

NO. A04-2176

State of Minnesota
In Supreme Court

Fin Ag, Inc.,

Respondent,

v.

Hufnagle, Inc., f/k/a P & H Trucking Inc., Cooperative Sampo,
Lloyd A. and Janet Lundquist d/b/a J & L Feeds,

Defendants,

Kent Meschke Poultry Farms, Inc.,

Appellant/Petitioner,

Red River Commodities, Inc., d/b/a Green Valley Bean,

Defendant.

**MINNESOTA GRAIN AND FEED ASSOCIATION'S
AMICUS CURIAE BRIEF IN SUPPORT OF APPELLANT**

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STATEMENT OF THE ISSUE

- I. Under the general farm products clear title rule, a buyer takes grain free and clear of liens unless the notice exception applies, which occurs only where the buyer has either direct or centralized notice of a lien applicable to the grain's actual owner. Here, the Court of Appeals incorrectly broadened the scope of the notice exception to operate when a buyer is deemed to have only constructive knowledge of the true owner's identity. Should this Court correct the Court of Appeals' analysis to clarify the notice standard under 7 U.S.C. § 1631(e)(3) to require actual knowledge so the clear title statutes may resume their stated purpose of protecting buyers from double-payment liability?

Trial Court Held: Buyer took subject to a lien, finding 7 U.S.C § 1631(d) did not apply.

Court of Appeals Held: Exception under 7 U.S.C. § 1631(e)(3) was triggered, therefore buyer took subject to a lien.

List of Most Apposite Statutory Provisions:

7 U.S.C. § 1631(d); 7 U.S.C. § 1631(e)(3); Minn. Stat. § 336A.15.

INTRODUCTION

The Minnesota Grain and Feed Association (“MGFA”) submits this amicus brief to provide this Court with its perspective concerning the severe harm the Court of Appeals’ ruling in Fin Ag, Inc. v. Hufnagle, Inc., 700 N.W.2d 510 (Minn. Ct. App. 2005), will impose upon the businesses of MGFA members, as well as the businesses of similarly situated non-member grain buyers in Minnesota.¹ For over a decade, Minnesota grain buyers have conducted grain purchases under the federal Food Security Act (“FSA”), 7 U.S.C. § 1631, and a centralized lien notification system under Minnesota Chapter 336A (“CNS”). Until now, both have operated efficiently and effectively to protect buyers from purchasing grain subject to hidden liens, which had frequently resulted in buyers having to pay twice for the grain they purchased—once to the buyer and once to the lender.

Under the new standard applied by the Court of Appeals in this case, however, buyers may no longer purchase grain without serious risk that they will be subjected to double-payment liability. This new standard ignores the plain language of the FSA and Chapter 336A, eviscerates their express purpose and operation, and imposes an unreasonable burden upon buyers of farm products in Minnesota. For the reasons stated below, the MGFA urges this Court to clarify the applicable standard for determining whether a buyer may take title free and clear of existing liens under these statutes.

¹ Party counsel did not author this brief in whole or in part. No person or entity other than the *amicus curiae*, its members, and its counsel made any monetary contribution to the presentation or submission of this brief. This disclosure is made pursuant to Minn. R. Civ. App. P. Rule 129.03.

BACKGROUND

A. The Minnesota Grain and Feed Association.

Founded in 1907, the Minnesota Grain and Feed Association provides information, education, and representation to member grain elevators and feed mills in Minnesota. Since its inception, MGFA has taken an active role in the evolution of the law in the area of agricultural liens and grain transactions and continues to keep its members informed about the law's development. The MGFA's members operate over 83% of the country grain elevators in Minnesota, comprised of approximately 250 cooperative associations and Minnesota corporations doing business in Minnesota. The MGFA's members operate nearly 500 individual elevators, feed mills, and related agribusinesses, which are all typically first buyers of grain from Minnesota farmers.

In 2004, MGFA's members handled more than 2 billion bushels of grain, all sold by Minnesota farmers and delivered by truck, for which its members paid over \$6 billion. In all, MGFA members purchased over 500,000 truckloads of grain in 2004 from Minnesota farmers. The Minnesota country-grain-elevator industry also employs approximately 10,000 citizens and pays over \$34 million in payroll taxes and over \$78 million in Minnesota property taxes each year.

