

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. & 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 REPLY BRIEF

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ARGUMENT

Fin Ag's analysis of the Food Security Act is unworkable. Fin Ag's "FSA" would create an unpredictable legal patchwork that would be impossible for farm buyers to consistently follow. That would undermine the expressly-stated purpose of the Act – the protection of buyers.

I. FIN AG'S ARGUMENTS WOULD UNDERMINE "CENTRAL" NOTIFICATION SYSTEM

The Food Security Act provides a straightforward framework for protecting buyers from the risk of double payments due to hidden liens.

The Central Notification System or "Central Filing System" is at the heart of the Food Security Act. By its plain terms, the Act strongly encourages states to create a "Central" filing and notification system for buyers to discover security interests. It provides a single "statewide basis" for filing Effective Financing Statements. 7 U.S.C. § 1631 (c)(2). It ensures all Effective Financing Statements are filed in one place – with the Secretary of State. *Id.*, subd. (A). The Secretary of State then compiles all EFSs into a single "master list," organized with the debtors' names in alphabetical order and the taxpayer ID numbers in numerical order. *Id.*, subd. (C). Finally, the master list is distributed to all registered buyers throughout the state. *Id.*, subd. (E).

In short, the FSA spells out in great detail a "central" system for ensuring reliable statewide access to Effective Financing Statements. It does this to provide buyers with a "practical method for discovering the existence of [a] security interest" and thereby avoid

the trap of “double payment for the products.” 7 U.S.C. § 1631(a). This gives buyers the certainty and predictability they need to avoid double payment for hidden liens.

These are the fundamental details of the Central Notification System, which is at the heart of the Food Security Act. The Act cannot and must not be read in a manner where peripheral or ambiguous provisions undermine the reliability of this “central” system. Congress does not alter the fundamental details of a statutory scheme by ancillary provisions. Whitman v. American Trucking Assoc., 121 S Ct. 903, 909-10 (2001). It does not “hide elephants in mouseholes.” Id. No statute is drafted to sow the seeds of its own destruction.

The “elephants in mouseholes” standard is a very useful rule of thumb, one that avoids absurd statutory interpretations. And it is directly relevant here. The Food Security Act cannot be read, as Fin Ag has done, to include constructive-possession and constructive-knowledge requirements. Those requirements would be true “mouseholes,” because neither is anywhere mentioned in the language of the Act. And yet, if implemented, they would become “elephants” undermining the very viability of the CNS.

Buyers need a reliable system. Minnesota buyers have relied with complete confidence upon our Central Notification System since 1993, and the FSA since 1986. However, if Fin Ag’s rule were followed, the “Central Notification” database would never be complete or reliable. It would not identify all lenders claiming a security interest. Such a system would be totally chaotic and worse than no system at all, because it would create a sense of confidence where none was warranted. In short, if the Court

adopted Fin Ag's statutory construction, persons like Meschke, even after checking CNS filings, would find themselves at risk for undisclosed liens

The FSA and CNS were intended to establish a *practical and reliable* system. They should be construed with that purpose in mind. The system must be usable on a regular basis, by buyers like Meschke, to accurately identify all persons to whom payments should be made. This protection is vital, because buyers are not paid for assuming the risk of double payment.

For buyers like Meschke, it does not matter if there is a lienholder, as long as the CNS discloses *all* lienholders to him. Once a price is determined, the buyer simply issues a grain check to the seller, or a joint grain check to the seller and CNS-1 filers. The purchase price is not affected by the number of payees named on the grain check.

There is only one reasonable way to read the FSA and 336A. The Court should place the risk of loss upon the lender for the conduct of its debtor. The Court should not place the risk upon the buyer, who lacks the time to investigate and receives no compensation for assuming the risk of double liability. The buyer should not become the surety for the lender's bad debts.

