person, other than a commission merchant, who is engaged in the business of negotiating the sale and purchase of any farm product on behalf of a person engaged in farming operations.” § 1631(c)(8). The general rule is that these persons purchase free of security interests created by the party from whom they acquired “farm products.” § 1631(d), (g)(1).

7 U.S.C. § 1631(c)(5) provides: The term “farm product” means an agricultural commodity such as wheat, corn, soybeans, or a species of livestock such as cattle, hogs, sheep, horses, or poultry used or produced in farming operations, or a product of such corn or

livestock in its unmanufactured state (such as ginned cotton, wool-clip, maple syrup, milk, and eggs), that is in the possession of a person engaged in farming operations.

There is a statutory exception to this general rule based on the notice scheme set out in the Act. A lender which complies with the notice scheme may deprive a farm product purchaser of the safe harbor.

The Act contains separate notice schemes for states which have enacted a “central filing system,” (a “certified” state) and states such as Texas which have not. The Texas system does not comply with and is not certified under the Act. In a “non-certified” state, the notice scheme is based on actual notice. The buyer, commission merchant or sales agent takes subject to a security interest if within one year before its purchase it received written notice from the lender or borrower of the security interest in the form and containing the information required by the statute.

In a “certified” state (see [www.usda.gov/gipsa/psp/cleartitlefiling.htm](http://www.usda.gov/gipsa/psp/cleartitlefiling.htm) for a list) the Act creates two alternative methods to allow a lien to continue. First, the buyer, commission agent or sales agent must fail to register centrally before the purchase and the lender must have filed an “effective financing statement.” This “EFS” is not the same as a UCC-1. Alternatively, the buyer, commission merchant or sales agent must receive a notice from the Secretary of State describing the lien. In both cases, if the lender is not paid the sale proceeds, it may enforce its lien.

In certified states the Act requires registration and filing where the farm product is “produced.” 7 U.S.C. § 1631(e)(2), (3); 7 C.F.R. § 205.210. The regulation states that the Act “provides only for filing an EFS covering a given product in the system for the State in which it is produced . . . [I]t does not apply to a filing in another state.” Thus, if the farm product is “produced” in a certified state, a filing must be made in that state. Livestock may present a problem because they may be “produced” at any number of locations; for example, cattle could be born and weaned in one state, put on pasture in another, and fed to finish weight in a third. Compare this to Article 9, which requires filing where the debtor is located, not where the collateral is located.

## 2. Open Issues.

Although Congress stated that it intended the Act to preempt applicable state law relating to the double payment issue, there are many issues in this area other than double payment.

For example, the Act does not address priority conflicts between competing security interests in the same collateral. In this situation, Code rules such as § 9.322 continue to govern. H.R. Rep. No. 99 - 271,

99th Cong., noted that “the bill would not preempt basic state-law rules on the creation, perfection, or priority of security interests.” Op. Atty. Gen. Tex., No. JM-657, 3 U.C.C. 2d 1208 (1987), concluded that the Act does not preempt § 9.401(a) and (f) (now § 9.501) of the Code which tell where to file to perfect security interests in farm products. The Act also may not affect possible avenues of attack by bankruptcy trustees. Therefore, lenders must continue to perfect their liens under state law.

Another problem not addressed by the Act, and not completely resolved by the Code, occurs when fraudulent borrowers attempt to grant a security interest in goods they do not own. This situation, which regrettably appears as a routine matter in contested cases in this area of the law, (see, e.g., *MBank Waco, N.A. v. L & J, Inc.*, 754 S.W.2d 245 (Tex. App.--Waco 1988, writ denied), is not fully addressed by the Code; 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).

## 3. Strict Compliance With Food Security Act Is Required.

In *Farm Credit Midsouth, PCA v. Farm Fresh Catfish Co.*, 371 F.3d 450 (2004), the court held that a lender had to comply strictly with 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.

## 4. Lien Continuation Theories under the Act and the Code Compared.

### a. Consent to Sell.

Under the Code, the heart of a lender’s case under the farm products exception was its right to enforce its lien in a farm product even against a buyer in ordinary course. Cases under the Code involving lenders’ attempts to enforce this right raised issues that are still viable under the Act. One frequently discussed issue was whether the lender had explicitly consented to the sale of the farm products by agreement or implicitly consented by course of performance, thereby forfeiting 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, 519-520 (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).

b. Buyer in the Ordinary Course.