B. The Operation of the CNS and the Grain-Selling Process.

In a typical grain transaction, a seller will bring a truckload of grain to a grain elevator, agree upon a price, and expect payment before leaving the grain elevator office. When the seller brings the grain to the elevator, the seller typically provides an operator with the name of the grain's owner. In making out payment, which generally takes the

form of a check, the elevator operator will look up the name provided in a CNS master list to determine if any outstanding liens exist against any farm products under that name.

The CNS is a database maintained by the Minnesota Secretary of State and established pursuant to the FSA through which buyers of farm products receive listings of outstanding liens. See Minn. Stat. Chapter 336A. The statutes make it the lender's responsibility to keep the list updated by filing lien notices called "effective financing statements." See Minn. Stat. § 336A.04. Nearly all of MGFA's members subscribe to the CNS service. Additionally, elevator operators also maintain a file of direct notices received from lenders that also provide information about outstanding liens. If the seller's name appears in the CNS list, or the operator has received a direct notice, the operator will then issue a joint check to the seller and to the lender. Elevator operators expect and rely upon the effective operation of the CNS to allow them to purchase grain free and clear of any outstanding liens.

The core issue of concern to the MGFA in this case, however, involves the problem of grain "fronting." Grain fronting is a situation in which the individual selling the grain misrepresents to the buyer the identity of the grain's owner at the time of the purchase. Although it may often be the case that the true owner knows of the fronting seller's activity, grain buyers have no way to determine at the time of the sale that the seller's representations are false. From the buyer's perspective, the sale appears to be just like any other grain transaction. Because the true owner is undisclosed in a fronting situation, a grain buyer's proper search of the CNS listings and direct notices is ineffective in determining the existence of any liens filed against the true owner of the

grain. The problem with the Court of Appeals' analysis is that it removes the certainty and predictability of the CNS system by including undisclosed names within the scope of what the buyer must search in order to avoid double-payment liability. In essence, the Court of Appeals shifts the risk of loss from the lender to the buyer in contravention of the purposes of the FSA and Chapter 336A.

C. Statutory Framework Underlying the Sale of Farm Products.

1. The UCC's "Farm Products Exception."

Before 1985, the Minnesota Uniform Commercial Code provided that a buyer in the ordinary course of business took free of a security interest created by the seller, unless the buyer was "a person buying farm products from a person engaged in farming operations." Minn. Stat. § 336.9-307 (1984). This exception to the general rule of clear title was commonly known as the "farm products exception," which placed a heavy burden on first buyers of farm products who risked taking title subject to any outstanding liens. Under this exception, buyers of farm products had to determine the existence of outstanding liens and the identity of the lien-holding lenders before making a purchase. If they failed to detect a lien, which was a frequent occurrence, the exception would subject buyers to double payment for farm products: once to the seller and once to the lender. The effect of the farm products exception was generally perceived as unfair, resulting in wide criticism, and many states enacted laws to protect against the exception's unjust effects. See Food Services of America v. Royal Heights, Inc., 871 P.2d 590, 594 (Wash. 1994).

2. Passage of the Federal Food Security Act.

Eventually, Congress responded to the situation by enacting the Food Security Act of 1985 ("FSA"), 7 U.S.C. § 1631, which Congress designed to protect purchasers of farm products by pre-empting the farm products exception in state UCC codes. The FSA was "intended to protect buyers of farm products . . . from the dangers of double payment where they might not know, or have any practical means of learning of a preexisting security interest." First Bank v. Eastern Livestock Co., 837 F. Supp. 792, 802 (S.D. Miss. 1993). The legislative history of the FSA further explains its purpose:

The adoption of this language will restore the equity in the relationship between the buyer and the seller of farm products and the seller's lender. Simply stated, a buyer would not have to pay for the commodities he purchased a second time unless he knew of the lien on those products, had been told to include the lender in any payment for those goods, and failed to follow those instructions.

H.R. Rep. No. 99-271(I) (1985) at 821 (statement of Hon. Steve Gunderson). Through the FSA, therefore, Congress struck the proper balance of the risks involved in farm product transactions by alleviating what had been the heavy burden on buyers to investigate the existence of outstanding liens or suffer the consequences.

