

# **CATTLE FINANCING**

Prepared for

**Texas Cattle Feeders Association**

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## I. SECURITY AGREEMENTS

### A. Lien Creation and Attachment

1. A security agreement is not enforceable against either the debtor or a third party and does not attach unless (1) the collateral is in the possession of a secured party pursuant to agreement, or the debtor has signed a security agreement which contains a description of the collateral, (2) the creditor has given value, and (3) the debtor has “rights in the collateral.”
2. In the cattle business the question of “rights in the collateral” can be very problematic. In the trade, lenders and others tend to equate possession coupled with the promise of the party in possession as evidence of ownership. Depending on circumstances, brands and eartags may add to the assumption of the validity of this representation. However, especially in pasture situations, cattle are often in the possession of parties who are not their true or undisputed owners. Thus, mere possession may not be sufficient to establish “rights in the collateral” sufficient to support a lien.
  - a) The legal test has been stated by some courts as involving a determination as to whether the debtor has anything more than “mere naked possession.” In other words, if the debtor has some right in the collateral, even if that right is not complete ownership, nevertheless that right is sufficient to permit attachment of the interest.
  - b) A very common example in the reported cases involves a debtor

who has obtained cattle from a seller by giving an NSF check. Even though the debtor has not paid for the cattle, once the debtor has some rights in the cattle by virtue of receiving possession, or contracting to purchase them, that interest is sufficient to permit the attachment of a security interest which will defeat the rights of the unpaid seller.

3. Problems created by industry customs.
  - a) The lender should be aware that in the trade cattlemen create many kinds of profit sharing and risk sharing arrangements often described as “partnering in” cattle, although these arrangements may, and often do not, constitute a legal partnership. This may mean that the apparent owner is not actually the owner at all.

### B. Lien Priority

1. A security interest must be “perfected” to offer protection against third parties. With respect to cattle, perfection may be made by the filing of a financing statement in the proper place or by retaining physical possession of the animals. The rules are described below in detail.
2. The UCC provides rules as to priorities among security interests. In general, the first to file at any given level of perfected status is given a superior interest. Thus, if two security interests are both perfected, the first of those to become perfected is given priority.

a) Purchase Money Security Interest

One major exception to this rule is made for a “purchase money security interest.” If a second lender provides financing for a borrower to purchase an item of collateral which would otherwise be subject to a prior lien, that second lender can obtain a superior security interest, by giving appropriate notice to the first lender.

As set out below, Revised Article 9 changes the rules for livestock in very important ways.

b) Agister’s Liens

Another exception relevant to agricultural law concerns “agister’s liens,” discussed below.

C. Lien Continuation Under the UCC

Once a security interest attaches the lien continues notwithstanding the debtor’s sale or other disposition of the collateral. Thus, until the Food Security Act became effective in 1986, if the debtor sold farm products subject to a lender’s security interest, the general rule provided that the lender could enforce its lien against a third party, even though that third party had paid the debtor for the collateral. Also, to a somewhat limited extent, a lender may be able to assert a security interest in identifiable proceeds.

This should be compared with some state laws under the various agister’s statutes, discussed below.

D. Enforcement of Security Interests

1. A secured creditor after default is entitled to a variety of methods to enforce its security interest. These

methods include repossession, foreclosure, and forced sale.

2. These actions can be taken without aid of the court if no breach of the peace occurs, so long as the secured party acts in a “commercially reasonable manner.” If so, the creditor is entitled to recover the deficiency if any from the debtor.

- a) If the creditor uses a third party who breaches the peace during a repossession, the lender is responsible for the consequences as a matter of law.

3. Different methods of foreclosure sales are authorized depending on the nature of the collateral. With respect to cattle, a question arises as whether they are “perishable,” whether they are “customarily sold on a recognized market,” or whether they “threaten to decline speedily in value” are raised.

- a) These are probably fact issues. For example, a sale barn may or may not be a “recognized market” depending upon the proof of facts and the stage in the feeding cycle of the animal.

4. If the secured party fails to act in a commercially reasonable manner, or fails to give proper notice to the debtor, the creditor cannot seek a deficiency. In addition, the creditor may be liable to the debtor for damages such as attorneys’ fees and “any loss caused by failure to comply with the provisions of” the statute.