The term “buyer in ordinary course of business” under the Code (§ 1.201(9)) is defined differently from the term “buyer in the ordinary course of business” under the Act. 7 U.S.C. § 1631 (c)(1) (1988). The Code definition of this term states that such a buyer must act in good faith and without knowledge that its purchase violates a security agreement. The Act only requires 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).

One issue may be whether the buyer qualifies as a “buyer in the ordinary course.” Under the Code, one who could not qualify would purchase subject to a lien even for goods not classified as “farm products.” See *Heinrich v. Wharton County Livestock, Inc.*, 557 S.W.2d 830 (Tex. Civ. App.--Corpus Christi 1977, writ ref’d n.r.e.). *Nelson v. American Nat’l Bank of Gonzales*, 921 S.W.2d 411 (Tex. App.—Corpus Christi 1996, no writ), held that a fact question existed if a buyer of cattle who did not receive notice was a “buyer in the ordinary course of business.” The standard for a purchase in the ordinary course of business under the FSA does not appear to be very high. For example, *Farm Credit Midsouth, PCA v. Farm Fresh Catfish Co.*, 371 F.3d 450 (8th Cir. 2004), held that a purchaser of catfish who received letters from the seller’s lender describing the lending relationship and claiming a first priority lien was not liable for payments it made to the borrower but not the bank in the amount of \$692,081.71 because the bank failed to comply strictly with the direct notice provisions. The letters did not contain the borrower’s taxpayer identification number, address, or describe the counties where the catfish was produced or located and, as a result, the court said that the purchase was free of the security interest, “even though Farm Fresh knew of the existence of such interest.”

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.”

c. Farm Products or Inventory.

Before the 2001 amendments many cases addressed whether goods that appeared to be “farm products” were actually “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 § 9.307 (now § 9.320) did not apply. The leading case is *United States v. Progressive Farmers Marketing Agency*, 788 F.2d 1327, 1331 (8th Cir. 1986). Ironically, that case, which was decided by a federal court exercising diversity jurisdiction and applying South Dakota law, was not followed by the South Dakota courts. See *Sanborn County Bank, Inc. v. Magness Livestock Exchange, Inc.*, 410 N.W.2d 565, 4 U.C.C. 2d 911 (S.D. 1987) (basing its decision on a strict liability conversion theory rather than on Code principles). Texas case law was not conclusive. *McGehee v. Exchange Bank & Trust Co.*, 561 S.W.2d 926, 930 (Tex. Civ. App.--Waco 1978, writ ref’d n.r.e.) held that the debtor’s interest when a security interest attaches to collateral controls the classification of goods as “consumer goods,” “inventory,” or “farm products.” *United States v. Hext*, 444 F.2d 804, 811-814, ns. 28-30 (5th Cir. 1971), noted that ginned cotton can be a “farm product” when in the hands of a farmer, but may be “inventory” when in the hands of a ginning company.

A Texas cattle case on this issue is *Cox v. BancOklahoma Agri-Service 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. The same argument has been entertained by other courts, sometimes meeting acceptance, sometimes rejection. See *Farmers State Bank v. Webel*, 113 Ill. App. 3d 87,

446 N.E.2d 525, 36 U.C.C. 319 (1983); *First State Bank v. Producers Livestock Marketing Association Non-Stock Cooperative*, 200 Neb. 12, 261 N.W.2d 854, 23 U.C.C. 500 (1978); *Security Nat'l Bank v. Belleville Livestock Commission Co.*, 619 F.2d 840 (10th Cir. 1979). Thus, a critical issue under the Code was the status of the borrower as a “trader” or a “farmer.”

Revised Article 9 modified the definition of “farm products” in a manner which is consistent with the “farm product/inventory” distinction. The Official Comment 4(a) to Revised § 9.102 says:

Crops, livestock, and their products cease to be “farm products” when the debtor ceases to be engaged in farming operations with respect to them. If, for example, they come into the possession of a marketing agency for sale or distribution or of a manufacturer or processor as raw materials, they become inventory.

This definition appears to strengthen the argument that the “farm products exception” to lien continuation will be given limited application.

It is not clear whether arguments based on the definition of “farm products” will succeed under the Food Security Act. The Act does not define “inventory.” Thus, it can be argued that the Act contains no language on which a distinction between “inventory” and “farm products” could be based. This argument was advanced, in a concurring opinion, in *Michigan National Bank v. Michigan Livestock Exchange*, 439 N.W.2d 884, 9 U.C.C. 2d 366 (Mich. 1989). The general policy of the Act to prevent lien continuation also suggests that the Code cases on this issue, which protected innocent buyers, should not be followed blindly. The only case found that addresses the issue under the Food Security Act, however, held that this is an issue with vitality. *See Fin. Ag., infra.*

d. The “Created by the Seller” Rule

The Food Security Act carried forward the same “created by the seller” language that appears in U.C.C. §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).