Under the FSA's general rule, first buyers of farm products take title free and clear of any security interest in the products, even though the security interest is perfected and the buyer knows of the existence of the interest. 7 U.S.C. § 1631(d). A first buyer of farm products, however, may take subject to a security interest under one of two exceptions specified in the act.

First, a buyer may take subject to a lien if the secured party provides direct notice to the buyer of the existence of the lien and the buyer fails to perform the payment obligations. 7 U.S.C. § 1631(e)(1). Second, a buyer may take subject to a lien if a state establishes a central notification system through which the secured party files an effective financing statement (“EFS”) providing information about outstanding liens. 7 U.S.C. § 1631(e)(2).

It is this latter exception that is at issue in this case. Under this second exception, if the lender files an EFS, a buyer takes subject to a lien if either the buyer fails to register with Secretary of State before the purchase or the buyer receives centralized notice of the lien and does not secure a waiver or release. 7 U.S.C. § 1631(e)(3). Minnesota has enacted a central notification system under Minn. Stat. Chapter 336A. It is the Court of Appeals’ erroneous interpretation of the operation of the FSA clear title notice exception under 7 U.S.C. § 1631(e)(3), and by extension its state law counterpart under Minn. Stat. § 336A.15, subd. 2(2), that this court must correct.

3. Minnesota’s Central Notification System.

Minnesota Chapter 336A was enacted in 1992 to provide a centralized lien notification system for the state of Minnesota pursuant to the FSA. See Minn. Stat. Chapter 336A. The Minnesota CNS is the culmination of years of negotiation and debate between lenders, organizations such as the MGFA, and the Minnesota Legislature, and the resulting notification system has operated efficiently and effectively for over a decade.

The Minnesota CNS is a centralized record of outstanding liens against farmers and their grain made available to buyers in order for them to verify proper payees and avoid the threat of double-payment liability. The Secretary of State maintains the CNS, and registered buyers receive a master list and monthly updates via mail or e-mail. The provisions of Chapter 336A parallel the provisions of the FSA and also set forth the general rule that buyers of farm products take with clear title even though a lien has been perfected and the buyer knows the lien exists. See Minn. Stat. § 336A.15, subd. 1. Chapter 336A also parallels the FSA notice exceptions. See Minn. Stat. § 336A.15, subd. 2.

When purchasing grain, MGFA members rely heavily on the CNS listings to identify lien claims before issuing grain checks. When buyers look up the grain owner's name, the CNS list identifies all secured lenders and other lien claimants to be added as co-payees on the grain-payment checks. The smooth and reliable operation of the CNS plays a critical role in the buying and selling of grain in Minnesota. If the CNS database lists a owner's name, a grain buyer can protect itself against claims of secured creditors and other lien claimants by making its check jointly payable to the owner and those secured creditors and other lien claimants who have properly filed an effective financing statement. If the CNS database does not list an owner's name, a buyer makes its check payable to the owner alone and acquires title to the grain free and clear. This is what MGFA members have come to believe and expect of the CNS, and they currently rely upon it thousands of time a day in nearly all grain transactions in Minnesota. The Court of Appeals' decision, however, introduces unwelcome uncertainty to this system.

DISCUSSION

A. **The Court of Appeals' Decision Regarding Clear Title Notice Exception.**

The overriding intent of both the CNS and the FSA is to enable grain buyers to acquire title to grain from sellers free and clear of any liens. The Court of Appeals, however, reached a startling conclusion regarding the operation of § 1631(e)(3)'s clear title notice exception, one which has implications that go well beyond the parties' dispute. The Court of Appeals held that, even in the context of fronting, grain buyers can still be liable for the payment of lien claims asserted by lenders if the buyer is deemed to have had constructive knowledge of the true owner's identity. Fin Ag, Inc., 700 N.W.2d at 519-20. Specifically, the court held that the FSA notice exception under § 1631(e)(3) still applies even where there exists only circumstantial evidence indicating the buyer may have known the individual selling the grain is not the true owner. The court based its decision in the case on evidence that the buyer had made joint payments to the undisclosed true owner and his lender in past transactions, that some payments in the sales at issue were made in names which turned out to be children of the true owner, and that the sellers of the grain at issue were revealed to be employees of the true owner.² Fin Ag, Inc., 700 N.W.2d at 520. The court also found there was an "absence of evidence" that someone other than the true owner owned the grain. Id.