II. PERFECTION RULES UNDER REVISED ARTICLE 9

## A. Revised Article 9 in General

### 1. Effective Dates and States Where Adopted

The intent was to have all 50 states adopt the revisions as of July 1, 2001. Texas, and Oklahoma have done this. New Mexico, Colorado, and Arkansas have introduced the bills, but have not yet made it law, and the other states are in a various combination of stages. The table at the end of this paper contains a current list of the status as to all states.

### 2. Transition Rules

- a) A security interest perfected under old Article 9 remains perfected for up to 5 years even if the new rules would require filing in a different place
- b) A security interest created after July 1, 2001, must be perfected in under the new rules.
- c) This means that for 5 years buyers and lenders must search in the locations required by both statutes.

## B. Perfection by Filing

Perhaps the most important change made by revised Article 9 concerns the procedures required to perfect by filing. Revised Article 9 requires filing based on the location of the debtor, not the location of the collateral. As a result, lenders will need to revise their compliance procedures completely, for every loan, performing and non-performing, and existing and prospective.

## C. Where to File

- a) The general rule under Revised Article 9 is that there is only one place to file: the debtor's "location." Rev. § 9.301; 9.501.
- b) 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.

## D. Governing Law

Generally, the law of the debtor's location determines how to perfect a security interest and the law of the jurisdiction where the goods are located determines the effect of perfection.

## E. Kinds Of Collateral Subject To Filing

The 1995 revisions to Article 8 and 9 introduced the concept of perfection by filing with respect to many classes of "investment property." Revised Article 9 continues the trend by expanding the categories of collateral for which filing is a permissible method of perfection.

## F. Location of the Debtor

Since the law of the jurisdiction where the debtor is "located" will govern how to perfect an interest, the lender must first determine where the debtor is located before searching for competing liens or attempting to perfect an interest. For example, if the borrower is a Delaware corporation and filing is required to perfect the interest, the lender must file in the place designated by Delaware law.

Revised § 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.”

An individual’s “location” is his or her principal residence. Rev. § 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 and limited partnerships. A “registered organization” that is organized under state law is located in that state. Special rules apply for federally created organizations.

“Organizations” are business entities not created by registration under state law. Examples are partnerships, 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.”

#### G. The Debtor’s Name

Revised § 9.503 says how to state the debtor’s name on a financing statement. For a corporation or other “registered organization” the financing statement must state the name of the debtor exactly as shown on the public record of the debtor’s jurisdiction of organization. Section 9.503(c) disapproves of “trade names.” If the debtor is an “organization” that “has a name,” 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.

Revised § 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 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 used in the relevant jurisdiction. (Under current practice in Texas, the search will pick up similar business names, but not necessarily on a state-wide basis, because the search service generally requires designation of a city of business location.)

#### H. Identification of the Collateral

Revised Article 9 continues to require designation of collateral type on a financing statement. The new provisions now permit general descriptions such as “all debtor’s assets,” “all debtor’s personal property,” or “all debtor’s assets except automobiles.” Rev. § 9.504. However, this type of general description will not grant a lien if used in the security agreement. Rev. § 9.108(c).

#### I. The Debtor’s Signature

Revised Article 9 eliminates the requirement that the debtor sign the financing statement. However, the debtor must authorize the filing in an “authenticated record.” Rev. § 9.509(a)(2). Revised § 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.

#### J. WARNING!! Purchase Money Security Interest Problem

Revised Article 9 makes it almost impossible as a practical matter for a feedyard to obtain a security interest in livestock that is

superior to a previously perfected lender's interest without an express subordination agreement. Under the amendments, a lender seeking to obtain a PMSI must give notice to the prior lender within 6 months before debtor receives the cattle, the notice must describe the cattle, and the security interest must be perfected when the debtor receives delivery. Since this cannot be done as a practical matter the feedyard must create a system to have written agreement with all other lenders.

This will place in jeopardy the feedyard's interest in the "equity" amount over the cost of feeding (which is presumably covered by an agister's lien) for every feedyard purchase money loan made after July 1, 2001.

#### K. Crop Financing and the New "Agricultural Lien"

Revised Article 9 creates a new rule concerning the financing of crops, and creates a new category of lien known as an "agricultural lien." All lenders engaged in agricultural financing must pay attention to these new rules.

##### 1. Crop Financing

Under former Article 9.312(b), a "new crop lender" received priority if it made an advance within three months "before the crops become growing crops by planting." The new crop lien took priority over an earlier perfected security interest if the earlier interest "secures obligations due more than six months before the crops become growing crops by planting or otherwise."

