

Dealer Statutory Trust

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Summary

Many livestock auction markets and producers have been devastated by livestock dealer payment defaults.

Under current law, a person selling to a dealer can be left unpaid and unable to reclaim livestock. Often, a dealer's lender gets paid while the producer who raised the livestock or the market who already paid the producer does not. While dealers are bonded, the average dealer bond claim recovers just 5–15 cents on the dollar.

To make a bad situation worse, in some cases these unpaid sellers are then contacted by a bankruptcy trustee demanding that payments received in the last 90 days prior to the dealer filing bankruptcy be pulled into the bankruptcy proceedings and shared with other creditors.

In the event of a dealer default, a Dealer Statutory Trust would significantly improve recovery by giving unpaid cash sellers priority to reclaim the livestock or, if they have been resold, first priority in the proceeds/receivables from those livestock. After all, shouldn't the producers who raised the animals, or the livestock markets who paid these producers and sold the livestock on their behalf, be paid first?

In the 115th Congress, the Securing All Livestock Equitably (SALE) Act, H.R. 4058, and Senate companion, S. 3140, were introduced to create a Dealer Statutory Trust. The Farm Bill included a provision for the U.S. Department of Agriculture to do a feasibility study on creating a Dealer Statutory Trust. This study was returned to Congress in December 2019. According to the USDA study, the establishment of a livestock dealer statutory trust could improve livestock seller recovery in the event of a dealer default. Additionally, the study found that commerce would continue as usual and implementation of a livestock dealer statutory trust would be unlikely to significantly impact credit availability or lender behavior.

In March 2020, the SALE Act, H.R. 6067, and Senate companion, S. 3419, were reintroduced in the 116th Congress. The House of Representatives passed the Health and Economic Recovery Omnibus Emergency Solutions (HEROES) Act, a Coronavirus response bill which included Dealer Statutory Trust in May 2020. A narrower version of the bill passed the House in September, with Dealer Statutory Trust continuing to be included. Possible future Coronavirus relief remains uncertain, with the House, Senate, and White House disagreeing about the ideal scope and cost of response.

Livestock Industry Structure Background

Farmers and ranchers (producers) make a living selling the livestock they raise. They sell directly to other producers, livestock dealers, feeders, and packers. Often, they also sell through local auction markets, where livestock are sold on a commission basis through a competitive bidding process to get the highest price. Buyers at livestock markets include producers, feeders, packers, and dealers.

Dealers are in the business of buying and reselling livestock, often grouping them to meet volume and type needs of their customers. Livestock dealers play a critical role facilitating the flow of livestock through different segments of the livestock industry.

Packers, livestock markets, order buyers, and dealers are all regulated under the Packers & Stockyards (P&S) Act. Under the Act, packers must maintain surety bonds and transactions are subject to the Packer Statutory Trust; livestock markets must maintain surety bonds and operate with a custodial account,

which is a trust account; dealers only have to maintain surety bonds. When producers sell to packers, they can look to both the bond and the statutory trust to help ensure payment. When producers sell at markets, they can look to both the bond and the custodial account to help ensure payment. Markets are required to pay sellers even if the buyer does not pay the market. When a producer sells directly (not through a market), the producer bears the risk of payment default. When producers sell to dealers and the dealer fails to pay, they can only look to a bond to help ensure payment.

The Problem

Unfortunately, the current law combined with the volume and nature of livestock dealer businesses has caused great harm when livestock dealers default on payment.

As noted earlier, sales to packers and markets are protected by both bonds and trust funds. Sales to dealers lack this second layer of payment protection.

Dealer businesses default for a variety of reasons. One common scenario is when a dealer's lender becomes concerned about the dealer's finances and exercises its priority position under the Uniform Commercial Code (UCC) by grabbing the money in the dealer's bank account, the dealer's livestock, and the receivables and proceeds from the dealer's already sold livestock. This leaves the producers and markets who sold those livestock to the dealer unpaid. Another common scenario is when a dealer has resold the livestock and doesn't get paid, causing a domino effect, so that the person who sold to the dealer doesn't get paid.

Current Law

In livestock transactions, livestock often change hands prior to money being received. If a dealer takes delivery of a seller's livestock and fails to pay (either because the dealer's check is returned unpaid or the dealer never sends a check), under current law, not much can be done to recover the livestock or the funds from those livestock.

P&S Act prompt payment rules allow dealers to take possession of livestock and pay for them later by placing a check in the mail the next day. 7 U.S.C. § 228b. With a slowing mail system, it often takes several days before the producer or auction market receives the dealer's check or finds out that a check is not coming.

When a dealer fails to pay, the original seller typically has no legal ability to reclaim the livestock. If the dealer has resold the livestock to a good faith purchaser for value, that second purchaser has clear title to the livestock, even if the dealer has not paid for them. *See Maryott v. Oconto Cattle Co.*, 607 N.W.2d 820, 827 (Neb. 2000) (available at <http://caselaw.findlaw.com/ne-supreme-court/1071589.html>).

Additionally, a dealer's lender usually has priority in livestock or receivables/proceeds from livestock even if the dealer has not paid the original seller. Many lenders have a blanket security interest in their dealer customers' livestock that covers all livestock "currently owned or hereafter acquired." Because of this broad "hereafter acquired" clause, a dealer's lender has a security interest in livestock as soon as the dealer gets any kind of interest in the livestock. This means a dealer's lender will take livestock and/or proceeds/receivables from livestock the dealer has already resold even if the dealer never paid the producer or market for the livestock. *See Kennett-Murray & Co. v. Pawnee Nat'l Bank*, 598 P.2d 274, 277-78 (Okla. Ct. App. 1979) (available at <http://law.justia.com/cases/oklahoma/court-of-appeals->

civil/1979/48060.html). This is the case even if the dealer still has the cattle and they can be identified. See *Kunkel v. Sprague Nat'l Bank*, 128 F.3d 636 (8th Cir. 1997); *Samuels & Co., Inc. v Stowers*, 526 F.2d 1238 (5th Cir. 1976).

Bonds

Often, the only recovery for unpaid sellers who have sold to dealers comes in the form of a claim on the dealer's bond. P&S Act regulations require dealers to be bonded. 9 CFR § 201.29. The minimum bond for dealers is \$10,000. The largest dealer bonds are about \$700,000. Bond size is based on a formula determined by volume of business, as set out in 9 CFR § 201.30. A specific bond size does not determine the amount dealers can buy; it is calculated by looking at historical data. Bond increases are typically based on annual report data submitted by dealers. 9 CFR § 201.30.

Between 2009 and 2018, P&S data shows \$41,925,908 in valid bond claims. Recovery from those dealer bonds was \$3,989,735 or 9% of the total valid claims.

Preferential Transfer

To make a bad situation worse, if a defaulting dealer goes into bankruptcy there is a very real risk of a preferential transfer claim. This is where the bankruptcy trustee demands the seller remit an amount equal to all payments the seller received from the defaulting dealer during the 90 days prior to the bankruptcy filing. The amount of 90 days' worth of sales that has already been deposited in the bank is often much greater than the amount for which the seller hasn't been paid. Additionally, sellers could end up tangling with a bankruptcy trustee in costly litigation over funds already long spent.

The elements of a preferential transfer claim (in the context of a livestock transaction) are:

- The seller (seen as a creditor by bankruptcy courts) receives payment for livestock, which is a transfer of an interest of the debtor in property for the benefit of the creditor;
- The payment was made at some point after the day of the sale (antecedent debt);
- The payment was made while the buyer was insolvent;
- The payment was made within 90 days of the date the buyer's bankruptcy petition was filed; and
- The payment allowed the seller to receive more money than it would have received if there was a liquidation under Chapter 7 bankruptcy

It is important to remember that even if payment is made in compliance with P&S Act prompt payment rules, any payment made after the sale may not be deemed "contemporaneous" by a bankruptcy trustee or court.

In the Eastern Livestock bankruptcy case, the trustee filed 116 adversary actions including 68 preferential transfer claims demanding more than \$29 million from livestock sellers to Eastern who were paid in the time leading up to the bankruptcy. See USDA Study, p.76.

