Memo

TO:	AGRIBUSINESS ASSOCIATION OF IOWA
FROM:	BROWN WINICK LAW FIRM
SUBJECT:	MIDWESTONE BANK V. HEARTLAND CO-OP: SUMMARY OF SUPREME COURT OPINION
DATE:	APRIL 17, 2020

The Iowa Supreme Court today released its opinion in *MidWestOne Bank v Heartland Co-op*. Ultimately, the court affirmed in part on the issue of unjust enrichment, reversed in part on the issue of the statute of limitations, and remanded the case to the District Court to dismiss the Bank's claims that are time-barred consistent with the Opinion.

Background:

District court applied the 2-year statute of limitations in Iowa Code § 614.1(10) for claims based on a security interest in farm products, but applied the discovery rule allowing the Bank's full recovery of costs deducted by Heartland because they had not been "discovered" by the Bank until within the 2-year statute of limitations. District court also rejected Heartland's claim of unjust enrichment on grounds that the Bank's perfected security interest trumped Heartland's claim for storage and drying costs.

Summary of Opinion:

Statute of Limitations / Discovery Rule

The Bank's claims are subject to the more specific 2-year statute of limitations in Iowa Code § 614.1(10) for claims based on a security interest in farm products. "The evident purpose behind § 614.1(10), which shortens the limitations period from five year under § 614.1(4) to two years for claims founded on secured interests in farm products, is to hasten resolution of such claims."[1] Although the Bank argued that section 614.1(4) applied to its conversion claim, the Court noted that the Bank's claims actually arise from a security interest in farm products. "Iowa Code section 614.1(4) carves out such claims with its final phrase, 'except as provided by subsections 8 and 10.'"[2] The Court concluded that the Bank's conversion claims were "founded on Heartland's alleged disregard for MidWestOne's 'secured interest' in the Harker's grain, clearly a 'farm product,' and in the proceeds of the sale of that grain," and as such the Bank would have no conversion claim against Heartland

[1] *MidWestOne Bank v. Heartland Co-op*, No. 19-1302 at 11 (Iowa April 17, 2020) (quoting *Farmers Coop. Co. v. Swift Pork Co.*, 602 F. Supp. 2d 1095, 1110 (N.D. Iowa 2009)) (quotations omitted).
[2] *Id.* (quoting Iowa Code § 614.1(4)).

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without the secured interest.[3] As such, the Court determined that the district court correctly concluded that the Bank's claims were subject to the two-year statute of limitations in section 614.1(10).

However, the Court agreed with Heartland that the district court erred by applying the discovery rule to section 614.1(10). "Under the discovery rule, the statute of limitations is tolled until the plaintiff knows or in the exercise or reasonable care should have known both the fact of the injury and its cause."[4] "When a plaintiff learns information that would inform a reasonable person of the need to investigate, the plaintiff is on inquiry notice of all of the facts that would have been discovered through a reasonably diligent investigation."[5] The Court concluded that Heartland's setoffs were not inherently unknowable from the Bank's standpoint as the Bank could have asked either Heartland or the borrowers for documentation that would have revealed the setoffs. Further, the Court noted that it has refrained from applying the discovery rule in the past when it would undermine the purpose of the UCC. The fundamental policy underlying the UCC is to establish finality and predictability in commercial transactions, including commercial agriculture transactions. Finally, the Court determined that the application of the discovery rule would conflict with the plain language of section 614.1(10), which expressly provides that the *date of sale* starts the statute of limitations time clock. The Court accordingly remanded the case to the district to reduce the Bank's judgment by the amount withheld by Heartland in transactions occurring more than two years before the lawsuit was filed.

