TOP TEN THINGS AG LAWYERS SHOULD KNOW

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John Huffaker grew up in Tahoka, Texas. He holds a Bachelor's of Science in Agriculture (1970) and a J.D. (1974) from Texas Tech. As an undergraduate at Texas Tech, he was a member of the Saddle Tramps. He also proudly held the franchise for the paper route in Carpenter and Wells Halls and later worked as the student foreman of the Texas Tech Creamery. At the Texas Tech Law School, he served as Editor in Chief of the Texas Tech Law Review and graduated as a member of the Order of the Coif.

Huffaker practiced law in Amarillo for 38 years, first with the firm of Gibson Ochsner & Adkins and then with Sprouse Shrader Smith P.C. His practice centered on all aspects of agriculture and agricultural finance and lending with special emphasis on the cattle industry. As a volunteer in Amarillo, he was the Founding Chairman of the Amarillo Education Foundation and served on the Amarillo College Board of Regents from 1988 to 2000.

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TOP TEN THINGS AG LAWYERS SHOULD KNOW

I. THE TEXAS AGISTER'S LIEN

The concept of a lien or charge on livestock for their care has its roots in the common 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 is an obsolete word meaning the act of feeding or pasturing for a fee." The authors of the present article suggest that common law 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. § 5.001).

The Texas agister's lien is now codified at TEX. PROP. CODE § 70.003. It provides:

> (a) A stable keeper with whom an animal is left for care has a lien on the animal for the amount of the charges for the care.
> (b) An owner or lessee of a pasture with whom an animal is left for grazing has a lien on the animal for the amount of charges for the grazing.

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, and is now mixed with the garageman's lien granted to auto repairmen.

A. Priority

Article 9 recognizes that state law "possessory" liens are excluded from its scope, (TEX. BUS. & COM. CODE § 9.109(d)(2)), and recognizes that such liens, if "possessory," have priority over competing Article 9 liens in the same collateral. § 9.109(d). A "possessory lien" is defined as:

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

TEX. BUS. & COM. CODE § 9.333(a). Section 9.333(d) says that "a possessory lien on goods has priority over a security interest in the goods unless the lien is created by a statute that expressly provides otherwise."

Under former Section 9.310, the predecessor to current § 9.333, the Texas Supreme Court held that a mechanic asserting a lien under the predecessor to §70.003 held an interest that was superior to a prior perfected contractual interest. *Gulf Coast State Bank v. Nelms*, 525 S.W.2d 866 (Tex. 1975). Practitioners should note that the lien is waived if the agister voluntarily releases possession. *Caprock Indus., Inc. v. Wood*, 549 S.W.2d 430 (Tex. Civ. App.—Amarillo 1977, no writ). This has very significant consequences. Agisters will often refuse to release possession of livestock until their bill is paid, and rightfully so – if they release possession, not only is the priority lost, but also the lien itself disappears.

From this the writers conclude that the Texas agister's lien at Property Code Section 70.003 is a "possessory" lien that is superior in priority to a prior and competing contractual lien in the same collateral but only during the time that the agister has possession.

B. Foreclosure

Liens under Property Code Section 70.003 require a claimant to give as much as 60 to 91 days notice before selling animals to which the lien attaches. *Dob's Tire and Auto Center v. Safeway Ins. Agency*, 923 S.W.2d 715 (Tex. App.--Houston [1st Dist.] (writ dism'd w.o.j). In some livestock operations, such as a feedlot, a waiting period of this length could be economically disastrous.

There is an exception that permits 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 Sections 9.610-9.619, Business & Commerce Code." TEX. PROP. CODE § 70.005. Therefore, an agister who has possession of an animal "fed in confinement for slaughter" may enforce its agister's lien in any manner which the UCC deems "commercially reasonable." *See* Tex. Prop. Code § 70.00. Agisters for other purposes must follow the lengthier notice provisions set out elsewhere in Section 70.005.

II. PROPERTY CODE LIENS

Provisions

- TEX. BUS. & COM. CODE ANN. § 9.102
- TEX. BUS. & COM. CODE ANN. § 9.333
- TEX. BUS. & COM. CODE ANN. § 9.308
- TEX. BUS. & COM. CODE ANN. § 9.301
- TEX. BUS. & COM. CODE ANN. § 9.310
- TEX. BUS. & COM. CODE ANN. § 9.307

- TEX. BUS. & COM. CODE ANN. § 9.501
- TEX. BUS. & COM. CODE ANN. § 9.302
- TEX. PROP. CODE ANN. § 70.003
- TEX. PROP. CODE ANN. § 70.201
- TEX. PROP. CODE ANN. § 70.402
- TEX. PROP. CODE ANN. § 54.001
- TEX. PROP. CODE ANN. §§ 58.002-.003

Article 9 addresses agricultural liens that are not dependent upon possession as well as additional involuntary liens that are dependent upon possession. The definition of an agricultural lien is found in TEX. BUS. & COM. CODE ANN. § 9.102.

(5) "Agricultural lien" means an interest in farm products:

(A) that secures payment or performance of an obligation for:

(i) goods or services furnished in connection with a debtor's farming operation; or
(ii) rent on real property leased by a debtor in connection with its farming operation;

(B) that is created by statute in favor a of a person that:

(i) in the ordinary course of its business furnished goods or services to a debtor in connection with a debtor's farming operation; or
(ii) leased real property to a debtor in connection with the debtor's farming operation; and

(C) whose effectiveness does not depend on the person's possession of the personal property.

A possessory lien is defined in TEX. BUS. & COM. CODE ANN. § 9.333.