Frequency of Dealer Default

Dealer defaults have been of a magnitude and frequency to draw the concern of producers and marketing businesses.

The largest and most detrimental defaults, such as Eastern Livestock, are well known within livestock circles. In 2010, Eastern Livestock was forced into bankruptcy, owing approximately \$112 million to creditors, including hundreds of livestock producers, other dealers, and markets. At the time, Eastern Livestock was the largest livestock dealer in the United States. There were approximately \$37 million in livestock bond claims filed, with just over \$17 million in claims deemed valid. Just under \$750,000 was paid to livestock sellers from Eastern's bond. The amount was distributed pro-rata with each unpaid seller receiving just 4.37% of their valid claim amount from the bond. According to the USDA study, Eastern had more than \$74 million in assets (accounts receivable, inventory, and cash) that could have been deemed trust assets had a Dealer Statutory Trust existed and could have "easily paid all of the unpaid livestock sellers' claims." USDA Study, p.12.

However, smaller defaults that do not capture the attention of media coverage are not infrequent and can have a significant impact on the sellers involved.

While there is no comprehensive database on payment defaults to cash sellers of livestock, an analysis of P&S bond claim data can provide helpful background. Between 2009 and 2019, P&S data shows an average of \$3.8 million in valid bond claims a year against an annual average of 7.5 registered dealers. Keep in mind that some dealer defaults do not result in bond claims, because the unpaid seller lacks confidence in their ability to recover significant funds through the bond, the time to file expires prior to a claim being made, or other reasons.

What is a Dealer Trust?

A Dealer Trust, patterned after the existing Packer Trust (7 U.S.C. § 228b), would be a change in the P&S Act to improve financial recovery for unpaid cash sellers in the event of a dealer default.

The trust would give unpaid cash sellers of livestock (farmers, ranchers, markets, and other dealers) first priority to recover livestock for which a dealer has not yet paid. If the dealer has resold the livestock, the unpaid sellers would have priority in the receivables or proceeds from those livestock.

Livestock purchased by a dealer in cash sales would start out from the moment of delivery as part of the trust. *A&J Produce Corp.*, 829 F. Supp. 651 (S.D.N.Y. 1993) (citing *Morris Okun v. Harry Zimmerman, Inc.*, 814 F. Supp. 346 (S.D.N.Y. 1993) (interpreting Perishable Agricultural Commodities Act Trust case.)). However, if the dealer has paid for all livestock purchased in cash sales, no valid trust claim exists. The trust is not a separate bank account. Rather, it is a legal concept that provides priority status for unpaid sellers in limited assets (livestock purchased in cash sales and, if resold, proceeds/receivables from those livestock). As drafted, the trust would only apply if a dealer has average annual sales of livestock in excess of \$100,000.

To preserve its rights in the assets of the statutory trust, an unpaid seller must give notice within thirty days of the final date for making prompt payment in accordance with Section 409 of the P&S Act if a payment instrument has not been received or within fifteen days of receiving notice that the dealer's payment instrument has been dishonored. The unpaid seller loses its rights to the statutory trust if it extends credit to the buyer.

Additionally, statutory trust assets would not become part of the dealer's bankruptcy estate until after unpaid cash sellers had been paid. *In re Frosty Morn Meats, Inc.*, 7 B.R. 988, 1007 (M.D. Tenn. 1980).

To determine if the Dealer Trust would apply, the following must be shown:

1. A cash (not credit) sale
2. of livestock
3. to a dealer
4. who buys \$100,000 or more of livestock a year.

For a valid claim to be made, it must also be shown that the dealer failed to pay for livestock purchased in cash sales.

See below for additional information on who is protected, the definition of a dealer, and what assets are subject to the trust.

Who is Protected?

The trust would protect all cash (not credit) sellers of livestock who sell to a livestock dealer. This would include producers selling directly as well as livestock auction markets that sell on a producer's behalf and pay the producer from the market's custodial account. Additionally, if a dealer is selling to another dealer and there is a default, the selling dealer would have the same right to claim statutory trust benefits as any other unpaid seller.

Cash Sale Definition

A dealer statutory trust would only apply to cash sales of livestock. The packer statutory trust law, after which H.R. 4058 is patterned, states that cash sales are all sales "in which the seller does not expressly extend credit to the buyer." As clarified by *In re Gotham Provision Co.*, an express extension of credit in the livestock context means "that unless the parties clearly agree in writing to a credit arrangement, the transaction is a cash sale." 669 F.2d 1000, 1005 (5th Cir. 1982).

The P&S Act requires prompt payment from each packer, market agency, or dealer purchasing livestock. Prompt payment is defined as payment before the close of the next business day following the purchase of livestock. 7 U.S.C. § 228b. Under this provision, failure to pay promptly is a violation of the Act on the part of the buyer (not the seller), but this has no bearing on whether or not the transaction was a cash sale or extension of credit.

Dealer Definition

Dealer Trust would apply when the buyer of livestock is a dealer. Sellers are at the most risk when dealers default for a number of reasons: (1) the livestock typically have already been resold by the time the sellers find out they are not going to get paid; (2) a lender usually already has a blanket security interest in both the livestock and the receivables and proceeds from those livestock; and (3) the only payment protection is a surety bond.

The term "dealer" has been defined since 1921 in the P&S Act, 7 USC § 201(d):

The term "dealer" means any person, not a market agency, engaged in the business of buying or selling in commerce livestock, either on his own account or as the employee or agent of the vendor or purchaser.

Creation of a Dealer Trust does not change the definition of dealer. This definition is backed up by nearly a century of U.S. Department of Agriculture (USDA) interpretation and case law.

Feeders are not dealers. See *Solomon Valley Feedlot, Inc. v. Butz*, 557 F.2d 717 (10th Cir. 1977).

Additionally, producers are not dealers unless they also have a livestock buying and re-selling business. “Farmers and ranchers are not dealers when buying livestock for their own stocking or feeding purposes, or when marketing their own livestock.” See <https://www.ams.usda.gov/rules-regulations/packers-and-stockyards-act/regulated-entities/faq> . According to P&S officials, determinations of who is a dealer depends on particular fact patterns. Typically, individuals do not qualify as dealers unless they are in the regular business of buying and quickly reselling livestock without changing the condition or character of those livestock. P&S recognizes that occasionally a rancher will buy animals, determine they aren’t right for the operation, and resell them. This doesn’t make them a dealer in it of itself as it would be seen as incidental to the ranching operation.

While the terms “dealer” and “order buyer” are sometimes used interchangeably in the livestock business, they are treated differently under the law. Although, an individual may act as a dealer in some transactions and as an order buyer in other transactions, the way the transactions are handled is very different. Livestock dealers take title to the livestock and bear the risk of loss for the livestock they buy and then resell the livestock. Order buyers act as agents for their principals who take title to the livestock and pay for the livestock. The order buyer receives a buying commission from the principal for the order buyer’s services. In the situation where an order buyer buys for a dealer (here, the principal) and that dealer defaults, the seller should still have the benefit of the Dealer Trust. This is because the dealer is the party responsible for paying for the livestock.

P&S regulations require dealers to register. A list of registered dealers is available on USDA’s website. See registered dealer list, available at <https://www.ams.usda.gov/sites/default/files/media/BondedDealers.xlsx>. Cash transactions made by an individual registered as a dealer as part of their dealer business would be covered by the Dealer Trust. Additionally, if an individual is a dealer who is in violation of the requirement to register, the Dealer Trust should still apply. However, in this case, there would be an additional burden of first proving that individual is a dealer. Livestock Marketing Association (LMA) has supported, and continues to support, efforts to make sure that businesses that meet the definition of “dealer” are properly registered to avoid any uncertainty.

Some have asked why the trust is not drafted to cover sales to any buyer. The P&S Act covers only packers, markets, order buyers, and dealers. Order buyers do not pay for the cattle they purchase, they are simply agents buying on behalf of another party, so an order buyer trust is not necessary. In the case of packers, the P&S Act already provides for a statutory trust. In the case of markets, the P&S Act already requires the use of custodial accounts, which are trust accounts. Farmers and feedlots do not fall under the authority of the P&S Act and there is strong livestock industry opposition to this changing.