Unjust Enrichment

"Unjust enrichment exist when (1) one party is enriched (2) at the expense of the other, and (3) it would be unjust under the circumstances for the enriched party to retain the benefit."[6] The Court specifically noted that it has never held that a grain elevator as an unsecured creditor can recover under a common law or equitable unjust enrichment theory against a bank with a valid perfected security interest in the grain and proceeds; rather, it has held the opposite and protected banks' security interests. The Court discussed the Colorado Supreme Court case relied upon by Heartland in its arguments—*Ninth District Production Credit Assn. v. Ed Duggan, Inc.*—at length, determining that the Colorado court concluded that "a determining factor [of whether equitable principle may require alteration of the UCC priority system] is whether the secured creditor initiates or encourages the transactions that enhance the value of the collateral."[7] The Court noted that "Duggan appears to represent the high water mark for allowing an unsecured creditor to recover against a secured creditor under an unjust enrichment theory."[8]

The Court ultimately distinguished Heartland's claim from *Duggan*, favoring to adhere to the UCC's priority system "to provide clarity, uniformity, and consistency in commercial transactions." The Court refrained from deciding whether it would allow unjust enrichment claim under the limited circumstances in *Duggan*,

[3] *Id.* at 12.
[4] *Id.* at 13 (quoting *K & W Elec., Inc. v. State*, 712 N.W.2d 107, 116 (Iowa 2006)) (quotations omitted).
[5] *Id.* (citing *Hallett Constr. Co. v. Meister*, 713 N.W.2d 225,231 (Iowa 2006)).
[6] *Id.* at 16 (quoting *Legg v. W. Bank*, 873 N.W.2d 763,771 (Iowa 2016)) (quotations omitted).
[7] *Id.* at 18 (quoting *Ninth District Production Credit Assn. v. Ed Duggan, Inc.*, 821 P.2d 788, 795-98 (Colo. 1991) (en banc)) (quotations omitted).
[8] *Id.*

particularly because the record showed that the Bank lacked *actual knowledge* of Heartland's actions before 2017 and no one sent documentation showing the deductions to the Bank. The Court noted that common industry practice of deducting storage and drying costs from sale proceeds was not enough for the Bank to have waived its lien rights through course of conduct. Instead, lien rights may only be impliedly waived through "clear, unequivocal, and decisive conduct demonstrating intent to waive."[9] "While the actions of the bank may not have been a model of diligence, and even rather gullible, there is no triable issue on the question of intentional and knowing waiver of the bank's interest in the proceeds through clear, unequivocal, and decisive conduct."[10] As such, the Court agreed that the district court correctly dismissed Heartland's unjust enrichment claim.

Recommendations:

Continue Legislative Efforts

The Court in *MidWestOne* noted that the legislature set forth the objectives of clarity, uniformity, and consistency in the UCC. However, the Court stated in a footnote that an amendment had been proposed last year in the legislature to amend the UCC to give grain elevators priority over prior perfected security interests, noting, "[w]e defer to the legislature whether to give grain elevators lien rights for storage and drying costs superior to a lender's prior perfected security interest in crops and their proceeds."[11] Given the Court's ruling today, it is more important than ever to find a legislative solution for grain elevators. The grain warehouse lien proposed in the 2020 legislative session by AAI would create a better solution for grain elevators and more clarity, uniformity, and consistency for the entire commercial agricultural industry. As such, we recommend that AAI continue its legislative efforts to give grain elevators lien rights superior to a lender's prior perfected security interest.

Send Notices of Setoffs to Lenders/Secured Parties as well as Farmers

The Court noted in multiple part of its opinion that no notice of the setoffs was ever sent to the Bank. Part of the reason the Court was not willing to analyze Heartland's unjust enrichment claim under the Duggan standard is because the Bank did not have actual knowledge of the setoff. We strongly recommend that grain elevators start sending notices of the set off of drying and storage costs from sale proceeds to any lender or other secured party that provides notice of a security interest to the elevator. This was prevent lenders and other secured creditors from claiming that they did not have actual knowledge of the setoffs. If such lenders continue to allow the setoffs and do not object after having actual knowledge, such action would create an implied waiver of their lien rights in favor of the elevator.

[9] *Id.* at 20 (quoting *Peoples Tr. & Sav. Bank v. Sec. Sav. Bank*, 815 N.W.2d 744, 763 (Iowa 2012)) (quotations omitted).
[10] *Id.* at 20-21 (quoting *Peoples Tr. & Sav. Bank*, 815 N.W.2d at 764).
[11] *Id.* at 19-20 n.5.