

CASE NO. A04-2176

State of Minnesota
In Supreme Court

FIN AG, INC.,

Respondent,

vs.

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,

and

RED RIVER COMMODITIES, INC.,
d/b/a GREEN VALLEY BEAN,*Defendant.*

APPELLANT'S BRIEF AND APPENDIX

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STATEMENT OF ISSUES

- I. Whether Fin Ag can assert a lien against the grain shipments Meschke purchased from the Tooker sellers, forcing Meschke to pay twice, when Fin Ag neither filed an Effective Financing Statement against the Tooker sellers in Minnesota's Central Notification System nor gave direct written notification to Meschke of Fin Ag's lien claim against the Tooker sellers.

Trial Court held: Yes.

Court of Appeals held: Yes.

Authorities: 7 U.S.C. § 1631(a); United States v. Progressive Farmers Marketing Agency, 788 F.2d 1327, 1330-31 (8th Cir. 1986); Lisco State Bank v. McCombs Ranches, Inc., 752 F. Supp. 329, 334-39 (D. Neb. 1990); Utah Farm Production Credit Ass'n v. Hansen, 738 P.2d 642, 645 (Utah App. 1987); Schluter v. United Farmers Elevator, 479 N.W.2d 82 (Minn. App. 1991); Minn. Stat. § 223.16, subd. 2a.

- II. Whether Fin Ag's security interest against grain owned by Larry Buck and Ronda Buck was perfected at the time of the sales in question because at that time it had failed to file a financing statement in the correct county.

Trial Court implicitly held: Yes.

Court of Appeals held: Yes.

Authorities: Minn. Stat. § 336A.05 (1999); Minn. Stat. § 336.9-401 (1999); Rowe v. Runyon, 702 N.W.2d 729, 739 (Minn. 2005).

STATEMENT OF THE CASE

This is an appeal from a summary judgment in favor of Fin Ag, enforcing a hidden and defectively-filed lien against Meschke, a good-faith purchaser of grain.

Fin Ag commenced this action against Meschke and others in April of 2002. The claims against the other defendants have all been settled or dismissed.

In June of 2003, the district court granted Fin Ag's partial summary judgment motion against Meschke. Judgment was entered in September of 2004 pursuant to Rule 54.02, and Meschke filed this appeal with the Court of Appeals.

On July 19, 2005, the Court of Appeals affirmed the district court's summary judgment. The Supreme Court granted review on September 28, 2005.

Meschke

Kent Meschke is a second-generation poultry farmer in Little Falls, Minnesota. As part of raising poultry to sell to processing plants, Meschke regularly buys corn from farmers, grain elevators and others. He mixes corn with other ingredients, mainly other grains, to make feed, which his poultry consume during their growing process.

Between October of 1999 and January of 2000, Meschke purchased several truckloads of corn for which he paid Mark Tooker, Mickey Buck, Paul Zuk, and Ryan Buck (collectively the "Tooker sellers") \$38,443.85.¹ (A. 106-07) The persons delivering the corn told Meschke that this grain belonged to the Tooker sellers, and that

¹ In December of 1999, Meschke also purchased \$7,129.24 in grain from Larry Buck (A. 107) The \$7,129.24 plus the \$38,443.85 yield the \$45,573.09 Fin Ag is claiming in this case

payment should be made to the Tooker sellers. (A. 107) Meschke made payment to the Tooker sellers, as instructed. (Id.)

Before issuing any grain checks to any of the Tooker sellers, Meschke checked their names in the computer lien records supplied to him by the UCC Division of the Minnesota Secretary of State. (A. 107) Meschke purchased and received those computer records, with monthly updates, as a registered grain buyer under Minnesota's Central Notification System (CNS) for Effective Financing Statements. (Id.)

The Tooker sellers' names did not appear in the CNS list. (A. 108) In addition, Meschke had received no direct notification of any lien claim or Effective Financing Statements against the Tooker sellers, from Fin Ag or any other creditor. (A. 108) Accordingly, Meschke made the checks payable to the Tooker sellers individually, without the addition of any lenders as co-payees. (Id.)²

Meschke did receive, in April of 2000, direct notice that Fin Ag claimed a lien against the grain of *Larry Buck*. (A. 109) However, at no time did Fin Ag ever advise Meschke that it claimed an interest in any grain that might be held or sold by *the Tooker sellers*. (Id.) In fact, Fin Ag has never filed an Effective Financing Statement showing any of the Tooker sellers as debtors on any CNS filing with the Minnesota Secretary of State. (Id.)

In short, before this lawsuit, Meschke never had actual knowledge that Fin Ag claimed a lien against the corn Meschke purchased from any of the Tooker sellers.