Threshold for Dealer Trust

The Dealer Trust bill, as drafted, would apply only to sales to dealers who have average annual purchases of at least \$100,000.

Both other USDA statutory trusts (the Perishable Agriculture Commodities Act Statutory Trust and the Packer Statutory Trust, after which the Dealer Statutory Trust was patterned) have a threshold level of business. This is to protect small/beginning/occasional buyers just entering the dealer business from the statutory trust applying. A dealer this small is seldom a consequential risk to sellers and is not significant competition to other dealers. Also, sellers to smaller dealers are better protected by the existing bond because the formula causes smaller dealers to have a larger percentage of their business covered by a bond. 9 CFR § 201.30.

What Assets are Covered?

Trust assets would include livestock purchased in cash sales and the proceeds/receivables from those livestock. The trust would not affect other assets of the dealer, such as land, vehicles, and equipment.

No Tracing Requirement

An unpaid seller of livestock would not be required to trace specific dollars in a bank account containing proceeds to his/her specific animals. *In Re Gotham Provision Co. Inc.*, 669 F.2d 1000 (5th Cir. 1982). Unpaid sellers of livestock would have to prove that they met the basic elements required by the trust (e.g., that they sold livestock in a cash sale to a livestock dealer who had failed to pay for the livestock and the unpaid seller filed notice of the claim within the time allowed). Then, the burden of proof would shift to the trustee or secured creditor to prove that the livestock or accounts receivable or proceeds were not subject to the trust.

A dealer can overcome this presumption by showing separation between the assets in question and trust assets through records, separate accounts, or other evidence commonly kept in the course of business. If a dealer also has a separate cattle business, such a cow-calf or stocker operation, and those livestock have been paid for, a default on a dealer transaction would not pull those cattle shown to be separate from the dealer operation into the trust.

Said in another way, if livestock not yet paid for or proceeds/receivables for unpaid for livestock are commingled, there would be a presumption that they are trust funds. The reason for this is that the unpaid seller would be in the worst position to prove a chain of custody of cattle and funds. How could they go into a commingled account and show which specific funds came from reselling livestock for which they were never paid? Thus, it makes sense that there would be a presumption when funds are commingled that they are trust funds and the dealer who defaulted (or their lender) would have the burden to prove if assets were not a part of the statutory trust.

Claw Back in Limited Situations

As a trustee of the Dealer Trust, the dealer (and anyone else acting as the trustee) would be required to follow basic trust law. This includes not improperly spending trust assets for non-trust purposes. Under the Dealer Trust, a dealer could, for example, buy feed for livestock to maintain the value of the assets held for the benefit of trust beneficiaries. However, if the dealer were to spend trust funds for improper purposes and the receiver of those funds was aware of the existence of the trust and the fact that the dealer was breaching the trust, those funds could be clawed back into the trust.

Consumers Produce Co. v. Volante Wholesale Produce, Inc. is instructive on several counts. 16 F.3d 1374, 1382 (3d Cir. 1994). First, it points to the standard for knowledge of breach of trust: "Restatement

(Second) of Trusts § 297(a): ‘A person has notice of a breach of trust if (a) he knows or should know of the breach of trust.’” Second, it delineates that loan repayments made in the ordinary course, for value, and not in breach of the trust cannot be “clawed back” into the trust, but that a massive loan repayment out of the ordinary course would likely indicate breach of the trust and be pulled back.

Trust Assets May Not Equal Amount Owed

The trust is one tool for attempting to make unpaid cash sellers whole. If trust assets are less than money owed for cash sales of livestock, a partial recovery would be made. If there are multiple valid trust claims, recovery would be proportional, with each claimant receiving a pro rata share of their total valid claim. For example, in the event of a \$500,000 dealer default where there are 400,000 of available trust assets, each claimant would recover 80% of their total valid claim.

If trust assets exceed money owed for cash sales of livestock, the sellers would be paid in full and the excess would be free of the trust.

Purchaser from Dealer Takes Clear Title

A good faith purchaser for value from a dealer will continue to take clear title to the livestock. At this point, trust assets would be proceeds/receivables rather than the livestock itself.

The Dealer Trust bill would not change the UCC, which governs the passage of clear title. Entities buying from a dealer would continue to take clear title as good faith purchasers for value if a Dealer Trust existed, just as they do today even if the dealer did not pay for the livestock. *See In re Leonard*, 565 B.R. 137, 148 (B.A.P. 8th Cir. 2017) (quoting *Maryott v. Onconto Cattle Co.*, 259 Neb. 41, 607 N.W.2d 820 (2000) “[t]he U.C.C. allows a buyer who has not paid for goods to transfer greater title to a good faith purchaser than he or she can claim.’ A secured creditor of a buyer can be considered to be a good faith purchaser under these provisions.”). If a dealer sold the livestock to a good faith purchaser such as a feedyard, the trust would only hold the proceeds/receivables paid to the dealer not the cattle themselves.

What isn’t a Dealer Trust?

The Dealer Trust would be a trust. It would not be a lien, a bailment, a payment protection plan, an alternative to bonds, or anything else; it would be a trust.

A Dealer Trust would not require dealers to keep a separate bank account. However, they may choose to do so if they want to keep funds segregated between trust and non-trust funds.

A Dealer Trust would not change bonding practices. No changes would be made to the current formula calculating the bond level required for dealers. The Dealer Trust would be an added tool for payment recovery in addition to bonds.

A Dealer Trust would not have a cost to administer or participation fees. There would be no pool of funds, so no federal or industry funding is required. Instead, the funds would come from the unpaid-for livestock or, if resold, the proceeds/receivables from these livestock.

A Dealer Trust would not change the day-to-day dealings of sellers or buyers of livestock. As long as a dealer is paying for livestock, money continues to move as it does today.

Packer Statutory Trust

The Dealer Trust is modeled after the long-functioning and effective Packer Statutory Trust. 7 U.S.C. § 196. The Packer Statutory Trust was enacted by Congress in 1976 to provide better protection to sellers in the event of a packer payment default. Similarly, in 1984, Congress created a Perishable Agriculture Commodities Act (PACA) Statutory Trust (7 U.S.C. § 499e(c)), also patterned after the Packer Statutory Trust, this time to protect sellers of fresh fruits and vegetables.

The Packer Trust has been a helpful tool.

USDA annual report data shows that from 2010 through 2018, there were \$185,820,970 in valid Packer Trust claims with \$134,846,712 of payments resulting from Packer Trusts. This is a 72.5% recovery rate from Packer Trusts. The total packer default recovery in these years was 78% when bonds and other payments were also considered. In the study, USDA mentioned that this reporting method of measuring only claims that are not withdrawn results in a measure of recoveries that is lower than the measure for all claims. Claims are withdrawn when the claimant is paid. USDA Study, p. 51.

In the study, USDA analyzed 21 different packer default incidents totaling \$4,746,587 in valid Packer Trust claims. The Packer Trusts in these cases paid 130.7% of the valid claims. The trust payouts logically exceeded valid trust claims because packers want to stay in business and thereby pay debts beyond eligible trust claims, including claims on their bonds. Bond claims have a longer time frame (60 days) for filing as compared to trust claims, so trust assets that exceed the amount of trust claims may be used at times to satisfy additional debts once all trust claimants are paid.

In the Agriprocessors default in 2008, every auction market that filed a Packer Trust claim recovered 100% of their money. If passed, a Dealer Statutory Trust implementation would benefit from decades of established Packer and PACA Statutory Trust case law.

Sam Kane Beef Processors

Sam Kane Beef Processors, LLC in Corpus Christi, Texas, defaulted on payment to cattle feeders in recent years. Unpaid cash sellers of livestock to Sam Kane recovered significantly greater assets because the Packer Statutory Trust existed. The USDA study summarized Sam Kane claims as of June 30, 2019. USDA Study, pp 54–58. All valid trust claims against Kane totaled \$159,869,490. The Packer Statutory Trust paid \$124,644,500. The original bond paid out \$3,500,000 and the court ordered another \$500,000. This shows that 80% of valid trust claims were paid.