The uniform revisions to Article 9 omit the "new crop lender" rule, but provided language that would allow states to adopt such a rule on an individual basis.

Texas did not adopt the rule. Therefore, priority for liens on crops in Texas will be based strictly on the date of attachment and perfection, as is the case generally with other lending. Other states may have retained the former rules.

Another very significant change concerns the place to file financing statements to perfect in crops. Revised Article 9 says to file in the debtor's location. This means that financing statements for crops will not need to be filed locally and will not need a description of the place where the crops are to be grown. Official Comment 4 to Rev. § 9.502.

##### 2. Agricultural Liens

Revised Article 9 established a new class of lien called an "agricultural lien." The key features of an "agricultural lien" are the following: (i) the borrower is engaged in "farming operations"; (ii) the lien arises by operation of law as opposed to the agreement of the parties; (iii) the effectiveness of the statutory lien does not depend on the debtor's possession of the property.

Texas recognizes a number of involuntary statutory liens that arise in connection with agricultural operations. Some examples are: (i) the agister's lien on livestock. (TEX. PROP. CODE § 70.003); (ii) the cotton ginners lien on ginned cotton. (TEX. PROP. CODE § 70.003); (iii) the chemical and seed suppliers lien on crop proceeds. (TEX. AG. CODE CHAP. 128); (iv) the feed suppliers lien on proceeds. (TEX. AG. CODE CHAP. 188); (v) the lien on livestock, carcasses and products with respect to livestock sold for slaughter. (TEX. AG. CODE § 148.021-.030); (vi) the stock breeders lien on offspring. (TEX. PROP. CODE § 70.201).

If a lender holds an “agricultural lien” the lender must comply with the other Article 9 requirements for perfecting a security interest, and 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. Rev. § 9.302.

Revised § 9.333 continues the prior rule of § 9.310 that gives priority to statutory liens that 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 authors believe that a good example of this involves the statutory agister’s lien contained at Property Code § 70.003. Since the effectiveness of that statutory lien is dependent on possession, we believe that it does not qualify as an “agricultural lien” and, if its provisions are satisfied, it should have priority over competing contractual liens and priority over competing “agricultural liens.”

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.

### III. PERFECTION BY METHODS OTHER THAN FILING

#### A. Possession by Bailee

Revised § 9.313(c) authorizes perfection by possession of goods in the hands of a bailee. A bailee is a third party who has possession of property held for the benefit of another. Grain elevators and feedyards are common examples of bailees involved in agricultural

lending. In order to perfect a security interest in goods in the hands of a bailee, without filing, the bailee “authenticates [signs] a record” stating that it is holding the collateral “for the secured party’s benefit.”

#### B. Possession by Secured Party

Revised § 9.313 continues the rule that allows a secured party to “perfect a security interest in negotiable documents, goods, instruments, money, or tangible chattel paper by taking possession of the collateral.” The law of the place where the collateral is located governs perfection, the effect of perfection or non-perfection, and priority.

#### C. Automatic Perfection

Revised Article 9 provides for automatic perfection of security interests in transactions involving the sale of payment intangibles, the sale of promissory notes, and in “supporting obligations,” which may be coupled with payment intangibles or promissory notes. See Rev. § 9.308 & § 9.309. In addition, automatic perfection will apply to purchase money security interests in a broad range of non-certificate of title consumer goods. Rev. § 9.309(1).

#### D. Control

The 1995 amendments introduced the concept of “control” as a method to perfect an interest, and as a factor in priority disputes. For many financial assets, a lender accomplishes “control” with a “three-party” agreement between the debtor, the secured party, and the securities or commodity intermediary. TEX. BUS. & COM. CODE ANN. § 8.106; & Rev. § 9.106(a) & (b).

Revised Article 9 expands the perfection by control concept and allows use of control to perfect as interest in deposit accounts, rights in letters of credit, and, for a new class of

collateral known as “electronic chattel paper.” Rev. § 9.314(a). The preferred priority status is control over filing. Rev. § 9.328(1) (investment property) and Rev. § 9.329(1) (letter of credit rights).

