

LAWS AND LIABILITIES AFFECTING THE SEEDSTOCK CATTLE INDUSTRY

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Foreword

This report presents general information on the laws and liabilities that govern transactions between seedstock cattle producers and their customers. This article is intended to provide buyers and sellers of seedstock cattle with a basic introduction to the specialized legal considerations relating to their business and should not be relied upon in making legal decisions.

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HIGHLIGHTS

Farm operators which sell or purchase seedstock cattle should be aware of laws affecting their livestock transactions and the potential for liability. Such an awareness provides producers an opportunity to arrange their transaction to minimize legal responsibilities and unexpected consequences.

Potential for liability includes breach of contract. Agreements to sell livestock for more than \$500 generally must be in writing to be enforceable. Sellers of livestock warrant they are the owners, that the cattle are of average grade and quality, and in some situations, that they are fit for a particular purpose. Sellers also warrant their livestock with spoken statements or in writing. Warranties not only apply to live animals but also cover semen, unborn calves, and embryos. In addition, producers may be liable for injuries to persons on their property.

Written agreements and dealing with reputable persons as well as acting to reduce potential liabilities can diminish the probability of a producer being responsible for damages to another.

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James A. Lodoen, Owen L. Anderson and David M. Saxowsky*

Cattlemen have typically prided themselves for their independence, trustworthiness, and "hand-shake" transactions. Customs were regarded as the law; the cattle business was simple and most cattle transactions were between a buyer and seller who were personally acquainted with one another.

Times have changed. Performance testing, multiple ownership, artificial insemination, embryo-transplanting, cloning, and blood typing have all added to the complexity of running a cattle operation. Much of today's complexity centers around the seedstock cattle industry. Many transactions are handled by letter or telephone, between individuals who have never met. Both buyers and sellers of breeding cattle need to be aware of consequences that may result from their management decisions and sale or purchase transactions.

Not all cattlemen are aware of the laws affecting their business. Disputes arise because parties to a transaction cannot agree on sale terms or have differing views on customs and laws. A lawsuit is often the only way to settle such a dispute. Usually when a lawsuit is filed, both parties have already lost. Attorney's fees, personal expenses, loss of the parties' time, and the stigma associated with a lawsuit usually make full recovery improbable.

The key to solving legal problems associated with the seedstock cattle industry is to understand one's legal rights and obligations. Such awareness allows precautions to be taken to prevent most potential problems from occurring.

Agreements to Sell Cattle

An agreement to sell cattle for \$500 or more usually is not enforceable unless it is written, signed by the party against whom enforcement is sought, and specifies the quantity of livestock to be purchased. An oral contract, however, may be enforceable once payment has been made and accepted or the livestock have been delivered and accepted.

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A second exception to the writing rule applies to transactions between "merchants." For purposes of this article, a merchant is defined as a person who deals with cattle or who holds himself out as being knowledgeable in this area. This exception provides that an oral agreement is enforceable if one merchant sends another merchant a written confirmation of an oral agreement and the second merchant does not deny it within 10 days.

Types of Warranties

Two types of warranties can be made between a buyer and seller of cattle: implied warranties and express warranties. Both have important implications in cattle sales and should be clearly understood by buyer and seller.

Implied Warranties

Implied warranties, unless specifically excluded, arise in each sale without mention by the seller. Three types of implied warranties are discussed: (1) implied warranty of title, (2) implied warranty of merchantability, and (3) implied warranty of fitness for a particular purpose.

Warranty of Title

Sellers of livestock automatically warrant that they have clear title to the animals, which means that there are no liens upon them. This warranty protects buyers by granting them a legal right to seek compensation from the seller should the title be defective. For example, a buyer can bring a legal action against a seller if the livestock are taken from the buyer by a seller's creditor, who had acquired a security interest (mortgage or lien) in the livestock prior to the sale. This legal right may be of limited practical consequence, however, if the seller is experiencing financial difficulty and has limited assets from which the buyer can satisfy his legal claim.