If the Packer Statutory Trust did not exist, the unsecured livestock sellers would likely have been at the very back of the line for repayment behind non-Trust beneficiary secured creditors, like utility providers and Sam Kane's lender, who reported debts in the tens of millions.

However, even with this excellent payout, Same Kane is not the best example of how a statutory trust is designed to operate. The Packer Statutory Trust process works best if industry participants file timely claims and do not continue to sell livestock to entities who cannot pay for them.

Sam Kane has been a longstanding slow pay and no pay problem. USDA was well aware of Sam Kane's prompt payment violations in recent years. Those violations led to a consent decision and order, signed January 17, 2017, where Sam Kane agreed to cease and desist from failing to pay for livestock when due. USDA documented payments being made between 10 and 25 days after they were due under prompt payment requirements. However, the slow and non-payments continued.

The first Packer Trust claims were filed in September 2016, and continued to be filed into 2018. Often, a feedyard would make a claim, get paid, rescind the claim, and then follow with a new claim for nonpayment for additional cattle. The cycle of filing and pulling back Trust claims coupled with fighting to prevent the plant's closure allowed Sam Kane to fall deeper into debt while still being able to purchase and not pay for cattle. For example, one feedyard which is listed as one of Sam Kane's largest owed creditors, is reported to have eventually cut Kane off but only after the tab reached \$4 million. In addition to court filings, these issues are documented in a December 2018 article in MEATINGPLACE. See *Critical Condition* available at [http://library.meatingplace.com/publication/?i=547727&p=43#{"page":46,"issue_id":547727](http://library.meatingplace.com/publication/?i=547727&p=43#{).

So why keep selling to the plant? Corpus Christi is nearly 700 miles away from the major beef packing plants located in the Panhandle of Texas and many feedyards felt the region depended on keeping the plant open and operational. The plant has changed hands several times due to financial struggles in the last ten years, selling in 2013, 2015, and again in 2019.

Even though plant was allowed to continue operate a failing business and thus rapidly dissipate Trust assets, millions in Packer Trust assets were distributed to unpaid sellers of livestock. These millions of dollars of funds are not available to the myriad other creditors of Sam Kane; even the secured creditors. Because of this, the feedyards who were owed by the plant received more than if they were not Packer Statutory Trust beneficiaries and were instead regular unsecured creditors.

Dealer Trust Claims Process

The creation of a Dealer Statutory Trust would neither remove any current debt collection tools nor eliminate bonding requirements. In fact, if the Dealer Statutory Trust was in place, an unpaid cash seller could choose to file a trust claim, a bond claim, a reparation claim, a civil suit, or (in the appropriate case) a bankruptcy claim, or multiple combinations of these options. In the event of a default, LMA would strongly suggest that unpaid sellers file at least both a trust claim and a bond claim to improve their chances of being made whole.

The Packer Statutory Trust claim process, after which the Dealer Statutory Trust is modeled, begins when an unpaid cash seller gives written notice to the packer and to the P&S. Notice must be given within 30 calendar days after the final date for making a payment under 7 U.S.C. § 228b if no payment instrument has been received or within 15 business days after receipt of notice that a payment instrument (such as a check) has been dishonored.

Upon receipt of notice of a claim, the packer must hold all subject trust assets for the benefit of unpaid cash sellers. Upon the advice of USDA, the Dealer Trust bill grants the agency the clear authority to enforce the trust, which would allow it to appoint an independent trustee if necessary. In many Packer Trust cases that coincide with a bankruptcy, the bankruptcy trustee will segregate trust funds as non-bankruptcy assets to which the unpaid sellers of livestock have priority.

When the P&S receives notice of the claim on a packer trust, the Agency's normal procedure is to contact the packer and remind it that the packer is responsible for holding assets subject to the trust for the benefit of unpaid cash sellers. At this point, P&S also audits the packer to determine if there are violations of the P&S Act and usually notifies the packer's bank of the trust claim. The Agency can penalize the packer for failing to pay for livestock, and, while proceedings are in progress, the Agency can also seek an injunction to prevent further violations of the Act.

Included in the Dealer Trust legislation is language that requires the Secretary to intervene if they have reason to believe that the dealer has failed to perform as a trustee or that it will be in the best interest of unpaid cash sellers. In these situations the Secretary must appoint an independent trustee, serve as trustee, or file suit to enjoin the dealer's failure to perform.

The statutory trust is only responsible for the amount necessary to satisfy unpaid cash sellers of livestock. All amounts above what is owed to unpaid cash sellers will be free of the trust.

Time Limit for Trust Claims

For a Dealer Trust claim to be valid, notice must be given within 30 calendar days after the final date for making a payment under 7 U.S.C. § 228b if no payment instrument has been received or within 15 business days after receipt of notice that a payment instrument (such as a check) has been dishonored. This mirrors the time frame provided for notice under the existing Packer Statutory Trust.

This time frame requires a timely notice while also taking into account that a payment issue might not immediately be apparent. Prompt payment under the P&S Act allows for mailed checks by the close of the next business day. It is entirely foreseeable that a dealer's check could take a week to reach the seller due to delays in the mail service. If no check comes, it could take another week after a check is re-issued to receive it. Once a check is received, a few days are required for the check to come back from the bank as insufficient funds. This is why a 30-day window from receiving no payment or a 15-day window from receiving a dishonored instrument (i.e. insufficient funds check) may be needed to know a payment issue is occurring.

Best practice will be to file on the trust as soon as a payment issue is recognized and not sell to a person that is behind in payment. This will be the best way for the unpaid sellers to improve their chances of recovery under the trust.

Dealer Trust Effect on Preferential Transfer in Bankruptcy

If a Dealer Trust were added to the P&S Act, previous payments from the now-bankrupt dealer made to sellers would be considered trust funds and not eligible to be pulled into bankruptcy proceedings through a preferential transfer claim. *See USDA Study, pp.75–79.* A preferential transfer claim happens when a bankruptcy trustee demands a seller remit an amount equal to all payments the seller received from the defaulting dealer during the 90 days prior to the bankruptcy filing. For more information on these claims, see the earlier section on preferential transfer.

Courts have ruled that no valid preferential transfer claim exists when the item/funds in question are covered by a statutory trust which exists upon delivery of a commodity. This is because the debtor (here the dealer) did not transfer their interest in property. The money paid would not be their property, but rather the unpaid seller's property held in trust for the benefit of that unpaid seller.

For an example of this analysis, see *In Re Fresh Approach, Inc.*, 51 B.R. 412 (Bankr. N.D.Tex. 1985). This case indicates that the Perishable Agriculture Commodity Act Trust, which is modeled after the Packer Statutory Trust, makes it so sales subject to that trust cannot be pulled in to a bankruptcy proceeding as a preferential transfer claim.

Process in Developing Policy

LMA hosted a nine-stop cross-country listening tour in 2015 to hear from its membership on policy issues particularly relating to the P&S program. The concern that surfaced as the top priority was buyer payment default and the lack of financial recovery for sellers. The largest examples of concern included dealer payment defaults.

LMA analyzed multiple options to address this issue including insurance products, larger bonds, changing prompt payment requirements, and a pool of funds for indemnification. More information on alternatives considered are below. Ultimately, LMA leadership determined that a Dealer Trust, patterned after the existing Packer Statutory Trust, would be the tool that would improve recovery in these defaults while having the least unintended consequences on the industry.

In September 2015, LMA hosted a meeting of national agriculture organizations to discuss potential updates to the P&S Act including the addition of a Dealer Trust. Groups participating included American Farm Bureau Federation (AFBF), American Sheep Industry Association (ASI), National Cattlemen's Beef Association (NCBA), National Farmers Union (NFU), National Livestock Producers Association (NLPA), National Pork Producers Council (NPPC), and United States Cattlemen's Association (USCA). LMA has presented the results of the LMA listening tour and national agriculture organization meeting to boards and committees of our national policy partners, including NCBA, AFBA, ASI, and NLPA, as well as to many of their state affiliates.