For hedging and commodities accounts, recent revisions to Article 9 have changed the law on how to perfect. The new revisions have created new, recognized descriptions for “investment property,” “commodity accounts,” “commodity contracts,” as well as financial assets like “securities entitlements.” The new law also creates two levels of perfection, with differing levels of protection; perfection by filing (UCC-1) and perfection by “control.” The lender needs to accomplish both levels of perfection. Because not all states have adopted the new Article 9 provisions, the conflicts of law rules make this a treacherous area. However, as a general rule file a UCC-1 in the central filing location of the debtor’s home state with a description reading something like this:

“. . . all debtors interests in general intangibles, commodity contracts, commodity accounts, and securities now owned or hereafter acquired and their proceeds.”

Also obtain a “three-party” agreement with the brokerage entity with whom the debtor does his trading. This is one way to accomplish “control.”

Security interests in promissory notes are perfected by actual possession. Under the newly revised Article 9, it is also appropriate to file a UCC-1.

#### E. The Agister’s Lien

In Texas, Oklahoma, Colorado, Kansas, Arkansas, and most other states, statutes have

been enacted which create liens on livestock as a matter of law in favor of the person who gives feed or care to the livestock. Since the lien arises by operation of law, no underlying contract or agreement is necessary to create the lien or to enforce it. The state laws in each case are different and are summarized on a state-by-state basis below, and in the table at the end of this paper.

#### 1. Texas

Texas provides for an agister’s lien, and a “feed supplier’s lien.” The former grants a lien arising as a matter of law in favor of a person who provides care and feeding to animals left in their care. No documents need to be signed or filed to support this lien. The “feed supplier lien” has several statutory requirements which must be closely followed, including a requirement of a notice of intent to claim the lien given at the time the feed is supplied.

The agister’s statute is probably superior to contractual liens, although no Texas case has decided this exact point. The “feed supplier’s lien” is not superior to previously-filed UCC liens and is not superior to an agister’s lien.

If the lien is on an animal “fed in confinement for slaughter” the lien may be enforced in any manner which is “commercially reasonable” under the UCC. For other agistment situations, the lien is difficult to enforce. The “feed supplier lien” can be enforced, after it is appropriately perfected, in any manner authorized under the UCC.

The agistment statute requires the caretaker to maintain actual “possession” of the livestock to perfect and enforce the lien. This means that when a feedyard

releases possession of livestock without enforcing its lien, it probably releases possession of livestock without enforcing its lien, it probably also releases the ability to enforce the lien, in the absence of other arrangements. The feed supplier's lien does not require possession.

## 2. Oklahoma

Oklahoma provides for a "herdsman's lien," and a "feedman's lien." The former grants a lien in favor of a person who is engaged in the "feeding, grazing, or herding" of domestic livestock, and the latter applies in favor of a person who has furnished or provided any "corn, feed, forage or hay" to the owner for the sustenance of domestic animals.

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

The Oklahoma agister's lien is not dependent on possession, and the feedman or herdsman does not need to keep possession of the livestock for the lien to continue. These liens arise by operation of law and do not need to be written or filed to be enforced.

## 3. Colorado

Colorado has an "Agister's Lien Act" which creates a broadly defined agister's lien that secures the unpaid amount due for feeding, herding, pasturing, keeping, ranching, boarding, and caring for livestock. This lien must be filed with the Colorado secretary of state before it may be enforced.

A properly filed agister's lien in Colorado is superior to all other liens and encumbrances on the subject livestock. Enforcement of this lien requires notice, hearing, and a public sale at the nearest public livestock market.

The lien does not require possession to be enforceable. It will continue after sale or other disposition of the livestock. Further, the agister's lien attaches to the proceeds received from a sale or disposition.

## 4. Kansas

Kansas provides for a "confinement feeding," an "agister's," and a "livestock production input" lien. The confinement feeding lien secures unpaid charges for "feed and care" of confined livestock; the agister's lien secures unpaid rents for pasture land; and the livestock production input lien secures the unpaid retail cost of all other feed and labor furnished to raise livestock.

The confinement feeding and agister's lien both arise by operation of law and do not require a writing or filing to be enforced. The livestock production input lien however, must be filed with the Kansas secretary of state before it may be foreclosed.

The confinement feeding and agister's liens are superior to all other liens and encumbrances. The livestock production input lien will also take priority over other liens, including a contractual lien, if the lien is perfected and proper notice is given to the contractual lender. Each lien must be foreclosed by a public sale for cash after timely notice is provided the owner.

