



Where's the Beef?

Legal Issues in the Texas Cattle Industry

BY DAVID LEBAS AND JOHN HUFFAKER

The cattle business is big business. According to the Texas Department of Agriculture, 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).

The modern beef production industry has 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. Even though the industry has modernized and adopted technology and efficiencies of scale, the legal problems that arise in the industry and the resolution of some of those problems are still highly influenced by traditions, customs, and practices that, in some ways, hark back to the days of the “open range.”

Although there are many legal and regulatory issues that affect the industry, this article will highlight a few recurring subjects involving cattle sales and financing and the duty to fence.





Industry Practices Related to Cattle Sales

The cattle industry is capital intensive and directly influenced by a volatile commodities market. As a result, crises of insolvency occur with some frequency and may have considerable ripple effects. 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 truly fungible, they are sometimes treated as if they are;
- Cattle often are sold several times during their production cycle, many times without either the buyer or the seller ever taking physical possession. Industry custom is that the cattle description (known as “representation”) occurs verbally and is not to be questioned. As a result, cattle may be bought and sold with marginal, if any, proof of ownership other than the seller’s 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 ear tags, 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 that involve different legal relationships. For example, a cattle trader may buy and sell on a commission basis; purchase and sell outright, taking a position that subjects him to market risk; or 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.

Priority Issue

In the various contests created by crises of insolvency, the Uniform Commercial Code (UCC) is of primary importance, but it is not the only source to be considered.

Unpaid Sellers v. Subsequent Purchasers

A common fact pattern is as follows: A producer agrees to sell cattle to a first purchaser, who agrees to pay for the cattle. The first purchaser then agrees to resell the cattle to a subsequent purchaser. The first purchaser’s check for payment of the cattle is dishonored, or the first purchaser simply fails to pay.

Unpaid Sellers’ Remedies Under the Code

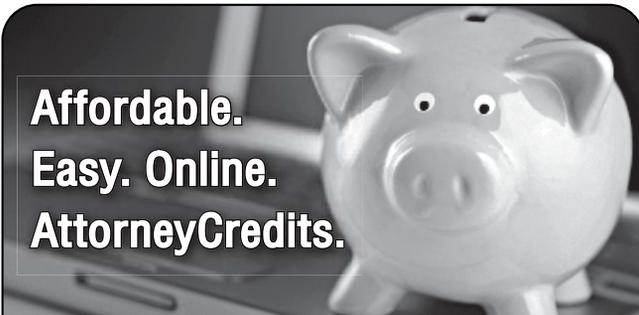
The UCC favors transfers, as is set out in §2.403. This statute allows a purchaser to acquire all titles which its transferor owned or had power to transfer. §2.403(a). Consequently, if the first

purchaser acquired the cattle through an unfulfilled promise to pay, as a result of a dishonored check or even through “fraud punishable as larcenous under the criminal law,” the first purchaser has the power to transfer an unassailable title to the subsequent purchaser. In addition, the first purchaser’s secured lender will qualify as a good faith purchaser for value and prevail over the seller. Even further, if the transferee is a “buyer in ordinary course,” he or she can acquire good title from a party that had no title, as long as the true owner entrusted his or her property to a transferor who deals in goods of the kind involved.

It is common in the industry for sales delivery invoices or other documentation to state that title will not pass until final payment or, in some cases, to explicitly reserve a security interest. While this documentation may be helpful in the ultimate priority contest, these retained security interests are seldom perfected by filing and, thus, are likely to lose out to subsequent purchasers or perfected lien holders. *See In re Samuels*, 526 F.2d 1238, 1246 (5th Cir.), cert. denied sub nom, 429 U.S. 834 (1976).

Because the problem is often created by insolvency, the unpaid seller’s UCC remedies against the first purchaser seldom provide solace. Nevertheless, it is important that they be mentioned here.