Policy to support the creation of a Dealer Statutory Trust was adopted by a vote of the LMA Board of Directors upon recommendation from the Government and Industry Affairs committee in February 2016. As with all LMA government and industry affairs polices, ballots were sent to all LMA members. There were 235 yes votes and 3 no votes returned for the P&S resolution which included support for Dealer Trust. This policy has been reviewed and re-affirmed at Government and Industry Affairs committee and LMA Board meetings in 2017, 2018, 2019, and 2020.

Significant time has been dedicated to educating LMA members about the Dealer Trust policy including information printed in the Daily News Brief and monthly InfoLink, providing a handout explainer and infographic, presentations at state LMA meetings, conference calls offered for the entire LMA membership, YouTube videos of former LMA attorney Ernie VanHooser explaining Dealer Trust, two well-attended breakouts at the June 2017 annual meeting, email alerts, and numerous individual conversations and in-person meetings.

This is not the first time the cattle industry has looked at Dealer Trust as a solution to the dealer default issue. Efforts to create a dealer trust date all the way back to the 1990s and early 2000s.

Farm Bill Study

The 2018 Farm Bill included a provision for the U.S. Department of Agriculture to do a feasibility study on creating a Dealer Statutory Trust. This study is due back to Congress in December 2019.

The study asks:

(a) IN GENERAL.—The Secretary shall conduct a study to determine the feasibility of establishing a livestock dealer statutory trust.

(b) CONTENTS.—The study conducted under subsection (a) shall—

(1) analyze how the establishment of a livestock dealer statutory trust would affect buyer and seller behavior in markets for livestock (as defined in section 2(a) of the Packers and Stockyards Act, 1921 (7 U.S.C. 182));

(2) examine how the establishment of a livestock dealer statutory trust would affect seller recovery in the event of a livestock dealer payment default;

(3) consider what potential effects a livestock dealer statutory trust would have on credit availability, including impacts on lenders and lending behavior and other industry participants;

(4) examine unique circumstances common to livestock dealers and how those circumstances could impact the functionality of a livestock dealer statutory trust;

(5) study the feasibility of the industry-wide adoption of electronic funds transfer or another expeditious method of payment to provide sellers of livestock protection from nonsufficient funds payments;

(6) assess the effectiveness of statutory trusts in other segments of agriculture, whether similar effects could be experienced under a livestock dealer statutory trust, and whether authorizing the Secretary to appoint an independent trustee under the livestock dealer statutory trust would improve seller recovery;

(7) consider the effects of exempting dealers with average annual purchases under a de minimis threshold from being subject to the livestock dealer statutory trust; and

(8) analyze how the establishment of a livestock dealer statutory trust would affect the treatment of sellers of livestock as it relates to preferential transfer in bankruptcy.

(c) REPORT.—Not later than 1 year after the date of enactment of this Act, the Secretary shall submit to the Committee on Agriculture of the House of Representatives and the Committee on Agriculture, Nutrition, and Forestry of the Senate a report describing the findings of the study conducted under subsection (a).

On December 20, 2019, USDA submitted to Congress its findings from the Dealer Trust study which included:

Based on its analysis of industry data, public input, and experience with the livestock industry, PSD finds that it would be feasible to implement a livestock dealer statutory trust. A statutory trust covering dealers' livestock purchases could be established in much the same manner as the statutory trusts covering meat packers, live poultry dealers, and produce buyers. The following respond to Congress's request for specific information.

1. Livestock dealers may perform multiple commercial functions. Depending on their various roles, dealers might not carry their own bonds, might not take possession of livestock they purchase, and might not maintain adequate assets to cover defaults, thus jeopardizing the financial welfare of sellers with whom they do business. A dealer statutory trust could improve sellers' chances of obtaining full recoveries if it took into account each of the unique

circumstances under which livestock dealers operate and the value of the livestock sales they manage.

2. Statutory trusts in other segments of agriculture are effective in improving financial recoveries for unpaid sellers of agricultural products. Similar results could be expected under a livestock dealer statutory trust. Authorizing the Secretary to appoint an independent trustee could improve the trust claim and payout process, but payment of trustee fees may reduce funds available for recoveries to livestock sellers.

3. Establishment of a livestock dealer statutory trust could improve livestock seller recovery in the event of a dealer default. Total recoveries under a statutory trust would likely be higher than what is achievable with only bond payouts. In cases of bankruptcy, livestock sellers would realize improved recovery compared to their potential recovery as unsecured creditors.

4. Under bankruptcy law, a livestock seller may offer valid legal defenses against trustee claims of preferential transfer. However, mounting those defenses can be costly to sellers and offset the potential benefits of preserving livestock payment funds. A livestock dealer statutory trust could improve conditions for livestock sellers as to preferential transfers in bankruptcy. Under a trust, livestock purchase payments made to sellers within 90 days before a dealer files bankruptcy would not be considered preferential transfers and could not be reclaimed from sellers.

5. A *de minimis* annual purchase threshold of \$500,000 exempting smaller dealers from a statutory trust could exclude a significant percentage of dealers, offering better protection only to those sellers who do business with larger livestock dealers.

6. Establishment of a livestock dealer statutory trust would likely have little effect on buyer and seller behavior in livestock markets. In general, commerce would continue as usual. Livestock sellers would enjoy a greater chance of financial recovery in the case of a dealer default.

7. Implementation of a livestock dealer statutory trust would be unlikely to significantly impact credit availability or lender behavior.

Who Supports?

Dealer Trust is supported by American Farm Bureau Federation (AFBF), American Sheep Industry Association (ASI), Livestock Marketing Association (LMA), National Cattlemen's Beef Association (NCBA), and United States Cattlemen's Association (USCA), in addition to many of these groups' state affiliates.

In 2017, national lending groups have indicated they will stay neutral on the topic.

Alternatives Considered

Many alternative solutions to this issue have been thoroughly explored. A Dealer Trust was selected as the best solution because it is the option that provides the most protection with the least changes to livestock businesses. Some of the alternatives considered, discussed in more detail below, include larger bonds, an insurance product, an indemnity fund, changes to title or lien laws, and changes to prompt payment timing.

Larger Bonds

Larger bonds have been analyzed as a potential solution for the dealer default issue. Most people in the livestock industry agree current dealer bonds offer insufficient protection. The average dealer bond claim today results in 5–15 cents on the dollar recovery.

Bonds would have to increase tenfold before they would be large enough to garner near full recovery in most cases. The cost of larger bonds (surety companies usually require as much as 9–10 times the non-bankruptcy proof assets of the bond amount) could push some dealers out of business if the bond amounts were significantly increased.

Insurance Product

LMA has invested significant research in the creation of insurance product options to address the risk of payment default, including partnering with another insurance provider to offer a payment protection product and the development of a new product through the LMA-owned Livestock Marketing Insurance Agency (LMIA).

While the offering of these insurance products is positive, LMA continues to believe that Dealer Trust is needed to fix a problem in the current law. For some, the insurance product might not be an affordable option. Additionally, policy limits could minimize recovery in a major livestock dealer default.

It is important to note this insurance product is **not** available for livestock producers, only livestock auction markets.

If at some point in the future Dealer Trust becomes law, the payment protection insurance product would continue to be valuable covering losses on payment defaults by farmers and feeders in addition to dealers. Additionally, Dealer Trust would be a benefit allowing the person suffering the loss or the insurance carrier, which assumes the rights of the insured, another avenue to pursue recovery on dealer defaults.

Indemnity Fund

LMA also analyzed indemnity fund models. In Canada, the provinces of Ontario and Alberta have funds that are established to provide indemnity in the event of a licensed livestock dealer default. The Ontario fund is established from a compulsory 10-cents-per-head deduction when cattle are sold. Similarly, the Alberta program is funded by a 10-cents-per-head levy.

This concept has been discussed with industry partners, P&S program officials, and congressional leaders. The appetite for a federal program mandating participation is low, both from legislative leaders who fear it would be seen as a tax and from industry participants themselves.