A prudent buyer will check the proper recording office to be certain that no third party claims an interest in the seller's cattle. The Register of Deeds Office in the county of the seller's residence (or in the county of the seller's executive office if the seller is a business) should be checked if the seller and cattle are both in North Dakota. The Register of Deeds Office in the county where the cattle are located should be checked if the seller is not a resident of North Dakota but has cattle in the state. A buyer purchasing cattle from a state other than North Dakota should refer to that state's filing laws to determine the proper filing location.

North Dakota law (North Dakota Century Code 41-09-28) provides that purchasers of farm products may choose to comply with specific procedures to be protected against purchasing farm products without clear title. Purchasers of livestock without clear title, who do not follow these procedures, might find themselves forced to return them to the creditor that claims a security interest in the livestock. The specific procedures

provided by Section 41-09-28 are not functioning very effectively and the 1985 legislature may revise them. However, this law must be complied with for total protection. In a majority of circumstances, one who follows the procedures as outlined in the preceding paragraph will be alerted to third party interests in cattle, but this procedure will not provide the absolute protection available through Section 41-09-28.

Warranty of Merchantability

An implied warranty of merchantability guarantees that the cattle are of average grade, quality, and value of similar cattle sold under similar circumstances. A seller also warrants that the cattle are reasonably fit for the general purpose for which they are purchased. A major problem with relying on the implied warranty of merchantability is determining an exact meaning of average grade, quality, and value as applied to a specific cattle transaction.

Implied warranty of merchantability applies only if a seller is considered a merchant in the eyes of the law. Courts do not agree whether a farmer or rancher is considered a merchant. Professionalism, special knowledge of the cattle business, and general business experience are factors that would indicate a particular cattlemen is a merchant. Seedstock cattle producers, particularly established and reputable breeders, are likely to be considered merchants subject to the warranty of merchantability.

An implied warranty of merchantability can be excluded by written agreement only if the word "merchantability" is conspicuously mentioned in a disclaimer. This warranty can also be excluded or modified by an oral agreement or offer to sell mentioning the word "merchantability" in a disclaimer or by stating that the cattle are being sold "as is," "with all faults," or similar language. When a buyer has examined the livestock as fully as desired there is no implied warranty with regard to defects which an examination ought to have revealed. An implied warranty can also be excluded by custom of the trade. Buyer and seller may be better protected if they exclude the implied warranty of merchantability and substitute specific warranties as terms of their sale agreement.

Warranty of Fitness

An implied warranty of fitness for a particular purpose will provide a buyer more protection than the implied warranty of merchantability. This warranty applies when a seller has reason to know the specific purpose for which the buyer intends to use the cattle and the buyer relies on the seller's skill to select and furnish suitable cattle for him. An implied warranty of fitness guarantees that the goods will reasonably fit the particular purpose for which the buyer purchased them.

For example: John Jones tells Expert Eddy, owner and manager of A-1 Registered Hereford Ranch, that he needs a bull that will produce heavier calves at weaning and heavier milking daughters. Eddy selects Prince Chess

as the bull for John to purchase. A year later John finds that Prince Chess' calves are extremely light weight. The following year John notices that Prince Chess' daughters are the poorest milking females in his herd. John may have a legal claim against Eddy because he relied on Eddy's judgment to select a suitable bull. In other words, Eddy may be liable for breach of the implied warranty of fitness.

Implied warranties of fitness can be modified or excluded only by: (1) a conspicuous writing, (2) provisions such as selling "as is," (3) failure of a buyer to notice defects which an examination should have revealed provided he was given the opportunity to examine, or (4) custom and usage of trade in the seedstock cattle business.