Therefore, the duty must be imposed upon every lien claimant, such as Fin Ag, to provide direct notice or file a properly executed Effective Financing Statement (CNS-1), placing farm-product buyers on notice of its interest. This is a small price for a lender to pay for protecting its own interest.

In conclusion, it is completely contrary to the FSA and 336A to allow lenders, through *unwritten* constructive-possession and constructive-knowledge rules, to

selectively enforce hidden liens. Unwritten rules cannot be allowed to undermine the fundamental details of the statutory scheme creating the “Central Notification System.” The statutes were not written to require buyers to investigate sellers, beyond checking the CNS.

II. MESHKE NOT LIABLE FOR HIDDEN LIEN

This is a classic case of a hidden lien. Fin Ag claims a security interest in the Bucks’ corn. Fin Ag is trying to extend this security interest to corn Meschke purchased from the Tooker sellers. Fin Ag claims the Tooker sellers were selling the Bucks’ corn.

However, as set forth below, when Meschke purchased corn from the Tooker sellers, he had **no knowledge** of the Bucks’ purported ownership of that corn. Therefore, he had no way to use the CNS system to find Fin Ag’s security interest against the corn. Fin Ag’s interest was a completely hidden lien to Meschke. Such a lien should not be enforceable.

A. Meschke Had No Actual Knowledge of Bucks’ Interest in Tooker Sellers’ Grain

Meschke’s undisputed affidavit states that he had no knowledge of the Bucks’ involvement. Instead, he was told to pay the Tooker sellers for the corn. (A. 107)

Fin Ag does not like this testimony, though, and seeks to sweep it away as “hearsay.” But Meschke’s communications are not offered to prove “the truth of the matter asserted,” as claimed by Fin Ag. See M.R.E. 801(c). Instead, they are offered to show what Meschke *believed* to be true. “If the out of court statement is being offered ...

to prove knowledge [or] notice ... it is not hearsay.” State v. Hanley, 363 N.W.2d 735, 740 (Minn. 1985).

Fin Ag has no contrary evidence of Meschke’s knowledge at the time of his purchase from the Tooker sellers. Thus, the material facts are undisputed. When Meschke acquired corn from the Tooker sellers, he had **no knowledge** of the Bucks’ purported ownership. And, when Meschke checked the Tooker sellers’ names in the CNS system, **no interest** of Fin Ag appeared.

B. Fin Ag Advocates Constructive Knowledge

Fin Ag cannot dispute Meschke’s lack of actual knowledge at the time of the purchase. So, instead, it attempts to switch to information Meschke learned *after* the purchase – Fin Ag’s claim that the Tooker sellers’ grain actually belonged to the Bucks. However, that information at the earliest came to light *after* the Tooker sellers endorsed Meschke’s checks over to the Bucks. But a grain buyer like Meschke does not have a crystal ball. What counts is what Meschke knew when he issued the grain checks. Information that Meschke learned after the payments is immaterial.

Grain buyers should not face double liability based upon information learned *after* the sale is completed. *Ex post facto* determinations are inherently unjust. Such a standard would be wholly inconsistent with a law specifically written to protect buyers.

This perfectly illustrates the fatal flaw in Fin Ag’s position, as adopted by the Court of Appeals. Buyers would be held liable for information they do not possess, and cannot obtain, in the 48-hour window they have to pay the seller. See Minn. Stat. § 223.16, subd. 2a.

Interestingly, though, Fin Ag denies that it is advocating a constructive-knowledge standard. (Fin Ag knows it cannot directly and explicitly advocate such a standard. It would be so obviously unfair.) But that is precisely the position Fin Ag is taking. It seeks to hold Meschke liable for information (the Bucks' purported ownership of the grain) that Meschke simply did not possess at the time of the sale.