² The Court of Appeals decision refers to Mickey Buck and Ryan Buck as Larry and Ronda Buck's "minor children," and to Mark Tooker and Paul Zuk as their "employees." Fin Ag, Inc. v. Hufnagle, Inc., 700 N.W.2d 510, 514 (Minn. App. 2005) However, there is absolutely no evidence in the record that *Meschke knew* that information at the time of his purchases

Meschke's first knowledge that Fin Ag intended to assert such a claim came with the commencement of this lawsuit. (A. 109-10)

Present Suit

In this case, Fin Ag claims that (1) it had an enforceable security interest in the 1999 crop of Larry and Ronda Buck, (2) it had filed a CNS-1 reflecting that it had a security interest (against the Bucks), (3) the Tooker parties were mere conduits for grain owned by Larry and Ronda Buck, and (4) Meschke converted the grain by failing to issue grain checks jointly payable to Fin Ag as well as the respective sellers.

In April of 2003, Fin Ag moved for summary judgment against Meschke. In support of its motion, Fin Ag submitted the affidavit of Randy Nelson of Cenex Harvest State Cooperative, which acted as Fin Ag's loan-servicing agent for Larry and Ronda Buck's loan. (A. 54) According to Nelson's affidavit, the Bucks "marketed" some of their 1999 corn crop through the Tooker sellers, and the checks were issued to those parties. (A. 55-58) Nelson expressed no objection of this arrangement. (Id.)

Significantly, Fin Ag's summary judgment motion offered no evidence that Larry Buck or Ronda Buck owned the grain for which Meschke issued checks to the Tooker sellers. *More importantly, Fin Ag's summary judgment motion offered no evidence that Meschke knew that Larry Buck, Ronda Buck or Fin Ag claimed an interest in the Tooker sellers' grain.*

In response to Fin Ag's summary judgment motion, Meschke argued *inter alia* that (1) no CNS-1 had been filed against the Tooker sellers and no direct written notice

had been given to him of any claim against any of them; and (2) Fin Ag lacked an enforceable security interest because it failed to perfect it.

On June 17, 2003, Judge Thomas Godzala granted Fin Ag's summary judgment motion, holding that Fin Ag had an enforceable lien against Meschke. (A. 1-4)

This appeal followed. The Supreme Court has granted review on two issues: (1) liability under the Food Security Act and (2) the enforceability of a financing statement filed in the wrong county.

Fin Ag and the Bucks

As a result of this lawsuit, Meschke has learned a great deal about Fin Ag, Inc. and the Bucks. In 1999, Fin Ag extended an agricultural operating loan in the form of a revolving line of credit to Larry Buck and Ronda Buck d/b/a Buck Farms (the "Bucks"). (A. 54) The Bucks executed a promissory note and security agreement dated April 1, 1999, (A. 61-70) granting Fin Ag a security interest in "all inventory, chattel paper, accounts, general intangibles, crops, farm products, livestock, farm equipment and fixtures, together with the following specifically described property: ALL CROPS 1999-2004." (A. 64) The security agreement described the real estate on which the crops were to be grown. (Id.)

The Bucks also executed UCC-1 financing statements in favor of Fin Ag, (A. 72-89) which were filed in the personal property records of the Wadena County Recorder on May 10, 1999 and in the real estate records of the Hubbard County Recorder on May 3, 1999. (Id.) All of Fin Ag's documents relative to the Bucks show their address as Grand

Rapids (Itasca County), Minnesota, and none contain any references to any of the Tooker sellers. (Id.)

Minn. Stat. § 336.9-401 was amended on August 1, 1984 to require all financing statements for individuals be filed in the county of the debtor's residence. (See Argument Section II, *infra*.) However, Fin Ag did not file any financing statement for the Bucks with the Itasca County Recorder until April 3, 2000 (A. 72) – i.e., after all the sales relevant to this case had been made.

STANDARD OF REVIEW

On appeal from a summary judgment, the Court determines whether (1) there are any genuine material fact issues, and (2) the district court erred in its application of the law. Jorgensen v. Knutson, 662 N.W.2d 893, 897 (Minn. 2003).

Questions of law are reviewed *de novo* on appeal, with no deference to the trial court. Hubred v. Control Data Corp., 442 N.W.2d 308, 310 (Minn. 1989).

Fin Ag and Meschke agree that none of the material facts are in dispute. This appeal concerns only legal issues, subject to *de novo* review.

SUMMARY OF ARGUMENT

Meschke purchased the Tooker sellers' grain with absolutely no knowledge that the grain might be owned or "possessed" by the Bucks, or that Fin Ag claimed a security interest in the Tooker sellers' grain. Therefore, under the Food Security Act, Fin Ag can have no enforceable lien in the grain the Tooker sellers sold to Meschke.

Moreover, at the time of the Tooker sellers' sales to Meschke, there was no financing statement in favor of Fin Ag filed against the Bucks in their county of

residence. Therefore, under the UCC, Fin Ag had failed to perfect its security interest and had no enforceable lien against the Bucks' grain.

Consequently, the trial court incorrectly granted Fin Ag's summary judgment motion against Meschke, and the Court of Appeals incorrectly affirmed. The Supreme Court should reverse the summary judgment.