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



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- If the seller still holds the goods that 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.
- 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.
- The seller may seek to reclaim. Cattle are often delivered without the requirement of payment on receipt. In cases of the buyer's insolvency, the seller's best remedy may be to demand "reclamation" under §2.702. The primary limitations to this remedy are that it must be exercised promptly, generally within 10 days after delivery, and that even if the seller does act timely, his or her interest will be subject to the "the rights of a buyer in ordinary course or other good-faith purchaser under this article (§2.403)" (which includes lenders to the now-insolvent buyer).

Rights of the Unpaid Seller — Non-Code Remedies

Because the UCC generally favors transfers of ownership, unpaid sellers will look to other sources of relief. For example, the seller might argue that the insolvent buyer was in a joint venture or partnership with someone who can pay. *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 appeals agreed, the Texas 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.

We also refer to UCC §1.130(b), which states that the common law principles of law and equity include "principal and agent, estoppel, fraud, misrepresentation, duress" and that other "validating or invalidating cause shall supplement" the UCC.

Unpaid Contractual Lienholders Or Holders of Involuntary Liens

A lien can arise by contract between the owner of the collateral and the holder of the lien, as in the case of a "security agreement", or, as in the case of the agister's lien, it can arise by statute.

Under the UCC, 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 that contains a descrip-

tion of the collateral; (2) value has been given; and (3) the debtor has "rights in the collateral." UCC §9.203(1) and (2).

If the security interest is not perfected, it is likely to be subordinate to perfected security interests that have already attached. 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 by special rules covering goods in the possession of third parties, including lenders.

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 add to the assumption of 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).

Involuntary Liens on Cattle THE AGISTER'S LIEN

The statutory agister's lien in Texas is Texas Property Code §70.003. The statute has been a part of Texas law since at least 1874, and probably dates to the common law of England. (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 associated with the garageman's lien statute and is generally encumbered with the long notice period prior to sale that applied to the garageman's lien. The statute requires the agister to give as many 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.*), although there is an exception for cattle fed in confinement for slaughter. *See*, Tex. Prop. Code §70.005(C). This statutory exception, unique to Texas' Uniform Commercial Code, could be very important in the context of cattle in a feedyard that markets cattle as "finished" cattle. However, it is important to note that the exception does not apply where cattle are on pasture, which is unpaid, or where cattle are in various types of "growing" or interim care facilities.

Because this lien is possessory (UCC §9.333), 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 interest). 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).

Another statutory lien on livestock is contained in Tex. Prop. Code §70.201. This statute, titled the "Stock Breeder's Lien," permits the "owner or keeper of a stallion, jack, bull, or boar 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 10 months from the day the offspring is born but is not permitted to be enforced until five months after the date of birth.

Because both the agister's lien and the "stockbreeder's lien" are possessory liens, they are not "agricultural liens" (UCC §9.102(a)(5k)) and priority does not depend upon filing. UCC §9.333(b).

Sales and Purchases

UCC PRINCIPLES

Huge volumes of cattle are bought and sold every day without pre-existing written contracts that would satisfy the requirements of UCC §2.201(a) (requiring a writing "signed by the party against whom enforcement is sought ... ") or §2.201(b) (requiring a written confirmatory memorandum between merchants). This is because most sales are for prompt or "spot" delivery; that is, the cattle are delivered shortly following the making of an oral agreement. Custom and practice, in addition to federal law (7 U.S.C. §228b), requires prompt payment. Consequently, most contracts become enforceable as a result of performance. *See* UCC §2.201(3). Written contracts are more commonly used when future delivery is contemplated.

Health Warranties

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

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 Texas Legislature, like those in a number of Midwestern states, added non-uniform §2.316(f):

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

This leaves for consideration whether a health warranty may be implied by course of dealing or trade usage. UCC §2.314(c) says: "Unless excluded or modified (Sec. 2.316) other implied warranties may arise from course of dealing or usage of trade." These terms are defined in §1.205. 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).