Fin Ag asserts that it is arguing based upon "notice," not constructive knowledge. Fin Ag is playing semantic games. **Under the Food Security Act, there are two forms of notice, both based upon actual knowledge.** First, direct notice to a buyer is based upon a direct written notice from the lender to the buyer, actually received by the buyer, informing the buyer of the lender's security interest. 7 U.S.C. § 1631(e)(1). Second, notice under the CNS system is based upon actual knowledge – the buyer's actual knowledge of the identity of the seller. With actual knowledge of the seller's name, the buyer can *then* input the seller's name into the CNS system and discover every Effective Financing Statement. See 7 U.S.C. § 1631(e)(3). But without actual knowledge of the seller's name, it is impossible for the CNS system to work.

Effective Financing Statements can have errors, as long as they are not seriously misleading. 7 U.S.C. § 1631(c)(4)(H); Minn. Stat. § 336.9-402(8) (1999). But an EFS that omits the Tooker sellers' names is *per se* seriously misleading, and provides no notice.

"Notice" without knowledge is a sham. It is absurd to say that a buyer has "notice" of a lien if the buyer does not even know whose name to put into the CNS

system! That is *constructive knowledge*, no matter what semantic gloss Fin Ag puts on it. That is not what the Congress and the Minnesota Legislature intended to be the law.

C. Constructive Possession Not Legally Justified

Fin Ag fails presents no meaningful arguments in support of a constructive possession standard. It cites no language in the Food Security Act providing for constructive possession, because there is none. It cites no FSA cases employing constructive possession, because there are none. Finally, it does not show how constructive possession could be reconciled with the purpose and intent of the FSA. Thus, Fin Ag cannot overcome the presumption that “possession” means “actual possession.”

Neither does the UCC support Fin Ag’s interpretation of “possession.” On the contrary, as the Court of Appeals held in Greenbush State Bank v. Stephens, 463 N.W.2d 303 (Minn. App. 1990), “possession” under Article 9 must be “unequivocal, absolute and notorious, so that third parties may be advised.” Id. at 308, quoting Transport Equipment Co. v. Guaranty State Bank, 518 F.2d 377, 381 (10th Cir. 1975). Thus, Article 9 requires possession that is actual, absolute and obvious. There is no room for implied or “constructive” possession.

The rationale for this actual-possession construction of Article 9 is straightforward. In Transport Equipment, the court noted that “possession” is one of the few undefined terms in the UCC. There was no need for a definition. In the context of the Code, there can be only one meaning – physical control:

The Code's general purpose is to create a precise guide for commercial transactions under which businessmen may predict with confidence the results of their dealings. In defining "possession" we must be guided by these considerations as well as by the underlying theories unique to Article 9. . . . "Possession" is used throughout Article 9 in establishing the filing scheme . . . and in providing perfection through means other than filing, such as through the secured party's taking possession. The ostensible ownership exercised through possession is demonstrated through simple physical control. One who controls the collateral possesses it, and leads others to believe it is his.

518 F.2d at 381, quoting In re Automated Bookbinding Serv., Inc., 471 F.2d 546, 551-52 (4th Cir. 1972).

Here, the same reasoning applies. Purchasers of grain must be able to "predict with confidence" the results of their dealings. They need a dependable definition of the word "possession." They must be able to rely upon their own observation of "physical control," which is simple to verify. To require the average grain purchaser to make a fact-intensive evaluation of "constructive possession," within 48 hours, is not realistic. Declining to accept the word of others is not conducive to promoting commerce.

D. Fin Ag's "Inventory" Argument

Fin Ag now asserts that the grain may have become "inventory" in the hands of the Tooker sellers. However, Fin Ag presents no evidence in support of that assertion. In fact, the Court of Appeals held as a matter of law that the grain was farm product owned by the Bucks, a determination that Fin Ag does not dispute. Fin Ag must cite specific facts to avoid summary judgment. A metaphysical doubt about an issue is insufficient. DLH v. Russ, 566 N.W.2d 60, 71 (Minn. 1997).