Express Warranties

An express warranty is created by any promise or assurance made by the seller concerning the quality or type of cattle to be sold or by a sample or model used to represent the type of cattle to be purchased. Specific statements or representations made during negotiation of a sale and factual information in advertisements are examples of express warranties. Specific words such as, "I warrant" or "I guarantee" are not necessary to create an express warranty. However, general predictions and opinions, such as, "This is the best bull that I've ever sold," or, "Some say his sire is the top in the state," are considered "puffing" and usually will not constitute an express warranty as long as specific facts are not included. A problem with recovery on breach of an oral express warranty is proving that a warranty was made. Thus, express warranties will be most effective when written and signed by all parties, thereby clarifying the scope of the warranty.

Application of Warranties

Live Breeding Cattle

Breeding cattle are usually sold by one of two methods: auction (consignment or production) or private treaty. Most registered cattle auctions make available to prospective buyers a catalog that includes the individual pedigree and performance information of cattle to be sold as well as the terms, warranties, and conditions of the sale.

A typical sale catalog warranty reads:

"All animals are guaranteed to be breeders and without known defects. Animals failing to breed after trial of six months may be returned to the seller if in good condition. The seller reserves the right to try said animal for six months and if it proves to be a breeder to return it to the station of the buyer at buyer's expense. If the animal proves to be a nonbreeder, a satisfactory exchange will be made or the purchase price will be refunded."

Some sellers will limit application of the above warranty by requiring that the buyer not use the cattle for breeding until they are at least 14 months of age. Many sellers also provide that damages shall not exceed the purchase price of the animal.

This type of warranty provides little practical protection to a buyer. Courts have held that anywhere from a 10-50 percent conception rate on females exposed to a bull will qualify him as a breeder. Furthermore, the current breeding season has often passed by the time a buyer determines that a bull may be sterile, returns him to the seller for six months, and receives an adjustment. A buyer of a problem bull purchased from a seller who is unwilling to make an adequate adjustment may be farther ahead by selling the bull for slaughter and purchasing a substitute from another breeder.

Announcements made from the auction block may be intended to take precedent over printed matter in the sale catalog. A clause in the sale catalog stating that such announcements will take precedent over terms as printed in the catalog will help guarantee their enforceability.

Neither implied warranties nor the previously quoted express warranty will conclusively guarantee that a bull's semen is capable of being frozen and successfully utilized in an artificial insemination program. Breeders who buy bulls intending to collect and sell semen are encouraged to request a written warranty from the seller that the semen is guaranteed to meet specific quality standards. Terms relating to semen quality can be defined by agreement, or by specifying a rating system such as the American Society of Theriogeneologists system (available from most veterinarians).

Normally buyers of an infertile female would suffer less economic loss than one who purchases a bull, since the loss of only one calf is typically at issue. However, warranty protection for females is important.

At least one court has held that the custom of the industry is that statements printed in a sale catalog are the warranties. In other words, there is no implied warranty of merchantability or fitness. This view, however, is probably not the approach most courts would take.

Private treaty sales often include no express warranties. An implied warranty can be relied upon by the buyer for protection, but the extent of the protection is not nearly as clear as can be provided by an express warranty. Furthermore, implied warranties may be limited by legislation. North Dakota, like several other states, provides that if applicable health regulations have been met at the time of sale there is no implied warranty of freedom from disease (Livestock Diseases: North Dakota Laws, Regulations, and Liabilities, North Dakota State University Agricultural Economics Miscellaneous Report No. 74, 1984).

Semen

Sale of semen generally carries an implied warranty that the semen is from the designated bull and capable of impregnating a female. Semen must meet the industry standard for fertility, usually capable of producing a

60-70 percent conception rate. A buyer of inferior semen may have difficulty proving that semen was defective at the time of receipt because nutrition of the breeding herd, semen handling, transportation, and insemination techniques also may contribute to poor conception rates.

Industry custom generally imposes risk of loss caused by semen carrying a genetic defect upon the buyer, unless the seller knew or should have known of the defect and did not inform the buyer.

Unborn Calf

An agreement to purchase an unborn calf, in the absence of any express warranties or representations made by the seller, implies only that the calf will be alive and from the represented parentage. Quality, genetic abnormalities, and other risks shift to the buyer unless the seller knew or should have known of the defects and did not inform the buyer.