Enforcement of the confinement feeding lien requires possession of the livestock. The agister's and livestock production input liens may be enforced without possession if proper filings are made.

#### 5. New Mexico

New Mexico provides for an agister's lien for persons who board or "furnish feed, shelter or pasture for the property and stock of others." This lien may be enforced without possession if, prior to relinquishment, the lien holder has filed a statement describing the livestock and declaring an intent to retain the lien with the clerk of the county in which the livestock are located.

The agister's lien does not take precedence over prior-filed chattel mortgages unless the holder of such mortgage expressly consents in writing.

#### 6. Arkansas

Arkansas provides for an agister's lien for unpaid amounts due for "feeding, herding, pasturing, keeping, or ranching" livestock. Enforcement of the lien requires possession of the livestock, unless the livestock are transported to market for sale in the joint name of both the lien holder and the owner.

The lien is effective only when all written contracts are properly filed and from the date when the last contract is filed. The agister's lien has priority to any conditional sale contract, filed chattel mortgage, or other encumbrance if the agister's lien holder has properly filed all written contracts and has properly notified the other lien holders about the existence of the written contract. However, if the other lien is prior in time to the agister's lien, the other lien holder

may retain priority by properly filing or serving a written protest within fifteen days from the date that the other lien holder received notice of the existence of the contract.

#### IV. THE "FARM PRODUCTS EXCEPTION"—LIEN CONTINUATION UNDER THE UCC

As mentioned above, the UCC generally provides that a lienholder may pursue its lien even against a third party who had paid the debtor. However, the UCC made a series of exceptions that became generally known as the "farm products exception." The specific mechanism was the following:

##### A. The Power of a Buyer in Ordinary Course to Defeat a Lien

1. If the third party buying collateral subject to a lien from the debtor qualified as a "buyer in ordinary course" the third party could take free of the lien, even if that third party knew of the existence of the lien and even if it was perfected. In order to qualify as a "buyer in ordinary course" the third party generally had to act in a transaction that did not involve fraud, a bulk sale, or express knowledge of the fact that the sale was in violation of the direct instructions of the secured party.
2. The "buyer in ordinary course" rule was thus an exception to the general rule of the UCC allowing lien continuation. Under the "buyer in ordinary course" rule, such a buyer could cut off the lien so long as the lien was created by the buyer's seller. Thus, in limited instances, a remote seller's lender could trace its lien into downstream buyer's hands.

## B. The “Farm Products” Exception

1. The “farm products exception” was itself an exception to the “buyer in ordinary course” exception. Under the “farm products exception” a person who otherwise qualified as a “buyer in ordinary course” could not take free of a security interest created by his seller if the goods so purchased were “farm products,” provided that the lender had not consented to sale of the collateral. In general, “farm products” includes agricultural commodities, and specifically includes livestock. Under the “farm products exception” a buyer was always at risk that his seller had created a lien in the goods purchased and had not paid his lender.
2. The “farm products exception” created what is commonly known as the “double payment” problem. This situation occurred when a buyer paid its seller for cattle, but the buyer did not pay its lender. The lender, using the farm products exception, could enforce its lien against the buyer, and in effect force the buyer to pay for the cattle twice.
3. The “double payment” problem proved to be a fertile ground for litigation. Many issues were litigated under this exception. One of the most common concerned the “consent” defense. Under this theory of law, a buyer of goods in defense to a suit brought by a lender or conversion of its security interest, would allege that the lender, whether through course of dealing, or actual agreement, had “consented” to the debtor’s practice of selling farm

products to third parties without requiring payment to the lender.

4. Another frequently argued issue concerned the distinction under the UCC definitions between “farm products” and “inventory.” Some cases made a distinction between livestock which were held for production purposes and those which were held for “inventory” purposes, and decided that when cattle became “inventory” they were no longer “farm products” and thus the “farm products exception” had no application. This theory of law operated to protect the buyer of goods from the seller’s lender. This theory, unlike the “consent” defense, probably will not continue to be an issue under the Act.

## V. THE FOOD SECURITY ACT (7 U.S.C. § 1631)

### A. Purpose

1. The Federal Food Security Act became law in December 1986. The Act expressly stated that its purpose was to eliminate the “double payment” problem because it created an impediment to the free transaction of commerce in farm products.
2. The Act operates with respect to transactions in “farm products.” The definition of “farm products” in the Act is generally the same as that in the UCC. The Act protects two general classes of persons: “buyers” of farm products, and “marketing agents,” which generally includes livestock sale barns and commission agents.