(a) In this section, "possessory lien" means an interest, other than a security interest or an agricultural lien:

(1) That secures payment or performance of an obligation for services or materials furnished with respect to goods by a person in the ordinary course of the person's business;
(2) that is created by statute or rule of law in favor of the person; and
(3) whose effectiveness depends on the person's possession of the goods.

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

The perfection and priority provisions of Article 9 cover agricultural liens. Under TEX. BUS. & COM. CODE ANN. § 9.308(b), "[a]n agricultural lien is perfected if it has become effective and all of the applicable requirements for perfection in Section 9.310 have been satisfied. An agricultural lien is perfected when it becomes effective if the applicable requirements are satisfied before the agricultural lien becomes effective."[1] Consequently, the steps for perfection of an agricultural lien follow the rules for perfection of contractual security interests.

TEX. BUS. & COM. CODE ANN. § 9.301(1) states ". . . while a debtor is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral." According to TEX. BUS. & COM. CODE ANN. § 9.307, legal entities, such as corporations, limited liability companies, and limited partnerships, are located in the state of charter. Individuals are located in the state of principal residence and general partnerships are located in the state of the principal place of business. However, if the debtor is "located" in a foreign state, perfection filings must comply with the filing rules of that state. TEX. BUS. & COM. CODE ANN. § 9.301(1).

According to TEX. BUS. & COM. CODE ANN. § 9.501(a)(2), "if the local law of [Texas] governs perfection of a[n] . . . agricultural lien, the office in which to file a financing statement to perfect the . . . agricultural lien is[] the office of the Secretary of State."

TEX. BUS. & COM. CODE ANN. § 9.302 provides a specialized provision for the perfection and priority of agricultural liens. The section states ". . . [w]hile farm products are located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of an agricultural lien on the farm products." Therefore, under this provision, if the debtor and the farm products are located in Texas, Texas law governs perfection, the effect of perfection or nonperfection, and the priority, and filing must be done according to Texas law. However, if the debtor is located in Texas and the farm products are located in another state, the other state's laws govern perfection, the effect of perfection or nonperfection and the priority and filing must be done according to the other state's laws. *See* TEX. BUS. & COM. CODE ANN. § 9.302 & Comments.

[1] TEX. BUS. & COM. CODE ANN. § 9.310 generally requires financing statements to be filed in order to perfect all security interests and agricultural liens.

Nearby states (New Mexico, Colorado, Nebraska, Oklahoma, Arkansas, and Louisiana) have all adopted an equivalent uniform provision to TEX. BUS. & COM. CODE ANN. § 9.302.[2] Each of these states also has adopted an equivalent to TEX. BUS. & COM. CODE ANN. § 9.307.[3] In these states, therefore, for a debtor located in Texas, a valid Texas filing should accomplish perfection of the security interest or agricultural lien in the foreign state where the farm products are located. If the debtor is located in a foreign state, a proper filing in that state would be viewed as valid for farm products located in Texas.

Finally, we add this cautionary note. Perfection of a security interest under the Uniform Commercial Code may not constitute "notice" to a buyer in ordinary course of farm products under the "Food Security Act" of 1985 (7 U.S.C. § 1631). A discussion of that subject is outside the scope of this paper.

Against that background, this note will briefly discuss six involuntary statutory liens. Four are agricultural liens, which are non-possessory, and two are possessory liens. A non-possessory lien's effectiveness "does not depend on the person's possession of the . . . property[,]" while a possessory lien's effectiveness does "depend[] on the person's possession of the goods." TEX. BUS. & COM. CODE ANN. §§ 9.102 & 9.333.

Stable Keeper's and Pasturer's Liens (Agister's Lien)
TEX. PROP. CODE ANN. § 70.003

This lien is possessory and therefore not an agricultural lien under Article 9. The statute gives a stable keeper and an owner or lessee of a pasture a lien "on the animal for the amount of charges" for the care and for the grazing, respectively. The lien attaches to the animal left for care or grazing. No Texas holding has ever contradicted the widely held assumption that this lien is available to commercial feeding entities to secure their charges.

Cotton Ginner's Lien
TEX. PROP. CODE ANN. § 70.003

This lien is possessory and therefore not an agricultural lien under Article 9. The statute gives a "cotton ginner to whom a cotton crop has been delivered for processing or who . . . is to be paid for harvesting a cotton crop[,] . . . a lien on the cotton processed or harvested for the amount of the charges for the processing or harvesting." The lien attaches to the cotton processed or harvested.

Stock Breeder's Lien
TEX. PROP. CODE ANN. § 70.201

This lien is non-possessory and therefore an agricultural lien under Article 9. The statute gives "[a]n owner or keeper of a stallion, jack, bull, or boar confined to be bred for profit . . . a preference lien on the offspring of the animal for the amount of the charges for the breeding services . . . ." The lien attaches to the offspring of the male animal.

Agricultural Producer's Lien
TEX. PROP. CODE ANN. § 70.402

This lien is non-possessory and therefore an agricultural lien under Article 9. The statute gives an agricultural producer who "is to receive consideration for selling an agricultural crop grown, produced, or harvested[,] . . . a lien for the amount owed under the contract, or for the reasonable value of the crop on the date of transfer or delivery if there is no provision concerning the amount owed in the agreement." The lien is on the agricultural crop.

Landlord's Lien for Agricultural Rent
TEX. PROP. CODE ANN. § 54.001

This lien is non-possessory and therefore an agricultural lien under Article 9. The statute gives "[a] person who leases land . . . a preference lien for rent that becomes due and for the money and the value of the property that the landlord furnishes . . . to the tenant to grow a crop on the leased premises and to gather, store, and prepare the crop for marketing." The lien is on the crops grown on the land and property on the land furnished by the landlord for the tenant to grow, prepare, and market the crops.