Embryo

Warranties regarding sale of embryos have not been specifically addressed by the courts. In the absence of any express warranty, an embryo is probably sold with only an implied warranty that it is the progeny of a specified sire and dam. Risk of genetic defects, abortions, or other complications often fall on the buyer unless the seller knew or should have known of the complications or defects and failed to inform the buyer.

Avoiding Disputes and Lawsuits

Deal With Reputable Buyers and Sellers

Most seedstock breeders have at some time sold a nonfertile or subfertile breeding animal. Consequently, all buyers and sellers should take steps to minimize any ensuing loss or disagreement. A buyer's simplest, cheapest, and most effective protection against defective breeding stock is to purchase from a reputable breeder. Respected seedstock breeders realize that their reputation is their livelihood. One dishonest transaction or unsatisfied customer could ruin a reputation developed over a lifetime. A reputable breeder will strive to make a quick adjustment for a defective or unsatisfactory animal. Many breeders rely on a veterinarian's evaluation of the animal's fertility or defectiveness, following a complaint, to determine if an animal is satisfactory instead of insisting on a trial breeding period at their location.

Examples of adjustments made for an infertile or defective bull include: (1) refunding the purchase price to the buyer in exchange for the bull, (2) having the buyer sell the bull at market with a refund of the difference between the market and purchase prices, (3) replacing the sterile bull, or (4) giving credit toward a future purchase. Similar adjustments also apply to females. When a seller does not cooperate, the expense of a legal action may easily outweigh the value of a potential recovery.

Written Sale Contracts

Written sale contracts provide protection for both the seller and buyer. An effective contract will address risk of loss, care of the animal, and purchase payment terms (including whether payment is in American or foreign currency when applicable). Breeding warranties, health and quality warranties, and multi-ownership terms (when applicable) will also be included.

A buyer may purchase cattle without taking immediate delivery. Such arrangements present the possibility of an animal dying or becoming disabled between time of sale and delivery. Accordingly, risk of loss must be borne by one of the parties. Risk of loss usually transfers from seller to buyer when the seller has completed all of his agreed upon responsibilities and the animal is ready for delivery. These responsibilities could include obtaining necessary health certificates, trimming feet, and sorting the animal from the herd. Alternatively, risk of loss can be allocated in a written contract thereby reducing or avoiding disputes.

A seller may also provide for maximum damages to be paid a buyer if the animals sold are not as warranted. A provision limiting damages to the purchase price is common.

Multi-ownership

Multi-ownership of breeding stock has created problems and disagreements among owners. The cause of most disagreements is not that owners fail to keep their word, but that they either misunderstood each other or failed to address potential problems. Accordingly, a written contract is important when a percentage interest of a bull or female is purchased or sold. The transferred interest might include either a semen interest, an interest in embryo flushes, or a possessory interest. A contract for an interest in a bull should address responsibility for care and boarding expenses; when each owner will have possession; any limitations on the number of females to be serviced; an allocation of semen collection, semen storage, and advertising expenses; an allocation of income from semen sales; and insurance provisions. A contract for an interest in a female may address responsibility for care and boarding expenses, transplant procedures and expenses, an allocation of embryos, and insurance.

Buyers of a partial possessory interest, a semen interest, or an interest in embryo flushes should consider having an equal voice in the management of the animal or interest, otherwise the transaction may violate security laws. This topic is discussed in more detail below (Syndication of Breeding Interests).

Sale of Semen

A buyer of semen should have a written agreement and warranty, signed by the seller, to provide protection against poor quality semen. The authors suggest that a buyer have a seller sign an agreement to ship semen

to a lab of the buyer's choice where the semen will be tested to assure it meets specified quality standards. The agreement could provide that if the semen does not meet the standards it may be returned to the seller along with the empty vial of test semen for a full refund. Such agreement protects a buyer's right to receive good quality semen and guards against poor conception because inferior semen will be detected before breeding use.