STATUTORY FRAMEWORK

When Minnesota adopted the UCC in 1962, Minn. Stat. § 336.9-307 provided that a buyer in the ordinary course of business took title free and clear of a security interest created by the seller, even if the buyer knew of the existence of the security interest. The principal exception to this rule was that it had no application to someone buying farm products from a person engaged in farming operations. This exception was commonly called the "farm products exception." In essence, the farm-products exception provided that the first buyer of farm products from a farmer took title subject to a properly-perfected security interest a farmer-seller had granted to a lender.

Under pre-1985 Minn. Stat. § 336.9-307, the burden fell upon the first buyer to determine the identity of any lenders and obtain a release of all liens from them. If a buyer paid a farmer and a lender thereafter asserted its properly-perfected lien rights, the buyer would also be liable to the lender. When a buyer discovered a lender, the buyer could avoid double exposure by making grain checks jointly payable to the farmer and the lender.

But this system proved completely unworkable. It was impossible for buyers to consistently discover the existence of lenders. Buyers simply lacked the time. Grain

buyers have a very short time window, after delivery, to pay for the grain. In Minnesota, for example, payment must be made within 48 hours. Minn. Stat. § 223.16, subd. 2a.

Lacking adequate time to identify lenders, many innocent buyers were trapped into paying twice for the same agricultural products: once to the farmer and again to the farmer's creditors. Thus, buyers had "no practical means of protecting themselves from becoming unwilling sureties on the loans of their sellers." D. L. Uchtmann, Julie A. Bauer and A. M. Dudek, The UCC Farm Products Exception – A Time To Change, 69 Minn. L. Rev. 1315, 1327 (1985).

Converting buyers into sureties was troublesome and unjust. Secured lenders came to rely upon the farm products exception to ensure payment of their loans, rather than spending the time and effort to effectively monitor their debtors' activities. It was fundamentally unfair that a buyer should suffer the loss when the seller-debtor defaulted, "especially when the lender is usually in a better position to monitor the solvency of the seller-debtor." Mark V. Bodine, Clear Title: A Buyer's Bonus, A Lender's Loss—Repeal of UCC § 9-307(1) Farm Products Exception By Food Security Act § 1324 [7 U.S.C. § 1631], 26 Washburn L. J. 71, 77 (1986).

To remedy this unjust situation, Congress in 1985 enacted the Federal Food Security Act, 7 U.S.C. § 1631. This law was named an Act for the Protection for Purchasers of Farm Products. As the name indicates, the Act was designed to protect *purchasers* of farm products, not lenders, by effectively eliminating the UCC farm-products exception in states that enacted a central lien notification filing system

authorized by the FSA. See 7 U.S.C. § 1631(c)(2) (stating requirements for a central filing system).

The FSA permits grain buyers to take grain free of lenders' lien claims. 7 U.S.C. § 1631(d). There are two principal exceptions. Purchases are still subject to a security interest if the lender (1) gives potential buyers direct written notice of its intent to assert a lien, or (2) files a lien notice under an approved central notification system. 7 U.S.C. §§ 1631(e)(1)(A) and (e)(3). However, if the lender provides one of those two forms of notice, the buyer can still buy lien-free grain by making the grain check payable jointly to the seller and the lender.

Congress passed the Food Security Act because many states (including Minnesota) permitted secured lenders to enforce liens against innocent purchasers of farm products -- a purchaser who "does not know that the sale of the products violates the lender's security interest" and "lacks any practical method for discovering the existence of the security interest." 7 U.S.C. § 1631(a)(1). "Knows and "knowledge" mean "actual knowledge," so knowledge is not imputed to a buyer. 7 U.S.C. § 1631(c)(6). The Act was written to eliminate potential exposure of such innocent purchasers to "double payment liability." 7 U.S.C. § 1631(a)(2).

The Food Security Act also transferred the burden of establishing lien rights from buyers to lenders. In states with a central notification system for lender liens, farm products pass free and clear of security interests created by farmer-sellers, unless the lender has filed an Effective Financing Statement. 7 U.S.C. § 1631(e). Farm products still pass lien free if the buyer issues a check payable to the seller and all lenders for

which a lien has been filed as to the seller. Taken together, the FSA was designed to eliminate all guesswork for buyers in identifying lenders and liens.

For states that enacted a central notification system for crop liens, then, the Act pre-empts the farm-products exception, thereby eliminating the harsh result of transforming buyers into “sureties on the farmers’ debts” by requiring them to pay twice for the same grain. See United States v. Progressive Farmers Marketing Agency, 788 F.2d 1327, 1330-31 (8th Cir. 1986).

In 1992, Minnesota created a central notification system (CNS) for farm product liens, as provided for in the Federal Food Security Act. See Minn. Stat. § 336A. This shifted the burden to the lender to obtain and file an Effective Financing Statement (“EFS”) signed by the debtor. See Lisco State Bank v. McCombs Ranches, Inc., 752 F. Supp. 329, 334-39 (D. Neb. 1990).

