'Breaking in' new laws:
An update on the livestock dealer statutory trust

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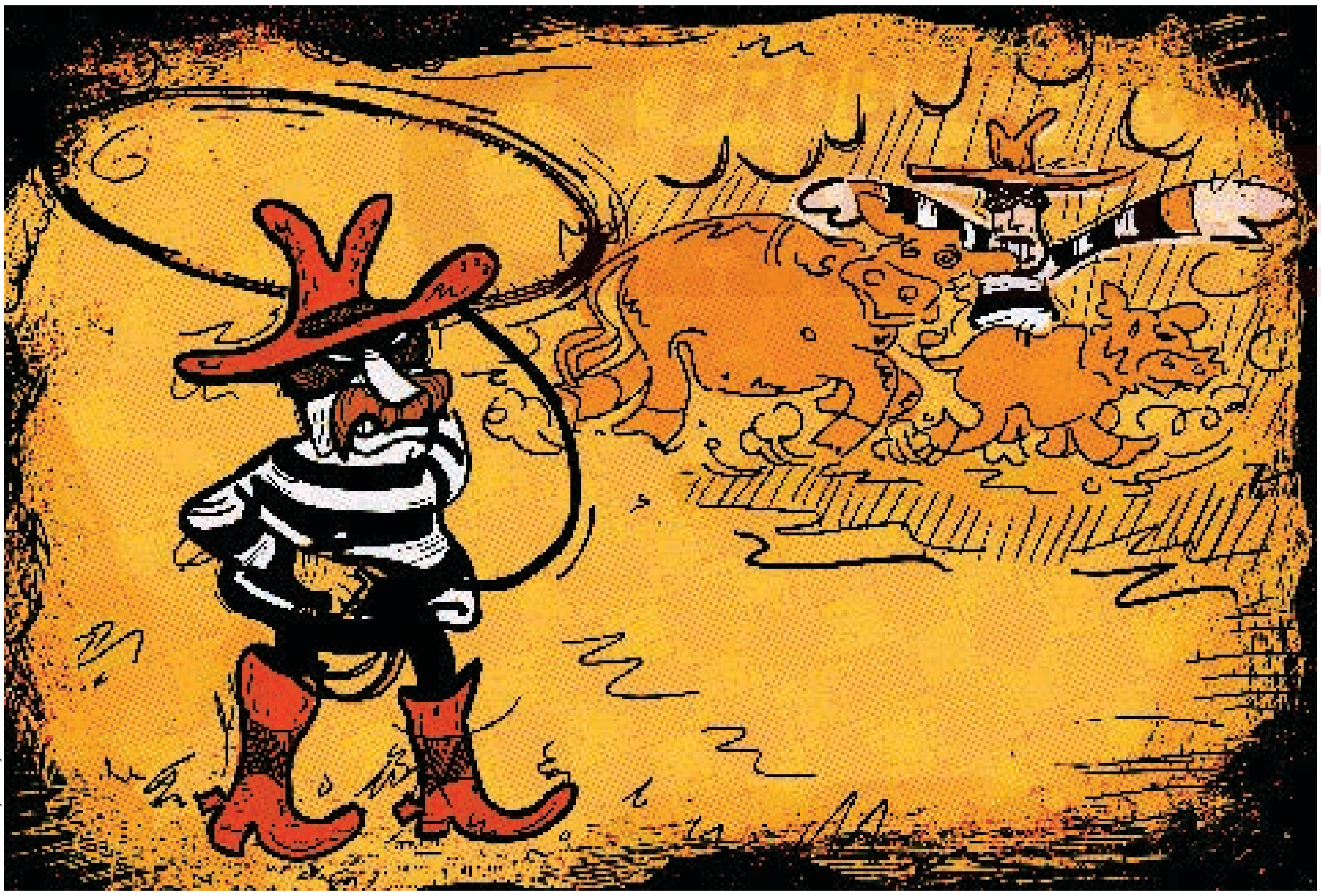

Illustration by Corey Lewis.

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AT A GLANCE

In 2020, the Dealer Trust Act was established for the benefit of unpaid cash sellers of livestock. If a dealer fails to pay sellers for livestock, the Dealer Trust Act then is intended to enable the seller to receive payment through these trust assets.