Farm, Factory, and Store Worker's Lien
TEX. PROP. CODE ANN. §§ 58.002 – 58.003

This lien is non-possessory and therefore an agricultural lien under Article 9. The statute gives a worker a lien if the worker "labors or performs a service in a[] . . . mill or on a farm." The lien attaches to "[e]ach thing of value owned by or in the possession or control of the employer . . . if [the thing is] created in whole or part by the claimant's work; used by or useful to the lien clamant in the performance of the work; or necessarily connected with the performance of the work."

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[2] N.M. STAT. ANN. § 55-9-302 (West 2001); COLO. REV. STAT. ANN. § 4-9-302 (West 2001); NEB. REV. STAT. U.C.C. § 9-302 (West 1999); OKLA. STAT. ANN. TIT. 12A § 1-9-302 (West 2000); ARK. CODE ANN. § 4-9-302 (West 2001); LA. REV. STAT. ANN. § 10: 9-302 (2001).

[3] N.M. STAT. ANN. § 55-9-307 (West 2001); COLO. REV. STAT. ANN. § 4-9-307 (West 2001); NEB. REV. STAT. U.C.C. § 9-307 (West 1999); OKLA. STAT. ANN. TIT. 12A § 1-9-307 (West 2000); ARK. CODE ANN. § 4-9-307 (West 2001); LA. REV. STAT. ANN. § 10: 9-307 (2001).

III. THE DOCTRINE OF EMBLEMENTS

The doctrine of emblements permits a former tenant to re-enter the leased premises to cultivate, harvest, and remove crops the tenant planted before the lease terminated. To obtain the benefits of the doctrine the tenant must prove that:

(1) The tenancy was for an uncertain duration;
(2) The termination was due to an act of God or an act of the lessor;
(3) The termination occurred without the tenant's fault; and
(4) The crops were planted while the tenant had a right of occupancy.

Miller v. Gray, 149 S.W.2d 582, 582 (Tex. 1941); *Dinwiddie v. Jordan*, 228 S.W. 126, 127 (Tex. Comm'n App. 1921, judgm't adopted); *Calhoun v. Kirkpatrick*, 155 S.W. 686 (Tex. Civ. App.—San Antonio 1913, no writ).

These elements of proof are discussed separately below.

A. Tenancy for an Uncertain Duration

The doctrine of emblements applies only when a tenancy is for an uncertain duration. *Dinwiddie* at 127. The duration of a lease is uncertain when there is no agreement limiting the lease to a specific term, or when a lease may terminate under its own terms before the expiration of the stated term. *See Dinwiddie* at 127-28 (lease was for an uncertain duration when it provided that if the property were sold during the lease term, then the lease would terminate even if the stated time of the lease provided for termination after that date).

B. Termination Caused by Act of God or of the Lessor

The second element of the test requires that termination of the lease be the result of an act of God or an act of the lessor. *Id.* at 127. In *Dinwiddie*, the Court said that an act of God could include the death of a party who has leased its property rights. A declaration of termination by the lessor should suffice as an "act" of the lessor.

C. Termination Not Caused By Tenant

The third element requires the tenant to prove the lease was not terminated as a result of an act of the tenant. For instance, when a tenant wrongfully refuses to pay rent, Texas courts have refused to apply the doctrine. *Calhoun v. Kirkpatrick*, 155 S.W. 686 (Tex.Civ.App.—San Antonio 1913, no writ).

D. Crops Must be Planted During the Tenant's Right of Occupancy

The fourth element requires proof that the tenant planted crops during the tenant's right of occupancy. *Garza v. Mitchell*, 607 S.W.2d 593, 601 (Tex. App.—Tyler 1980, no writ). If the crops are not planted when the tenant has a right of occupancy, then title to the crops will pass to the landowner. *John Hancock Mutual Life Insurance Co. v. Dameron*, 131 S.W.2d 122, 124 (Tex. Civ. App.—Waco 1939, no writ). The tenant in this case is treated like a trespasser, and crops planted by a trespasser belong to the owner of the real estate, not the trespasser. *Garza v. Mitchell*, 607 S.W.2d 593, 601 (Tex. App.—Tyler 1980, no writ); *John Hancock* at 124. *Love v. Perry*, 111 S.W. 203, 205 (Tex. Civ. App.—Dallas 1908, no writ).

E. Bonus Point – The crops must be planted

The doctrine of emblements is probably limited to annual crops harvested from the soil. In *Brooks v. Evrett*, 33 Tex. 732 (1871), the Texas Supreme Court quoted Blackstone in defining emblements to be limited to certain crops, namely "corn, peas, beans, tares, hemp, flax, and annual roots, as parsnips, carrots and turnips." *Brooks v. Evetts*, 33 Tex. 732 (1871). In the time since *Brooks* the courts have expanded this definition and applied the doctrine to other crops harvested from the soil such as cotton and wheat. *See Dinwiddie* at 128, *Collins* at 784. One court stated in dicta that the fruit of trees is not considered to fall within the doctrine of emblements. *Lewis v. Pittman*, 191 S.W.2d 691, 695 (Tex. Civ. App.—Eastland 1945, rehearing denied) (stating that pecans are not within the definition of emblements).