² Meschke had bought grain in the past from Buck and, pursuant to the CNS, made payment jointly to Buck and Fin Ag, Inc. In the sales at issue, Meschke made payments directly to the Tooker sellers. Fin Ag had not filed an EFS against the Tooker sellers, but it was later established that the Tooker sellers were selling Buck's grain. Fin Ag now seeks to hold Meschke responsible for double-payment liability.

At no point in the opinion, however, did the court address whether the buyer had actual knowledge that the sellers were not the true owners. Absent a finding that the buyer had actual knowledge of owner's true identity, the Court of Appeals' holding completely undermines the protections Congress and the Minnesota Legislature intended to provide to grain buyers under the FSA and Chapter 336A. Following this decision, elevators buying grain from farmers can no longer rely upon the simple operation of the CNS to check for liens and to verify lenders to whom payment should be jointly made. Instead, grain buyers will again acquire grain with exposure to lenders whose existence and identity are completely unknown to them. The decision in this case leaves MGFA's members unable to rely upon the CNS and unable to purchase any grain without significant risk of double-payment liability.

The Court of Appeals' constructive-knowledge standard unfairly and improperly places the threat of dealing with an unscrupulous seller claiming to be the true and rightful owner of the grain entirely upon grain buyers. Under such a holding, secured lenders and other lien claimants will bear none of the risk of such transactions. Rather, the result of the court's opinion is that a new, affirmative duty is now placed on all grain buyers to investigate and establish the true ownership of grain before each and every purchase or risk severe financial losses.

B. Clear Title Notice Exception is Inapplicable in a Fronting Context Absent a Buyer's Knowledge of True Owner.

A buyer's actual knowledge of a grain shipment's true owner is essential to the operation of the clear title notice exception under the FSA and Chapter 336A. If a buyer

does not know the name of the true owner, the exception cannot operate. Stating the general clear-title rule, both the FSA and Chapter 336A expressly provide that a buyer of farm products takes free of existing liens even though such liens have been perfected and the buyer knows such liens exist. See 7 U.S.C. § 1631(d) and Minn. Stat. § 336A.15, subd. 1. As stated above, the only exceptions to this general rule are if the buyer fails to register with the Secretary of State or the buyer receives notice of the lien and fails to secure a waiver or make payment as directed. Minn. Stat. § 336A.15, subd. 2. Per the express language of the statute, if a buyer does not receive notice that both the seller of the grain and the farm products being sold are subject to a lien, the buyer takes free and clear.

As a practical matter, for the clear title notice exception to operate two things must occur. First, the buyer must actually receive a letter from a lender or a listing through the central notification system stating the owner and the products being sold are subject to a lien. Second, the buyer must actually know the identity of the owner of the grain in order to locate and review such lien records. Buyers must have knowledge of the identity of the owner because the true owner's name is the only information a buyer can use to check against all collected direct notices and CNS listings. Without this information, the entire system of notice contemplated by the statutes cannot function. Absent actual knowledge of the grain owner's identity at the time of the sale, a buyer cannot possibly utilize the CNS as it was intended and, therefore, the buyer cannot receive notice of outstanding liens as required under Minn. Stat. § 336A.15, subd. 2(2). See also 7 U.S.C. § 1631(e)(3). Not only would a buyer, unaware of the true owner, be incapable of

receiving notice of any outstanding liens, the buyer would also be unable to “secure a waiver or release” as required under the statutes in order to avoid the threat of double payment.

In a fronting context, therefore, the second step necessary for a buyer to receive notice under the clear title exception does not occur. The fronting individual deliberately prohibits the operation of the notice exception, and therefore the general rule of clear title must apply. Minn. Stat. § 336A.15, subd. 1 and 7 U.S.C. § 1631(d).