Damages

Parties to a transaction may need to resort to a court of law if they are unable to resolve their dispute. A court will attempt to place a damaged party in the same financial position he would have been in had the agreement not been breached (broken). For example, a buyer may recover the cost of an infertile bull as well as other "consequential damages." Consequential damages include loss of calves, reputation, and other economic losses. Proving the amount of consequential damages can be difficult, especially if the damaged party is seeking redress for lost reputation or delay of future reputation. Legal fees usually are not recoverable unless provided for in the sale contract.

A buyer is responsible for mitigating a loss resulting from breach of warranty. For example, the buyer of an infertile bull may be expected to rebreed his herd in the fall instead of waiting until spring. A buyer may even be expected to periodically watch a bull to see if he appears to be breeding adequately.

Damages for breach of warranty are usually only recoverable if the buyer has given the seller written notice of a breach within a reasonable time. Reasonable time will be determined for each situation. Therefore, prudent cattlemen give notice as soon as possible after a breach is detected. A buyer may be unable to recover any damages if reasonable notice is not given. Thus, prompt written notice of a breach is imperative.

Other Potential Liabilities

Misrepresentation or Fraud

Sellers of registered breeding cattle are subjected to intense competition within the industry. One or two inches of additional height on an animal at a particular age may mean the difference between a selling price of \$2,000 or \$20,000. Consequently, a few breeders are tempted to falsify birth dates, production records, registration papers or tattoos.

A seller who has made false representations, whether or not intentional, may be liable for damages resulting from a buyer's reliance on misleading information. For example, if a buyer purchases an animal, relying on parentage as specified in the registration paper, but later discovers a misrepresentation, he is entitled to payment from the seller for at least the difference between the purchase price and the livestock's commercial value. A seller may also be liable for consequential damages (such as lost profits) and for punitive damages (money awarded as a penalty

for seller's intentional wrongdoing). In addition, the seller could be guilty of criminal fraud. However, a seller may not be responsible for unintentional mistakes if a buyer is given the opportunity to examine the animal or records but fails to do so.

A seller can protect himself against innocent or unintentional misrepresentations by carrying a comprehensive liability insurance policy. Most policies do not protect against intentional wrongdoing.

Liability for Personal Injury

Seedstock breeders usually have visitors on their property. This is especially true when a production sale is held at a seller's facilities. In addition, registered breeders often take cattle on the road to shows, sales, and other exhibitions. These activities increase a breeder's risk of liability for accidents and injury to other persons and property.

A seedstock breeder should have comprehensive liability insurance coverage with high limits of coverage. Multi-million dollar liability lawsuits are not unheard of. Signs saying "Attend at Own Risk" or "Not Responsible for Accidents" are virtually meaningless. It is likely that the breeder will be liable for damages if someone is injured as a result of a breeder's livestock or his facilities. Injuries, such as being kicked by an animal, falling off bleachers or being run over by machinery, are possibilities. A reputable insurance agent can provide advice on protecting against a devastating liability lawsuit.

Joint Liability

Cattle exhibited or sold under the name of "Jones Hereford Ranch" may include cattle from two or three separate family operations. Ownership may be separate and all expenses may be incurred individually, but to the public the operation can appear to be a joint business. Consequently, an injured party could sue to recover damages from all families operating under the name of Jones Hereford Ranch, although caused by only one of the families. The argument of the injured party would be that he thought he was dealing with "Jones Hereford Ranch" which included all three families. Separate ranch names for each family or some other type of notice that the families have separate operations may provide some protection, but maximum protection is obtained when each family maintains adequate insurance coverage.

Syndication of Breeding Interests

A recent development in the seedstock cattle industry is syndication of breeding interests, embryo interests, and semen interests (including semen sales) of breeding animals. A syndication is an arrangement whereby several persons share ownership of livestock. Each co-owner could: (1) own an undivided interest in the animal or (2) a portion of an entity which owns the animal. Either way, syndicates are a means of allowing individuals to own a portion of an animal they would otherwise be unable to

acquire for financial or other reasons. This discussion on syndication will be general but laws affecting this topic are very complex. Questions concerning an existing or potential syndication can be answered by an attorney with expertise on this subject.