After the EFS is filed with the Secretary of State, the lien is good against the first buyers of farm products. 7 U.S.C. § 1631(e)(3). A grain buyer who subscribes to the CNS (a “registered grain buyer”) can protect itself by issuing checks for farm products payable to the farmer-seller and any persons who had filed an EFS covering the product. Alternatively, a buyer can pay the seller directly if the lender issues a written waiver for the sale in question. 7 U.S.C. § 1631(e)(3)(B).

In addition, under “direct notification,” a lender can preserve its lien by writing directly to prospective agricultural buyers, warning them of the lender’s interest in a particular producer’s farm products, and requiring that all checks for those farm products

should include the lender's name as a co-payee. See 7 U.S.C. § 1631(e)(1)(A). Direct notice is effective for one year. Id.

Therefore, a first buyer of farm products can safely pay the seller and own the farm product free and clear of all liens, if (a) the buyer had not received a letter (direct notice) from a lender, and (b) the CNS does not show the seller's name. As set forth below, Meschke had no knowledge, from *either* source, that Fin Ag would assert a lien on the Tooker sellers' grain.

ARGUMENT

Fin Ag can have no enforceable lien against the grain the Tooker sellers sold to Meschke. FinAg (1) failed to notify Meschke of its security interest in the Tooker sellers' grain, and (2) failed to file a financing statement in the correct county. Therefore, the lower courts incorrectly granted Fin Ag summary judgment against Meschke.

I. MESHKE NOT LIABLE FOR HIDDEN LIEN

When Meschke purchased grain from the Tooker sellers, he had neither knowledge nor notice of Fin Ag's claimed lien on that grain. Such hidden liens should not be enforced. See FBS Business Finance Corporation v. Edison Financial Group, Inc., 464 N.W.2d 304, 306 (Minn. App. 1990) (noting the UCC's "abhorrence of secret liens").

Fundamental fairness requires that a person whose rights are deprived be given real and effective notice. The Court of Appeals' ruling flies in the face of this basic right, creating an unreliable and inconsistent notice system based upon constructive possession and constructive knowledge.

The Court of Appeals held that Fin Ag's lien against the Bucks extended to the grain the Tooker sellers sold to Meschke. In order to arrive at this result, it had to employ a two-step analysis. First, the Court of Appeals expressly held that the Bucks had "constructive possession" of the grain that was actually in the custody of the Tooker sellers. Second, the Court of Appeals necessarily held that Meschke was constructively liable for *knowing* about the Bucks' constructive possession.

Meschke will address these two "constructive" rules in their logical order – first constructive possession, then constructive knowledge. However, constructive knowledge is by far the greater flaw in the Court of Appeals' decision, and presents the greatest danger to grain buyers throughout the State. Therefore, Meschke will devote greater scrutiny to constructive knowledge.

A. Constructive Possession Not Applicable or Practical.

Going well beyond any arguments raised by Fin Ag, the Court of Appeals added into the Federal Food Security Act the Minnesota common-law doctrine of constructive possession. According to the Court of Appeals, the Tooker sellers had mere "custody" of the grain, while the Bucks retained "constructive possession." The Court of Appeals acknowledged that there is no federal authority concerning this constructive-possession rule.

The Court of Appeals then decided that, in the absence of federal law, it should apply state law on constructive possession. However, that analysis is not correct. Federal law, not state law, governs the adequacy and effect of a lender's Effective

Financing Statements. AG Services of America, Inc. v. United Grain, Inc., 75 F.Supp.2d 1037, 1042 (D. Neb. 1999).

The Court of Appeals then compounded the error by relying upon an inapposite Minnesota insurance case concerning the constructive possession of a motor vehicle. In Jacobson v. Aetna Cas. & Sur. Co., 233 Minn. 383, 46 N.W.2d 868 (1951), the Supreme Court recognized that the word “possession” can, *in some contexts*, extend beyond actual possession to include constructive possession. It requires that the owner intend to release physical custody of the property, but retain ownership and control. It is an analysis designed to extend insurance coverage to situations where a non-owner has custody of the vehicle.

The doctrine of constructive possession is generally applied to motor vehicles, when owners leave them with third parties. See Jacobson, 46 N.W.2d at 871, citing Bennett Chevrolet Co. v. Bankers & Shippers Ins. Co., 58 R.I. 16, 190 A. 863 (1937) (overnight parking in hotel garage) and Gibson v. St. Paul Fire & Marine Ins. Co., 117 W. Va. 156, 184 S.E. 562 (1936) (afternoon parking in public garage).

However, constructive possession applies to the *temporary* release of custody. It has no application where an owner relinquishes custody of a vehicle in the hopes of *selling* it. Jacobson, 46 N.W.2d at 872 (no constructive possession when vehicle’s owner delivered physical control of vehicle to a prospective buyer).