C. The Constructive-Knowledge Standard Eviscerates the Purpose and Operation of the FSA and Chapter 336A.

Even if hindsight might suggest a buyer may have discovered a fronting scheme, basing the operation of the notice exception under the FSA and Chapter 336A upon the buyer’s constructive knowledge of the grain’s true ownership presents the wrong standard. Applying a constructive-knowledge standard in the context of fronting eviscerates the purpose and operation of the FSA and Chapter 336A. It places an unreasonable burden upon grain buyers to conduct an investigation before each and every purchase. This, in turn, places an unreasonable burden upon the entirety of farm product commerce. Moreover, a constructive-knowledge standard would force a burden upon buyers that cannot be met because no practical method exists for buyers to identify the true owner of each load of grain.

The express purposes of the FSA, and by extension Chapter 336A, are to remove the threat of double payment by buyers without knowledge of existing liens and put the burden on lenders to protect their own collateral. Moreover, the statutes were intended to

relieve the burden on commerce from inefficient or inhibited farm product transactions.

The FSA itself states the findings Congress made precipitating its passage:

Congress finds that—

(1) certain State laws permit a secured lender to enforce liens against a purchaser of farm products even if the purchaser does not know that the sale of the products violates the lender's security interest in the products, lacks any practical method for discovering the existence of the security interest, and has no reasonable means to ensure that the seller uses the sales proceeds to repay the lender;

(2) these laws subject the purchaser of farm products to double payment for the products, once at the time of purchase, and again when the seller fails to repay the lender;

(3) the exposure of purchasers of farm products to double payment inhibits free competition in the market for farm products; and

(4) this exposure constitutes a burden on and an obstruction to interstate commerce in farm products.

7 U.S.C. § 1631(a). Further, the FSA also provides that “[t]he purpose of this section is to remove such burden on and obstruction to interstate commerce in farm products.” 7

U.S.C. § 1631(b). Therefore, Congress intended this statute to shift the burden of tracking loan collateral away from buyers of farm products and onto lenders. “The abrogation of the farm products rule was to eliminate the harsh result of transforming buyers . . . into sureties on the farmers’ debt.” Food Services of Am. v. Royal Heights, Inc., 871 P.2d 590, 595 (Wash. 1994); See Lisco State Bank v. McCombs Ranches, Inc., 752 F. Supp. 329, 334 (D. Neb. 1990) (noting that, with the FSA, Congress shifted the risk “to the lenders who finance farm operations, rather than have that burden imposed

upon buyers”). Enacted pursuant to the FSA, the Minnesota CNS statutes create the mechanism by which this unjust situation was corrected.

The constructive-knowledge standard applied by the Court of Appeals would turn these express purposes of the clear-title statutes on their head. Instead of maintaining the clarity and uniformity of the statutory scheme, which provides buyers with confidence they will take clear title to grain if they follow the statutory requirements, this standard casts every transaction back into the uncertainty that existed before 1985. Moreover, the legislative history of the FSA indicates that its sponsors were also concerned with the unreasonable burden the pre-FSA system placed upon farm product buyers to investigate potential liens prior to each transaction. See H.R. Rep. No. 99-271(I) (1985) at 109. Under a constructive-knowledge standard, Minnesota buyers will again be forced to conduct similar investigations before each sale. This time, however, instead of an investigation into potential liens, the investigations will be to determine who actually owns the grain being purchased so buyers will not be at the mercy of circumstantial evidence, which may be deemed sufficient to constitute constructive knowledge long after the sale.

Another purpose of the FSA is to relieve what had been the existing strain on interstate commerce in agricultural products. The burden on buyers to investigate grain ownership before each sale will inevitably result in delayed transactions and decreased efficiency. During the peak season, MGFA grain elevators accommodate an enormous number of grain sellers, with 150 to 400 transactions per facility, per day, depending on the size of the elevator. Time is not an available luxury for the participants in a typical

grain transaction. Often grain buyers must make their payments within 48 hours of the time the grain is delivered. See Minn. Stat. § 223.17, subd. 5 (Grain Buyers Act). In reality, however, most sellers expect payment upon delivery.

Under such circumstances, placing a duty to investigate grain ownership upon buyers will result in an effective shutdown of grain transactions in Minnesota. Moreover, farmers near Minnesota's borders are likely to choose to sell their grain out of state rather than endure the delays that would inevitably result from this new standard. Grain buying in Minnesota requires the certainty and stability of a smoothly functioning and reliable CNS database. Without this, the entire grain-buying industry will be required to re-evaluate its procedures and may be forced to implement costly, time-consuming measures to counteract the imminent consequences of the Court of Appeals' decision.