B. “Central Filing” States and “Actual Notice” States

1. The Act creates a distinction between states which have adopted a centralized filing system and states which have not. To protect a lien position, lender should know what state cattle have come from and will go to and should know whether the states are a “central filing” state or “actual notice” state. Texas and Kansas are “actual notice” states; Oklahoma and Colorado are “central filing” states. A list of states that have qualified as “central filing states” is attached as Appendix “C.”
2. In states that have enacted a central filing system, the secured party files a specialized notice with the state-designated authority that gives specific information about the extent of the lien. A buyer of farm products which have been “produced” (see discussion below) in that state take subject to the lender’s security interest if the documentation is in order. Otherwise, the buyer takes free of that security interest.
3. In non-central filing states, such as Texas and Kansas, actual notice is required. In these states, the borrower may be required by the lender to give a list of potential buyers. The lender then must contact the potential seller and give notice of its security interest. The burden is thus on the lender to contact the buyers.
  - a) In the Texas Panhandle there is a “newspaper notice” which attempts to provide actual notice to buyers. Lenders subscribe to the newspaper and give the statutory

information about their borrowers, and the newspaper is delivered to potential buyers. To our knowledge, the effect of this “newspaper notice” has not been tested by the courts.

C. Federal Preemption

1. In general, the Act governs any conflict between the underlying state law and the Act itself. For example, if under the farm products exception of the UCC a lender attempted to enforce its security interest against a buyer who had not received notice of the security interest as required by the Act, the lender would be unsuccessful because of the Act.
2. Despite the preemption rule, there are many situations involving farm products which are addressed only under state law. Some of these issues are discussed below, and they mainly concern questions dealing with third party interests.

D. Issues Not Addressed by the Food Security Act

1. The Act, as does the UCC, protects a buyer from a security interest created by the immediate seller to the buyer. Therefore, in some circumstances, an upstream seller’s lender could attempt to enforce its security interest against the ultimate buyer.
2. The Act protects “buyers in the ordinary course.” The regulations promulgated pursuant to the Act suggest that this term will be interpreted in a manner consistent with the term “buyer in ordinary course under the UCC. Therefore, for example, if a buyer acts without good faith in a

transaction, or takes under a bulk sale, he will almost certainly find himself in litigation over his status as a “buyer in ordinary course.”

- a) However, cases under the Act have applied a less strict definition of “buyer in the ordinary course” than is applied under the Code. Although it is perhaps overbroad, at least one case, from Kansas, can be read to say that a purchase by a buyer who knew about the existence of the security agreement and ignored nevertheless qualified under the Act because the lender had not given the exact statutory notice.
3. With respect to states which have qualified central filing systems, the Act raises an ambiguity as to where to file in multi-state transactions. The Act provides that an effective filing should be made where the farm product is “produced.” With respect to livestock it could be argued that they are “produced” at any number of points; for example, cattle could be born and weaned in one state, put on pasture in another, and fed to finish weight in a third. It is safest for the lender to file in all possible places and to continue to give, even in central filing states, actual notice to all potential buyers. From the standpoint of the buyer, this means that the buyer could check the central filing records of the state in which the seller resides, become satisfied that no liens exist, and pay the buyer, and end up facing a lien conversion charge arising from a lender in a neighboring state also with a central filing system who had filed where the farm products were lo-

cated at one time and thus were “produced.”

4. It is important to recognize that the Act does not protect a buyer from claims by any party other than a lienholder. Therefore, the Act offers no protection to a buyer who has purchased cattle from a seller under circumstances which will create lack of “title” or “ownership” in the seller for reasons based on inability to convey title, agency allegations, or the like. The Act simply does not speak to these issues.
5. The Act does not address issues of perfection under state law. Therefore, the UCC should govern questions that relate to perfection under state law. These issues relate to a wide range of areas, such as enforceability of a lien when the borrower files bankruptcy, competition between competing lienholders, questions concerning the ability of a lender to trace proceeds after cattle have been sold.