IV. FEED AND SEED LIENS

Provisions

- TEX. AGRIC. CODE CHAP. 188: Liens for Animal Feed
- TEX. AGRIC. CODE CHAP. 128: Agricultural Chemical and Seed Liens

Under TEX. AGRIC. CODE CHAP. 188, a lien for animal feed attaches to the proceeds received "from the sale of: (1) the livestock for which the animal feed was used; (2) meat, milk, skins, wool, or other products derived from that livestock; or (3) issue born to that livestock." TEX. AGRIC. CODE § 188.002. Under TEX. AGRIC. CODE CHAP. 128, a lien for agricultural seed attaches to the proceeds received from the sale of "the crop produced from the agricultural seed supplied by the lien claimant or applied, delivered, or prepared by the lien claimant." § 128.002. The lien is not on the actual livestock or seed, but only the proceeds.

According to TEX. AGRIC. CODE §188.006 and § 128.006, in order to claim a lien for animal feed and seed, the supplier must have provided notice of the provisions of TEX. AGRIC. CODE CHAP. 188 and TEX. AGRIC. CODE CHAP. 128 before purchase. Then, before claiming the lien, the supplier must send notice to the debtor by certified mail. The notice must include the amount that is more than thirty days overdue. Then, the debtor has three alternatives: (1) to allow the lien to be filed; (2) to enter a security agreement; or (3) to pay the charges. If the debtor does not select an alternative within ten days, the claimant may file notice of claim of lien in the office of the secretary of state. The liens created under the TEX. AGRIC. CODE CHAPS. 188 & 128 "ha[ve] the same priority as a security interest perfected by the filing of a financing statement on the date the notice of claim of lien was filed[,]" but do not have priority over labor claims for wages and salaries or the claims for charges for the care of the livestock. § 188.026; §128.026.

V. THE PACKERS AND STOCKYARDS ACT TRUST FUND

In the early 1970's several packers filed for bankruptcy and in the ensuing contests between the packers' lenders and the unpaid cash sellers of livestock, the secured lenders prevailed. *See In re Samuels*, 526 F.2d 1238, 1243 (5th Cir. 1976). To offer some protections to livestock producers, Congress amended the Packers and Stockyards Act in 1976 to include automatic floating trusts for producers. The Act provides: "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 such packer in trust for the benefit of all unpaid cash sellers of such livestock until full payment has been received by such unpaid seller . . . " 7 U.S.C. § 196(b)

The unpaid seller must preserve its claim by filing a proof of claim with the Secretary of Agriculture. *Id.* 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. *Id.*

In Re Gotham Provision Co., 669 F.2d 1000 (5th Cir. 1982), is the base case in this area. It held that producers were entitled to receive the benefits of the trust if:

1. The sellers sold livestock;
2. The purchaser of the livestock was a packer;
3. The transaction was a "cash sale;"
4. The cash sellers have not received full payment for their livestock;
5. The packer makes average annual purchases of more than $500,000; and
6. The cash sellers have preserved the trust by giving notice to the packer and filing with the Secretary of Agriculture within the appropriate time.

Id. at 1004, 7 USC § 196.

Producers are sometimes concerned about the "cash sale" requirement, because sales to packers rarely, if ever, are transacted in "cash." The statute and the regulations create presumptions that favor the seller on this point. The statute provides that a mere delay in payment will not create a credit sale because all sales are presumed to be cash sales unless the seller "expressly extends credit to the buyer." 7 U.S.C. § 196(c) (emphasis added). The regulations provide a form with language to satisfy this "express" agreement requirement. In effect, the regulation creates the means for a producer to opt out of trust protection. The form says: "On this date I am entering into a written agreement for the sale of livestock on credit to _____, a packer, and I understand that in doing so I will have no rights under the trust provisions of section 206 of the Packers and Stockyards Act, 1921, as amended (7 U.S.C. 196, Pub. L. 94–410), with respect to any such credit sale." 9 C.F.R. § 201.200. In addition to this language, the agreement must be for a single transaction, have a specified end date, and remain in effect until it is canceled in writing. *Id.*

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

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

1. "Buying or selling in commerce livestock on a commission basis; or
2. "Furnishing stockyard services."

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

When a market agency receives a payment it is required to deposit the proceeds into an account designated as or similar to "Custodial Account for Shippers' Proceeds." 9 C.F.R. § 201.42(b). The market agency is required to deposit the proceeds it receives by the close of the business day following its actual receipt, and by the close of the seventh day

following the sale regardless of whether or not it has received payment from its buyer. 9 C.F.R. § 201.42(c).

VI. ELEVATOR BOND CLAIMS

Provisions

- Bankruptcy Code: 11 U.S.C.A. § 507
- TEX. BUS. & COM. CODE § 7.205 and Comments
- TEX. BUS. & COM. CODE § 7.207 and Comments

Warehouse's Liability

Under TEX. BUS. & COM. CODE § 7.207, with respect to fungible goods a "warehouseman is severally liable to each owner for that owner's share." The statute goes on to say that when fungible goods are overissued and the goods are "insufficient to meet all the receipts which the warehouseman has issued against it, the persons entitled include all holders to whom overissued receipts have been duly negotiated." The comments state "there is no policy reason for discriminating between successive purchasers of similar claims." This provision seemingly is intended to avoid contests based on dates of acquisition of receipts.

Buyers in Ordinary Course

Under the TEX. BUS. & COM. CODE § 7.205, "[a] buyer in ordinary course of business of fungible goods sold and delivered by a warehouse that is also in the business of buying and selling such goods takes the goods free of any claim under a warehouse receipt even if the receipt is negotiable and has been duly negotiated." The comments to this section make clear that this section is intended to apply to insolvency situations in the grain storage and marketing industry. If the fungible goods have actually been delivered, a good faith purchaser of fungible goods takes free of a claim from a receipt holder.