(Even if constructive possession had any possible application to FSA cases, the doctrine would not apply here. There is nothing in the record that shows that the Bucks had an interest in any grain the Tooker sellers sold to Meschke, or that the Bucks

intended to retain ownership and control over any grain sold by the Tooker sellers. There is certainly no evidence or claim that the Bucks merely gave the Tooker sellers temporary custody of the grain, like a vehicle owner parking a car overnight.)

Moreover, actual possession remains the “ordinary” sense of the word. Jacobson, 46 N.W.2d at 871. See also Koecher v. Koecher, 374 N.W.2d 542, 546 (Minn. App. 1985) (general meaning of “possession” is actual possession). **When in doubt, actual possession is the meaning that should be supplied.**

There is *nothing* in the Food Security Act that suggests any intent by Congress to broaden the scope of “possession” to include “constructive possession” as well. On the contrary, the primary purpose of the FSA is to eliminate guesswork for buyers in identifying lenders. The FSA has no reference to constructive possession, a term that inherently introduces uncertainty for the grain purchaser. Instead, the FSA was written to protect the purchaser who “does not know that the sale of the products violates the lender’s security interest” and “lacks any practical method for discovering the existence of the security interest.” 7 U.S.C. § 1631(a)(1).

This legislative intent should be respected. “[N]othing is better settled than that statute should receive a sensible construction, such as will effectuate the legislative intention, and, if possible, so as to avoid an unjust or an absurd conclusion.” Johnson v. U.S., 529 U.S. 694, 706 n.9, 120 S. Ct. 1795, 1804 n.9 (2000), quoting In re Chapman, 166 U.S. 661, 667, 17 S. Ct. 677, 680 (1897).

The constructive-possession rule would undermine the legislative intent, and lead to absurd and unjust results. Minnesota grain buyers have relied upon the CNS system

for nearly 25 years. Adding constructive possession to the scope of “possession,” as the Court of Appeals has done, would make it impossible to *consistently* identify lenders by using the CNS database. There would be no practical method for consistently discovering the existence of a “constructive possessor.” Therefore, to depart from the ordinary meaning of the term “possession” would undercut the purposes of the FSA.

Most importantly, though, as set forth below, a constructive-possession standard would be completely unworkable in real-life grain-purchase transactions. A purchaser will seldom know if the party making delivery lacks “constructive possession.” There is simply not enough time for a grain purchaser to conduct an investigation to determine the “constructive owner” of grain being sold. Therefore, constructive possession inherently involves *constructive knowledge*, a concept completely at odds with the FSA.

B. Constructive Knowledge Not Legally Justified.

As stated above, the buyer would seldom if ever have actual knowledge of a hidden owner’s “constructive possession.” Therefore, under the realities of the grain industry, a constructive-possession standard would inevitably include a constructive-knowledge requirement.

1. Court of Appeals Applied Constructive Knowledge to Meschke

The present case is a classic example of how constructive possession leads to constructive knowledge. Meschke did not know that the Tooker sellers’ grain was actually “possessed” by the Bucks. Meschke had no actual knowledge of *any* connection between the Tooker sellers’ grain and the Bucks.

So the Court of Appeals made a huge leap. Meschke had previously purchased grain from the Bucks, and knew of Fin Ag's security interest in the Bucks' grain. Therefore, the Court of Appeals assumed, Meschke should have known that Fin Ag had a lien on grain sold by the Tooker sellers.

It is one thing for Meschke to know Fin Ag claimed a lien on *the Bucks'* grain. It is another thing to know that particular shipments of grain, which belonged or appeared to belong to *the Tooker sellers*, might actually belong to the Bucks!

In reality, Meschke had no knowledge that the Tooker sellers were fronting for the Bucks. There is nothing in the record that supports such a conclusion. Meschke was told to make the checks payable to the Tooker sellers. Meschke did not know that Larry and Ronda Buck might have been the original owners. Meschke checked the CNS computer database for the Tooker sellers. He found none were listed as persons against whom a lien was claimed. Accordingly, Meschke correctly issued grain checks payable to them.

Since Meschke had no actual knowledge, the Court of Appeals was saying that Meschke "should have known" the Bucks owned the grain. The Court of Appeals was extending to Meschke some undefined duty to investigate the true ownership of the grain that he purchased. That is constructive knowledge. The FSA was designed to eliminate precisely this kind of guesswork for grain buyers, and the risks that go with it.

2. Unworkable Constructive Knowledge Standard Inconsistent with FSA

Constructive knowledge would undermine the predictability promised by the FSA. In practice, a buyer could no longer rely upon the CNS to ascertain if there were any liens filed against a seller. There would never be any assurance that a seller was the true

owner or “possessor” of the grain. To gain assurance and certainty, the buyer would have to investigate *all* possible sellers. Commerce in grain would grind to a halt.

It is completely unrealistic and impractical to place such a burden of investigation upon grain purchasers. There is simply not enough time for a purchaser to do a complete and thorough investigation. Under the Grain Buyers Act, after grain is unloaded, a buyer like Meschke must make payment within *48 hours*. Minn. Stat. § 223.16, subd. 2a. In practice, buyers usually have less than 48 hours. In many instances, farmers are operating on such thin margins that they wait for checks to be issued *immediately* after unloading.