A fact pattern that raised these issues was reported in *Kinchloe v. Geldmeier*, 619 S.W.2d 272 (Tex. Civ. App. — Tyler 1981, no writ). In that case, 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 infected with brucellosis. The court noted that UCC §2.316(f) "now precludes application of the implied warranty of merchantability to the sale of livestock," but held that the statute did not apply because the operative facts occurred before it became effective. The court held that the evidence was sufficient to support the trial court's finding that the implied warranty of merchantability was excluded or modified by usage of trade under §1.205(b) of the Code. The evidence was that a buyer of cattle from an auction purchases the cattle "as is," and the court found this was sufficient to support a finding that this was a "trade usage" disclaimer of the implied warranty of merchantability.

Sales Out of Trust: Contests Between Lenders And Purchasers or Auctioneers

UCC Background and the Double Payment Problem

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 an 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 his or her lien in the hands of 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 his seller and once to his seller's lender.

The Food Security Act

Congress addressed the issue of lien continuation as a part of the Food Security Act of 1985. The Act became effective Dec. 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:" (1) a "buyer in the ordinary course of business," (2) "commission merchants," and



(3) “selling agents.” 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).

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

The Act contains separate notice systems for states that have enacted a “central filing system” (a “certified” state) and states (such as Texas) that 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 his or her purchase, he or she 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 <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, he or she may enforce his or her lien.

Control of Animals

Duty to Fence

Texas Constitution Article 16, §23 delegates to the legislature the authority to pass laws to regulate livestock 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, however, that any local law must be approved by the “qualified voters of the section to be affected thereby” who 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.

In Texas, there is no common law duty to fence livestock in. *Clarendon Land, Investment & Agency Co. v. McClelland*, 35 S.W. 474 (Tex. 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). Texas Agriculture Code §143.001 states that, absent the acceptance by local vote of the Texas statutes prohibiting animals “running at large,” the landowner is obligated to fence animals out.

Road Accidents

There is no common law duty in Texas of a livestock owner or caretaker to keep animals off of any roadway. *Gibbs v. Jackson*, 990 S.W.2d 745 (Tex. 1999). *Goode v. Bauer*, 109 S.W.3d 788 (Tex. App. — Corpus Christi 2003, rev. denied). However, Tex. Agric. Code §143.102 prohibits a “person who owns or has responsibility for the control of ... livestock to knowingly permit the animal to traverse or roam at large, unattended, on the right-of-way of a highway.” “Highway” means all U.S. and state highways, but does not include farm-to-market roads. This statute applies even if the county has not adopted a stock law that requires livestock to be fenced or controlled.

Some counties have adopted stock laws that require an owner or person in control of livestock to restrain livestock. Counties that have not adopted such laws are “open range” counties. If the local statute applies, the livestock must be restrained even from a “farm-to-market” road. *Weddle v. Hudgins*, 470 S.W.2d 218 (Tex. Civ. App. — Tyler 1971, writ ref'd n.r.e.).

This means that in an “open range” county, a person who owns or controls cattle has no duty to keep them off of farm-to-market or smaller roadways, unless that person knows that the animals are “vicious in the matter of fence breaking or that they are afflicted with infection or contagious diseases.” *Harlowe v. Hayes*, 991 S.W.2d 24 (Tex. App. — Amarillo 1998, rev. denied); *Gibbs v. Jackson*, 990 S.W.2d 745 (Tex. 1999).

Under these statutes, the writers believe the following situations would be resolved in the following ways:

1. Accident occurs in an “open range” county on a U.S. or state highway. The party that controls the livestock or the real estate may be held liable if the party “knowingly” permitted the cattle to get on the roadway.
2. Accident occurs in a county that has adopted a stock law on a U.S. or state highway. The party that controls the livestock or the real estate may be held liable if the party “knowingly” permitted the cattle to get on the highway.
3. Accident occurs in an “open range” county on a farm-to-market road or smaller roadway. The party that controls the livestock or the real estate has no duty to prevent livestock from entering the roadway by their natural behavior.
4. Accident occurs in a county that has adopted a stock law on a farm to-market or smaller roadway. The party that controls the livestock or the real estate may be held liable if the party “negligently” permitted the cattle to get on the highway.

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