Producers' Limited Priority

Under the Bankruptcy Code, 11 U.S.C. § 507(a)(6), persons engaged in the production of raising grain with unsecured claims against a debtor who owns or operates a grain storage facility are given priority up to $6,150 for each individual. The priority is sixth in line after unsecured claims for domestic support obligations, administrative expenses, unsecured Federal reserve bank related loans, unsecured claims allowed under 502(f)[4], unsecured claims for wages, salaries, or commissions, and unsecured claims for contributions to an employee benefit plan. Bankruptcy Code section 557 provides the terms for an expedited procedure for the court to process priority claims under § 507(a)(6).

Secured Lenders

Although Texas law does not directly address priorities between lenders issued a warehouse receipt as collateral versus holders of warehouse receipts as purchasers, a warehouse receipt holder is likely to hold priority over a bank if the warehouse has insufficient grain to cover outstanding warehouse receipts. This should be the result because, no matter what the warehouse books might show as "company owned" grain, if the grain in storage is insufficient to meet storage claims, there is no "company" owned grain. The lender's position is only derivative of the debtor warehouse's position.

Cases

In re Esbon Grain Co., Inc., 55 B.R. 308 (Bankr. D. Kan. 1985).

- The issue in this case was the determination of the rights of grain depositors as opposed to the rights of a holder of a security interest in stored grain belonging to the warehouse. At the time of the Esbon decision, the producer / depositor priority of § 507(a)(6) existed, although the priority amount was less than the current $6,150.
- In this case, the court determined that the purpose of the section 557 expedited procedure is to allow grain producers / depositors to receive distribution in advance of other classes of creditors if they can prove ownership. *In re Esbon*, 55 B.R. at 315. Due to this, ". . . a grain producer / depositor's rights no longer may be treated on a parity with those of a secured creditor." *Id.* at 314. This means that distribution of stored grain (or proceeds) must be made ". . . to the producer / depositor before distribution to the debtor's secured creditors." *Id.*
- However, if a producer cannot recover all of his grain under section 557, ". . . the producer holds an allowed unsecured claim [under section 507, which] provides a $2,000 [now $6,150] maximum fifth [now sixth] priority." *Id.* at 315. Any additional shortage remaining after the 507 distribution "is relegated to a general unsecured status to share equally with other like claims in the residue of the estate." *Id*.

In re Childress, 182 B.R. 545 (Bankr. W.D. Mo. 1995).

- The bankruptcy court rejected the argument "that lien rights against the warehouseman's own stored grain were on an equal footing with the rights of the grain depositors holding warehouse receipts . . . and that all must share pro rata when there is an

[4] Section 502(f) relates to claims arising in an involuntary case in the ordinary course of the debtor's business after commencement of the case, but before a trustee is appointed.

overall shortage of grain in the storage facility. . . .” *In re Childress*, 182 B.R. at 552.

  - According to an excerpt from a report of the Committee for the Omnibus Bankruptcy Improvements Act of 1983, “[b]ankruptcy courts are mandated to order distribution of stored grain (or proceeds) to the producer / depositor *before* distribution to debtor’s secured creditors.”[5] *Id*.

- Under Missouri law, the relationship between a warehouse and a grain depositor is that of a bailor-bailee. Grain producers retain actual ownership so ownership of the grain never passes to the warehouse as debtor-in-possession. *Id*. at 554.

  - Therefore, the bailor is entitled to recover his property if the bailee goes bankrupt. *Id.* at 555. However, because there is “. . . . nothing in the plain language of section 557 that sets forth any priorities between grain producers and other creditors of the debtor[,]” if a grain claimant cannot fully recover because of shortages, section 507 sets out the priorities. The grain claimant has priority for the first $4,000 [now $6,150] of the loss suffered and any additional loss “will be satisfied in the same manner as other general unsecured creditors by pro rata sharing in the distribution of the estate.” *Id*. at 555-56.

In re Mount Moriah Elevator, Inc., 143 B.R. 905 (Bankr. W.D. Mo. 1992).

- While some state statutes contain their own distribution schemes, the Bankruptcy Code contains a distribution scheme in 11 U.S.C.A. § 507.

  - “Under the Code, grain producers are entitled to a priority claim to the extent of $2,000 [now $6,150] per individual. . . . The remainder of grain claims would then be treated as unsecured non-priority claims, to be paid pro rata alongside the non-grain unsecured claims.” *In re Mount Moriah Elevator, Inc.*, 143 B.R. at 908; 11 U.S.C.A. § 507(a)(6).

- Furthermore, in determining the property of the estate, the bankruptcy court must look at a full presentation of the evidence. *In re Mount Moriah Elevator, Inc.*, 143 B.R. at 909.
- In this case, the grain “. . . is not specifically owned by, or identifiable to any particular grain producer. Nor is it owned by the state. Therefore, it can only be an asset of the debtor’s estate, to be liquidated by the trustee and distributed to creditors.” *Id*.

VII. THE ACCOMMODATION DOCTRINE

After the mineral estate has been severed from the surface estate, the interests of the two estates are at odds. Because the owner of the mineral estate has the dominant estate, it has the right to use the surface of the property when extracting minerals, and has “incidental rights reasonably necessary for the extraction” of those minerals. *Merriman v. XTO Energy, Inc.*, 407 S.W.3d 244, 248-49 (Tex. 2013). “If the mineral owner has only one method for developing and producing minerals,” it may use that method regardless of its effects on the existing use of the surface property. *Id.* at 249. But if the mineral owner has reasonable alternative means of developing and producing the minerals, and one of those alternatives would allow the surface owner to continue to use the surface in its existing manner, then the mineral owner must use that alternative. *Id.* This principle is known as the accommodation doctrine or the alternative means doctrine. *Merriman* at 250. The goal of this doctrine is to attempt to balance the “rights of surface and mineral owners to use their respective estates . . . while recognizing the dominant nature of the mineral estate.” *Id.* at 250.