*Fin Ag*, also addressed an “inventory vs. farm products” contest in a grain purchase dispute. 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 with *Fin. Ag.* The

court also 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.”

e. Sufficiency of Collateral Description.

In *First Bank v. Eastern Livestock Co.*, 837 F. Supp. 792 802 (S.D. Miss. 1993), the lender’s debtor, Wells, sold cattle to Eastern Livestock, was paid, but then failed to pay the proceeds to its lender. The court denied summary judgment motions of Eastern and First Bank, but in its ruling held that the lender’s description of the collateral in its EFS should be evaluated under the “seriously misleading” standard developed under the Code. This standard provides that a financing statement collateral description is sufficient to perfect an intent if it does not contain errors which are “seriously misleading.”

**5. Auctioneer Liability under the FSA.**

Lien continuation problems frequently 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, supra*, 859 F.2d at 848. 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). Some auctioneer cases are: *Sanborn County Bank, Inc. v. Magness Livestock Exchange, Inc.*, 410 N.W.2d 565, 4 U.C.C. 2d 911 (S.D. 1987) (holding that an auctioneer is liable under the conversion theory regardless of classification of goods as “farm products” or “inventory”); *Commercial Bank of Alma v. Hales*, 281 Ark. 439, 665 S.W.2d 857, 38 U.C.C. 680 (1984) (auctioneer cannot be a “buyer” under the Code to prevent lien continuation); *Utah Farm Production Credit Association v. Hansen*, 738 P.2d 642, 4 U.C.C. 2d 906 (Utah Ct. App. 1987) (holding that lien continuation would not be allowed under a “public policy” argument akin to estoppel); *First National Bank in Lenox v. Lamoni Livestock Sales Co.*, 417 N.W.2d 443, 5 U.C.C. 2d 23 (Iowa 1987) (rejecting *Progressive Farmers* decision and holding that once cattle are classified as “farm products” in the possession of a debtor they do not lose that classification when placed with an auctioneer); *Michigan National Bank v. Michigan Livestock Exchange*, 439 N.W.2d 884, 9 U.C.C. 2d 366 (Mich. 1989) (allowing lien continuation, but noting the passage of the Act, and stating that “its purpose is to avoid the very situation in which the litigants in this case find themselves and to shield auctioneers. . . .”); *FDIC v. Bowles Livestock Commission Co.*, 937 F.2d 1350 (8th Cir. 1991) (decided under pre-Act law).

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

## V. STATUTORY LIENS

### A. The Agister’s Lien.

#### 1. The Common Law Root.

The concept of a lien or charge upon livestock for their care is of ancient derivation. In the ancient law, to “agist” meant to take in and give feed to the cattle of strangers in the King’s forest, and to collect the money due for the same to the King’s use. BLACK’S LAW DICTIONARY 61 (5th ed. 1979). *In re Zwagerman*, 115 B.R. 540, 547 (Banker. W.D. Mich. 1990), said that the “term agistment is an ancient one derived from the old Germanic word *giest* meaning guest. The Random House Dictionary of the English Language (1973) indicates agistment as being an obsolete word meaning the act of feeding or pasturing for a fee.” The author suggests that agistment became a part of the Texas Rules of Decision when the Republic of Texas adopted the common law. See *Grigsby v. Reib*, 153 S.W. 1124, 1125 (1913) (citing, Laws of 1840, p.3, now codified at TEX. CIV. PRAC. & REM. CODE ANN. § 5.001 (Vernon 1986)).

#### 2. Modern Usage.

The modern agister’s lien typically is a creature of state statute. States vary in how they resolve issues of priority and vary in whether they address the methodology for foreclosure of the agister’s lien.

#### 3. The Texas Agister’s Lien.

TEX. PROP. CODE § 70.003. The statutory agister’s lien in Texas is TEX. PROP. CODE ANN. § 70.003. The statute has been a part of Texas law since at least 1884. Act of 1874, 14th Leg., 1st R.S., ch. 146. In 1983, the statute was placed in the Property Code. This made the lien difficult to enforce, and therefore less effective. It is now mixed with a garageman’s lien granted to auto repairmen. Before September 1, 1997, Texas agister’s lien was encumbered with the long notice period prior to sale which applied to the garageman’s lien. The statute required the agister to give as much as 60 to 91 days notice before selling animals on which the lien attached. *Dob’s Tire and Auto Center v. Safeway Ins. Agency*, 923 S.W.2d 715 (Tex. App.--Houston [1st Dist.] writ dismissed w.o.j.). In a feedlot, such a waiting period might be practically the entire feeding period for the animals and could be economically disastrous.