Change Title or Lien Laws

Over the years, livestock industry stakeholders have suggested legislation that would provide that title to livestock not pass until the livestock market has been paid. These attempts have not been successful and have been seen as an impediment of the free flow of commerce.

Industry stakeholders have also suggested a lien or automatically perfected security interest be provided until livestock are paid for. This would involve the cumbersome task of attempting to change lien laws in a large number of individual states. While a few states have passed legislation establishing liens when buyers fail to pay, such as Oklahoma and Florida, state lien laws raise issues regarding consistency, jurisdiction in multi-state transactions, and how much protection is actually afforded. Additionally, lien laws would do nothing to protect against preferential transfer claims.

Retention of a Security Interest in Livestock Under Current Laws

It should be noted that sellers of goods often include a provision in the sales agreement which states that title to the goods does not pass until the seller has received final payment. Under the UCC, such a reservation of title is deemed to be nothing more than the retention of a security interest. There are two serious problems: (1) such a security interest would be unperfected until perfected in some manner, usually by filing a financing statement with the appropriate government office, and (2) even when filed it would fall in line behind other previously filed security interests in the same goods.

To have any real clout, a security interest in a dealer transaction would need to be a purchase money security interest (PMSI). A PMSI is a security interest or claim on property that enables a lender who provides financing for the acquisition of goods or equipment to obtain priority ranking ahead of other secured creditors. If a livestock market or producer could get a PMSI for livestock they sell to a dealer, the market or producer would have priority over a bank that has a blanket security interest in “all livestock hereinafter acquired” by the dealer. Unfortunately, this is no longer a practical option and is virtually impossible for auction markets.

Prior to 2000, a seller of livestock could obtain a PMSI in livestock (under Section 9-312) by filing a financing statement within 10 days after the purchaser took possession of the livestock. If the seller was diligent and got the financing statement timely filed, the seller’s PMSI would be retroactive to the date of sale and take priority over conflicting security interests in the same livestock.

In 2000, when revised Article 9 of the UCC went into effect, the provision in Section 9-312 regarding filing within 10 days after the purchaser received possession was removed. Now, under Section 9-324, in order to get a PMSI in livestock, (1) the PMSI must be perfected when the buyer receives possession of the livestock; (2) the purchase money secured party must send notification to the holder of any conflicting security interest (i.e., the dealer’s lender(s)); (3) the holder of the conflicting security interest must receive this notice within six months before the dealer takes possession of the livestock; (4) the notification must state that the person sending the notification expects to acquire a PMSI in the buyer’s livestock, and (5) the notice must describe the livestock subject to the security interest.

Under Section 9-324, it is virtually impossible for a livestock market to obtain a PMSI in a buyer’s livestock. Auctions would have to complete all the steps listed above each time a dealer buys in their market. Markets don’t know which livestock any given purchaser will buy until a successful bid is cast. Oftentimes markets do not know if or how many competing secured parties exist. And, the biggest hurdle is the fact that the filing must be made and perfected before the dealer is allowed to possess the livestock. This is contrary to industry practice where livestock are loaded out during and immediately after the sale.

Changes to Prompt Payment Timing

The Dealer Trust would not change current P&S Act prompt payment requirements. Currently, dealers, livestock auctions, and packers must pay for livestock before the close of the next business day. 7 U.S.C. § 228b. It is important to remember the prompt payment requirement belongs to the buyer of livestock, not the seller.

In 2016, LMA worked with industry and congressional partners to update prompt payment requirements to make clear that in addition to a check in the mail or wire transfer by the close of the next business day, buyers may also use other expeditious modern payment methods, such as Automated Clearing House (A.C.H.) payment, by the close of the next business day. H.R. 5883 (2016). The hope is that by providing modern options that are both efficient and low cost, some may use these tools to speed up payment. However, a check in the mail is still the most common method of payment used.

As part of the process of vetting potential P&S Act changes, there were significant discussions of speeding up the prompt payment requirement and possibly keying it off when collected funds are received, not when they are sent. While most support quicker payment, industry consensus does not exist to mandate quicker payment by law. Many dealers must resell cattle prior to being able to pay for them. Although markets would be pleased for all their buyers to have the significant cash assets necessary to pay for all livestock up front, the reality is the population of buyers who have those types of resources is limited. Changing the method of payment from a check in the mail to something else would be a significant shift in the way the livestock industry functions today and would likely cause many small- and medium-sized dealers to go out of business or significantly reduce their buying volume.

As exists today, a buyer and seller have the right to agree to terms other than prompt payment. Markets who have attempted alternative payment policies which would require faster payment have experienced serious pushback from buyers. Dealers regularly say they'll stop buying at a market if they must pay prior to taking the cattle because that isn't required at other places where they buy and is quicker than the P&S prompt payment. Feedlots often will not pay for cattle until they arrive at the feedlot for inspection. If one market requires stringent payment rules and the market 20 miles down the road does not, the strict market stands to lose significant business, reducing prices for their producer consigners.

Even if payment was sped up by leaving a check or running an A.C.H. payment on sale day, this does not prevent defaults. Checks and A.C.H. payments can bounce. Many livestock sales conclude well after the banking day has wrapped up and it sometimes takes multiple days for a bank to return an insufficient funds check.

Lending Implications

The creation of a Dealer Trust fixes a problem in current law. The change is not anti-bank. Almost everyone in the livestock business has a lender. Most lenders in the livestock industry have more producer customers than dealer customers. This change would help ensure that livestock sellers and their lenders get paid if a livestock dealer fails to pay for livestock.

The USDA study concluded "implementation of a livestock Dealer Statutory Trust would be unlikely to significantly impact credit availability or lender behavior." USDA Study, p.7.

A dealer's financing is an individual arrangement with their lender and depends on many factors. Several LMA dealer members have discussed the concept with their lenders to confirm it would not change their lending relationships.

LMA has also discussed the Dealer Trust concept with several individual bankers and banking groups. In these conversations, rural dealer lenders especially often point out that they also have producer and livestock market customers who would benefit from this change in the law. Essentially, everyone has a lender and the current law unfairly favors buyers' lenders over sellers of livestock and their lenders.

A Dealer Trust would only affect a lender's position in the event its dealer client fails to pay for livestock. In that situation, the trust would cover livestock purchased in cash sales as well as the proceeds and receivables of livestock purchased in cash sales. The trust would be limited to the dollar amount needed to pay the unpaid sellers of livestock. All livestock, receivables, and proceeds beyond that would still be available to lenders. Additionally, lenders would retain their first priority in non-trust assets such as land, vehicles, and equipment.

The USDA study summarized discussions with lenders where the agency found "as an industry practice, lenders currently discount accounts payable against accounts receivable, dealer credit availability would arguably not be impacted by a dealer trust because lenders have already excluded those funds subject to a potential trust." USDA Study, p.91.

If a dealer's lender adjusts a dealer's access to credit following a Dealer Trust going into effect, this would mean they likely have concerns about that dealer's ability to pay for livestock and are basing the current loan only on livestock or proceeds from livestock that have not yet been paid for. This dealer would still have the option to pledge additional non-trust collateral (e.g., land, equipment, or livestock that are not subject to the trust) to secure this loan.

The Federal Reserve has analyzed the Dealer Trust provision on multiple occasions and confirmed as recently as 2020 it would not affect the way their bank examiners analyze lenders they regulate.

Lien Holder Notice

At the request of lenders consulted, the Dealer Trust bill includes a provision providing notice to a dealer's lien holders when a trust claim is made. This provision is not in the Packer Statutory Trust law. As a practical matter, when a Packer Trust claim is made, USDA investigates and notifies the packer's lenders when it has been determined the trust claim is likely valid. The same procedure would likely be followed for Dealer Trust claims.

With this said, in most cases, what starts a dealer's failure to pay is a lender cutting off the dealer's line of credit or cleaning out the dealer's bank account. Regardless of notice, the lender is almost always the first entity to know that a default is happening, because checks were presented without sufficient funds in the account for them to clear. Many sellers' lenders have seen this ability taken advantage of by lenders to dealers.