Even if grain purchasers had private investigators on retainer to track down every load of grain, it is absurd to think that the true “possessor” could be consistently (if ever) identified with assurance and certainty in a 48-hour time frame. See Charles W. Wolfe, Comment, Section 1324 of the Food Security Act of 1985: Congress Preempts The “Farm Products Exception” of Section 9-307(1) of the Uniform Commercial Code, 55 U.M.K.C. L. Rev. 454, 465 (1987) (short time frame gives the buyer “insufficient time to engage in an intense, if not impossible, search for security interests”). To force buyers to make such a fact-intensive determination in only two days would completely undermine the predictability of the FSA.

Grain purchasers must know, within 48 hours, *with certainty*, to whom the checks must be made payable. If a partial or incomplete investigation leads them to identify the incorrect owner or possessor, the purchaser will make out the check to the wrong party. Then the correct owner or possessor will come back and demand payment. This cannot

be the law. The purchaser needs rock-solid assurance about the correct payee. There can be no doubts or gray areas, such as would be introduced by the Court of Appeals' vague and indefinite holding. Any other result would be completely disruptive to the State's grain economy.

In contrast to the impractically-short 48-hour window for buyers to investigate, lenders have ample time to determine if their debtors are selling through intermediaries. Lenders have months or even years to study the habits of their borrowers, and have access to their records upon demand. There is no question that a lender can obtain a far greater amount of information than any buyer.

Rather than holding the purchaser liable for the hidden liens of unknown owners or "possessors," then, the burden should be on the lender. The lender has the on-going relationship with the debtor, and is able to monitor the debtor's activities, including sales through intermediaries. If the debtor has evaded the lender's supervision, the lender can demand immediate repayment of the debtor's balance. Thus, it is completely realistic to place the burden upon the lender to discover any "intermediary sales" by the debtor.

A lender knows that the grain it finances will be purchased by innocent buyers. See First Bank of North Dakota (N.A.) – Jamestown v. The Pillsbury Company, 801 F.2d 1036, 1038 (8th Cir. 1986) ("the Bank knew it was financing goods that could become inventory subject to purchase by innocent buyers in the ordinary course of business"). This is a risk lenders are able to manage, by monitoring the business practices of their debtors. It is not a risk that individual purchasers are able to oversee.

Any other rule would reward predatory lenders, who make loans realizing that a high percentage will fail. They should not receive a windfall on loans gone bad against innocent purchasers like Meschke. Instead, they should have the burden of investigating their debtors. See Utah Farm Production Credit Ass'n v. Hansen, 738 P.2d 642, 645 (Utah App. 1987) ("The lender should be motivated to protect itself and is in a superior position to do so"); United States v. Progressive Farmers Marketing Agency, 788 F.2d 1327, 1330 (8th Cir. 1986) (buyers of farm products should not be transformed into "sureties on the farmers' debts"); Lisco State Bank v. McCombs Ranches, Inc., 752 F. Supp. 329, 334 (D. Neb. 1990) (Congress shifted the risk of loss "to the lenders who finance farm operations, rather than have that burden imposed upon buyers"); Charles W. Wolfe, Comment, Section 1324 of the Food Security Act of 1985: Congress Preempts The "Farm Products Exception" of Section 9-307(1) of the Uniform Commercial Code, 55 U.M.K.C. L. Rev. 454, 466 (1987) (duty to supervise debtors "should belong to the lenders and not innocent buyers").

Placing the burden on lenders is fully consistent with the stated legislative intent of the FSA. The Act was written to eliminate this kind of guesswork for all grain buyers. It was written to protect the purchaser who "does not know that the sale of the products violates the lender's security interest." 7 U.S.C. § 1631(a)(1). "Knows" and "knowledge," of course, mean "actual knowledge." 7 U.S.C. § 1631(c)(6). That is about as plain as a statute can be.

The FSA was also written to protect the purchaser who "lacks any practical method for discovering the existence of the security interest." 7 U.S.C. § 1631(a)(1).

Here, again, the issue is clear. There is no practical method to consistently discover the existence of some “constructive possessor,” within the 48-hour payment window. **Therefore, there is no practical method to consistently discover the existence of the constructive possessor’s security interest.**

3. Actual Knowledge Requirement Reinforced By Purposes of UCC

This actual-knowledge construction of the FSA is reinforced by the basic purposes of the UCC. Even before the FSA, the UCC protected good-faith buyers like Meschke from hidden liens.

Parties must be able to rely upon the “certainty” and “consistency” of UCC remedies. Halla v. Norwest Bank Minnesota, N.A., 601 N.W.2d 449, 451 (Minn. App. 1999). The UCC must be construed to avoid “absurd” or “unreasonable” results. See Minn. Stat. § 645.17.