#### E. Need to Update FSA Notices

Although under the Food Security Act a lender is required to describe collateral much more thoroughly than under the UCC, it is not clear that a lender’s previously filed Effective Financing Statement which has become inaccurate through the passage of time (for example, in January it describes 300 head of steers, which have, by July, been sold and replaced by 300 head of heifers) continues to be effective protection to the lender. It is therefore strongly suggested that for every new set of cattle financed, a new Effective Financing Statement be prepared, signed and filed.

#### F. Effect of FSA on Lien Priority

1. The lender must continue to keep current its UCC filings. The Food Security Act does not address the question of lien priority. State law addresses this question, and in general, under state law, the first to perfect a security interest is given a superior position.

#### G. Movement of the Collateral

1. Under the FSA the requirements for filing and notice are determined by the place where the farm products are "produced." This may involve more than one location.
2. If the debtor moves the cattle, or if the debtor changes its residence, the lender may be required to refile to maintain perfection under the UCC, and under the Food Security Act. The UCC contains a rule that a filing that is effective before the debtors move is effective only for four months after the change in residence. The Food Security Act contains a requirement that filings be made with respect to areas in which the cattle have been "produced," a requirement which may require multiple filings.

### VI. INTER-CREDITOR AGREEMENTS

#### A. Scope of the Problem

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

2. The questions frequently arise concerning the way in which lenders can work with one another to assure they each are secured to the best extent possible.
3. The three most common methods are subordination, release, and assignment.
4. All of these require specific agreements between lenders.

#### B. Purchase Money Security Interests

1. See the discussion above on this subject.

#### C. Release

1. This involves a complete release of the security interest.
2. Most lenders would not want to do this, even if the release is specific as to location. Instead, most lenders would want to retain a second lien even if they agreed to subordinate their otherwise first lien.
3. If a release is given, it typically will relate to specific locations, for example, cattle located in a specific feedyard.

#### D. Subordination

1. This requires an agreement by a prior lender to subordinate its lien to a new lender.
2. Typically, the prior lender retains a second lien behind the new lien.

#### E. Assignment

1. An assignment is appropriate if one lender is buying out the lien position of another.
2. 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.
3. Technically, however, the assignment is probably 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.

#### F. All agreements of this nature should be in writing and signed by all parties.

1. A letter to describe the general notice and intent of the agreement is recommended.

### VII. FEEDING AGREEMENTS

#### A. Resistance to Written Feeding Agreements

Feedyards are typically reluctant to ask their customers to sign feeding agreements. This reluctance appears to stem from fear that customers will feel that the feedyards do not trust them, or that the documents are getting too complicated, and the fear that if they require feeding agreements, and the competitors don't, the customers will go to a feedyard that does not require the agreements. Despite this historical reluctance,

more feedyards are now using feeding agreements.

#### B. Suggestions for Feeding Agreements

A well-drafted feeding agreement will address at least the following concerns:

1. Arbitration. The TCFA By-Laws provide that TCFA members may utilize the TCFA's arbitration procedures. If the parties are not TCFA members, an arbitration agreement, if properly constructed, is generally enforced by the courts. These provisions can be extremely helpful in reducing litigation expense and exposure in disputes with feeding performance, and can reduce the effect of such legal "technical" arguments such as the Deceptive Trade Practices Act, usury, RICO, and the like.
2. Agister's Lien. A feeding agreement should contain a provision that the feedyard acquires a "agister's lien" but should go on to provide that this lien is a security agreement.
3. Interest on Feedbills. The feeding agreement should contain a agreement by the borrower to pay interest on outstanding feed bills. In the absence of an agreement, the mere notation on a feed bill of a charge of interest, and the collection of interest, without the specific agreement of the customer to pay interest on the feed bill, can lead to disastrous results under the state usury laws.
4. The feeding agreement should address the authority of the feedyard to negotiate the sale of sell the cattle after they become fat. The feedyard should be given the ability to accept proceeds for the borrower, deduct

the feed bill and other expenses, then pay the remainder to the borrower or the borrower's lender or lenders.

5. The agreement should cover all cattle that may be delivered to the feedyard. This is necessary because after a customer relationship is established, the niceties of the paperwork often become forgotten, and a feeding agreement relating to 220 head on feed in August of 1999 may be held by a court to have no application to a set of 220 steers placed on feed in August of 2001.
6. The feeding agreement should also contain some warranty that the person signing the agreement is the owner, or is authorized to act for the owner, of the cattle. All the safeguards, and the dangers, described above with respect to lienholders should also apply to a feedyard seeking to be diligent in caring for the cattle and collecting its feed bill.
7. The question of lien priority as to the liens granted by the feeding agreement needs to be understood. As noted above, in some states the agister's lien has priority over previously-filed contractual (bank) liens, but in other states it does not. In some situations it may be advisable to obtain a written agreement with all prior lenders so that these prior lenders recognize that the feedyard lien is superior to their lien. These agreements are common and are generally described as "subordination agreements." Often, they are nothing more than a "letter of understanding" between the parties.