Oklahoma and Florida Lien Laws

Since 2011, a law in Oklahoma gives first priority to unpaid sellers of livestock. The law states:

A. To secure the obligations of a first purchaser to pay the sales price, every livestock owner is granted a lien in all livestock sold by such livestock owner, for any unpaid portion of the sales price for such livestock. The lien granted by this act is granted and shall exist as part of and incident to the ownership of livestock.

B. An owner's lien:

1. Exists in and attaches immediately to all livestock on the effective date of this act;
2. Continues uninterrupted and without lapse in all livestock upon and after sale of any livestock; and
3. Continues uninterrupted and without lapse in and to all proceeds

Livestock Owner's Lien Act of 2011, 4 OK Stat. 4-201.3.

Discussions with Oklahoma dealers, lenders, and industry groups reveal that dealers in the state have not seen their access to credit change as a result of this law.

In 2018, Florida followed suit with a bill which provides sellers of livestock a lien in livestock and proceeds therefrom. This law states:

A seller that sells livestock to a purchaser shall have a lien on such animal and its carcass, all products therefrom, and all proceeds thereof to secure all or a part of its sales price.

Florida CS for CS for Senate Bill 740 (2018).

Unfortunately, lien priority statutes like the Oklahoma and Florida laws do not protect against preferential transfer claims and questions regarding which state's laws apply exist for transactions where multiple parties are located in multiple states.

Packer Consolidation

Some have asked if the Packer Statutory Trust caused concentration in the packing sector. The short answer is no. Packer concentration predates the Packer Trust and is the result of a variety of complex factors.

The move toward packer consolidation and anti-competitive behavior can be seen as far back as the 1880s. See *Assessing Competition in the U.S. Beef Packing Industry*, Clement E. Ward, CHOICES (available at <http://www.choicesmagazine.org/magazine/article.php?article=121#sthash.80yCG6vB.dpuf>). In fact, the 1921 passage of the P&S Act was aimed at supporting competition in the packing industry. However, concentration in the packing sector continued following the passage of the P&S Act.

Economies of scale favored the efficiency and cost management associated with operating larger businesses with lower per-head costs at slaughter. Historically, large plants had much smaller cost advantages over small plants. In the early 1980s, that cost advantage noticeably widened. For example, the largest hog plants' relative cost advantage over smaller plants was about twice as large in 1992 as in 1982. The largest cattle plants' 1992 cost advantage was half again larger than its 1982 index. See *Consolidation in Meatpacking: Causes & Concerns*, Agricultural Outlook, Economic Research Service/USDA (June-July 2000) (available at

<https://www.meatinstitute.org/index.php?ht=a/GetDocumentAction/i/7072>). Declining cattle numbers and increased competition from poultry – which had an impact on cost and profit margins – are also pointed to as key factors in the mass concentration and consolidation seen in the 1980s. See *Market Conditions Will Shrink U.S. Packing Sector*, Beef Magazine, Wes Ishmael (Dec 27, 2012) (available at <http://www.beefmagazine.com/processors/market-conditions-will-shrink-us-packing-sector>).

Another clear trend coinciding with increasing concentration is increased packer procurement of livestock by non-cash-price means. The first year P&S collected data on contracting by the four largest beef packing firms (1988), forward contracts and marketing agreements accounted for 15.8% of steer and heifer slaughter. However, formula pricing represented 33 % of total fed cattle procurement in 2007 and grew to 58 % in 2016. *P&S 2016 Annual Report* (available at https://www.gipsa.usda.gov/psp/publication/ar/2016_psp_annual_report.pdf).

Other factors affecting concentration include labor issues, unions, strikes, and food safety regulation pressure.

Regulatory agencies, notably the P&S program and the Department of Justice (DOJ) have been routinely criticized for not halting the trend in concentration. However, the failure of court systems to render decisions to combat anti-competitive behavior may also share some of this blame.

Business Practices

As with the Packer Statutory Trust, a Dealer Trust would provide an additional tool for sellers to recover in the event of a default; however, it would not be a guarantee of complete recovery. Because of this, good business practices will remain important.

LMA encourages our member markets to obtain buyer registration consent agreements from buyers. These agreements provide consent to contact the buyer's financial institutions and obtain information on a buyer's financial position. Some markets process these bank inquiries internally. Others fax the agreements to LMA where professionally trained staff contact the lending institutions and share information gathered with the market. A successful inquiry process provides an overview of the buyer's financial position including average and current checking balance, savings, certificates of deposit and other investments, lines of credit, term loans, and number of returned or insufficient funds items during past 30 days. The form is continuous until buyers rescind their authorizations, so LMA is able to check on a buyer at other times at a market's request. The LMA processes a little more than 4,300 inquiries a year.

Markets also monitor business alerts from the LMA regarding verified insufficient fund checks or other buyer payment failure.

Even with these precautions taken, dealer defaults occur. The default can come from the least expected person. In some cases, it has been a dealer with whom a seller has done business for decades.

When livestock markets call LMA with concerns about a dealer or packer who has not paid promptly, LMA recommends filing on the relevant bond and, in the case of the packer, on the trust in a timely manner. With statutory trusts, the probability of trust assets being available for recovery is higher the sooner the trust claim is made.

Livestock markets are limited in their ability to choose with whom they do business. A market doesn't pick who is the highest bidder or how much volume a dealer buys on any particular day. Additionally, Sections 312 and 307 of the P&S Act prohibit markets from discriminating against buyers. The extremely broad view of "discrimination" by P&S is not intuitive and not a standard by which many businesses must operate. Essentially, P&S sees markets as public utilities that, unlike other businesses, do not have the right to refuse service without just reason and must treat all patrons the same. So, if a market requires a certain individual to pay quicker or limits his or her buying ability, they must do the same for all other similarly situated individuals. Even more concerning, markets have at times been instructed they may not refuse to sell to an individual without documentation of reasoning – whether that be proof of previous insufficient funds check, behavior issues, etc.

Texas Opposition

While LMA has seen significant support for the Dealer Trust policy across its membership, there has been some pushback, particularly from those in the state of Texas. LMA has met with concerned Texans and those with whom they do business multiple times, including in person meetings in July 2017, February 2018, March 2018, and March 2020. LMA has offered potential adjustments to the Dealer Trust concept for consideration. The most significant adjustment offered has been including a waiver provision which would allow parties to voluntarily enter into agreements waiving Dealer Trust protections without changing other P&S Act requirements, such as prompt payment. This waiver option is discussed more in depth below.

Credit Agreements

In January 2018, a group of Texas dealers have sent letters to livestock auction markets stating that if the Dealer Trust law goes into effect, they will request the markets extend credit on the cattle the dealers buy at their auctions. The Dealer Trust only applies to cash sales of livestock. Therefore, sellers who sign agreements extending credit to a dealer would no longer have Dealer Trust protections.

However, the decision to extend credit should not be contemplated lightly as there are significant legal consequences to consider. If a market signs a letter extending credit, they must put the equivalent amount of funds owed to them by the person to whom they extended credit in the market's custodial account by the close of the next business day. 9 CFR § 201.42. This is different than a cash sale where money from buyers goes into the custodial account as it is received and, by the close of the seventh day following the sale for cash transactions, markets must put their own money into the custodial account to make it balance if they have not yet received the remaining money. *Id.*

Sellers have a choice about whether to sign a credit agreement. However, some markets may feel pressured to sign an agreement if it is requested by a significant volume buyer.

Dealers considering these agreements should remember it is prohibited to impose, demand, compel, or dictate the terms or manner of payment, or attempt to obtain a payment agreement from a seller through any threat of retaliation or other form of intimidation. 9 CFR § 201.43(b)(4).

Additionally, dealers are required to conduct their buying operations in competition with, and independently of, other dealers. 9 CFR § 201.70.

Waiver

At a meeting between LMA and the Livestock Marketing Association of Texas (LMAT) on February 11, 2018, the groups discussed the possibility of adjusting the legislation to allow a seller and buyer to sign an agreement waiving Dealer Trust protections without changing payment terms. This would provide an alternative to utilizing credit agreements as the avenue to make a Dealer Trust no longer apply to specific transactions or buyer/seller relationships. Parties to the waiver agreement would document if the waiver was for a single sale, every sale before a specific date, or “evergreen,” meaning it could be signed once and apply to all transactions between the two parties until canceled by one of the parties.