For a surface owner to obtain relief on a claim that a mineral owner failed to accommodate the existing surface use, the surface owner has the burden to prove:

(1) The mineral owner’s use “completely precludes or substantially impairs the existing use”;
(2) “There is no reasonable alternative method available to the surface owner by which the existing use can” continue; and
(3) “There are alternative reasonable, customary, and industry-accepted methods available” that would allow the recovery of the minerals and allow the surface owner to continue the existing use.

Id. at 249.

[5] Excerpt from S.Rep. No. 98-65, 98th Cong., 1st Sess., p. 25, The Omnibus Bankruptcy Improvements Act of 1983, report of the Committee on the Judiciary United States Senate.

A. Existing Use of the Surface

A court must define the existing use of the surface narrowly when applying the accommodation doctrine. In *Merriman v. XTO Energy, Inc.*, 407 S.W.3d 244, 248-49 (Tex. 2013), a cattle operator sought to stop a drilling operation, then to remove the well after he failed to obtain an injunction to prevent the drilling operation, under the accommodation doctrine. Merriman, the surface owner, used a network of fencing, corrals, and pens on the property to sort and work his cattle. *Id.* The installation of the well and its accompanying equipment made much of Merriman's cattle equipment useless. *Id.* at 251. The Texas Supreme Court found that the Court of Appeals erred by classifying Merriman's existing use as broadly "agricultural." *Id.* at 250. The Texas Court said the Court of Appeals should have considered whether Merriam could continue his existing "cattle operation and its essential parts." *Id.* at 250-51. Even with this more narrow definition of the existing use, the Court found that Merriman could continue his existing use by rearranging his pens and installing new ones. *Id.* at 251-52.

B. No reasonable alternative for the surface owner

It is not enough for the surface owner to show that no convenient alternative exists. *Id.* The surface owner must show that there is no alternative way to continue its existing use or that the cost of the only available alternative method "is so great as to make the alternative method unreasonable." *Id.*

However, when evaluating the surface owner's alternatives, the court may not take into account other properties that the surface owner has access to as lessee. *Id.* at 250.

C. Alternative Industry Accepted Methods

The third prong of the test examines whether other methods for extracting the minerals exist, and whether those methods are "industry-established and technically and economically feasible." *Valence Operating Co. v. Tex. Genco, LP*, 255 S.W.3d 210, 218 (Tex. App.—Waco 2008, no pet.). An important factor is whether the other methods have been implemented by mineral operators. In the landmark case of *Getty Oil Co. v. Jones*, 470 S.W.2d 618, 621 (Tex. 1971), the court relied on evidence that another oil company had installed cellars for its pump jacks pumping system, as opposed to above-ground units, which preclude the surface owner's existing use of a circle irrigation system to hold that this a was a feasible alternative. Typically this issue is addressed by experts who testify that the cost and feasibility of an alternative method suggested by the surface owner. *See e.g. Getty Oil* at 622 (consider expert testimony concerning the cost of an alternative method for placement of pump jacks), *Valence Operating* at 217 (considering expert testimony about the availability of directional drilling).

VIII. ADMINISTRATIVE SALES TO BANKRUPTCY (DOING BUSINESS WITH BANKRUPT ESTATE)

Provisions

- Bankruptcy Code: 11 U.S.C.A. § 507
- Bankruptcy Code: 11 U.S.C.A. § 503
- Bankruptcy Code: 11 U.S.C.A. § 363
- Bankruptcy Code: 11 U.S.C.A. § 361
- Bankruptcy Code: 11 U.S.C.A. § 721
- Bankruptcy Code: 11 U.S.C.A. § 1108
- Bankruptcy Code: 11 U.S.C.A. § 1203
- Bankruptcy Code: 11 U.S.C.A. § 726
- Bankruptcy Code: 11 U.S.C.A. § 364
- Federal Rules of Bankruptcy Procedure, Rule 4001

Prepetition Sales

The Bankruptcy Code provides some limited assistance to a vendor who provided goods to a purchaser on the eve of bankruptcy. If "goods have been sold to the debtor in the ordinary course of such debtor's business[,]" and then the debtor files for bankruptcy, the seller is allowed to have an administrative expense claim for ". . . the value of any goods received by the debtor within 20 days before the date of commencement of a case." 11 U.S.C.A. § 503(b)(9). The administrative expenses allowed under section 503(b) have second priority after allowed unsecured claims for domestic support obligations. 11 U.S.C.A. § 507(a)(2).

Postpetition Sales

In a chapter 7 liquidation proceeding, there is no assumption of business continuation. However, a chapter 7 trustee may seek court authorization to continue operations so long as ". . . such operation is in the best interest of the estate and consistent with the orderly liquidation of the estate." 11 U.S.C.A. § 721.

In proceedings under chapter 11, a ". . . trustee may operate the debtor's business" unless the court orders otherwise." 11 U.S.C.A. § 1108. Thus, under chapter 11, it is presumed that authorization is not needed and continued operation of a business is automatic.

In proceedings under chapter 12, ". . . a debtor in possession shall have all the rights, . . . and powers, and shall perform all the functions and duties . . . of a trustee serving in a case under chapter 11, including operating the debtor's farm or commercial fishing operation." 11 U.S.C.A. § 1203. Thus, under chapter 12 as well, it is presumed that authorization is not

needed and continued operation of a business is automatic.