In addition, Fin Ag presents no evidence that Meschke had knowledge that the grain was “inventory.” Meschke had no duty or ability to investigate the status of grain as “inventory,” for all the reasons previously discussed. A grain buyer, in 48 hours, simply cannot perform a reliable investigation on the status of grain in the seller’s hands. See Minn. Stat. § 336.9-109 (1999). The CNS system must work for all grain, not just for grain that *later* turns out to fall into a particular category. The buyer must be able to rely upon the CNS search as being final and complete, or the system is a mirage.

E. Farm Product Exception Eliminated in Minnesota

Fin Ag is operating under a misconception about the farm-product exception in Minnesota. That exception was eliminated many years ago, even before the enactment of our CNS.

The UCC was enacted in Minnesota in 1965. Congress enacted the FSA on December 23, 1985. It became effective in all 50 states one year later. Minnesota dropped the farm products exception to Minn. Stat. § 336.9-307 on March 15, 1986 and re-enacted a *part* of it in Minn. Stat. § 336A.15 (1992), limited, however, to “farm products statutory liens.” Minn. Stat. § 336A.01, subd. 11.

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

As set forth above, Fin Ag failed to provide notice to Meschke under the Food Security Act. However, Fin Ag’s claim has an even more fundamental flaw. Fin Ag failed to create an enforceable security interest in the first place.

Fin Ag's brief fails to specifically address Minnesota law on the burden of proof. It fails to address or distinguish the relevant case law cited by Meschke. See e.g. 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"). Neither does it cite any contrary case law. (Fin Ag merely makes the conclusory statement that "Meschke's argument that Fin Ag had the burden of proof to demonstrate good faith on its part is without merit.") Therefore, without dispute, Fin Ag had the burden of proof on the central material issue within its control – whether Fin Ag had a good-faith reason for filing the Bucks' financing statement in the wrong county – which it failed to meet.

The undisputed facts show that Fin Ag failed to perfect its security interest before the sales and payments involving the Tooker sellers. Since August 1, 1984, Minn. Stat. § 336.9-401(1)(b) has required that financing statements covering crops be filed in the office of the county recorder of the debtor's residence. That has been the law ever since.

The Bucks live in Itasca County. However, Fin Ag did not file a financing statement for them in Itasca County until April 3, 2000. Instead, they chose to file in Wadena County on May 10, 1999 and in Hubbard County on March 6, 2000. The last relevant grain check of Meschke that is the subject of Fin Ag's Complaint was issued on January 15, 2000. (A. 107)

Fin Ag cites absolutely no evidence that it had a good-faith basis for its clearly erroneous filings, because it had none. Amazingly, Fin Ag cites its very errors as proof of its good faith: "[T]he record is sufficient to show Fin Ag acted in good faith filing in Hubbard and Wadena Counties." (Response Brief at 23) It is absurd to think that a

lender can satisfy its burden of showing *good-faith* errors by simply reciting the fact of its misfilings. Fin Ag has yet to state *any* reason for its misfilings, much less a good-faith reason.

Finally, Fin Ag never filed a financing statement or an Effective Financing Statement wherein any of the *Tooker sellers* were named or in any way identified.

CONCLUSION

Meschke fully complied with the requirements of the Food Security Act. Nevertheless, Fin Ag would have Meschke pay twice for the same grain.

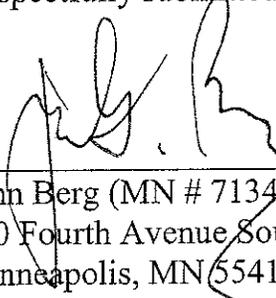
Fin Ag's analysis of the Food Security Act would destroy the Act and deal a devastating blow to the entire grain industry. The Supreme Court should reject Fin Ag's arguments, and restore to buyers the full protections of a Central Notification System, which Minnesota buyers have relied upon with complete confidence since 1993.

Finally, Fin Ag has 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: 12-14-2005



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