Secret liens are strongly disfavored under UCC Article 9. See FBS Business Finance Corporation v. Edison Financial Group, Inc., 464 N.W.2d 304, 306 (Minn. App. 1990) (noting the UCC’s “abhorrence of secret liens”); First Savings Bank of Virginia v. Barclays Bank, S.A., 618 A.2d 134, 138 (D.C. Ct. App. 1992) (“The antagonism to the ‘secret lien’ runs through our law of sales and security transactions alike”); In re Hurst, 308 B.R. 298, 303 (S.D. Ohio 2004) (“secret liens” are “abhorrent to a significant purpose of Article 9 perfection requirements – to provide notice of a security interest to the world”); In re Eagle Enterprises, 223 B.R. 290, 296 (E.D. Pa. 1998) (“secret liens ... degrade the reliability of U.C.C. filing indexes and ultimately impede commerce”).

Consistent with such principles, Minnesota has construed the UCC to protect good-faith buyers of grain. For example, in Schluter v. United Farmers Elevator, 479 N.W.2d 82 (Minn. App. 1991), a pre-FSA case, a trucker sold farm-bought grain to an elevator, representing to the elevator that he was the owner. In fact, the trucker was a merchant selling grain entrusted to him by the farmers – the true owners. Because the elevator had no actual knowledge of the farmers’ ownership, the court held that the elevator had purchased in good faith, and was not liable to the farmers.

In Minnesota, the court held, “good faith” means “honesty in fact in the conduct or transaction concerned,” and “knowledge” means “actual knowledge rather than reason to know.” Id. at 85. The test of good faith is subjective, not objective. It requires honesty of intent, rather than the absence of circumstances that would put an ordinary “prudent purchaser on inquiry.” Id. Since in Schluter the elevator had no actual knowledge of the identity of the true owners, the elevator was not liable to them. “[T]he UCC mandates that the farmers, not the elevator, bear the loss.” Id.

Thus, even before the FSA, the rule in Schluter would have protected Meschke from unknown owners like the Bucks. Now, under the FSA, the argument is far stronger.

In conclusion, it is completely contrary to the FSA and the UCC to allow lenders, through constructive-possession and constructive-knowledge rules, to enforce hidden liens on unsuspecting third parties. Instead, it is the obligation of the lender (Fin Ag) to track the operations and intermediaries of its debtors (the Bucks), then update or amend its EFS or provide direct notification to potential buyers.

C. Fin Ag Filed no EFS Identifying the Tooker Sellers.

Fin Ag never filed an Effective Financing Statement wherein any of the Tooker sellers were named or in any way identified. Fin Ag only sought, obtained and filed an EFS for Larry and Ronda Buck.

Errors in an Effective Financing Statement are disregarded when the EFS “substantially complies with” the Act’s requirements, if it only contains “minor errors that are not seriously misleading.” 7 U.S.C. § 1631(c)(4). But if there is a “material change” in the information on the EFS, the lender must amend it in writing within 3 months. 7 U.S.C. § 1631(c)(4)(E). Here, Fin Ag never made a written change to the EFS for Larry and Ronda Buck’s grain, even though possession had been transferred to the Tooker sellers.

In conclusion, Meschke had no knowledge that the grain shipments he bought from the Tooker sellers might be encumbered by a Fin Ag lien. Meschke had no knowledge that the Bucks may have had an interest in any of those shipments, and Fin Ag provided Meschke no direct notice about the Tooker sellers. Meschke fulfilled his duties by checking the Tooker sellers and buying without knowledge. Any risk of hidden liens should fall upon the lender, Fin Ag, which is in the very best position to monitor the activities of its debtor.

II. BY FILING IN THE WRONG COUNTY, FIN AG FAILED TO CREATE AN ENFORCEABLE SECURITY INTEREST IN GRAIN SOLD TO MESCHKE

Fin Ag failed to prove that it had perfected its security interest on a timely basis. Fin Ag failed to perfect any security interest in any possible grain until after the grain

which is the subject of its complaint had been purchased, received and paid for by Meschke. However ownership is analyzed, Fin Ag was too late.

A. Ownership

If the grain in question belonged to the *Bucks*, Fin Ag failed to file a UCC-1 financing statement in Itasca County – the county of the Bucks’ residence – until April 3, 2000. Accordingly, Fin Ag’s security interest was not perfected until that date. By that date, April 3rd, all of Meschke’s grain purchases that are the subject of this lawsuit had been completed.

If the grain belonged to the *Tooker sellers*, no financing statement was ever filed as to any of them. And there is no evidence that the Tooker sellers entered into a security agreement with Fin Ag.

B. UCC Requirements

Even if Fin Ag had complied with the filing and notice requirements of the FSA, this alone would not protect Fin Ag and the inquiry cannot end there. If the requisites of a properly-perfected security agreement are lacking, compliance with the FSA will mean nothing.

To establish a valid security interest, the creditor must prove that (a) it obtained a security agreement with the debtor, (b) it perfected its security interest by filing a UCC-1 financing statement in the county of the debtor’s residence, and (c) it filed an Effective Financing Statement with the Secretary of State. See Minn. Stat. §§ 336.9-203, 336.9-302, 336.9-401 and Minn. Stat. § 336A.05 (1999).