Effective September 1, 1997, the legislature amended the agister’s statute to permit a “person holding a lien under Section 70.003(a) on an animal fed in confinement for slaughter [to] enforce that lien in any manner authorized by Section 9.504, Business & Commerce Code.” Thus, an agister which has possession of an animal “fed in confinement for slaughter” may enforce its agister’s lien in any manner which the Code deems “commercially reasonable.” Agisters for other purposes, will need to follow the lengthier notice provisions set out elsewhere in Section 70.05.

Another statutory lien on livestock is contained in Section 70.201. This statute, titled the “Stock Breeder’s Lien” permits the “owner or keeper of a stallion, jack, bull, or bore confined to be bred for profit” to enforce a lien on the offspring of the animal to pay the charge for the breeding service. The lien is enforceable “in the same manner as a statutory landlord’s lien,” and remains in force for ten months from the day the offspring is born but is not permitted to be enforced until five months after the date of birth.

#### 4. The Texas Agister’s Lien Is Lost When The Agister Relinquishes Possession.

Because the lien is possessory, UCC § 9.310, providing that certain statutory possessory liens are superior to contractual liens, probably applies. The Texas agister’s lien, therefore, is probably superior to a prior perfected contractual security interest so long as the agister maintains possession of the cattle. See *Gulf State Bank v. Nelms*, 525 S.W.2d 866 (Tex. 1975). (Garageman’s lien superior to UCC security intent).

However, the lien is waived if the agister voluntarily releases possession. *Caprock Industries, Inc. v. Wood*, 549 S.W.2d 430 (Tex. Civ. App.--Amarillo 1977, no writ).

## B. Feed Supplier's Lien.

### 1. Tex. Agric. Code Chap. § 188.

This statute was passed in 1995. Chapter 188 creates an involuntary lien in favor of a supplier of feed or labor or services performed in connection with the delivery of preparation of feed. A companion statute, in Chapter 128, creates an involuntary lien in favor of a seller of agricultural chemicals, seeds, or feed, or to a provider of labor in connection with these products.

### 2. The Statute Creates A Lien On "Proceeds."

The lien attaches to the proceeds of livestock grown or maintained with the feed supplied. The statute does not create a lien on the actual crop or on the livestock.

### 3. The Lien Is Not Possessory.

Unlike the agister's lien, the lien provided by this statute does not depend upon the lienholder's possession of the livestock. In fact, the statute assumes that the lien claimant does not possess the livestock, but is simply a supplier of feed.

### 4. Procedure To Claim Lien.

The procedure for the crop supplier and the feed supplier is similar. If the supplier is not paid, the supplier must give notice, providing the statutory information by certified mail, stating that the payment is more than thirty days overdue. The debtor has three alternatives: 1) the debtor may permit the lien to be filed; 2) the debtor may enter into a security agreement; or 3) the debtor may agree to pay the charges. If the debtor has not paid within ten days after the notice, the creditor is permitted to file the notice of lien claim. The lien claim must be filed in the Secretary of State's Office and is considered to have the same effect as a UCC financing statement. To enforce the lien, the creditor may proceed under UCC Art. 9 or, if the parties elect, the dispute may be resolved through an administrative procedure.

## C. Liens Provided by Federal and State Prompt Payment Statutes.

### 1. The Floating Lien Provided By The Packers And Stockyards Act.

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.

#### a. § 196 Of The Packers And Stockyards Act.

- (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 fifteen business days after the seller received notice of dishonor.

#### b. In re Gotham Provision Co., 669 F.2d 1000 (5th Cir. 1982).

*In re Gotham* 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.

#### c. Other Effects Of § 196.

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).

#### d. Other cases interpreting the statute.

Include *Fillippo v. S. Bonaccorso & 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. Bonaccorso & Sons*, 466 F. Supp. 1025 (E.D. Pa. 1978) (application of the act--determination of "cash sale," "packer" and what is included as "assets.")

## 2. State Prompt Payment Statutes.

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.