If a trustee or debtor in possession is able to continue to operate the debtor's business, the best practical advice to a would be provider is to only sell goods "cash on delivery" (C.O.D.). However, if cash on delivery is not available or practical for the trustee, the trustee may be able to obtain credit through an allowable administrative expense. *See* 11. U.S.C.A. §§ 364(a)-(b). If the grant of an administrative expense priority is insufficient, ". . . the court . . . may authorize the obtaining of credit or the incurring of debt[:] (1) with priority over any or all administrative expenses of the kind specified in section 503(b) or 507(b) . . .; (2) secured by a lien on property of the estate that is not otherwise subject to a lien; or (3) secured by a junior lien on property of the estate that is subject to a lien."

Cash Collateral

"'[C]ash collateral' means cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offspring, rents, or profits on property . . . subject to a security interest . . . whether existing before or after the commencement of a case under this title." 11 U.S.C.A. § 363(a).

"If the business of the debtor is authorized to be operated under section 721, 1108, 1203, 1204, or 1304 . . . and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing. 11 U.S.C.A. § 363(c)(1). However, using cash collateral is not automatic. In order for a trustee to use, sell, or lease cash collateral, "each entity that has an interest in such cash collateral [must] consent[]; or the court, after notice and a hearing, [must] authorize[] such use, sale, or lease . . . ." 11 U.S.C.A. § 363(c)(2).

In order to provide adequate protection of such interest, "the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary. . . ." 11 U.S.C.A. § 363(e).

In order to have use of cash collateral authorized by the court, Rule 4001 of the Federal Rules of Bankruptcy Procedure requires a motion for authority. The motion must list or summarize: "the name of each entity with an interest in the cash collateral; the purposes for the use of the cash collateral; the material terms, including duration, of the use of the cash collateral; and any liens, cash payments, or other adequate protection that will be provided to each entity with an interest in the cash collateral or, if no additional adequate protection is proposed, an explanation of why each entity's interest is adequately protected." Examples of methods of providing adequate protection are set forth in 11 U.S.C.A. § 361. Adequate protection may be provided by periodic cash payments, lien replacement, or granting other relief. 11 U.S.C.A. § 361.

11 U.S.C.A. § 363(p) states that "the burden of proof on the issue of adequate protection" is on the trustee and "the burden of proof on the issue of the validity, priority, or extent of such interest" is on the entity asserting an interest in property. However, "[c]ourts have split over the burden of proof that the Debtor must carry . . . . Some bankruptcy courts have required proof by clear and convincing evidence" while others believe "the proper burden is preponderance of the evidence." *In re Glasstream Boats, Inc.*, 110 B.R. 611, 613 (Bankr. M.D. Ga. 1990).

Finally, under a chapter 7 proceeding, if property of the estate is available for distribution, distributions are to follow the priority scheme of section 507; i.e., the administrative expenses used to operate the business that are allowed under section 503(b) are still given priority after allowed unsecured claims for domestic support obligations. 11 U.S.C.A. § 726(a)(1).

IX. WHERE ARE FARM PRODUCTS "PRODUCED" UNDER THE FOOD SECURITY ACT?

The Food Security Act (7 U.S.C. § 1631) provides that buyers of farm products that have been "produced in" a state take subject to a security interest created by its seller if the seller's lender has filed an Effective Financing Statement (an "EFS") in that state, or if the buyer has received direct notice. 7 U.S.C. § 1631(e). Buyers are also authorized to register in central filing states. If a buyer registers, and the lender does not, then the buyer takes free of the interest. 7 U.S.C. § 1631.

In a direct notice state like Texas, a lender must provide written notice containing statutory information directly to the buyer. 7 U.S.C. § 1631(e)(1). The "direct notice" section of the statute does not contain language that restricts the effect of the notice to goods "produced in" any particular state. Thus, a lender in a central filing state may give direct notice to a buyer in a direct notice state to enforce its interest. Buyers in direct notice states may take subject to a security interest if the lender has provided actual notice to it, regardless of whether that lender is located in a direct notice state or a central filing state.

A difficult question presented by these provisions is whether a buyer in a direct notice state who buys farm products that were "produced in" a central filing state is subject to a filing in an EFS central notice state. For example, what happens when a buyer in Texas receives no notice of an EFS filing made in a state like

Oklahoma when the farm products are "produced in" Oklahoma? The statute says that a buyer in a direct notice state is subject to such a filing if the farm products were "produced in" the central filing state, but the statute does not define "produced in." 7 U.S.C. § 1631(e). The writers generally believe that "produced in" involves a husbandry function, [6] but there is room to argue that the term has a greater scope, and could extend to the area of marketing as well as husbandry.

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

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

The Court held that the cattle were "produced in" Oklahoma:

> The FSA does not define "produced in." We are unaware of, and the parties have not directed us to, any case law defining the phrase as used in the FSA. Consequently, we give the phrase its plain and ordinary meaning, which may include consideration of dictionary definitions…[and] the legislative purpose of the FSA, legislative history, and the consequences of particular constructions to discern the meaning of the phrase.
>
> *…*…*
>
> Because the FSA is focused on ensuring buyers can obtain adequate notice of potential security interests in farm products, the meaning of "produced in" should be interpreted to reflect that focus. Accordingly, we conclude that "produced in," as used in this context, means the location where farm products are furnished or made available for commerce. Such an interpretation allows lenders to discern where they must file notice of their security interests and ensures a practical means for buyers to discover otherwise unknown security interests in farm products, as Congress intended. 7 U.S.C. § 1631(a)-(b); *see also* H.R. Rep. No. 99-271, at 109-10 (1985) (the FSA was intended to create a "universal rule" preempting state laws forcing "innocent buyers of farm products to become unwilling loan guarantors").