To have an enforceable lien, the lender must file a UCC-1 financing statement, Minn. Stat. § 336.9-203(1), in the county of the debtor's residence. Minn. Stat. § 336.9-401 (1999).³ A financing statement filed in the wrong county is generally ineffective. See e.g. First National Bank of Glasgow v. First Security Bank of Montana, N.A., 222 Mont. 118, 721 P.2d 1270, 1273-74 (1986).

Minn. Stat § 336.9-307 (1) (1986), in effect as of the date of the transactions in question, provided:

A buyer in the ordinary course of business (subsection (9) of section 336.1-201) takes free of a security interest created by the seller even though the security interest is perfected and the buyer knows of its existence.

The accompanying Uniform Commercial Code Comment in relevant part provided:

This section provides that such a buyer takes free of a security interest, even though perfected, and although he knows the security agreement exists... [I]t results that the buyer takes free if he merely knows that there is a security interest which covers the goods but takes subject if he knows, in addition, that the sale is in violation of some term of the security agreement not waived by words or conduct of the secured party.

There is no evidence that Meschke was aware of the terms of any security agreement wherein Fin Ag was the creditor, or that he somehow might be violating the same.

Here, Larry and Ronda Buck lived in Itasca County, as noted in all of Fin Ag's documents. But Fin Ag filed its UCC-1 in Hubbard County Recorder's real estate records on May 3, 1999 and in Wadena County on May 10, 1999. Neither of these filings was effective to perfect its security interest. Fin Ag finally filed its first UCC-1 in Itasca County on April 3, 2000. Thus, Fin Ag had no valid security interest in the Bucks' grain

³ Minn. Stat. § 336.9-401 (1999) provided that: (1) The proper place to file in order to perfect a security interest is as follows: . . . (b) When the collateral is farm products then in the office of the county recorder in the county of the debtor's residence if the debtor is an individual or organization with residence in this state. "

until April 3, 2000 and prior sales would be lien free. This was after Meschke's last check – on March 7, 2000. Consequently, Fin Ag has no claim against Meschke.

C. Fin Ag Had Burden of Proof On Good-Faith Exception

The Court of Appeals held that Fin Ag's failure to file in the correct county was irrelevant, under the good-faith exception of Minn. Stat. § 336.9-401(2) (1999). That statute provided:

A filing which is **made in good faith** in an improper place or not in all of the places required by this section is nevertheless effective with regard to any collateral as to which the filing complied with the requirements of this article and is also effective with regard to collateral covered by the financing statement against any person who has knowledge of the contents of such financing statement.

(Emphasis supplied)

With no analysis of the burden of proof, the Court of Appeals placed the burden of proving this issue on Meschke, saying "Meschke has not disputed that Fin Ag acted in good faith, and no evidence suggests a lack of good faith." Fin Ag, 700 N.W.2d at 520.

However, it makes no sense for the *purchaser* to have the burden of proof on this issue. *That information is in the lender's control.* See Rowe v. Runyon, 702 N.W.2d 729, 739 (Minn. 2005) (policy of "placing the burden [of proof] on the party with the greater amount of information"), citing Morlock v. St. Paul Guardian Ins. Co., 650 N.W.2d 154, 165 (Minn. 2002) (Russell Anderson, J., dissenting) ("Generally, the burden of proof is placed on the party with the greatest access to the relevant evidence").

The lender knows whether it has a good-faith reason to have filed in the wrong county. If it presents *prima facie* evidence of this claimed good-faith reason, then the

buyer can do discovery on the subject and try to rebut. Here, though, when Fin Ag moved for summary judgment, it placed no evidence in the record providing any good-faith reason for its erroneous filing.

Therefore, Fin Ag never shifted the burden to Meschke. Fin Ag failed to make a *prima facie* case, and failed to establish the good-faith exception. Consequently, its failure to file in the correct county was not excusable.

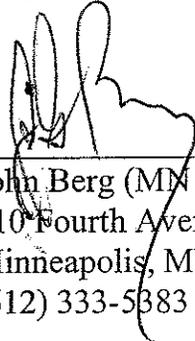
CONCLUSION

Minnesota grain buyers need a clear ruling from the Supreme Court. Buyers must know that they can rely entirely upon Minnesota's CNS filing system. The CNS must provide a "one-stop shopping" where purchasers can verify all farm liens. Buyers should not be subject to hidden liens from unknown owners or "constructive possessors." And they should not be subject to liens from financing statements filed in the wrong county.

In short, Fin Ag failed to demonstrate that it had an enforceable lien on the grain Meschke purchased from the Tooker sellers. Therefore, the Supreme Court should reverse the summary judgment for Fin Ag and remand for dismissal.

Respectfully submitted,

Dated: 10-27-2005



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The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2) (with amendments effective July 1, 2007).