Finally, no reasonable method exists to verify the ownership of each load of grain. On average, as many as half of the grain transactions conducted by Minnesota grain elevators do not involve the true owners of the grain. Buyers have to be able to rely on sellers' representations about ownership. In order for buyers to ensure they are taking grain with clear title, the only conceivable alternative procedure would be to hire investigators to verify the identity of the true owners of every grain delivery. Such investigations, if even possible, would be logistically impractical given the realities and time constraints of a typical grain transaction. One of the main purposes of the FSA is specifically to protect buyers who "lack[] any practical method for discovering the existence of the security interest." 7 U.S.C. § 1631(a). The Court of Appeals' constructive-knowledge standard would return grain buyers to just this situation.

Moreover, the unavailability of any practical methods would increase the operational cost of each grain transaction so significantly that MGFA members would have to re-evaluate their entire business strategies.

Therefore, imposing a constructive-knowledge standard upon grain buyers would be in direct contradiction to the express purposes of the FSA and Chapter 336A and would place an unreasonable and potentially impossible burden upon grain buyers who are in no position to detect and confront unscrupulous, fronting sellers. A constructive-knowledge standard undercuts the very reason these statutes were enacted by reallocating the risk of such transactions from the lender back onto the buyer.

D. Actual Knowledge is the Proper Standard Under the Notice Exception in the Context of Fronting.

Instead of relying on circumstantial evidence to determine a buyer's knowledge at the time of the sale, the proper test under the FSA and Chapter 336A notice exception is an actual-knowledge standard. The express language of the FSA and Chapter 336A mandate actual knowledge as the correct test. Moreover, the Court of Appeals has already applied such a standard to a grain elevator in an analogous grain fronting context. See Schluter v. United Farmers Elevator, 479 N.W.2d 82, 85 (Minn. Ct. App. 1991).

Under an actual-knowledge standard, a court would assess whether the buyer had actual, subjective knowledge of the grain's true owner at the time of the sale. If a buyer 1) checks the name provided at the time of the transaction against all mailed notices and CNS listings, 2) finds no existing liens under that name, and 3) has no actual, subjective knowledge that the owner's name has been misrepresented, the notice exception cannot

operate and the buyer takes free and clear of any liens. A standard any broader than the buyer's actual knowledge would lead to an unreasonable and unintended operation of the clear title rule. An expansive standard such as constructive knowledge would throw each and every grain transaction into doubt and would impose a duty on all buyers to attempt to investigate the true ownership of each load of grain or risk the threat of double payment.

The express language of the FSA instead mandates an actual-knowledge standard. The FSA states that its intended purpose is to protect a buyer of farm products who "does not know that the sale of the products violates the lender's security interest." 7 U.S.C. § 1631(a)(1). The FSA expressly defines "knows" or "knowledge" as meaning "actual knowledge," not some broader standard such as constructive knowledge. 7 U.S.C. § 1631(c)(6). Congress made clear that the FSA's purpose is to protect buyers from the enforcement of liens where buyers have no actual knowledge of the lender's security interest.

Additionally, Chapter 336A provides that, in the context of whether notice has been received by a buyer, a buyer of farm products "must act in good faith." Minn. Stat. § 336A.13. Under Minnesota law:

the good faith test is a subjective rather than objective test. It requires honesty of intent rather than the absence of circumstances which would put an ordinarily prudent purchaser on inquiry. It is an issue of honesty of intent rather than of diligence or negligence. . . . We have traditionally held that the subjective good faith is simply the honest belief that your conduct is rightful.

Schluter, 479 N.W.2d at 85 (quoting Wohlraabe v. Pownell, 307 N.W.2d 478, 483 (Minn. 1981)). Therefore, in the context of the clear title notice exception, Chapter 336A requires that the proper test for a buyer's good-faith receipt of notice should be whether the buyer honestly believed he knew the true owner's name.