## VIII. SUGGESTIONS AND DANGER SIGNS

### A. Suggestions

1. Establish as best as possible that the borrower owns the cattle. To do this, the lender must understand the nature of the borrower's operation.
2. When financing cattle purchases, make distributions directly to the seller of the cattle, based on invoices, weight tickets or other documentation.
3. Inspect cattle often. When cattle are on pasture, get signed statements from the debtor and his cowboys to verify numbers. When cattle are in a feedyard, obtain verification from the feedyard office that the cattle are actually owned by the borrower.
4. In pasture operations require strict use of brands and require the debtor to register a brand. This is useful even though in many states, such as Texas and Oklahoma, brand laws do not necessarily tie brands to ownership.
5. Suggest that the borrower use hedging to minimize risk.

### B. Danger Signs

1. Commingling of cattle in feedyards or pasture. An honest cattleman wants his cattle separate from others to know their performance.
2. Non-timely marketing can be a danger sign. If the borrower says simply that he is holding his cattle until the market goes up or until the grass

runs out, he may be diverting proceeds.

3. Be suspicious of any new or additional cattle that appear in the debtor's operation. If one lender didn't lend the money to buy the cattle, the chances are good that some other lender did, and the lender may be facing a double mortgage problem.
4. Multi-lender operations offer the opportunity for checking account abuse. Also make sure that all lenders are aware of and consent in writing to all questions.
5. Watch for performance reports from the borrower that differ from the general market.

BIOGRAPHICAL SKETCH  
OF  
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David LeBas was born in Kassel, Germany, in 1957. He graduated from the University of Texas with a B.A. in 1979 and a J.D. in 1982. He is Board Certified in Civil Trial Law, and he practices in the areas of business litigation, concentrating in areas of agriculture, lending, construction law, probate, and intellectual property. Bar associations include Amarillo Area Young Lawyers Association (President 1988-1990), Texas Young Lawyers Association (Director 1988-1990), Texas Bar Foundation (Life Fellow), Texas Association of Defense Counsel, and the State Bar's Agricultural Law Committee (Chair 1998-1999).

Mr. LeBas' recent bibliography includes:

1. "The Recovery of Expectancy Damages in Misrepresentation Cases" (Spring 1996 and Summer 1997, TADC).
2. "Recent (and Relevant) Texas Supreme Court Cases" (Winter 1997, TADC meeting).
3. "Insurance Code Art. 21.21 and Art. 21.55 Highlights" (Spring 2000, TADC).
4. "Texas Livestock Law" (1992, 1995, 1996, 1998 Agricultural Law Seminar).
5. "Creating and Protecting Agricultural Loans" (1999 State Bar Agricultural Law Seminar).
6. "Risks to Lenders in the Use of Forward Contracts by Borrowers" (1999 Texas Tech Agricultural Lending School).
7. "Creating and Protecting Agricultural Liens" (Fall 2000 Texas Assoc. of Bank Counsel Annual Convention).

BIOGRAPHICAL SKETCH  
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John Huffaker graduated from Texas Tech University with a B.S. and later received his J.D. from The Texas Tech University School of Law in 1974. While at The Texas Tech University School of Law, he served as Editor in Chief of The Texas Tech Law Review, and graduated Order of the Coif. His practice areas include general commercial litigation, agricultural law, bankruptcy and creditors' rights, employment law, and representation of public entities. He has served as Chair of the State Bar of Texas Committee on Agricultural Law. He is a member of the Texas Association of Bank Counsel and frequently speaks on issues arising in lender liability, risk avoidance, and agricultural law. He is a current member of the Texas Bar Foundation and the College of the State Bar of Texas. Mr. Huffaker is Board Certified in Civil Trial Law.

As a civic volunteer, Mr. Huffaker serves as a director of the Rotary Club of Amarillo, the United Way Campaign Cabinet and is active at Amarillo's Polk Street United Methodist Church.