## VI. DUTY TO FENCE

### A. Constitutional Delegation of Authority.

TEX. CONST. ART. 16, Sec. 23 delegates to the legislature the authority to pass laws to regulate livestock and for “the protection of stock raisers in the stock raising portions of the state,” and further provides that the legislature may exempt from these laws portions, sections or counties. The article requires that if the particular portion, section or county is to be exempt, the “freeholders of the section to be affected thereby” must vote in favor of that proposal.

The Constitution thus permits local control by voters to adopt or reject the stock laws enacted by the state legislature. For example, as noted above at II(B), the “bill of sale” laws may be in effect in some counties and not in others.

### B. Law Relating to the Open Range.

1. TEX. AGRIC. CODE Chapter 143 contains the open range laws. It creates a series of local options for fencing schemes.

2. In Texas there is no common law duty to fence. *Clarendon Land, Investment & Agency Co. v. McClelland*, 89 Tex. 483, 35 S.W. 474 (1896). Even though other states may provide for common law strict liability for the trespasses of animals, this concept is “unsuited to local conditions, and is not enforced in Texas.” *Archer v. Storm Nursery, Inc.*, 512 S.W.2d 82, 84 (Tex. Civ. App.--San Antonio 1974, no writ). Thus, Texas is still an “open range” state unless the government provides otherwise. *See also, Hollingsworth v. King*, 810 S.W.2d 772, 775-777 (Tex. App.--Amarillo 1991), *writ denied per curiam*, 816 S.W.2d 340 (Tex. 1991).

3. Sections 143.101-143.108, titled “Animals Running at Large on Highways,” contains a statute that bars animals from running at large on “highways,” but excludes some roads, such as “a numbered farm-to-market road” from the definition of “highways.”

4. An important issue with respect to stock accidents, therefore, may be the place where the accident occurred, because the laws can vary from county to county, and even within counties.

### C. Road Accidents.

1. AGRIC. CODE § 143.102 states that a person who “owns or has responsibility for” livestock may not “knowingly” permit the livestock to “traverse or roam at large, unattended, on the right-of-way of a highway.”

2. AGRIC. CODE § 143.101 defines “highway” as a “U.S. highway or a state highway in this state, but does not include a numbered farm-to-market road.”

3. Issues under this law include:

a. Whether the animal has escaped due to the owner’s “fault.” If not, no violation of the statute exists. *Ramey v. Richardson*, 397 S.W.2d 288 (Tex. Civ. App.--Amarillo 1965, writ ref’d n.r.e.).

b. Whether the owner of the property or the animal had actual knowledge that the animal was on a “highway.” *Beck v. Sheppard*, 566 S.W.2d 569 (Tex. 1978). *Beck* held that the fact that the animal is on a highway is not sufficient by itself to show negligence per se; instead, the owner must have “actual knowledge.”

c. Whether the county has adopted the stock law. If so, even if the animal is on a “farm-to-market road,” the owner will be subject to the statute. *Weddle v. Hudgins*, 470 S.W.2d 218 (Tex. Civ. App.--Tyler 1971, writ ref’d n.r.e.).

### D. Damage to Crops.

1. TEX. AGRIC. CODE § 143.001 generally requires a landowner to “fence out” livestock. *Pace v. Potter*, 85 Tex. 473, 22 S.W. 300 (1893).

(The land owner was not entitled to receive damages from the owner of cattle which destroyed its crop because the duty to fence was that of the land owner, not the cattle owner.)

2. The county may change the law by local election. AGRIC. CODE § 143.021.

### E. Mineral Production.

In Texas, a mineral estate owner has the right to use as much land as is reasonably necessary to carry out the purposes of the lease. The only duty owed by the operator of an oil lease to the owner or lessee of the surface who is pasturing cattle is not to injure cattle intentionally, willfully, or wantonly. There is no duty on the part of the operator to put fences around his operations. However, if the operator used more land than was reasonably necessary, and as a result some negligent act or omission on his part proximately caused

injury to cattle, he is liable for the damage caused. *Satanta Oil Co. v. Henderson*, 855 S.W.2d 888 (Tex. App.—El Paso 1993, no writ).

In *Burk v. Union Pacific Resources Co.*, 138 S.W.3d 46 (Tex. App.—Texarkana 2004, pet. denied), the court considered an award of damages against a seismic company that allegedly caused damages to a cattle operation by damaging the water supply to the operation. The court held that damages for dead cattle and for decreased weight gain of surviving cattle were special damages rather than direct or general damages, if they result from damage to a water well. This conclusion meant that there needed to be a pleading of special damage, which the court found was satisfied by the incorporation by reference of a DTPA demand letter into the plaintiff's pleading.