Finally, the Court of Appeals has already applied an actual-knowledge standard in the context of grain fronting in a case decided before the passage of Chapter 336A. In Schluter v. United Farmers Elevator, farmers sought recovery of the price paid for grain delivered and sold by a trucker to a defendant elevator operator. *Id.* at 83. The trucker had represented to the elevator operator that he owned the grain, and the elevator operator performed a lien check on the trucker's name. Schluter, 479 N.W.2d at 85. The farmers never received payment for their grain from the trucker. *Id.* at 83. The Court of Appeals upheld the trial court's grant of summary judgment in favor of the elevator, holding that the elevator was a buyer in the ordinary course of business and therefore took title to the grain free and clear. *Id.* at 86. The court reasoned that "the farmers failed to offer any evidence that the elevator had actual knowledge of the farmers' interest in the grain" at the time of the sale. *Id.* Although this decision does not address a lienholder's interest in grain under the FSA and Chapter 336A, it is instructive in that the court determined, in the context of grain fronting, that the proper standard allowing an elevator to purchase grain with a clear title was whether the elevator operator had subjective, actual knowledge of the who actually owned the grain. This Court should apply the same standard in the context of grain fronting under the FSA and Chapter 336A.

E. Lenders Are in a Better Position to Prevent Fronting and Seek a Remedy from Their Debtors.

As a final consideration, the implicit shifting of the burden for tracking loan collateral from lenders back onto grain buyers, by the application of a constructive-knowledge standard, is also inappropriate in view of the more extensive remedies available to lenders and the lender's longer-term relationships with grain producers. Utah Farm Prod. Credit Ass'n v. Hansen, 738 P.2d 642, 645 (Utah Ct. App. 1987) (finding in a secured transaction context that a lender "should be motivated to protect itself and is in a superior position to do so"). Lenders are better positioned to reduce or eliminate the likelihood of such fronting transactions at the time they enter their credit agreements with farmers. If a farmer attempts to convert a lender's collateral by selling encumbered grain through a fronting third party, thus avoiding the scrutiny of the CNS database, lenders and lien claimants have a potent and effective arsenal of creditor's remedies available to them. Lenders have recourse, for instance, under the UCC, the FSA, banking laws, and statutory-lien laws. The MGFA's members have no such battery of remedies and can only resort to expensive and time-consuming litigation to try to recoup their losses in such transactions.

Additionally, lenders tend to have longer-term relationships with their debtors than do grain buyers. As farming operations in Minnesota and across the country evolve, more and more grain transactions are being conducted by employees or agents of grain owners, instead of the owners themselves. It is also becoming more common for grain sellers to travel farther than they have historically in order to sell at the best price. Grain

buyers are no longer in a community of farmers in which each farmer sells his own grain and the elevator is familiar with every seller that comes through. As a result, it is increasingly becoming the case that elevator operators do not have an on-going business relationship with the individuals selling the grain at their elevators. Lenders, who already conduct financial and other background checks of their debtors, maintain a closer relationship with their debtors, and their debtor's collateral, and therefore are better positioned to manage the risks resulting from fronting transactions.

CONCLUSION

Minnesota's existing grain-buying system is the product of much hard work over the last 20 years by Congress, the Minnesota Legislature, and the farm products industry. Moreover, the system works. If this Court allows the Court of Appeals' opinion regarding the operation of the clear title notice exception to stand, Minnesota grain buyers will be subjected to a reversion to pre-1985 "double-payment" lien law, which would be contrary to Congress's purposes in promulgating the FSA and the Minnesota Legislature's purposes in creating the CNS. Grain buyers would again find themselves in the role of unknowing sureties for lenders, without any reasonable method or recourse to protect themselves, for the portion of Minnesota's \$6 billion in yearly grain sales involving grain fronting.

The MGFA respectfully urges this Court to consider these arguments and to clarify the proper standard applicable to the notice exception under the federal and state clear title rules. A buyer of farm products should take free of all existing liens unless the buyer has actual, subjective knowledge of the identity of the true owner. Without such

knowledge, a buyer cannot possibly receive notice sufficient to trigger the notice exception.

LINDQUIST & VENNUM P.L.L.P.

A handwritten signature in black ink, appearing to read 'P.A. Banker', is written over a horizontal line.

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