An owner of a syndicated share in a bull usually is entitled to semen and artificial insemination certificates to breed a specific number of cows each year plus a share of profits from the sale of semen and A.I. certificates to nonmember breeders. The owner of a syndicated interest in a female is usually entitled to a share of embryos, live calves, or income from sales of embryos and calves.

Syndicates easily involve hundreds of thousands of dollars and comprise a significant investment. Thus, a detailed contract between all parties to a syndication is encouraged. Oral or implied agreements regarding future sales of shares or interests, semen collection, semen sales, embryo allocation, advertising costs, feed and health expenses, management fees, and a host of other issues often cause heated disputes among shareholders who have not addressed these issues in a written agreement.

Persons organizing or entering into a syndication also need to consult with legal counsel to assume that the syndication is structured properly and not in violation of state or federal security laws. Security laws probably are not violated as long as all members of the syndicate directly share in the management of the syndicate including the pricing of semen, embryos, offspring offered for sale, and shares of the sale of the syndicated animal or herd. However, once a particular person, group of persons, or entity has more control than another member, the syndicated shares may be considered securities requiring proper registration with state and federal security agencies before they can be offered for sale. A check with the state securities commissioner or an attorney before selling syndicated shares will determine if the shares must be registered. Unlawful sale of unregistered securities can result in harsh civil and criminal liabilities.

Security Interest

The sale of breeding cattle may occasionally be financed by the seller. In these cases, the buyer makes a down payment with the balance plus interest paid over a specified time. A financially insolvent buyer may later sell the purchased cattle or have them subjected to a judgment lien of a creditor or tax collector. The original seller, at this point, may not receive any further payments, plus his security may be gone.

A seller can protect himself against this loss by having the buyer sign a security agreement at the time of the sale. This agreement would grant the seller a security interest in the animals. The seller must then file a financing statement within 10 days following the transaction, usually in the county where the cattle are located and in the county of the buyer's residence or place of business. This low-cost procedure protects the seller's interest in the cattle against most outside creditors of the buyer.

Livestock owners who lease out their livestock or who graze their cattle on leased land should consider filing a financing statement providing notice that the livestock are not owned by the rancher who appears to be in possession. This prevents creditors from claiming a lien or interest in the cattle.

Sellers consigning to a commercial livestock market may also protect themselves against creditors of the market should the business fail. A prudent consignor will send a notice to creditors of the commercial livestock market holding a security interest in the market's inventory or after acquired property (which includes cattle). This notice would specify that the cattle are on consignment and are not the property of the commercial livestock market. A call to the Register of Deeds Office where the livestock market is located and to the Secretary of State's Office will provide the consignor with a list of the market's secured creditors. Notice to the secured creditors stating that the consignor's cattle will be consigned at the market from time to time will protect the consignor against those creditors for five years.

A financing statement also should be filed at the register of deeds office in the county where the market is located. This protects the consignor for five years against any subsequent creditors of the market.

The above-mentioned financing statements and notices must be given before the animals are on the rancher's or market's premises.

Conclusion

Many of those involved in the seedstock cattle business have had limited legal problems. However, the cattle business is becoming more complex, and the potential for legal disputes is increasing. The best method for buyers and sellers of seedstock cattle to solve a legal dispute is to prevent it from occurring. A few hours and dollars spent in analyzing one's transactions, alone and with an attorney, can save time, money, and frustration. If a dispute does arise that cannot be quickly resolved, bring it to the immediate attention of an attorney so necessary precautions or actions can be taken. It is much easier to settle a minor disagreement early than a heated and bitter argument later.

Whether you win or lose, the stigma of being involved in a lawsuit may remain for a long time. A little prevention now may yield many rewards later.