LMA believes that a Dealer Trust would be a positive protection for sellers (including markets, producers, and dealers selling to other dealers) by giving them first priority in livestock sold or proceeds/receivables from those livestock. Because of this, it would be LMA’s hope that sellers would not opt to sign agreements waiving the trust. However, if the Dealer Trust is not a desired tool for some, a waiver provision would allow the seller and buyer to contract out of it applying without the unintended consequences associated with credit agreements, namely slowing down payment and putting markets under additional financing pressure with their custodial accounts.

A person waiving the Dealer Trust would no longer have a trust claim if that dealer defaulted. If another seller to that dealer was defaulted upon and did not sign a waiver, this second seller would still have a trust claim. The claim would be limited to the amount of cash sales of livestock to the second seller who did not sign a waiver.

The 2020 bills do not include a waiver provision as LMA has been told it is not a suitable solution for the concerned Texans.

COVID Impacts

The volatile down market in cattle prices due to COVID-19 has increased the urgency of addressing livestock seller recovery when livestock dealers default. This effect has already been seen with a significant increase in dealer defaults the Spring of 2020. Additionally, default issues often take time to unravel. Significant concern exists for continuing defaults and especially the possibility of a large default.

USDA bond claim data for the 9-week period from the beginning of March through the first week of May shows that in 2020, there were 10 claims in that timeframe. From 2011–2019, that same timeframe ranged from 0 to 4 bond claims, with an average of 1.11 claims per year. So, the first couple months of COVID showed an increase in claims that was 9 times greater than in a normal year.

With some effects already being felt, it will take time for the true fallout to be known. History shows that during volatile down cattle markets dealers can get behind. However, their banks tend to continue to work with them for a while before they pull their line of credit. This is when the default occurs. For example, Eastern Livestock’s liquidity issues probably originated in the 2008–2009 recession, but they were able to continue operating for another year before their bank pulled their line of credit and the massive default occurred.

Sometimes dealers can’t resell feeder cattle at a profit, so they keep ownership and feed (and finance) the cattle. This often leads to bigger losses and digging the hole deeper when the default does occur.

Some key indicators causing concern include buyers refusing to take delivery on cattle contracted, dealers asking livestock markets for credit agreements to delay payment, a spike in LMA Risk Mitigation activity processing buyer verification of deposit inquiries, and a significant increase of markets quoting and binding Payment Protection Insurance.

Real-World Dealer Default Example

Background:

A dealer, we'll call him Dwight, has a \$50,000 bond. He has some personal assets and some cash, but his livestock purchases are financed by a bank. The bank has a security interest in "all livestock hereafter acquired" by Dwight as well as some trucks, equipment, etc.

Dwight has been doing business with the same producers and livestock markets in his area for many years and always pays for livestock, but sometimes takes a few days or even a week to get a check to the sellers.

Fact Pattern:

Adam is a cow/calf producer who markets his cattle privately. He has had good luck selling cattle to Dwight for the last two falls. He sells \$50,000 worth of feeder calves to Dwight on September 1 and gets a good check from Dwight on September 5. He cashes the check and pays off the note on a portion of his cow herd.

On Monday, October 1 Dwight the dealer buys \$50,000 worth of feeder calves through Acme Livestock Market. After the sale, he tells the folks in the office he is going to mail a check tomorrow (in compliance with prompt payment rules). Dwight does indeed mail the check on Tuesday, October 2.

On Wednesday, October 3, Dwight the dealer buys \$50,000 worth of feeder calves from Bill, another dealer, and again indicates that he'll mail a check the next day, which he does.

Also, on Wednesday, October 3, Clarence the producer sells Dwight the dealer \$50,000 worth of feeder calves privately. Dwight leaves a check with Clarence who plans to cash it the next time he gets to town, which will be in a couple days.

Dwight the dealer takes all the cattle he bought this week (a total of \$150,000 worth of calves) to Sigma Feeders, the local feedyard on Thursday. Sigma writes him a good check for \$150,000 (not accounting for markup etc.) and Dwight immediately deposits the funds into his bank account.

In the meantime, Dwight's banker becomes concerned about Dwight's financial situation. She knows Dwight's other businesses have taken huge losses due to poor investing and Dwight's messy divorce has stripped him of many of his assets. The banker decides to cut off Dwight's line of credit and take advantage of her priority position in "all livestock hereafter acquired." Because of her secured position at the front of the line, she is able to clean out all of Dwight's bank accounts, including the \$150,000 from Sigma Feeders for the livestock Dwight purchased this week, but had not yet paid for.

Acme Livestock Market, Bill the dealer, and Clarence the producer all receive their checks from Dwight and attempt to cash them on Friday. By the middle of the following week, all three receive notice that the checks are being returned unpaid because there are insufficient funds in Dwight's bank account.

How it Shakes Out:

Under current law, without a Dealer Trust, the bank ends up with \$150,000 in cash from the cattle sold to Sigma Feeders, any other livestock Dwight had on hand, and some equipment, trucks, etc. Acme Livestock Market, Bill the dealer, and Clarence the producer are not entitled to the \$150,000 paid by Sigma Feeders for the cattle they raised/sold and cannot repossess those cattle. This is because Sigma Feeders takes them free of a security interest and gains good title as a buyer in the ordinary course of business and a good faith purchaser for value. The only real recourse these unpaid sellers have is to file on Dwight's bond. If the bond pays out the full \$50,000, they will each get a pro-rata share of the \$50,000 bond. In the best situation, that leaves Acme, Bill, and Clarence each short \$33,334. However, if a Dealer Trust were in existence, Dwight's bank would stand behind Acme, Bill, and Clarence as unpaid cash sellers of livestock. The \$150,000 Sigma Feeders paid to Dwight would be trust funds held for the benefit of Acme, Bill, and Clarence. Thus, Acme, Bill, and Clarence would have the first right to the \$150,000 paid to Dwight by Sigma Feeders. These folks would also be able to file on Dwight's bond. Any money left over would be paid to Dwight's secured creditor, the bank. Dwight's bank would still stand first in line for any cattle Dwight had on hand that were already paid for, proceeds/receivables from cattle sold and already paid for, and any equipment, trucks, etc. that fell under a perfected security agreement between the bank and Dwight.

What about Adam?

Remember Adam? He is the producer who sold cattle directly to Dwight back in September and got a good check that cleared the bank and he turned around and used those funds to pay off a note on his cows. Well, Dwight ultimately declared bankruptcy at the end of October. Now, the bankruptcy trustee, through the power of the doctrine of "preferential transfer" has come back to Adam and demanded he reimburse the bankruptcy trustee the full amount of \$50,000 Dwight paid to Adam for cattle back in September.

If a Dealer Trust were in existence, the funds used to pay Adam would have been trust funds, which cannot be subject to a preferential transfer claim and Adam would not have had to spend time, legal fees, and stress fighting the bankruptcy trustee to keep the money he was paid.

Additional Information

Dealer Trust Bill

[H.R. 6067: Securing All Livestock Equitably \(SALE\) Act](#)
[S. 3419: Securing All Livestock Equitably \(SALE\) Act](#)

Explainer Documents

[Dealer Trust Explainer and Infographic](#)

YouTube Video Explainers

Dealer Trust – The whole story - <https://youtu.be/bNIRWd8g2i8>
Dealer Trust – How does it work? - <https://youtu.be/msL3bcqwOEc>

Dealer Trust – What is it? - <https://youtu.be/POLMiGtnsZk>

Testimonial Videos

Dwayne Mays, Ogallala Livestock, Ogallala, NE - <https://www.youtube.com/watch?v=JR57B00-1fQ>
Jim Akers, Bluegrass Stockyards, Lexington, KY - <https://www.youtube.com/watch?v=XB6eAKzR17E>
Brody Peak, Emporia Livestock, Emporia, KS -
<https://www.youtube.com/watch?v=zBQncWkCq9U&feature=youtu.be>