Careful buyers will therefore check lien filings in states from which their sellers are located.

X. RECLAMATION

Provisions

- TEX. BUS. & COM. CODE § 2.702: Seller's Remedies on Discovery of Buyer's Insolvency
- Bankruptcy Code: 11 U.S.C. § 546(c): Limitations on avoiding powers

When buyers are insolvent, the seller's best remedy may be reclamation under § 2.702.[7] Section 2.702(b) provides that "[w]here the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of insolvency has been made to the particular seller in writing within three months before delivery the ten day limitation does not apply…." Section 2.702(c) provides that "[t]he seller's right to reclaim under Subsection (b) is subject to the rights of a buyer in ordinary course or other good faith purchaser or lien creditor under this

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

[7] David LeBas & John Huffaker, *Where's the Beef? Legal Foundations of Texas Cattle Marketing and Lending* (2010) page 6.

chapter (Section 2.403)[8]. Successful reclamation of goods excludes all other remedies with respect to them." A lender usually will be a "good faith purchaser." *See* TEX. BUS. & COM. CODE § 1.201(20), (29), & (30).

Under the Bankruptcy Code, 11 U.S.C. § 546(c), a seller may reclaim "goods if the debtor has received such goods while insolvent, within 45 days before the date of the commencement of a case under this title, but such seller may not reclaim such goods unless such seller demands in writing reclamation of the goods not later than 45 days after the date of receipt of such goods by the debtor; or not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case."

Cases

Archer Daniels Midland Co. v. Charter Int'l Oil Co., 60 B.R. 854 (M.D. Fla. 1986).

- One issue in this case was whether the Bankruptcy Court erred when the Court held that Archer Daniel's Midland Co. could only reclaim the ethanol that was in storage at the time of notice of reclamation.

This Court held that the Bankruptcy Court did not err because "the seller's right of reclamation extends only to those goods which are identifiable and in the buyer's possession at the time the demand for reclamation is received." *Archer Daniels Midland Co.*, 60 B.R. at 856.

XI. SECURED PARTY TRICKS OF THE TRADE

A. Purchase Money Security Interests in Livestock.

Section 9.324 of the U.C.C. contains the purchase money security interest ("PMSI") rules. The holder of a PSMI can trump a pre-existing lender, making this a valuable status in situations of insolvency. However, the rules are difficult to follow for a livestock lender.

Section 9.324 requires a lender who seeks a priority purchase money security interest secured by livestock to take the following steps: (1) The lender must advance funds to enable the debtor to acquire the collateral; (2) The security interest must be perfected when the debtor receives possession of the livestock; (3) The purchase money lender must send an "authenticated notification" to the conflicting security interest holder; (4) The holder of the conflicting security interest must receive the notice within the six months before the debtor receives possession of the livestock; and (5) The notice must state that the purchase money lender has or expects to acquire a purchase money security interest in the debtor's livestock and describe the livestock. This poses great difficulty because livestock are often purchased on a spot basis, which makes advance notice to the previous lienholder. These writers suggest that this priority contest be resolved by contract, such as a subordination agreement.

An argument can be made that if the debtor never receives possession of the goods, the notice provisions of Section 9.324, which require advance notice to a previous lender, do not apply. 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. *First National Bank in Munday v. Lubbock Feeders, L.P.*, 183 S.W.3d 875 (Tex. App. — Eastland 2006, pet. denied), adopted this reasoning and held that a feedyard that perfected an interest in its customer's cattle was not required to give advance notice to obtain purchase money priority because the customer never received possession of the cattle.

B. Secured Party's Notice to Bailee

Although creditors will always want to perfect by filing, Section 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 sale barn. These parties may in some instances be characterized as bailees. If collateral is in the hands of a bailee, perfection may occur by notice to the bailee. The secured party is deemed to have possession from the time the bailee receives notice of the secured party's interest. TEX. BUS. & COM. CODE § 9.313.

C. Perfection by Possession

Security interests may be perfected by possession. A secured party may "perfect a security interest in negotiable documents, goods, instruments, money, or tangible chattel paper by taking possession of the collateral." TEX. BUS. & COM. CODE § 9.313. This concept was addressed in the feedyard cattle case of *First Nat'l Bank v. Lubbock Feeders, L.P.*, 183 S.W.3d 875, 883 (Tex. App.—Eastland 2006, pet. denied):

> Lubbock Feeders argues that it perfected its purchase money security interest in the cattle by taking possession of the cattle and by filing financing statements covering the cattle. A secured party may perfect a security interest in goods by taking possession of the goods or by filing a financing statement. Sections 9.310(a), (b)(6), 9.313(a); *see also*

[8] Section 2.403 is titled "Power to Transfer, Good Faith Purchase of Goods; 'Entrusting'"

Kunkel v. Sprague Nat'l Bank, 128 F.3d 636, 644 (8th Cir. 1997)(Feed yard perfected its purchase money security interest in cattle by taking possession of the cattle); *MBank Abilene, N.A. v. Westwood Energy, Inc.*, 723 S.W.2d 246 (Tex. App. —Eastland 1986, no writ).

Cox purchased all of the subject cattle from third party vendors at sale barn auctions. Lubbock Feeders received delivery of the cattle at its feed yard. Cox never had possession of the cattle. Thus, the summary judgment evidence established that Lubbock Feeders perfected its security interest in the cattle by taking possession of the cattle. Sections 9.310(b)(6) and 9.313(a); *Kunkel*, 128 F.3d at 644. Therefore, we need not address Lubbock Feeders's contention that it also perfected its security interest by filing financing statements nor the Bank's contention that the financing statements filed by Lubbock Feeders were insufficient to perfect its security interest.