Between high production costs, drought and other unpredictable market factors, there are many challenges facing those in the cattle industry. But one challenge no cattle producer wants to experience is when a buyer of cattle defaults on payment. The following hypothetical details such an unfortunate situation:

• Cattle Producer raises commercial cattle and sells his calves at weaning to Cattle Dealer. Cattle Dealer may background and feed these calves before selling to a feedyard or market them another way. Cattle Dealer has a line of credit with Cattle Baron's Bank, which has secured this line of credit with collateral, including Cattle Dealer's farm products (broadly defined to include livestock).

• Here, Cattle Producer sells 300 weaned calves to Cattle Dealer. After those calves are shipped, Cattle Dealer fails to pay Cattle Producer. As it turns out, Cattle Dealer's financial condition is not good, and shortly thereafter Cattle Dealer files for bankruptcy. Here, Cattle Producer remains unpaid for the calves he sold and is now facing an uphill fight in bankruptcy as what would be considered an unsecured creditor. Cattle Baron's Bank, in contrast, as a secured creditor, now technically has a preferential interest in those 300 calves located at Cattle Dealer's backgrounding yard.

In 2020, Congress attempted to address this issue by amending the Packers and Stockyards Act and adding a new section known as the "Livestock Dealer Trust" or "Dealer Trust Act." In general, this new Dealer Trust Act was established for the benefit of unpaid cash sellers of livestock. In theory, the Dealer Trust Act requires a livestock dealer to hold certain assets in trust for the benefit of unpaid sellers of livestock. If a dealer fails to pay sellers for livestock, the Dealer Trust Act then is intended to enable the seller to receive payment through these trust assets. While still in its infancy, a quick review of this statute and when it applies may be helpful for anyone who is in the business of selling cattle.

Basic terms of the Dealer Trust Act

The Dealer Trust Act provides

that "[a]ll livestock purchased by a dealer in cash sales and all inventories of, or receivables or proceeds from, such livestock shall be held by such dealer in trust for the benefit of all unpaid cash sellers of such livestock until full payment has been received by such unpaid cash seller" 7 U.S.C. § 217b (a)(1). Importantly, the sale must be to a "dealer" and be considered a "cash sale."

A dealer is defined to include "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" 7 U.S.C. § 201(d). The act exempts dealers whose average annual purchases of livestock do not exceed $100,000. A cash sale is "a sale in which the seller does not expressly extend credit to the buyer" 7 U.S.C. § 217b (a)(d).

Mechanics of the Dealer Trust

The Dealer Trust is initiated when the dealer takes delivery of livestock without paying the seller. However, in order to take advantage of the Dealer Trust, a seller has to give written notice to the dealer and the USDA. This claim must be sent to the dealer and USDA either within 30 days after payment was due (generally due before the close of business the next business day following the purchase and delivery of the livestock), or if the dealer did provide payment to the seller but the dealer's payment instrument was dishonored, the seller must submit the claim to the dealer and the USDA within 15 days after receiving notice that the dealer's payment instrument was dishonored.

Documenting payment terms and carefully identifying the cattle that were sold (e.g., type of cattle, average weight, lot numbers, eartag numbers, brands, etc.) may be helpful information to have as part of submitting any Dealer Trust claim.

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In response to these claims, the dealer is then required to maintain all of dealer's livestock-related assets for the trust, which will then be used to pay the unpaid sellers. The assets of the Dealer Trust are not property of any potential bankruptcy estate, meaning they would not be subject to a preferential claim by a secured creditor.

The Dealer Trust Act requires if the USDA has reason to believe a dealer is not complying with the act or it would be in the best interest of the unpaid cash sellers, the USDA can step in and, among other things, appoint an independent trustee to carry out the duties of the dealer or itself serve as the trustee, preserving trust assets and enforcing the trust.

Dealer Trust in action

The Dealer Trust Act came into the news earlier this year when the USDA sent out notifications to sellers who sold cattle to entities owned by Brian McClain out of Benton, Kentucky, informing them of the need to file Dealer Trust claims. The entities subsequently filed for bankruptcy, which are now pending in the United States Bankruptcy Court for the Northern District of Texas. The effectiveness of the Dealer Trust Act will certainly be put to the test as this matter plays out. More to come here, so stay tuned.